Forms of Doing Business

I. Introduction

A. Sole Proprietorship
1. Liability = Unlimited. If the owner is liable, his personal assets can be used to satisfy the judgment.
2. Economics/Taxation = One layer. Just like your salary, it is only taxed once. It goes on a schedule C.
3. Control = Total for owner.
4. Cost = basically zero. You may need to obtain a DIBJA certificate or a privilege license from the city.

B. Partnership
1. General: Two or more persons carrying on an activity for profit.
2. Liability = Joint and several unlimited liability: A creditor can pursue recovery against both partners or against either partner individually, regardless of whom created the liability.
3. Economics/Taxation = One layer: Partnership is not taxed, there is a flow through, partnership allocates by capital.
4. Cost = You write a partnership agreement to opt out of the partnership act, which involves an expense. File a DIBJA as well.
5. Control = Joint and several: Any partner can bind the partnership.

2. Limited: You have a general partner and a limited partner.
6. Liability: Limited partner's liability is limited to capital contribution; general partners are jointly liable.
7. Control: General partners control the partnership. Limited partners may have negative control: "Any expenditure beyond stock requires approval by the limiteds."

I. Note: The general partner can be a corporation, and the limiteds can be corporation.

C. Corporations (C Corp) = Every state has a corporation statute
1. Liability = Shareholders get limited liability.
2. Economics/Taxation = Two layers of tax. The corp is taxed and shareholders.
   a) An S Corp has only one layer of tax, although the tax accrues when the income is earned. No more than 75 shareholders, must be people, etc.
3. Control = Shareholders have control because they elect directors.

D. LLC's = Try to give you all the benefits of both
1. Limited liability with one layer of tax
2. Concern: Limited law available on entity attributes to offer certainty.

E. Switching
1. Can be easy from a partnership to a limited partnership.
2. But, if an S Corp sells stock to a venture capital firm, it will destroy the S Corp status and you'll have to convert.
3. You can't flip flop, there are penalties.

F. Notes
1. Passive losses = They can only be used to offset against active gains.
   Regulations of the IRS, such as this, complicate and limit the terms of a partnership agreement.
2. Basis = The amount you invested originally, and the amount that is subtracted from your investment proceeds to determine your tax liability.