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### TO LP OR LLC

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Economic downturns often provide opportunities for those with an entrepreneurial bent: Proctor & Gamble, IBM, General Electric, Federal Express, Microsoft and Hewlett Packard are just a few of the many well-known companies founded during economically challenging times.

While you might not be planning on starting the next Fortune 100 Company, you may be thinking that now would be an ideal time to start a business. If so, one thing that you should consider is the form your new business will take.

Your choice of form can have important ramifications, from the time and expense of setting up and maintaining your business, to your potential personal liability for the business's debts and obligations, to how the business's income will be taxed.

To assist you in deciding upon an appropriate business form, the following is a brief overview of the advantages and disadvantages of the more popular business forms: the sole proprietorship, partnership, limited partnership, corporation and limited liability company.

Sole Proprietorship: A sole proprietorship is the easiest type of business to form, as it automatically comes into being whenever a single person engages in a business for profit. In addition, it has advantageous tax treatment: business income "passes through" to the business owner, and is therefore taxed only once.

A sole proprietorship has one significant limitation: the business owner can have virtually unlimited personal liability for the business's obligations. Should a customer get hurt on the business premises and obtain a judgment against the business, or should the business be unable to pay its creditors (vendors, its landlord, etc.), the owner's personal assets – including the owner's bank accounts, residence, and so forth – may be reached to satisfy such creditor claims.

As discussed below, some business forms provide owners with protection from personal liability. In determining whether the sole proprietorship is the right form for your business, you should therefore consider the level of risk you are willing to take in the event your business results in creditor claims.

General Partnership: A general partnership is very similar to a sole proprietorship in that it is automatically created whenever two or more people engage in a business, as co-owners, for

profit. It is no surprise, therefore, that this business form has many of the same advantages (minimal formalities for creation; pass-through taxation) and disadvantages (unlimited personal liability) as the sole proprietorship.

The potential for unlimited personal liability is an even greater concern with a general partnership than a sole proprietorship: a general partner has potential unlimited personal liability with respect to not only his own conduct and transactions, but also his partner's conduct and transactions. Indeed, potential unlimited personal liability can be a major concern in a large partnership, in which the business's day-to-day need for prompt decision making results in decision-making authority being delegated to a single partner or group of partners. A partner could potentially be personally liable for business decisions in which not only did he have no role, but of which he actually had no knowledge.

If potential unlimited personal liability is a concern in your particular business, a limited partnership, corporation, or a limited liability company (all discussed below) may be a more appropriate business form for your needs.

Similarly, if your business will involve the provision of professional services, you may be able to organize it as a professional limited liability partnership, which protects partners from personal liability for the professional malpractice of their partners.

Limited Partnership: A limited partnership ("LP") addresses, to a certain degree, the issue of a partner having unlimited personal liability for the conduct of another partner. An LP is comprised of at least one limited partner and one general partner. The limited partner usually invests in the partnership, but has no role in its day-to-day management; accordingly, the limited partner is generally shielded from personal liability for the LP's debts and obligations. The general partner, in contrast, has a day-to-day managerial role, and, as in the case of a general partnership, is subject to unlimited personal liability.

To avoid the general partner having unlimited personal liability, it is possible, however, to form a corporation or limited liability company to act as the LP's general partner.

In addition to providing limited liability for limited partners, the LP, like the sole proprietorship and partnership, provides pass-through tax treatment.

While another business form, the limited liability company, shields *all* of its owners from personal liability and has therefore become, in many contexts, more popular than a partnership or LP, there are still instances in which an LP might be a more appropriate business form: since an LP's limited partners are passive investors, they may prefer to invest in a business in which the general partners running the business have their personal assets at stake in the event that they make bad business decisions.

Corporation: A corporation is unique business form in that the corporation, itself, is deemed to have its own legal existence, separate and apart from the people who own, control, manage and operate it.

If you are considering a business in which limited personal liability is important to the owners and employees of your business, you may wish to consider forming a corporation; because the corporation has its own legal identity and can, itself, be sued, the corporation's owners and employees are not generally subject to personal liability for the corporation's debts and obligations.

You may also wish to consider forming a corporation if it is important that ownership interests in your business be liquid and widely dispersed. In general, interests in a corporation, through corporate stock, may be transferred from one owner to another without causing a corporate dissolution, and corporate stock may be sold to the public to raise capital. If, on the other hand, just you and a few other people are forming a corporation, and you would like to limit who owns corporate shares, you may include transfer restrictions that will limit stock transferability.

The drawbacks of the corporate form are that it results double taxation: both the corporation and its owners are taxed on its profits. And, forming and operating a corporation involve significant formalities, such as completing and filing papers for incorporation, holding board meetings, keeping board minutes, preparing corporate resolutions for corporate action, and so forth; these formalities are even more onerous in the case of a private corporation. Finally, a corporation cannot be easily converted into another corporate form, such as a partnership or limited liability company.

Corporate double taxation can be address through formation of an S corporation, but an S corporation has significant limitations on shareholding: all stock must have the same distribution rights; an S corporation may not have more than 100 shareholders; and all of the shareholders must be U.S. resident individuals or certain U.S. resident trusts.

Limited Liability Company: A limited liability company ("LLC") combines the best elements of each business form: pass-through tax treatment, like sole proprietorships and partnerships, and limited personal liability, like corporations.

Not surprisingly, in recent years, LLC's have become one of the more popular business forms. LLC's provide their owners, referred to as "members," with tremendous flexibility because the members can custom design the LLC operating agreement to address myriad issues, including: the amount and timing of capital contributions and distributions; allocations of profits and losses; powers of managers and officers; scheduling and conduct of voter meetings; voting rights; transfer restrictions; and liquidation rights and procedures.

We have sought to identify some of the factors that you might consider in selecting an appropriate business form. An in-depth discussion of the advantages and disadvantages of particular types of business forms is beyond the scope of this article; business entities are governed by state law, and there is considerable state-to-state variation in such laws. We recommend that you consult with a legal and tax professional to obtain more specialized guidance for your particular circumstances and objectives.

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