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**THE DISPROPORTIONATE COSTS OF FORMING LLCs VS.
CORPORATIONS: THE IMPACT ON SMALL FIRM LIABILITY PROTECTION**

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ABSTRACT

The LLC is increasingly the ownership form of choice by nascent small business owners as it has some advantages over corporations and sole proprietorships and partnerships. Despite its advantages, some states have higher filing fees for LLCs than for corporations. Some states have significantly higher filing fees than other states for both LLCs and corporations. As a result, emerging companies are often discouraged from seeking liability protection, or they seek a corporation, reducing the flexibility that could be provided with an LLC. Our research shows that the disproportionate cost of starting an LLC is related to the percentage of LLCs formed in comparison with corporations. This can have significant implications to small business owners since they may be choosing ownership forms that are not advantageous to their particular venture strictly based on initial filing costs. These state policy decisions may lead to long-term tax revenue loss within states with higher filing fees.

Keywords: small business, legal entity, LLC, corporation, state fees

INTRODUCTION

The limited liability company (LLC) is a relatively new form of entity that is appealing for many small companies. Although the first LLC statute was

passed in Wyoming in 1976 (Dreyer, 2003), most states did not adopt LLC regulations until the 1990s, and the last state passed enabling regulation in 1997 (Fox & Luna, 2005). LLC regulations

vary state-by-state and, while attempts have been made to make consistent statutes among the 50 states with the Uniform Limited Liability Act, these attempts have failed (Kleinberger & Bishop, 2007). The LLC is generally considered to be superior to a C corporation for small business owners because of tax considerations, such as a lack of double taxation, and superior to an S corporation because of ownership flexibility considerations. LLCs do not require as many formal aspects such as establishing a Board of Directors, by-laws, or shareholder restraints. It is also considered superior to sole proprietorships and partnerships because of liability considerations (Ribstein, 2003).

Small business owners can easily access many sources of information on LLCs and corporations and these sources fall generally into one of two categories. The first category is trade books found in bookstores. These books range from an in-depth treatise on forms of ownership to a brief treatment found in the *Idiot's Guide* or *Dummies* genre (Bellafante, 1998). The second source of information comes from textbooks when small business owners take certain small business, entrepreneurship or business law classes. These textbooks are most likely small business and/or entrepreneurship textbooks or are legal textbooks used either in business schools or law schools. Law school texts will treat the topics in great depth for law students, while business school texts typically offer a few pages for the

aspiring small business owner. These sources generally leave small business owners with limited access to detailed information on the advantages of forming an LLC or corporation.

Small business owners really need to know the risks and rewards of various ownership forms for their potential business. However, small business owners generally are not good strategic planners. They tend to be better at creative tasks such as idea creation than at managerial tasks like long-term planning (Khandekar & Young, 1985; Smith, Hampson, Chaston, & Badger, 2003). In addition, small business owners are bombarded with a myriad of tasks when starting a new business, so they often make decisions based on limited factors which may not lead to quality decision making (Blair, 2010). This includes the possibility that small business owners focus on the price to file rather than the long-term benefits of one form of ownership over another. Concrete distinctions such as differences in filing costs are easy for a small business owner to quickly compare and may be used more often when making decisions on business forms, even if this leads to poorer quality decisions.

Due to the variance in regulations from state to state, there is a wide disparity among the states regarding filing costs to launch a protected entity. Table 1 shows the filing costs for corporations and LLCs by state for the year 2007. For example, Arkansas charges \$50 to start a corporation and also \$50 for an LLC, but

Texas charges \$300 for both a corporation and an LLC. In addition, while many states charge the same amount for a corporation or an LLC,

such as those stated above, some states charge more for a corporation, like California, and some charge significantly more for an LLC.

Table 1 – Costs to file for an LLC and corporation by state (2007).

State	LLC filing costs	Corporation filing costs	State	LLC filing costs	Corporation filing costs
AK	\$250	\$250	MT	\$70	\$70
AL	\$85	\$95	NC	\$125	\$125
AR	\$50	\$50	ND	\$125	\$90
AZ	\$50	\$50	NE	\$110	\$60
CA	\$70	\$100	NH	\$100	\$100
CO	\$125	\$125	NJ	\$125	\$125
CT	\$60	\$275	NM	\$50	\$100
DE	\$90	\$89	NV	\$75	\$75
FL	\$125	\$70	NY	\$200	\$125
GA	\$100	\$100	OH	\$125	\$125
HI	\$60	\$50	OK	\$100	\$50
IA	\$50	\$50	OR	\$50	\$50
ID	\$100	\$100	PA	\$125	\$125
IL	\$500	\$175	RI	\$150	\$230
IN	\$90	\$90	SC	\$110	\$110
KS	\$165	\$90	SD	\$125	\$125
KY	\$40	\$50	TN	\$300	\$100
LA	\$75	\$60	TX	\$300	\$300
MA	\$500	\$250	UT	\$52	\$52
MD	\$100	\$100	VA	\$100	\$75
ME	\$175	\$175	VT	\$75	\$75
MI	\$50	\$60	WA	\$180	\$180
MN	\$160	\$160	WI	\$170	\$100
MO	\$50	\$50	WV	\$100	\$50
MS	\$50	\$50	WY	\$100	\$100

To illustrate, Illinois charges \$175 for a corporation, \$500 for an LLC, and \$750 for a series LLC. It seems to us that these costs can influence a small

business owner to choose one ownership form over another. We believe this is true even if the amount is nominal, such as the \$325 difference in the above

example. Our argument is that small business owners, with the myriad of decisions they make in the early stages of business formation, often need specific and easily comparable information to make their decisions. Thus, a small business owner may see the cost to file as an LLC or corporation as a way of evaluating their relative merits and use it as a major decision factor. In addition, we believe that high costs of forming either type of protected entity can dissuade or bias a small business owner from gaining desirable liability protection and perhaps relying solely on liability insurance, if anything, to meet their needs.

There is a dearth of academic research on the relative merits of different ownership forms and especially a lack of academic research on the relative costs and benefits of LLCs vs. corporations. Little is known about how the costs of forming an LLC or corporation impact a small business owner's decision to form a particular business entity. This article takes the following form. First, we present a review of the literature on limited liability companies and corporations, focusing on the unique advantages of each and the cost or challenges of forming each. We then look at the relative costs of forming an LLC vs. a corporation on a state-by-state basis and the relationship that cost has with the number of LLCs and corporations formed. Next, we examine how these implications could impact how a small business owner chooses a particular form of business. We will

then discuss those findings and the implications they may have for public policy as well as for small business owners seeking liability protection. Finally, we will suggest avenues for future research regarding related topics.

LITERATURE REVIEW

We begin our literature review with a comparison of the benefits to a small business owner between corporations and LLCs as the most common choices of business formation that provides liability protection. Other business forms, such as sole proprietorships and partnerships generally lack liability protection and are not discussed in detail here.

Corporations

Corporations have been in existence for centuries. The first corporation in the United States was formed in 1636 and is known today as Harvard University (Kaufman, 2008). Because of their longevity, the benefits as well as the problems of the corporate form of business are well known, and both state statutes and case law regarding corporations are well accepted in the legal profession (Blair, 2004). Perhaps the most significant advantage of forming a corporation is the concept of limited liability (Carney, 1998). Owners of sole proprietorships and partnerships are subject to unlimited liability in the case of lawsuits or claims by creditors. That is, they can lose not only what they have invested, but also other wealth or assets held personally in the name of the owner. The corporation provides

protection of those personal assets not invested in the business itself. Thus, if an owner invests a total of \$50,000 in the business, the lien the creditors obtain can only attach up to \$50,000. They also cannot take other assets outside the business, except when a lender requires the owner to sign personally for a loan rather than in the name of the corporation, which is a separate legal entity (Soderquist, 2000).

Some small business owners may substitute liability insurance to protect them against losses instead of incorporating their business or forming an LLC. Complete liability insurance for a business should include workers' compensation, auto, general liability and property/casualty coverage, plus an added layer of protection, the umbrella policy. Too little insurance leaves the business vulnerable. All insurance premiums are based on the risks involved within the business, thus varying from business to business. At first glance, this may seem like an approach to reduce the costs of business formation; however, insurance coverage may not cover potential litigation, leaving the small business owner who remains a sole proprietor with high out of pocket liabilities, usually resulting in risk to personal assets. All businesses, regardless of their entity, should have proper insurance coverage to protect the entity as well as the owner. In addition, some states have passed laws limiting the tort liability judgments that can be awarded by juries. Small business

owners should not interpret this as minimizing their liability risks in their business.

Corporations also provide the advantage of ease of sale of all or portions of the business (Carney, 1998). In sole proprietorships and partnerships, owners own actual assets in the business. Thus, if a potential owner desires to buy into the business or a current owner wants out of the business, the owners must go through the often laborious task of valuing each of the assets of the company and then deciding how the new ownership set will take possession of those assets (Tuller, 1994). In a corporation, owners own shares of stock in the company. Thus, adding or subtracting owners involves only the process of agreeing on the value of the stock itself and not the individual assets of the company (Carney, 1998). In the case of publicly held corporations, the value of stock or other assets is determined by the market and can easily be traded.

A third benefit of the corporate form is the relative ease of raising capital. Since the corporation utilizes shares of stock as ownership units, it is relatively easy to issue more shares of stock (Shleifer & Vishny, 1997). Private or public placements of stock can yield substantial sums of capital to operate the business. Adding equity capital through issuance of additional stock also then sets the stage of leveraging that equity by adding still more capital in the form of debt.

Thus, growth of a business is enabled by the corporate form of business that is typically beyond the capacity of many sole proprietorships and partnerships. We believe this is one reason why corporations are more advantageous for fast-growing entrepreneurial firms, which often need to raise capital in stages, than the more steady growth found in most small businesses.

The major disadvantage of the corporate form of ownership is the concept of double taxation (Morck & Yeung, 2005). Corporations are taxed on their income since they are a separate entity. If the owners of the corporation receive dividends from the corporation, then those dividends are also taxed as income to the shareholders. Owners of corporations can overcome this double taxation, however, by declaring the business as an IRS subchapter S corporation. This provides the pass-through taxation for owners (Goolsbee, 2004). There are a number of limitations to the subchapter S corporation. These include that the owners of the subchapter S corporation must be individuals rather than other companies, trusts, and other entities, they must be US citizens, and the number of owners is limited to 100 shareholders (Goolsbee, 2004).

The Sarbanes-Oxley Act of 2002 (SOX), a federal law, provides that large corporations that are subject to public reporting requirements of the Securities and Exchange Act of 1934 must take greater internal control of financial

reporting. One goal of SOX is to promote greater investor protection by providing for criminal liability for violations by corporations. Although these laws are uniform for all corporations regardless of their state of incorporation, the requirements do not pertain to most small business owners.

Limited Liability Companies

The limited liability company (LLC) is a relatively recent phenomenon. The first LLC was formed in Wyoming in 1977 (Dreyer, 2003), but general acceptance of LLCs throughout the United States developed primarily during the 1990s (Murdock, 2001). Limited liability companies are now accepted in all states, although states do vary somewhat in their treatment (Murdock, 2001).

Limited liability companies have the same limited liability protection as corporations (Friedman, 2004). Like corporations, they must be registered with the state in which they are formed or are doing business. They can also have the pass-through taxation comparable to sole proprietorships and partnerships. Thus, they have many similarities with the subchapter S corporation. The advantage of LLCs, however, is that they have more flexibility than the subchapter S corporation (Murdock, 2001). They can have more than one form of ownership such as individuals, other businesses, and trusts. They can be managed either by the membership of the LLC or by a manager who may or may not be a member of the LLC.

Members of an LLC adopt an operating agreement that specifies the voting rights, withdrawal rights and issues, responsibilities of members, and how the LLC is to be managed. The operating agreement determines whether the members manage the LLC, delegate that power to one of their members, or hire an outside manager (Jennings, 2009). However, these are much more flexible than the articles of incorporation that are required by state corporate formation statutes. LLCs can have, for example, shareholders from outside the United States, unlike subchapter S corporations, and are not required to have a Board of Directors or annual meetings as required by corporations.

Disadvantages of limited liability companies are relatively minor (Murdock, 2001). Like the corporation, forming an LLC requires filing with a state Secretary of State's office (or similar government office), thus there is some paperwork that must be completed (Ribstein, 2008). It also typically requires payment for submitting an annual report fee. These fees often vary from state to state from as little as \$0 in Minnesota to as high as \$500 in Massachusetts. An LLC also requires an operating agreement which includes the determination of whether the LLC is manager-managed or member-managed (Ribstein, 2008). Since LLC enabling statutes are relatively new in many states, there has not been a significant amount of case law filed to help owners

anticipate how legal disputes might affect their business (Barringer & Ireland, 2008).

State Filing Costs and Other Fees: Perspectives of the States

States levy taxes and other fees on state-chartered entities in order to generate fees. This is due partially to offset the expenses incurred by each state because of the additional paperwork and regulatory monitoring of the business entities. A more significant reason for the fees, however, is that the fees add money to state treasuries. Thus, there is a quandary with setting state-imposed fees. Businesses and their associations attempt to reduce the cost of operating a business by lobbying for lower fees and taxes. State governments are sensitive to their constituents but realize that lowering fees also lowers revenues to the state. State budget offices will resist any legislation that has the effect of reducing revenues even though the action could be interpreted as a business-friendly move (Wetzler, 1993). States will generally only approve modifications to existing laws that make these fees more equitable when they can ensure that the net result is revenue-neutral or revenue-positive (C. Moles, personal communication, March 9, 2009).

A case can be made that the advent and growth of LLCs are revenue-negative, thus bringing less revenue into the state, either when fees for LLCs are less than for corporations or when fees for LLCs in one state are more desirable than fees in

another state. Fox and Luna (2005) concluded that, indeed, the proliferation of LLCs across the United States did have a negative impact on state revenue generation, because of the loss of double taxation revenues associated with corporations. The total impact of LLCs on state revenues, however, should consider whether owners choosing LLCs previously held C corporations, S corporations, or one of the non-entity forms of ownership, such as a sole proprietorship or partnership. Business owners that switch from a sole proprietorship or partnership to an LLC will increase revenues to the state because no initial filing fees or renewal fees are collected for sole proprietorships or partnerships. These business owners would most likely switch their venture to an LLC if the filing costs were lower. Thus, lower filing fees could actually increase revenues to the state by the increase in the volume of LLCs.

**State Filing Costs and Other Fees:
Perspectives of the Small Business
Owner**

Considering the impact of LLCs from the perspective of the small business owner rather than state governments, the issue is one of costs to form and operate the business as well as the ease of operation of the business itself. One of the advantages of sole proprietorships and, to an extent, partnerships, is the ease of formation (Doran, Whittenburg, & Bunn, 2004). This ease of formation relates both to the lack of filing

requirements and the relatively low cost of forming the business. Conversely, owners of both corporations and limited liability companies are required to file articles of incorporation for corporations or articles of organization for LLCs and pay necessary fees (Miller, 2009). Owners of start-up companies must decide which form offers the most benefits for the cost (Friedman, 2004). Owners of existing companies may, at some time, consider whether their current ownership form still meets the needs of the company as it grows.

Articles of incorporation must include the name of the corporation, its shareholders' names and addresses, and shareholder rights. The fees for corporations vary by state. Some states charge as little as \$50 while others, such as Texas, charge up to \$300. States may charge a franchise tax based on the size of the capital contribution. In addition, states charge for incidentals such as change of address, dissolution, amendments of articles of incorporation, late filing penalties, and others (Spadaccini, 2007).

Limited liability companies file articles of organization which are similar to the articles of incorporation. The articles of organization include names and addresses, the operating agreements, and other issues. Fees for these vary from state to state with Arizona, Oregon, and others charging \$50 and Illinois and Massachusetts charging \$500. In addition, some states allow a series LLC, which is an LLC within an

LLC. The series LLC is one or more LLCs formed as subsidiaries to a main LLC. There are seven states with series LLCs, Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, and Utah. Series LLCs are useful when different LLCs (such as real estate properties) have differing risk factors, and the owner desires to keep them separate but under the overall ownership of a single LLC. Again, Illinois tops the list of statutory filing fees for a series LLC at \$750. States typically require annual reporting and assess fees for those annual reports, reservation of names, amendments, dissolution, and other issues.

It is the filing fees and tasks associated with forming and reporting LLCs or corporations that are of concern to a small business owner considering which ownership form of business to use (Friedman, 2004). Sole proprietorships cost virtually nothing to start. Partnerships require only partnership agreements (and do not require that in all states). Partnership agreements should be done with the help of an attorney. However, since this adds additional costs, even if relatively minor, some small business owners may choose to file their business form independently (Schanz, 2007). Corporations and LLCs, however, have the cost of filing plus the cost of attorney assistance if the small business owner seeks legal advice. This cost can be significant for start-up companies, to the extent that some small business owners elect not to avail themselves of the benefits of

corporations or LLCs because of the added expense. Further, in states that charge more for an LLC than a corporation, small business owners may be encouraged by the disproportionate costs to adopt the corporate form of business rather than the LLC, despite the potential disadvantages for doing so.

THEORY DEVELOPMENT

Our interest is in determining whether or not the filing fees and other costs of forming the business dissuade small business owners from adopting business organizational forms that limit liability. In addition, we are interested in whether states that assess higher fees for LLCs will see fewer LLCs registered.

Based upon the literature research above and analysis of information regarding corporations and limited liability companies among states, we make the following hypotheses. When filing fees are higher, we would expect fewer small business owners choosing that form of business. States with lower fees are more likely to have greater numbers of registered businesses than in those states with high filing fees. These hypotheses test how much the fees to file as a corporation or LLC encourage or deter a small business owner in that state compared to other states with lower or higher filing fees.

H1a: *States requiring higher fees for establishing corporations will have a lower percentage of their total businesses*

registered as corporations than LLCs than those states with lower fees.

H1b: *States requiring higher fees for establishing LLCs will have a lower percentage of their total businesses registered as LLCs than corporations than those states with lower fees.*

Even though many states charge essentially the same fees for LLCs as for corporations, some states charge substantially higher fees for LLCs. The reasoning here is most likely that corporation fees were established many years ago, and it is a difficult legislative process to amend the statutes to keep up with cost or revenue needs of the states. LLCs, however, are relatively new. Thus, state legislatures or Secretary of State's offices may have seen higher LLC filing as a revenue-positive move when the statutes were created, generally in the early 1990s. These revenues are positive in the sense that since new legislation was needed to create the LLC statutes, higher fees, relative to the fees of corporations, were also included with the legislation, and higher fees should lead to more revenue. However, this discrepancy in costs might lead a small business owner to choose to file as a corporation.

H2: *States that charge disproportionately higher fees for LLCs compared with corporations will have a smaller ratio of their total businesses formed as LLCs.*

Hypothesis 2 asserts that these higher fees in comparison with that state's

corporation filing fees will encourage small business owners to form corporations rather than forming LLCs. Those small business owners will most likely utilize the corporation with subchapter S treatment or will use a sole proprietorship or partnership, which will likely not protect them from personal liability.

METHODOLOGY

Fees charged for LLCs and corporations were determined by checking each state's Secretary of State's Office (or similar state agency) website. Website addresses were obtained from Michael Spadaccini's (2007) *Forming an LLC in Any State*, as well as independent internet searches. Tables 2a, 2b & 2c show the differences in costs of filing for corporations and LLCs by state, with states divided into three categories: states with the same filing fee for LLCs and corporations, ones with higher LLC filing fees than corporations, and ones with lower LLC filing fees than corporations. The numbers of corporations and LLCs filed each year were provided by the International Association of Commercial Administrators *Annual Report of Jurisdictions*. Many states charge a primary filing fee as well as a bevy of secondary fees for minor aspects, such as reserving a name, dissolving the entity, or even changing the location of the business. While we note these as additional costs, we do not include them in our analysis for several reasons. First, some initial fees, such as filing to reserve

a name, may be paid earlier than the decision to form as an LLC or corporation, and thus may not be considered in the business formation decision. Second, states are not consistent on what fees they require, so reliable control variables for these costs could not be obtained. Third, we believe that small business owners are looking

at the initial filing fee to make their business formation decision, not later fees, which is consistent with our belief that small business owners look at one concrete factor (the differences in filing fees) without considering the long-term impact of later annual renewal costs.

Table 2a – Filing Costs - States with equal costs to file (2007)

State	LLC	Corporation	State	LLC	Corporation
AK	\$250	\$250	NC	\$125	\$125
AR	\$50	\$50	NH	\$100	\$100
AZ	\$50	\$50	NJ	\$125	\$125
CO	\$125	\$125	NV	\$75	\$75
GA	\$100	\$100	OH	\$125	\$125
IA	\$50	\$50	OR	\$50	\$50
ID	\$100	\$100	PA	\$125	\$125
IN	\$90	\$90	SC	\$110	\$110
MD	\$100	\$100	SD	\$125	\$125
ME	\$175	\$175	TX	\$300	\$300
MN	\$160	\$160	UT	\$52	\$52
MO	\$50	\$50	VT	\$75	\$75
MS	\$50	\$50	WA	\$180	\$180
MT	\$70	\$70	WY	\$100	\$100

Table 2b – Filing Costs - States with greater costs to file an LLC (2007)

State	LLC	Corp.	Diff.	State	LLC	Corp.	Diff.
DE	\$90	\$89	\$1	NE	\$110	\$60	\$50
FL	\$125	\$70	\$55	NY	\$200	\$125	\$75
HI	\$60	\$50	\$10	OK	\$100	\$50	\$50
IL	\$500	\$175	\$325	TN	\$300	\$100	\$200
KS	\$165	\$90	\$75	VA	\$100	\$75	\$25
LA	\$75	\$60	\$15	WI	\$170	\$100	\$70
MA	\$500	\$250	\$250	WV	\$100	\$50	\$50
ND	\$125	\$90	\$35				

Table 2c – Filing Costs – States with less costs to file an LLC(2007)

State	LLC	Corp.	Diff.	State	LLC	Corp.	Diff.
AL	\$85	\$95	\$10	MI	\$50	\$60	\$10
CA	\$70	\$100	\$30	NM	\$50	\$100	\$50
CT	\$60	\$275	\$215	RI	\$150	\$230	\$80
KY	\$40	\$50	\$10				

For the study, the authors gathered U.S. state-by-state data on LLC and corporation filing costs and the numbers of LLCs and corporations filed per year from the International Association of Commercial Administrators *Annual Report of Jurisdictions* as well as other publically available data sources. Data from 2006 to 2008 were entered. Because of a lack of independence among data from one state across three years, only one year’s data was used for each state. 2007 data was chosen because that year included the most complete data and was the most recent economically stable year, since in 2008 there was a drastic economic recession. The 2007 data was used when this data for the state was available (n = 42 states). To make this dataset as complete as possible, 2008 data (n = 2 states) and then 2006 data were used for the analysis (n = 4 states), giving a total sample size of n = 48. Due to missing data, our dependent variable has 46 cases.

The dependent variable used for this analysis is the **filed ratio**, the ratio of the number of LLCs filed over the number of corporations filed in that state for the year collected. This ratio demonstrates how many more or fewer

LCCs were filed than corporations filed in that year, with values above 1 meaning more LLCs were filed and below 1 meaning fewer LLCs were filed than corporations. The following independent variables are used for this analysis:

- **LLC cost** – the cost, in U.S. dollars, for a business to file as an LLC, mandated by each state.
- **Corp cost** – the cost, in U.S. dollars, to incorporate a business, mandated by each state.
- **Cost ratio** – the ratio of LLC filing costs over corporation filing costs. Values greater than one demonstrate a greater cost for filing a firm as an LLC than incorporating in that state.
- **Cost difference** – the dollar value difference in LLC filing cost minus the corporation filing cost.

RESULTS AND DISCUSSION

Figure 1 shows the means of the average ratio of LLCs to corporations filed divided into three categories: those states where filing costs for LLCs are greater than corporations, those where it is less, and those where the costs are

equal. Table 3 reports key descriptive statistics for the main variables. Pearson correlations are reported. The *filed ratio* variable was inversely correlated ($r = -0.31, p < 0.05$) with *LLC cost*, suggesting

that higher costs to file an LLC was correlated with a lower ratio of LLCs filed compared to corporations, supporting H1b.

Figure 1 - The mean ratio of LLCs to corporations filed by the cost differences of filing as an LLC or corporation

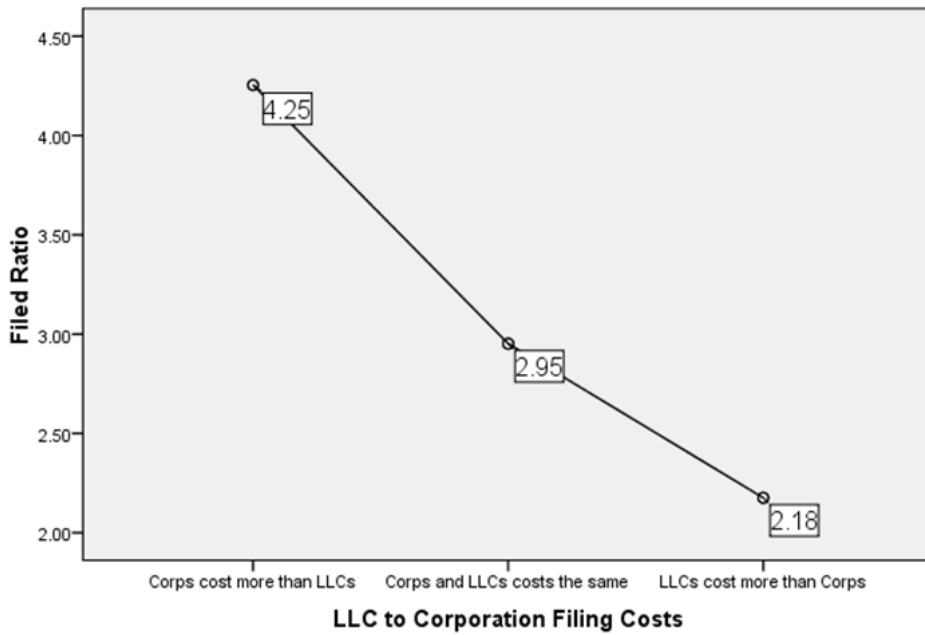


Table 3 - Correlation matrix

	n	Mean	s.d.	1	2	3	4	5	6
1. Filed ratio	46	2.87	1.91						
2. LLC cost	48	\$128.17	\$98.66	-.31*					
3. Corp cost	48	\$110.54	\$63.09	.12	.63**				
4. LLC filed	46	28,564.33	27,383.00	-.06	-.03	.02			
5. Corp filed	47	15,974.68	25,357.65	-.38*	.13	.01	.77**		
6. Cost ratio	48	1.19	.53	-.40**	.63**	-.10	-.08	.15	
7. Cost difference	48	17.63	76.79	-.31*	.42**	-.17	-.01	.11	.80**

* $p < .05$

** $p < .01$

The correlation between *filed ratio* and *corp cost* was not statistically significant; suggesting the cost to file a corporation is not related to more LLCs being filed than corporations, which suggests no support for H1a. *Filed ratio* and *cost ratio* were significantly correlated ($r = -0.40, p < 0.01$), suggesting that, when LLC filing costs are higher than corporation filing costs, fewer ventures file as an LLC compared to corporations, providing support for Hypothesis 2. This proportional difference also holds true when examining the actual dollar difference (*cost difference*) between the cost to file as an LLC and a corporation ($r = -0.31, p < 0.05$), providing additional support for H2.

We used a hierarchical regression to test the hypothesized relationships between the filed ratio variable and the various filing costs variables mentioned above. These three models appear in Table 4

and depict the effects of entering additional variables into the equation. Model 1 examines the effects of the straight dollar difference between LLCs and corporation filing costs and its ability to predict the proportion of LLCs to corporations filed. Model 2 added the variable of the ratio of differences in the costs of LLCs over the costs of corporation filings. Model 3 included the costs to file an LLC and the costs to file a corporation, although LLC filing costs were excluded from the analysis due to multicollinearity effects. The only significant predictor in the variables included for the different proportion of filings was the difference between LLC and corporation filing costs, which provides additional support for H2. Adding additional variables to the model did not improve the predictability of Model 1.

Table 4 - Hierarchical regression results predicting ratio of LLCs over corporations filed.

Variable	Filed ratio		
	Model 1	Model 2	Model 3
Cost difference	- 0.50**	- 0.67*	- 0.72*
Cost ratio		0.20	0.25
Corporation filing costs			0.13
R ²	0.25	0.26	0.27
Adjusted R ²	0.23	0.22	0.22
Δ Adjusted R ²		0.01	0.02
F	14.56**	0.46	0.92

* $p < .05$

** $p < .01$

CONCLUSION

This article finds evidence that state policies towards filing fees are an

important factor when initial business organizational decisions are made by start-up companies. States with equal

costs between filing for an LLC or a corporation and states in which it costs less to file for an LLC than a corporation typically have a higher proportion of ventures filed as an LLC than as a corporation than those with greater differences in costs. This suggests that small business owners do use the cost to file between the two entities as a decision factor when choosing between filing for an LLC or a corporation. This may mean that small business owners lose the benefits of greater flexibility and fewer restrictions of an LLC because they see incorporating as a less expensive alternative.

There are, however, some disadvantages to changing the fee structure. Illinois, with the highest disparity between LLC filing costs (\$500) and corporations (\$125) reported that they would stand to lose almost \$7 million (of the forecasted \$27.2 billion in revenues (Quinn, 2009)) if the state lowered their filing fees (Moles, 2009b). However, this assumption made by the Secretary of State's Office, does not account for additional filings if small business owners switch to an LLC from their existing sole proprietorship or partnership. It is possible that lower filing fees could encourage more small business owners to file as an LLC, thus increasing state revenues.

State laws regulating the formation of business entities, their operation, and dissolution are unique to each state, which could have an impact on business

formation decisions. However, relatively uniform laws have been adopted by most states in the areas of partnerships, i.e. the Uniform Partnership Act (and subsequent revisions) and corporations, i.e. the Model Business Corporation Act. In an attempt to create a uniform template for state legislatures to adopt, the Uniform Limited Liability Company Act was adopted by the National Conference on Commissioners on Uniform State Laws by the U.S. in 1996; however, as of 2002, only eight states had adopted those regulations. Despite this lack of adoption and given that the laws for the formation of various business entities are state laws, not federal laws, most laws are very similar in nature. We believe that this uniformity suggests that the relatively minor state statute and liability practice differences do not have an impact on the business formation decision.

Implications

As the greatest difference between LLC and corporate filing costs is \$325, and the most expensive filing cost is \$500, some might argue that the expense paid to file is negligible when compared to a) the risk of liability if a small business owner does not form an LLC or corporation, or b) the risk of inflexibility and greater requirements of a corporation because it is more expensive to file as an LLC. However, it does appear that there are a smaller proportion of filings of LLCs compared to corporations when the filing costs of

LLCs are higher than corporations. Anecdotal evidence from discussions with small business owners supports this assertion. Despite the relatively small cost to file in comparison to all start-up costs, small business owners do seem to take these costs into account.

Small business owners are faced with numerous decisions that they must make early on in their venture. As stated earlier, these owners generally are not nearly as good at the managerial and planning tasks as they are with the creative tasks, such as opportunity recognition and product development (Khandekar & Young, 1985; Smith et al., 2003). Thus, with the dozens, if not hundreds, of decisions they make early in the business formation process, small business owners might prioritize their time and energy on more interesting and creative aspects of starting their firm. They may choose simple, specific factors, like filing fees, when making decisions on business forms of ownership. Sifting through the various advantages and disadvantages of forming one business form over another takes longer than comparing two separate dollar values and often requires the use of a lawyer and/or an accountant, which adds to the complexity in making a decision as well as the additional legal and accounting fees. Small business owners may be making poor business ownership decisions in lieu of ease in evaluating the process.

These oversimplified decisions can put the small business owner at risk. First, small business owners may choose the easier and less expensive forms of business, like a sole proprietorship, which puts them at personal risk for liabilities incurred by the firm. Second, they might choose a corporation despite an LLC having the greater flexibility and tax incentives they need, or choose an LLC when they are planning to grow into a large, public firm, where a corporation has greater advantages. Changing forms of business once the business is in operation is expensive and time consuming. Firms have to wind down their businesses, in essence shutting down, to reform as another form. This not only costs money, time and paperwork, but it is also a taxable event. Small business owners uneducated on the advantages and disadvantages of each form are at the greatest risk of using differences in cost as a major decision factor. Educated small business owners are at less risk, but are still probably likely to use filing costs as a factor when the differences are greater. A small business owner knowledgeable about the characteristics of each form of business in a state with equal costs to file for an LLC or corporation will probably make the best decision based on the relative merits of each business ownership form.

States argue that lowering the filing fees for an LLC will hurt the state, since revenue from filing fees will decrease. However, this makes the assumption that the number of LLCs filed each year

will remain the same. This assumption is likely to be incorrect. High LLC filing fees may dissuade a number of small business owners from choosing to form an LLC and instead remain a sole proprietorship or partnership. This has two implications for states. First, lower LLC and corporation filing fees may cause more businesses to switch from sole proprietorships or partnership to an LLC or corporation. Thus, revenue lost from lowering the filing fee may be made up and surpassed because of higher volume of LLC filings. Second, the states run a financial risk when more of the small business owners in their states remain unprotected from liability. For example, if an employee is disabled in a workplace accident and a firm is unprotected, the employee may end up on state disability when the financial resources of the firm and the personal assets of the small business owner are exhausted. Even if the employees do not need public assistance, the income tax revenues of the firm in the case of a corporation, or the small business owner in terms of the corporation and LLC, would diminish if a firm must close because of an incident in which it was not protected from liability.

Future Research

As stated above, while states like Illinois could lose revenue if they reduced their filing fees, it is possible that ventures that are currently sole proprietorships or partnerships might be more likely to file as an LLC if the costs to do so were

lower, thus perhaps making up or even surpassing revenue from filing. A possible future study might look at how many more ventures would file as an LLC if costs were lower. Also, researchers could examine the factors that small business owners use when determining their form of business, such as the costs to file, the desire to limit liability, tax implications, the size and nature of the business, and the advice of professionals, such as attorneys or accountants. These research questions could be of interest to researchers, small business owners, and policy makers, and lead to further policy adjustments and implications.

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