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# Business Organizations

Presented by Charlie Shah and Andrew Vazquez

# Bios

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## Charlie Shah

Charlie is a graduate of the Samford University Cumberland School of Law. He has been practicing law since 1996. Charlie's practice focuses on business planning and litigation as well as Tax Court litigation. He is an active member of the North American South Asian Bar Association.



## Andrew Vazquez

Andrew graduated from the Georgia State University College of Law in 2015. His practice focuses primarily on tax planning, estate planning, and business planning. He is an active member of the Atlanta Bar association and the Georgia Hispanic Chamber of Commerce.



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# Forms of Business Organizations

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- Sole Proprietorship
- Partnership
- Corporation
- Limited Partnership
- S Corporation
- Limited Liability Company

# Characterizing the Form

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- Types of characteristics that vary between forms of business organizations include:
  - Manner and Cost of Creation
  - Continuity of the Organization
  - Managerial Control
  - Personal Liability of Owners
  - Taxation

# Characterizing the Form

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## Manner and Cost of Creation

- Creation – the legal steps necessary to form the organization
- How is the organization formed?
- How much does it cost to form the organization?
- How much paperwork is involved?
- How long will it take?

# Characterizing the Form

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## Continuity of the Organization

- How does the organization's existence relate to its owners?
- What happens if one of the owners dies?
- How is the organization dissolved?

# Characterizing the Form

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## Managerial Control

- How much control will the owners exercise over the management of the organization?
- How much of a voice will each owner have in management?

# Characterizing the Form

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## Personal Liability of the Owners

- To what extent will the owners be liable for acts of the organization?
- To what extent will the owners be liable for the debts of the organization?

# Characterizing the Form

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## Taxation

- How is the income the organization earns taxed?
- How is the money distributed from the organization to the owners taxed?

# Sole Proprietorship

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- A sole proprietorship has a single owner and serves, in effect, as an alter ego of the owner
- Creation
  - Simplest of the business organizations
  - Does not require formal documentation or fees to be formed

# Sole Proprietorship

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## Continuity

- Tied directly to the will of the owner
- Owner dictates when organization will be dissolved
- Ownership of organization cannot be transferred

# Sole Proprietorship

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## Managerial Control

- Owner is in total control of organization

## Personal Liability of Owners

- Owner is personally liable for all debts of the organization
- In effect, a debt of the organization is a debt of the owner (treated as the same person)

# Sole Proprietorship

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## Taxation

- Organization is not taxed on income
- Instead, owner must report all of organization's income as his own, even if he does not receive the income

# Partnership

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- An agreement between two or more persons or businesses to share a common interest in a commercial endeavor and to share profits and losses
  
- Creation
  - Easily formed; cost to form is low
  - Formal agreement to form partnership is called articles of partnership

# Partnership

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## □ Continuity

- Technically, partnership is dissolved when a partner withdraws or dies
- Business activity of partnership can be carried on by remaining partners under a new partnership
- Liability can be imposed on partner who withdraws from partnership in violation of partnership agreement

# Partnership

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## Managerial Control

- Default rule is that every partner has equal voice in the management of the partnership
- Partners can agree, through partnership agreement, to divide control of partnership differently

# Partnership

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## □ Personal Liability of Owners

- All partners are jointly and severally liable for all partnership debts
- Creditor may sue partnership and all partners on partnership debts
- One partner who pays partnership debt can seek contribution from other partners

# Partnership

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## Taxation

- Partnership is not a taxable entity
- Known as a “pass-through” entity
- Partnership files an information return but does not pay tax
- Partners report their pro rata share of partnership profits and losses on their individual tax returns
- Partners are taxed on partnership profits even if partnership retains profits

# Corporation

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- ❑ An artificial, intangible entity created under the authority of a state's law
- ❑ Much more complex to create and operate than other business organizations
- ❑ Known as a domestic corporation in the state in which it is incorporated
- ❑ Known as a foreign corporation in a state other than its state of incorporation

# Corporation

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## Creation

- Incorporators prepare and file articles of incorporation
- State issues charter
- Initial board of directors meets, passes corporate bylaws, and approves issuance of stock
- Higher fees to create than for partnership
- Must qualify to do business in every additional state in which corporation intends to do business

# Corporation

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## Continuity

- Corporation is an entity separate from its owners (the shareholders)
- Shareholder's death or sale of his stock does not affect the organizational structure of the corporation

# Corporation

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## □ Managerial Control

- Shareholders (owners) elect the corporation's board of directors
- Directors set the objectives and goals of the corporation and appoint the corporate officers (president, vice presidents, etc.)
- Corporate officers manage the daily operations of the corporation

# Corporation

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## ☐ Shareholder Liability

- Shareholders have limited personal liability
- Owners are liable for debts of corporation only to the extent of their investment in the cost of the stock
- With small corporations, owners are often required to personally guaranty loans of corporation

# Corporation

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## ☐ Shareholder Liability (cont'd)

- Limited liability for shareholders can be defeated when it is shown that the corporate form is being misused. Known as “piercing the corporate veil”

### ☐ Liability can be imposed on corporation's owners when:

- corporation is alter-ego of owners
- corporate form is not respected
- corporation is under-capitalized

# Corporation

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## Taxation

- Corporation's profits and losses are not allocated to shareholders
- Corporation pays income tax on its earnings
- Shareholders pay income tax on dividends, even though already taxed as earnings to the corporation (double tax)

# Limited Partnership

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- A partnership in which one or more partners are designated general partners and one or more partners are designated limited partners
- Creation
  - Created by agreement
  - Certificate filed with state government

# Limited Partnership

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## Continuity

- Same as partnership with regard to general partners
- Limited partner can assign his interest in the partnership to another without causing dissolution of the partnership

## Managerial Control

- General partners control the partnership
- Limited partners may not participate in management of partnership

# Limited Partnership

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## □ Personal Liability of Owners

- General partners have unlimited personal liability for debts of the partnership
- Limited partners' liability is limited to amount of investment in partnership
- If limited partner engages in management of the partnership, he becomes personally liable for partnership debts like a general partner

## □ Taxation – same as partnership

# S Corporation

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- ❑ A corporation that has elected to be treated like a partnership for purposes of federal income tax under Subchapter S of the Internal Revenue Code
- ❑ S Corp does not pay income tax; instead, profits and losses are passed through to the shareholders, who report their share of the profits and losses on their individual income-tax returns, even if profits are retained and not distributed to shareholders

# S Corporation

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- S Corp cannot have more than 100 shareholders
- Election under Subchapter S must be unanimous among shareholders
- Shareholders must be individuals, not business organizations

# Limited Liability Company (LLC)

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- ❑ A hybrid business organization that has corporation- and partnership-like qualities.
- ❑ Owners of LLC are called “members”
- ❑ Business organization can be member of LLC

# Limited Liability Company (LLC)

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## □ Creation

- Created much like a corporation
- “Organizers” file Articles of Organization with the state government
- Cost is similar to incorporating a corporation
- Must qualify to do business in every additional state in which LLC intends to do business

# Limited Liability Company (LLC)

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## □ Continuity

- When a member dies or withdraws from LLC, LLC is dissolved
- Remaining members can decide to continue the business of the LLC, and new LLC is thereby formed

# Limited Liability Company (LLC)

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## □ Managerial Control

- Management is vested in members unless articles of organization provide for management by one or more “managers”
- Members have equal right to share in profits and losses of company

# Limited Liability Company (LLC)

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## Personal Liability of Owners

- Members are not personally liable for debts of company beyond their investment

## Taxation

- LLCs are pass-through entities like partnerships and S Corps; they are not taxable entities
- Members report their pro rate share of LLC profits and losses on their personal income tax returns