

INTRODUCTION

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- ▶ Presenter: James F. West, Esq.
Scamardella, Gervasi, Thomson & Kasegrande, P.C.
- ▶ Subject: Ins and Outs of Business Entity Formation
 - ▶ Sole Proprietorship
 - ▶ General Partnership
 - ▶ Limited Partnership
 - ▶ Corporation
 - ▶ Limited Liability Company
- ▶ Attributes
 - ▶ Formation
 - ▶ Term
 - ▶ Transferability
 - ▶ Management
 - ▶ Liability

The Business Organization

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- ▶ Sole Proprietorship
- ▶ General Partnership
- ▶ Limited Partnership
- ▶ Corporation
- ▶ Limited Liability Company

Factors/Attributes

1. Formation: How is the entity created?
2. Term: How long can the entity last?
3. Transferability: How easily can ownership interest be transferred?
4. Management: Who calls the shots?
5. Liability: Who is responsible for debts?

Entity Charts

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Entity	Formation	Existence	Transferability	Management	Liability
Sole Proprietorship	Simple	Death of Owner	Difficult	Owner	Owner
General Partnership	Simple	Death of Partner	Difficult	Partners*	Partners*
Limited Partnership	Difficult	Death of General Partner	Difficult	General Partner	Gen'l Partner
Limited Liability Company	Difficult	Perpetual	Simple	Flexible (Members)	Limited
Corporation	Difficult	Perpetual	Simple	Stockholders, Board, Officers	Limited

Sole Proprietorship

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- ▶ A business individually owned by a single person
- ▶ Formation: No filing needed. No formalities needed.
 - ▶ Person
 - ▶ Idea
- ▶ Term: If no transfer, goes to the owner
 - ▶ Death
 - ▶ Termination
 - ▶ Personal Bankruptcy
- ▶ Transferability: Easy!
 - ▶ Sell assets to a third party
 - ▶ Transfer assets to corp.
 - ▶ Change the entity
 - ▶ Change the type of entity
- ▶ Management: Owner is in charge
- ▶ Liability: Personal liability is UNLIMITED
 - ▶ Business/personal assets the same
 - ▶ Can limit w/insurance

General Partnership

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- ▶ Definition: An association of **two or more people** who are **carrying on** as co-owners of a **business for profit**
- ▶ Formation: **OBJECTIVE**
 - ▶ Intent is irrelevant
 - ▶ If issue litigated, jury controls
 - ▶ Jury will look at objective actions for determination
 - ▶ Profit sharing key
- ▶ Revised Uniform Partnership Act §202(a): even an express term in an agreement that there is no GP is not controlling
- ▶ Term: Event of dissolution
 - ▶ Death
 - ▶ Completion
 - ▶ Expiration
- ▶ In New York:
 - ▶ Partners have choice to continue
 - ▶ Not elsewhere (UPA)

General Partnership

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- ▶ Transferability: Liquidity vs. Illiquidity
 - ▶ What can be transferred, what can't be?
- ▶ Typically addressed in partnership agreement
 - ▶ If no agreement, goes back to the statutes (RUPA 503/UPA 27(1)) : financial aspects are transferable, not decision making power
- ▶ Share of Profits
 - ▶ Liquid!
 - ▶ Personal property (profits) may be transferred to 3rd parties
- ▶ Share in Management
 - ▶ Illiquid!
 - ▶ Right to vote or ownership interest not transferable
- ▶ Partnership Assets
 - ▶ Illiquid!
 - ▶ Who bought it?

General Partnership

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- ▶ Management: Equal, unless otherwise agreed upon in a partnership agreement
 - ▶ RUPA 401(f)/UPA(e)
- ▶ Objectivity still controls
 - ▶ Scenario: someone operates a store, but not a “partner.”
 - ▶ Ordinary vs. fundamental voting
 - ▶ Veto power: courts are divided
- ▶ Liability: jointly and severally liable
- ▶ Personal debts
 - ▶ Creditors => ownership
- ▶ How to limit
 - ▶ Insurance, agreement
- ▶ New partners liable for extent of their investment
 - ▶ Prior to becoming a partner (UPA 17)
 - ▶ ALL debts after (RUPA 306(b))

Limited Partnership

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- ▶ One or more general partners (GP) and one or more limited partners (LP).
- ▶ LP NOT personally liable for debts, NOT expected to participate in day to day affairs.
- ▶ Only stand to lose what they have invested
- ▶ Formation: Must register with the state
 - ▶ ULPA 201 – public filing of Certificate of Limited Partnership with Sec. of State
 - ▶ Puts world on notice of limited liability
 - ▶ Must include names of all the general partners
- ▶ Corp can be GP
 - ▶ Careful!

Limited Partnership

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- ▶ Term/Transferability: similar to a General Partnership
- ▶ Management: GPs vs. LPs
- ▶ General partners
 - ▶ Managerial control
 - ▶ Day to day affairs
- ▶ Limited partners
 - ▶ ULPA 202 – passive partners
 - ▶ In exchange for LL, not much management/control
 - ▶ Can lose this!
- ▶ Liability: GPs v. LPs
- ▶ General partners
 - ▶ Jointly and severally liable
- ▶ Limited Partners
 - ▶ Only investment
 - ▶ Gateway Potato Sales – act like a general partner, you are liable as a general partner
 - ▶ Newly revised ULPA: might not be the case!

Limited Liability Company

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- ▶ Hybrid of corporation and partnership
 - ▶ Limited liability of a corporation plus the freedom of governance of a partnership
- ▶ Creature of statute
 - ▶ When you join, you become a member
- ▶ Preferred business entity
 - ▶ Limited liability + freedom + partnership tax treatment
- ▶ Formation: File articles of organization with the state
- ▶ Adopt an operating agreement
 - ▶ Identify the purpose
 - ▶ Corporate kit (we prepare)
 - ▶ Minutes of the first meeting
 - ▶ Operating Agreement
 - ▶ Necessary waivers
 - ▶ File with the secretary of state
 - ▶ Obtain an EIN letter

Limited Liability Company

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- ▶ Term: unanimous consent of the members, or as otherwise provided in the operating agreement
- ▶ Transferability: Operating agreement again!
 - ▶ Generally: can transfer financial interests, not managerial unless there's unanimous consent
- ▶ Management: all members entitled to control unless operating agreement provides otherwise
- ▶ Member managed (default)
 - ▶ Each member has the power to operate the LLC for any act carrying on the business of the LLC in the ordinary course
 - ▶ Not ordinary? Authority can be given and withdrawn
- ▶ Manager managed

Limited Liability Company

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- ▶ Management (cont.):
Manager managed
 - ▶ Managers have the apparent authority
 - ▶ Members do not
 - ▶ All delineated in the Operating Agreement
- ▶ Liability: Limited
 - ▶ All members have limited liability
 - ▶ Can lose investment, creditors cannot attach personal assets

Limited Liability Company

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▶ The Operating Agreement

- ▶ The LLC Law was drafted based on the Business Corporations Law
- ▶ Restricts how the LLC operates
- ▶ Caveat: DEFAULT rules where Operating Agreement is silent
- ▶ Can override default rules!

▶ OA Considerations

- ▶ Management
- ▶ Dilution of shares
- ▶ Right to transfer
- ▶ Death
 - ▶ Doesn't all go to spouse!
 - ▶ Do you really want to go into business with someone else's spouse?
- ▶ Disability

The Corporation

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- ▶ What is it?
 - ▶ Legally distinct entity separate from the owners
 - ▶ History dates all the way back to the Roman Empire
 - ▶ Comes from the Latin “corpus” for “body” or “body of people”
 - ▶ Considered a “legal person”
 - ▶ (Most) of the Rights that come with it
- ▶ Formation – can be formed anywhere, any time. A person files the Certificate of Incorporation, the Corporate Charter, the Articles of Incorporation
- ▶ Filed in the appropriate state with the Secretary of State
- ▶ People
- ▶ Paper
- ▶ Act

The Corporation

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- ▶ Formation(cont.) – PEOPLE – PAPER – ACT
- ▶ People
 - ▶ Who? The incorporators
 - ▶ One or more persons OR ENTITIES! To execute the articles
- ▶ Paper
 - ▶ Certificate of Incorporation
 - ▶ By-Laws
 - ▶ Meetings
 - ▶ Voting/Quorum
- ▶ By-Laws (cont.)
 - ▶ Board of Directors
 - ▶ Voting
 - ▶ Resignation
 - ▶ Duties
 - ▶ Officers
 - ▶ Stock
 - ▶ Distribution
 - ▶ Classes
 - ▶ Other provisions
 - ▶ Amendments
 - ▶ Notices
 - ▶ Conflicts

The Corporation

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▶ Formation (Cont.)

▶ Paper

▶ Required information

- ▶ Name
- ▶ Names/addresses
- ▶ Duration
- ▶ Purpose
- ▶ Structure

▶ Act

- ▶ Incorporators deliver the articles to the state and pay the fees
- ▶ State accepts

▶ Act (cont.)

- ▶ Proof of valid formation - De Jure Corporation
- ▶ Board holds meeting

▶ De Facto Corporation

- ▶ Statute
- ▶ Good faith effort
- ▶ Corporate exercise
 - ▶ Ex: mess up the documents, begin acting like a corporation, enter into contract
 - ▶ Personally liable unless court applies DFC

The Corporation

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- ▶ Formation (cont.)
 - ▶ Corporation by Estoppel
 - ▶ Act like a corporation, may not be able deny you are one
 - ▶ Prevent the improperly formed corporation from evading liability
 - ▶ Both De Facto and Estoppel corporations are abolished in some states, careful regardless
- ▶ Term – perpetual
 - ▶ It's a person – doesn't go away
 - ▶ Dissolution
 - ▶ Termination specified in Certificate of Incorporation
- ▶ Transferability – Stocks (more later)
 - ▶ Public stocks: freely transferable on stock exchange
 - ▶ Private stocks: shareholder agreement restrictions (no 2nd market) (unregulated)

The Corporation

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- ▶ Management – Shareholders (Stock Holders), Board of Directors, Officers
- ▶ Shareholders elect the Board of Directors
 - ▶ Board manages the business
- ▶ Board of Directors elect Officers
 - ▶ Officers manage day-to-day affairs
- ▶ Public corporation: separation between ownership and control
 - ▶ Shareholders don't call the shots
 - ▶ Have to publicly disclose financial results, accounting, etc.
- ▶ Private corporation:
 - ▶ Control/ownership not separate
 - ▶ Everything private

The Corporation

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- ▶ Liability: LIMITED
 - ▶ Shareholders NOT personally liable
- ▶ BIG EXCEPTION: Piercing the Corporate Veil
 - ▶ Only applies to “close corporations”
 - ▶ Operate similarly to partnerships
 - ▶ Have very few shareholders, stock not publicly traded
- ▶ To Pierce the Veil:
 - ▶ Shareholders must abuse privilege of incorporating
 - ▶ Fairness must require holding them liable
- ▶ Courts are looking for fraud, *not sloppiness*
 - ▶ “Alter Ego”
 - ▶ Undercapitalization

The Corporation

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▶ Liability (Cont.)

▶ Alter Ego

- ▶ Tony and Steve only SH in A Corp. Tony commingles funds, buys personal stuff with corporate card.
- ▶ Tony treats Corp's assets as his own.

▶ Undercapitalization

- ▶ Tony again. A Corp. is a weapons dealer, no insurance, \$1,000 in the bank.
- ▶ Truck blows up, hurts Bruce.

▶ S-Corp vs. C-Corp:

- ▶ S-Corp: Can legally avoid income tax at the corporate level
 - ▶ But not NY income tax
- ▶ Rules:
 - ▶ No more than 100 shareholders
 - ▶ Must be human, U.S. citizens
 - ▶ One class of stock
 - ▶ NOT Publicly traded

Real Estate Considerations


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- ▶ Two ways to go about it: purchasing a building and entering into a lease
- ▶ Purchasing a building
 - ▶ BIG MISTAKE: buying personally or through your business entity
 - ▶ Correct path: holding company
 - ▶ Limits liability
 - ▶ Tax benefits
- ▶ Lease
 - ▶ BIG MISTAKE: not getting attorneys
 - ▶ Don't be fooled by a landlord
 - ▶ Have attorneys look at the lease
 - ▶ Representations could hurt
 - ▶ Repairs?
 - ▶ Right to expand?
 - ▶ Perfect a default?
 - ▶ Guaranties

Questions?

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- ▶ (718) 442-0900
- ▶ jwest@statenlaw.com



THE LAW FIRM OF
SCAMARDELLA, GERVASI, THOMSON & KASEGRANDE
A PROFESSIONAL CORPORATION