**8803. What considerations regarding transferability of interests in an entity should be taken into account when choosing the business entity form?**

Free transferability of interests is a factor that must be considered when a business owner is determining which business entity structure to choose. Shares in a corporation may be simpler to transfer than an interest in a partnership or a proprietorship. This can be attractive if, for example, an older shareholder wishes to dispose of his interest to finance his retirement, but younger members want to keep operating the business (see Q 8806 to Q 8825, which addresses issues in business succession planning). A corporation can also be recapitalized to freeze the value of an estate and pass a family business to a younger generation. As is the case with limited liability, free transferability of interests, particularly in a closely held corporation, is not absolute.

First, there may be a limited market for minority interests in a closely-held or family business, even one that is organized as a corporation. Prospective investors may simply refuse to risk being frozen out of management decisions and profits, and may be reluctant to upset the balance of personalities and interests already existing in any company. Second, it may be extremely difficult to value the shares in the business. Third, a sale to an inappropriate shareholder may jeopardize a business’s status as an S corporation. The solution to many of these problems is to restrict transferability of shares to those within a family, those approved by all other shareholders, or those who would not jeopardize the business’ S corporation election. These restrictions, of course, destroy the same free transferability of interests that some incorporators may find attractive.

Finally, increased prestige and image may be a factor to consider. A new corporation may find it easier to attract bank financing and venture capital than a partnership or proprietorship, even if the shareholders must personally guarantee the debt. This advantage comes, however, at the higher price of establishing a corporation than for a partnership or proprietorship. State filing fees and attorney and accountant’s fees all add to the cost of starting the venture. However, a corporation may amortize its organizational expenses over 60 months from the month in which the corporation begins business.[[1]](#footnote-1)

1. . IRC Sec. 248. [↑](#footnote-ref-1)