

New Dimensions in Estate & Trust Planning

*An Article to Benefit Clients & Friends
of*

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Trust & Estate Planning ♦ Probate & Estate Administration ♦ Business Formation & Planning

THE CHOICE OF BUSINESS ENTITIES IN VIRGINIA

Every prudent business owner wants to make sure that his personal assets are protected from his business liabilities. To protect both personal and business assets, the owner needs guidance on which structure best fits the business. Although the business may begin as a **sole proprietorship** or **partnership**, incorporating (either as S or C **Corporation**), forming a **limited partnership**, or forming a Limited Liability Company (**LLC**) will protect the owner's personal assets from business liability and provide structure for the growth and succession of the business.

Sole Proprietorship

A **sole proprietorship** is a business entity which has no separate existence from its owner. Any person who does business alone is a sole proprietor by default. In a sole proprietorship, the owner is personally liable for all debts of the business. In short,

a sole proprietorship is an 'easy' business entity that offers no protection for the owner and has no defined structure.

Partnership

A **partnership** is a business entity in which partners share with each other the profits or losses of the business. If two or more people engage in a business they are a partnership by default. Absent an agreement, the partners share profit and loss equally. Such an equal divisions of rights and liabilities is called a **general partnership**. A partnership agreement can determine how the partnership is managed and how profits and losses are allocated. Like sole proprietors, general partners are personally liable for all debts of the business. By default, every partnership begins as a 'General Partnership.' Partners can organize their business with a document called a 'partnership agreement' which describes the rights, duties, and liabilities of the

individual partners to each other and to the business.

Limited Partnership

A **limited partnership** is a type of partnership which is organized into two classes of partners: general partners and limited partners. General partners manage the business and are personally liable for all debts of the business. Limited partners may own part of the business but they do not manage the business. Limited partners' responsibility to pay business debts is limited to their investment in the business. This **limited liability** means that if the business goes bankrupt, all the business assets may be lost but **no personal assets will be lost!** The General partners enjoy no such immunity and remain 'on the hook' for business liabilities. Therefore, business owners will find it easier to find investors if the business is a limited partnership than a general partnership.

Corporation

A Corporation is business entity that has an existence separate from its owners. **Corporations have 3 Major Benefits over partnerships:**

- 1) While a general partner would be personally liable for business debts, every shareholder's liability is limited to his or her investment in the company.
- 2) The Corporation can continue in perpetuity.
- 3) Shares of a corporation are easier to transfer than other business interests.

Corporations must be created in a legal document and must be registered with a State to conduct business there. There are

two main forms of corporation: C Corporations and S Corporations.

C Corps and S Corps

S Corporations are taxed like partnerships (to the shareholders). This is good for companies with high earnings but whose value is unlikely to increase. Some accountants use S Corporations to treat some income as a dividend to shelter income from self-employment taxes for contractors. S Corporations have limitations: They are limited to one class of stock, there can be no more than one hundred shareholders, and all shareholders must be United States citizens or US residents and must be personal (and not entity) taxpayers.

C Corporations are more commonly used for publicly traded or growing companies because there are no limits as to who may own stock. C corporation stock is the easiest business interest to sell; publicly traded companies are typically C corporations. Unlike S Corps, C Corporations can have different classes of stock to suit the needs of the directors and investors. The disadvantage of C Corporations is that they pay double taxation: they pay tax on corporate earnings first and then shareholders pay income tax on dividends upon receipt.

LLC

In 1991, Virginia authorized a new business entity which shares both the liability benefits of a corporation with the beneficial tax treatment and structural flexibility of a partnership: The **Limited Liability Company (LLC)**. In many ways, a LLC is like a corporation. Both LLCs and corporations are business entities that enjoy limited liability for owners, have their own separate existence, and can continue in perpetuity. Like corporations, LLCs must be registered with a State to conduct business there. Owners of an LLC are called 'members' instead of a corporation's 'shareholders.' Like a C Corporation, a LLC can have multiple classes of membership (stock).

LLCs are **more flexible** and **less burdensome** than corporations. A LLC can choose to be taxed as a sole proprietor, a partnership or a C-Corporation. An LLC in Virginia can have only one member or it can have many. Like a partnership, a LLC can operate without a written agreement but to do so would be very risky.

LLCs share the **major benefits** of corporations and are **easier** to create and manage. As a result, LLCs are becoming the premier choice of entity for businesses ranging from personal contractors to rental properties, to service and sales companies.

Conclusion

Most business owners want to organize their company in order to shelter personal assets from business liabilities. Determining which of the many business entity options is right for your business takes a careful survey of the nature and size of your business as well as your business' goals and objectives. It is always imperative that you explore these options with an experienced Attorney as well as your business' tax advisor.

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