

BL Speer & Associates
ATTORNEYS AT LAW


New Life – New (ad)Venture Choosing a Legal Entity

© 2011 BL Speer & Associates

719.381.1708 | fax: 719.466.8098 | info@blspeer.com | www.BLSpeer.com
29 EAST MORENO AVENUE, COLORADO SPRINGS, CO 80903-3915

BL Speer & Associates
ATTORNEYS AT LAW

Disclaimer!




- This may be boring
- You may not learn anything
- If you do learn something, it may be just enough to make you dangerous
- Information is based on **Colorado State Law** and Federal Law
- This is **NOT** tax advice
- This is **NOT** legal advice

BL Speer & Associates
ATTORNEYS AT LAW

Choosing a Legal Entity

- Your choice impacts:
 - Taxes
 - Legal risk
 - Financing
 - Ownership – roles & duties
 - Exit strategy



BL Speer & Associates
ATTORNEYS AT LAW


One Size Does **NOT** Fit All

- Important Factors:
 - Number and type of owners (individuals, investors)
 - Earnings distributions (dividends, salary, disbursements)
 - Timing of distributions (periodically, upon sale)
 - Time to solvency
 - Exit strategy

BL Speer & Associates
ATTORNEYS AT LAW

Sole Proprietorship


- Default legal entity – most basic
- Limited entity lifespan
- No legal formalities
 - No formal agreements required BUT
 - **Required** to register a trade name if NOT operating under surname
- Profit/loss pass through to owner (Owner's 1040, Schedule C)
- Taxpayer ID number: owner's social security number
- **NO** legal separation between personal/business assets



BL Speer & Associates
ATTORNEYS AT LAW

General Partnership

- IRS default classification
- Limited entity lifespan
- No legal formalities
 - No formal agreements required (HIGHLY recommended) BUT
 - **Required** to register a trade name if NOT operating under surname(s)
- Profits/losses pass through to owner's based percent of ownership (Individual owner's 1040, Schedule C)
- Taxpayer ID #: Federal Employer ID Number (EIN)
- **NO** legal separation between personal/business assets



Sole Proprietorship/General Partnership
Pros & Cons

- Pros
 - No legal formalities
 - Cheaper, short-term, to setup
 - Very flexible regarding profit/loss distribution
- Cons
 - **UNLIMITED** legal liability
 - NO legal separation between owners/business
 - Unlimited liability – responsible for employee and partner acts
 - Joint and several liability
 - Limited investor potential



Limited Liability Corporation (LLC)

- Sole member OK
- Perpetual lifespan
- Member v. Manager Managed
- Legal requirements
 - Registration with Colorado Secretary of State
 - Initial: Articles of Organization
 - Ongoing: Annual Report
 - Operating Agreement
 - Corporate formalities (minutes, document retention, etc.)
 - Not “technically” required but HIGHLY recommended (see Piercing the Corporate Veil)

Limited Liability Company (cont.)

- Profits/losses pass through to members based on membership interest
 - Members NOT personally responsible for losses
 - Taxes
 - Single member = profits taxed at personal rate (disregarded entity) and reported on member's 1040, Schedule C
 - 2+ members = partnership; reported on members' 1040, Schedule C
 - UNLESS elect another tax status, but alternative tax status does NOT affect entity status
- Legal separation between LLC and members' personal assets

Corporation

- Sole shareholder is OK
- Perpetual lifespan
- Board of directors, officers and shareholders
- Legal requirements
 - Registration with Colorado Secretary of State
 - Initial: Articles of Incorporation
 - Ongoing: Annual Report
 - Bylaws, Shareholder Subscription Agreement, Share Ledger
 - Corporate formalities (minutes, documentation retention, etc.)



Corporation (cont.)

- Profit/losses DO NOT pass through to shareholders
- Taxes:
 - Default = C Corp. - double taxation (taxed at corporate level and then shareholder level)
 - May elect S Corp.
- Legal separation between corporation and shareholders

S Corporation

- Tax election
 - Underlying legal entity = LLC, LP, LLP, PC or Corporation
 - Income/deductions pass through to shareholders/members
- Legal requirements depend on underlying legal entity
- Requirements/limitations
 - Domestic registered entity
 - No more than 75 shareholders/members
 - Shareholders/members = individuals, estates, and certain tax-exempt organizations (NOT corporations)
 - No non-resident alien shareholders/members
 - One class of stock (corporation)
 - NOT insurance company, bank, international sales corporation, etc.

BL Speer & Associates
ATTORNEYS AT LAW

Less Common Entities

- Limited Partnership (LP)
- Limited Liability Partnership (LLP)
- Limited Liability Limited Partnership (LLLLP)
- Professional Corporation (PC)
- Professional Association (PA)

BL Speer & Associates
ATTORNEYS AT LAW

Legal Liability & Piercing The Corporate Veil

- Limitations on entity legal liability DO NOT extend to owners'/members'/shareholders' personal acts or omissions
- Piercing the Corporate Veil – 3 Part Test
 - (1) Alter ego:
 - Organization is operated as a distinct business entity?
 - Comingling of funds and assets?
 - Adequate corporate records?
 - Misuse of entity form by an insider?
 - Inadequate funding?
 - Organization is a "mere shell"?
 - Legal formalities are ignored?
 - Organization funds/assets used for non-corporate purposes?
 - (2) Was the corporation form "used to perpetrate a fraud or defeat a rightful claim"?
 - (3) Is it just to hold the owner/member/shareholder personally liable for the acts of the business entity?



BL Speer & Associates
ATTORNEYS AT LAW

Other Legal Issues

- Choosing a business partner – buy/sell agreements
- Choosing a name
 - Legal entity name
 - Trade name (legal alias)
 - Trademarks
- Leasing/buying business space – lease agreements (personal guarantees)
- Engaging customers – contracts
- Hiring help – employees v. independent contractors
- Business insurance – errors and omissions, malpractice, workmen's compensation, etc.





BL Speer & Associates
ATTORNEYS AT LAW

Questions?

- **ANSWERS**
 - The Answer to Life, the Universe and Everything is "42"
 - Douglas Adams, Life, the Universe and Everything (Hitchhiker's Guide to the Galaxy Trilogy)
 - "It Depends"
 - Universal legal answer