

## BUSINESS ENTITIES

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1. **Limited Liability Companies.** Limited Liability Companies have become very popular in the last several years because of the ease of formal operation as opposed to a standard Corporation. They are formed by filing a Certificate of Organization with the Pennsylvania Department of State. It is important when the LLC is first created to determine whether it will be a single member LLC or a multi-member LLC, since the initial designation determines its taxability and the appropriate documentation. The Operating Agreement is the formal document that regulates the operation of the LLC and it is extremely important that it be properly prepared. An LLC can be managed by either a member or by a non-member. Further, persons can be designated as the president, secretary and treasurer, although it is not required. The conveyance of real estate by one of the members to an LLC is taxable for purposes of the Pennsylvania realty transfer tax i.e. 2% of the fair market value of the real estate. The operation of a business as an LLC protects the members from personal liability resulting from the operation of the LLC as long as it is adequately capitalized i.e. sufficient assets are contributed to the LLC, and as long as none of the members personally guarantee any loans which the LLC takes out with a lender in order to initiate the business or to continue the operation of the business. There are many, many more aspects of the creation and operation of an LLC which are all governed by the appropriate Pennsylvania statute.
2. **General Partnership.** A general partnership consists of two or more persons and can be oral in nature although it is strongly recommended that any partnership agreement be reduced to writing. Such written Partnership Agreement would spell out the rights, duties and obligations as well as responsibilities of each of the partners which can, obviously, be quite confusing and misunderstood if not reduced to writing. Any personal or real property contributed to the partnership by any partner legally is considered to be personal property. Consequently, a judgment entered against any partner individually and not as a partner, does not constitute a lien against any partnership property. Only a judgment entered against the partnership itself can constitute a lien against partnership property. Every partner is an agent of the partnership for the purpose of its business and the act of every partner, including the execution for the partnership of any instrument for apparently carrying on in the usual way the business partnership of which he is a member, binds the partnership unless the partner acting has no authority to act for the partnership in a particular matter and the person with whom the partner is dealing has knowledge of the fact that such partner has no such authority. An admission or misrepresentation made by any partner concerning partnership affairs within the scope of his authority is evidence against the partnership. Notice to any partner of any matter relating to partnership affairs and the knowledge of the partner acting in a particular matter acquired while a partner and then present

in his mind, and the knowledge of any other partner who reasonably could and should have communicated to the acting partner operate as notice to or knowledge of the partnership, except in the case of fraud of a partnership committed by or with the consent of the partner. Where, because of any wrongful act or omission of any partner acting in the ordinary course of the business partnership or with the authority of his co-partners, loss or injuries are caused to any person, not being a partner in the partnership, or any penalties incurred, the partnership is liable therefore to the same extent as the partner so acting or omitting to act. All partners are liable jointly and severably for anything chargeable to the partnership under state law and jointly for all other debts and obligations of the partnership, but any partner may enter into a separate obligation to perform a partnership contract. State law is very specific and very detailed with regard to the operation of a general partnership and with regard to the liability of the general partners.

3. **Limited Partnerships.** In order to form a limited partnership, a Certificate of Limited Partnership must be executed and filed with the Commonwealth Department of State. The fact that a Certificate of a Limited Partnership is on file in the Commonwealth Department of State is notice that the partnership is a limited partnership and that all partners are limited partners except the persons designated therein as general partners, but it is not notice of any other fact. A limited partner is not liable for the obligations of a limited partnership unless he is also a general partner or, in addition to the exercise of his rights and powers as a limited partner, he can participate in the control of the business. However, if the limited partner participates in the control of the business, he is liable only to the persons who transact business with a limited partnership reasonably believing, based upon the conduct of the limited partner, that the limited partner is a general partner. A Partnership Agreement may be written or oral but, again, any limited partnership that is attempted to be operated as an oral versus a written partnership is asking for very serious legal problems. A general partner of a limited Partnership has the rights and powers, and are subject to the restrictions, of a partner in a partnership without limited partners and has the liabilities of a partner in a partnership without limited partners with persons other than the partnership and the other partners. A limited partner, as long as they do not participate in the operation of the partnership, has no liability except for the amount of their financial contribution to the partnership. It is only the general partners who are liable for the general debts of the partnership.
4. **Family Limited Partnerships.** The term is not a term that is created by Pennsylvania statute or by the provisions of the Federal Internal Revenue Code, but rather refers to a limited partnership which is formed to hold a family business or family investments with the idea that the parents will make gifts of their limited partnership interests to their children. Since the limited partnership interests are not meant to be transferred or sold to third parties and, therefore, are considered not to be marketable, their value should be substantially discounted for federal gift and estate tax planning purposes. An Operating Agreement is essential and the rules and regulations set forth in the Operating Agreement must be followed

in order to make certain that the limited liability partnership form is not disregarded by either the Internal Revenue Service or by a Court that determines that the Limited Partnership entity is a nullity because the partners never followed precepts required for a limited partnership to operate legally and effectively. No matter what you call the entity, it is a limited partnership and must be used solely for business purposes. Consequently, the transfer of the parents' residence or other personal property that is not meant to be used in the business of the limited partnership should not be transferred to the limited partnership and, obviously, none of the normal expenses incurred by the family in their personal lives should be paid from the limited partnership. The use of the limited partnership for personal purposes and personal expenses could very well result in the entity being disregarded by the Internal Revenue Service and the Pennsylvania Department of Revenue for tax purposes and by those organizations, as well as the court, for asset protection purposes. Obviously, if the parent is both the general partner and the only limited partner, the court may take the position that since the parent owns all of the interests, there truly is no partnership and, consequently, all the assets are subject to claims of the parents' creditors. It goes without saying that the attempt of parents to protect their assets of any type through a legal entity that smells or smacks of transfers in fraud of creditors would encourage creditors to attack such entities and attempt to have them disregarded by the court system. The same principle holds true for all taxing authorities. A family limited partnership must be treated as a business and not a family trust. As long as it is operated as a business and not as a personal vehicle to escape personal taxes, and if it is properly created, operated and maintained, it can operate as a valuable tool in estate planning.

5. **Sole Proprietorship.** Ownership is by a single individual and any assets owned or titled by her or in her name alone, are completely liable for any and all debts and obligations of the business. There is no separate licensure by the Commonwealth of Pennsylvania unless it is a particular type of business which requires the owner to be separately licensed i.e. lawyer, doctor, insurance agent, title insurance agent, remodeling contractor, certified public accountant, funeral director, etc. If the sole proprietor operates under a name other than their own personal name, they should register the "Fictitious Name" with the Pennsylvania Corporation Bureau in order to get access to the judicial system, if they find it necessary to sue their customers to collect money due and owing to them. Management is completely by the sole proprietor although the sole proprietor may well have employees, one or more of whom the sole proprietor might appoint as a manager, although they have no ownership interest. The owner is solely responsible for obtaining financing. However, if the owner is married, even though the owner is operating as a sole proprietorship, most financial institutions will require the owner's spouse to join in any financing in order to provide the owner's home (if married and usually owned jointly with spouse) with a lien as security for the loan. As in any small business, with regard to estate planning, the owner should enter into a Purchase Agreement with her employees (or key employees) to purchase the business, if they are willing and able upon the owner's

death or retirement, or there should be a provision in the owner's Will authorizing the Executors to either sell the business to the employees or, hopefully, sell the business as a going concern to a third party purchaser.

6. **Business Corporation.** Any business corporation must be created by the filing of Articles of Incorporation with the Commonwealth of Pennsylvania, the creation of By-laws and maintenance of a minute book, as well as numerous other formal documentation. The corporate name cannot be similar to any other registered Pennsylvania corporation. The By-laws should provide that the Directors and Officers do not have any personal liability as long as they adhere to all the requirements of the business corporation law of the Commonwealth of Pennsylvania and of the By-laws. A Certificate of Stock must be issued to each shareholder indicating the number of shares to which they are entitled as a result of the value of their contribution to the corporation. The corporation can elect to be taxed either as a C Corporation or as an S Corporation (which means, basically, it elects to be taxed as a partnership). No shareholder is liable for the debts of the corporation as long as they are merely shareholders and do not enter into any type of Guarantee Agreements for the debts of the corporation, or in some other manner render themselves liable for corporate obligations or debts.
7. **Taxes.** Generally, C Corporation's income is double taxed, first on the corporate level for both Federal and State Corporate Income Taxes and then to the shareholders, with regard to any dividends distributed to them, on their Federal and State Income Tax returns. With regard to a subchapter S Corporation, generally the tax flows to the shareholders in the same manner as any partnership. Consequently, there generally is no double taxation as the C Corporation. Prior to choosing any particular type of entity to which to conduct a new business, the tax ramifications and legal ramifications of any plausible entity must first be explored and the pros and the cons of the various types of entities must be compared with the pros and cons of the taxation of those various entities. I employ a method used by many attorneys when advising a client on the type of entity to be used for the proposed business, i.e. make a column of pros and cons with regard to the various types of entities themselves, and then consult with a client's CPA or tax counsel, make a list of the pros and cons of the taxation of various entities which must closely fit the situation of the proposed new business. Entities are separate from stockholders, shareholders, partners and members. Transfers of title to real estate between entities and their stockholders, shareholders, partners and members, including transfers between a subsidiary and a parent corporation and a transfer in consideration of the issuance and cancellation of stock, are fully taxable, unless otherwise excluded.
8. **Use of Professionals in Creation of Legal Entities.** With regard to the formation of legal entities it is imperative that legal counsel with knowledge of the various state statutes pertaining to such legal entity be retained to represent the persons creating the legal entity. Preparation of any documents creating a legal entity by anyone other than a licensed attorney in the Commonwealth of

Pennsylvania constitutes the Unauthorized Practice of Law which, under state law, constitutes a Misdemeanor of the Third Degree for the first offense and a Misdemeanor of the First Degree for the Second and subsequent offenses which carry with them possible fines and jail terms. That being said, in any transaction involving a legal entity a team approach is best suited for the planning of the transaction including an attorney, a Certified Public Accountant, an insurance agent, a life insurance agent and a representative of a client's financial institution.

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