

Business Formation

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When starting a business, you have many decisions to make; who to hire, where to locate, how to get customers and where to start. But, one of the most important and overlooked decisions is how to protect yourself. Going into business involves risk, but certain risks can be avoided or, at least, minimized. One of the easiest way to protect yourself is to choose the right business entity. There are four basic entities to choose from: sole proprietorship, partnership, corporation, and limited liability companies.

A "sole proprietorship" offers no protection to the owner, but is the simplest to set up. No papers need to be filed, you simply start doing business. For a small business with exposure to only minimal risk, a sole proprietorship may be acceptable. However since any lawsuit puts your personal assets including your home, car and bank accounts at risk, most individuals want to consider a more formal business entity. If you do conduct business as a sole proprietorship, but plan to do business under a different name, you need to file a trade name application (sometimes called a "d/b/a" or "doing business as"). Filing is simply a matter of completing a short form indicating your name, the trade name, business location and paying a small fee. Upon completion, you will be able to open a bank account in the trade name and conduct business in the trade name.

Another relatively informal business entity is a "general partnership." These entities do not require documentation to come into formation. However, it is always a good idea to document your relationship and responsibilities with a written agreement. Like sole proprietorships, general partnerships do not provide any asset protection. Additionally, they can create unexpected exposure. For example if Partner A decides to make a purchase in the partnership name, Partner B is very likely to be personally responsible for the debt even if he did not sign any documents.

A "limited partnership," requires at least one general partner and at least one limited partnership. To properly form this type of entity, documentation must be filed with the secretary of state. A Limited Partnership is best used when someone intends to be a "silent partner" or "money man". The general partner runs and manages the business and remains personally liable. The limited partner cannot participate in daily management and has no personal liability for partnership debts. However, the limited partner can lose his protection if he begins to manage the business. If he does, he becomes a general partner and exposes himself to personal liability.

Corporations provide personal liability protection for all of its shareholders. However, if certain formalities are not adhered to, the protection can be lost. The corporate structure is simple: shareholders own the business, shareholders elect a board of directors who oversee the long term objectives, and directors appoint officers who run the daily business. In many small businesses the share holder is also a director and officer. Very often they are also employees. Nonetheless, the law respects the different capacities, even if the same person occupies all three positions.

The key fact to remember is that the corporation is a distinct and separate entity from its shareholders. This distinction is what provides for the protection. While the corporation may be liable for corporate debts, the shareholders are not.

Unfortunately, the protection provided for by a corporation is not perfect. It can be given away, taken away or, simply, may not apply. For example, if your corporation is paying your personal expenses, or corporate funds and personal funds are put in the same account, the corporate protection is often revoked. Alternatively, a corporate owner may be required to sign a personal guarantee in order to enter a lease or purchase contract. In these cases, the owner has given way his corporate protection. Finally, corporations are run by people and people commit wrongful acts. If you as the worker commit the wrongful act (improper construction, repairs, accidents, etc.) you will be personally responsible for the damage you cause. However, if your employee commits the wrongful act, you are generally protected from personal liability. Although not perfect, corporate entities provide one of the best levels of protection to the business owner.

Once the decision to form a corporation is made, there is a second decision to make: should you be a C-corporation or sub chapter S corporation. There is no difference between C and S corporations for the purposes of liability. It is merely a tax election which can often save money. For a small business which has no intention of going public, an S election is very common and usually advantageous. You should consult with an attorney or tax expert to determine whether the sub chapter S election is appropriate for your situation.

The last entity to consider is the limited liability company or LLC. An LLC generally provides the same liability protection as a corporation but can have different tax consequences. It is often said that an LLC is more flexible than a corporation. While there is some truth to this statement, the flexibility is often minimal. Moreover, the tax liability can be more substantial than a sub chapter S corporation. It is important that you discuss your business needs with an attorney or accountant before you elect to become an LLC.

There is no best business entity for all situations, and there is no such thing as perfect protection. The best idea is to meet with an attorney and discuss your business situation. You can then weigh the initial expenses, long term costs and risks against your needs and make the best decision for you. As a final note, remember that you can lose your protection under certain circumstance. The right business entity, a good lawyer and good accountant can help you avoid problems before they occur.

For more information on filing small business or personal bankruptcy, or bankruptcy options, in the state of Georgia please call Ian Falcone at The Falcone Law Firm in Marietta, Georgia at (770) 426-9359 or visit <http://www.falconefirm.com>