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KEY BUSINESS ISSUES IN TODAY'S ECONOMY

PROTECTING BUSINESS EQUITY AND MANAGING CASH FLOW

Learning the Law™ Seminar

24th in a Series

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CHOICE OF BUSINESS FORM AND PROTECTING YOUR ASSETS

Presented by
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I. FORM OF BUSINESS

A. Sole Proprietorship:

1. Owned by single person – no management disputes.
2. Formation involves few formalities and start-up costs.
3. Unlimited personal liability of owner – personal assets at risk.

B. Partnership:

1. Two or more co-owners – need not be equal.
2. Usually requires express agreement, preferably written. If no partnership agreements exist, the provisions of Uniform Partnership Act apply.
3. Each partner has unlimited personal liability for all business obligations.
4. Any partner can obligate partnership – even if unauthorized.
5. Rarely the best choice since 1994 when Oregon law began allowing limited liability companies.

C. Corporation:

1. Artificial, intangible entity owned by one or more persons. Each person with an ownership interest holds stock in the corporation.
2. Corporation is a separate legal entity.
3. Liability of shareholder is limited to his/her interest in the corporation. Personal assets should be safe from corporation's creditors.
4. Allows ability to raise capital by selling stock in the corporation.
5. Long-term continuity – business continues even after death or withdrawal of an owner.
6. Possible "double" taxation problem; however, this is usually avoided by use of "S" form of corporation for tax purposes.

- D. Limited Liability Company (LLC):
1. An unincorporated association which combines the flexibility and tax status of a partnership with the limited liability protection given to owners of a corporation.
 2. Owners are called members. An LLC does not have officers or directors.
 3. LLC is a separate legal entity.
 4. Liability of members is limited to his/her interest in the LLC – comparable to a corporation.
 5. Long-term continuity comparable to a corporation.
- E. Professional Entity Choices:
1. Certain professionals (attorneys, doctors, architects, dentists, chiropractors, psychologists, etc.) have additional choices. Possible business forms include professional corporations (PC) or limited liability partnerships (LLP).
 2. These entities limit, but do not eliminate, all liability. In general the professional remains liable for:
 - (a) Their own negligent acts or misconduct;
 - (b) negligent acts or misconduct of a person under their direct supervision and control; and
 - (c) negligence or misconduct of other professionals or employees of the firm up to a maximum of \$300,000 per year per professional.
 3. Despite these limits, a PC or an LLP can significantly reduce liability exposure for professionals.
- F. Other:
1. There are certain other forms of business which are appropriate only in limited circumstances and are rarely used, such as limited partnerships and cooperative corporations.

II. WHICH ENTITY BEST PROTECTS YOUR PERSONAL ASSETS?

- A. For most businesses either a corporation or a limited liability company (LLC) offers the most protection for your personal assets. Each of those entities offers equivalent liability protection. Except in unusual circumstances the liability of the owners is limited to the assets of the business.
- B. Are corporations and LLCs “bullet proof”? No- but if properly set up and correctly managed they provide powerful liability protection.

III. TAX ISSUES

- A. LLCs have more flexible tax treatment than corporation. For example, LLCs are generally:
- (1) Not subject to any tax on distributions from the business to its owners; and
 - (2) not subject to any tax upon liquidation of the business.

- B. Because of these potential tax advantages, LLCs are often a preferable choice for a small business.

IV. SHOULD YOU CHANGE YOUR BUSINESS FORM?

- A. If you are a sole proprietor or a partnership, you should seriously consider changing to a corporation or an LLC.
- B. If you are currently a corporation, the conversion of a corporation into an LLC is generally a taxable transaction. Therefore changing to an LLC is probably not worthwhile.
- C. If you are currently an LLC, the conversion of an LLC into a corporation is generally tax free but it would be an unusual circumstance where the conversion would be beneficial.