BUSINESS LAW REPORT

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CHOICE OF BUSINESS ENTITIES

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California recognizes the following types of business entities:

- Sole Proprietorship
- General Partnership
- Limited Partnership
- Limited Liability Company
- Limited Liability Partnership
- Regular ("C") Corporation
- Sub-Chapter "S" Corporation

Selecting the proper form of business entity for a business in which you are involved (even as a passive investor) can have significant consequences.

SOLE PROPRIETORSHIP

A sole proprietorship is a business owned by a single individual (or with a spouse). It may have no employees, or many employees. All profits are taxed to the owner, and the owner receives the tax benefit of losses. Business expenses are listed on an I.R.S. Schedule C. There is no limit on the owners' potential liability for debts or other liabilities arising from the business.

GENERAL PARTNERSHIP

Two or more partners may jointly own and operate a general partnership. Although the partners can appoint a central manager, each partner is responsible for the business management and for all of the debts and liabilities of the partnership business (whether the obligation arose from a partner or an employee). The partners are taxed for profits, or obtain the tax benefit of losses, based upon their specific percentage of ownership in the business. Partners receive an I.R.S. Form K-1.

LIMITED PARTNERSHIP

A limited partnership must file for limited partnership status with the California Secretary of State. It has two classes of partners: (1) a general partner who manages the business and is responsible for all debts and liabilities of the partnership, and (2) limited partners who do not have management control and whose potential liability is limited to the amount they invested in the limited partnership. Partnership profits (or losses) pass through to the individual limited partners based upon the percentage of their partnership investment.

LIMITED LIABILITY COMPANY

An LLC must register with the California Secretary of State. It must have two or more members. Its management is flexible; it may be managed by all members, managed by a designated member, or be managed by a hired, third party manager. No LLC members are required to be liable for debts or liabilities of the LLC beyond the amount of their investment. Profits, or losses, of the LLC are passed through to the LLC members, usually based on the percentage of ownership. An I.R.S. Form K-1 is issued for tax purposes. LLC's usually have (and may be required to have) restrictions on how long the LLC can continue in business and restrictions on the transfer of membership interests (shares). In California, certain types of businesses are not allowed to form LLC's (e.g., real estate brokers, construction contractors, insurance brokers, accountants, attorneys, doctors, insurance companies, and banks).

LIMITED LIABILITY PARTNERSHIP

LLP's are much like LLC's, but the LLP business structure may only be used by a small group of businesses that may not operate as LLC's (e.g., attorneys and accountants).

REGULAR ("C") CORPORATION

The regular corporation (formed under Chapter "C" of the Internal Revenue Code) must be registered with the California Secretary of State. "C" corporations are owned by one or more shareholders (to whom share, or stock, certificates are issued). The shares may be transferred to other parties. The shareholders select a centralized board of directors to supervise the management of the business. The corporation, itself, pays tax on profits and deducts losses. The board of directors may distribute after-tax profits to shareholders as dividends. Shareholders are taxed on dividends as regular income. Thus, corporate profits can receive double taxation. The shareholders have no responsibility for the debts