

Legal Forms of Business

Objectives: Help you understand the differences when dealing with:

- Sole Proprietorships
- Partnerships
- Corporations
- S-Corp
- Limited Liability Company
- Types of Stock, Capital, Common, Preferred

Why Is It Important To Know What The Business Entity Of A Debtor Is?

- If a Company becomes insolvent you may have another course of collection.
- Some business entities shield the personal liability of the owners
- You need to know when to get a personal guaranty and when the signer is personally responsible for the company debt.

Types of Business Entities

- Sole Proprietors
- Partnerships
- Corporations
- S- Corporation
- Limited Liability Company (LLC)

Characteristics of a Sole Proprietor

- Business is Owned and Operated by one person
- No need for a personal guaranty
- More risk involved
- Easiest to set up
- Only pays tax on earnings once
- Legal action you sue the owner not the company

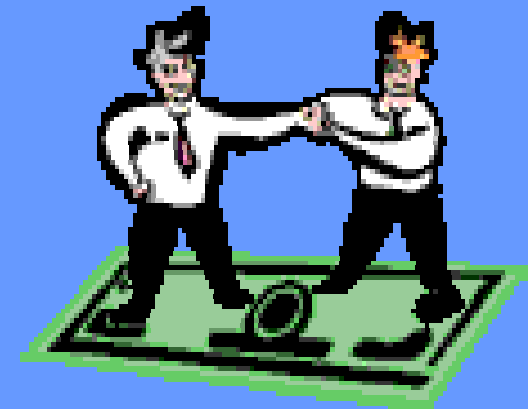


Pit Falls of Proprietorships

- Less resources to draw from.
- Does the owner have the ability to Market, Sell, Collect, Buy, Supervise?
- Can not take in a partner without changing the status of the company.
- Business loans may be harder to get.
- Ability to raise cash is limited.
- Owner will take care of his needs first.
- Personal liability if company fails

Characteristics of Partnerships

- Two or more owners
- Can be formed without a formal contract
- Either partner can commit for business obligations
- Additional knowledge
- Additional capital
- Can sue partnership or Partner
- Tax Savings. Only taxed once



Types of Partnerships

- General Partnership = All partners are active in affairs of management.
- Limited Partnership = 1 or more General partners and 1 or more limited partners.
- Limited Partners are liable only up to the amount of their investment.
- Silent Partners

Pitfalls of Partnerships

- It is common that Partnerships split up, usually because of a disagreement.
- Partnership dissolves upon death or withdrawal of a partner.
- A new partnership can be formed and we don't know.
- Partnerships can incorporate
- Many Partnerships don't have a written contract that spells out the obligations of each partner.

Characteristics of Corporations

- A Corporation is its own entity
- Shields owners and officers from personal liability
- Income is taxed twice
- More difficult to set up than proprietorship and partnerships
- Must sue the corporation unless you have a personal guaranty.
- Can usually raise capital easier than proprietorship or partnership.
- Can sell stock to generate capital
- Has a Board of Directors
- More employee's, more knowledge better chance of survival.

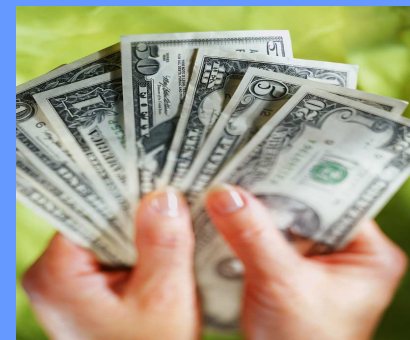


Types of Stock

- Capital Stock
 - Issued with no par value, privately held
- Common Stock
 - Can vote on who will serve on the Board of Directors
- Preferred Stock
 - No voting rights but get paid dividends first

Capital Stock

- Represents the minimum original investment in cash property and services.
- Usually issued with no par value
- Can be issued with a specific dollar amount shown on the face of the stock certificate.
- Any money contributed in excess of par amount or face amount is recorded for accounting purposes as a capital surplus.



Common Stock

- Common Stock found on the balance sheet.
- Represents all or a portion of the money that was received when a company issued its shares.
- No correlation to market price
- Owners of Common Stock are the shareholders of the company.
- Shareholders have voting rights
- Shareholders receive dividends based on profits
- Shareholders get paid after preferred stock holders.
- Selling Common Stock raises capital for the company



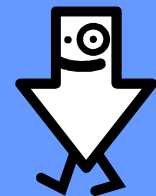
Preferred Stock

- Have a higher priority to assets than Common Stockholders
- Can be issued as cumulative or non-cumulative
- Usually issued with a fixed dividend schedule
- No voting rights
- Stockholders could be liable for the debt of the company only up to the amount of their investment.
- Preferred Stock can be bought back by the company or converted to common stock.



Dilution of Stock

- If 100 shares of stock are issued, and 100 shares of stock are sold, the stock is fully diluted.
- GAAP principles state that the stock must be shown both diluted and fully diluted on the financial statements. This gives a picture of the ability in the future for the company to raise cash through the sell of stock.



S Corporations

- Referred to in the past as a Subchapter S Corporations
- Provided tax advantages of proprietorships and partnerships by only being taxed once.
- Shareholders instead of corporation pay federal taxes.
- Limits amount of stockholders to 35.
- 75% of gross income must come from everyday operations.
- If more than 25% of income comes from an outside source 3 years in a row the S-Corp is terminated.
- Shields Owners from personal liability of business debt.

Limited Liability Companies

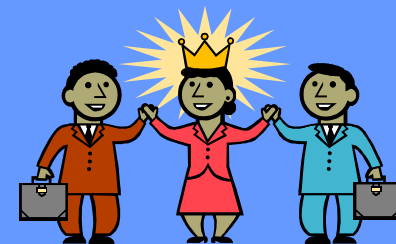
- An unincorporated business association does business under a corporate structure but combines the benefits of a partnership.
- LLC's are not legal in all states
- Only taxed once
- Provides members protection from personal liability of business debt.
- Loses are passed on to members personally

Limited Liability Partnership

- Operates as a partnership
- Limits liability of partners.
- Not all partners liability is the same.

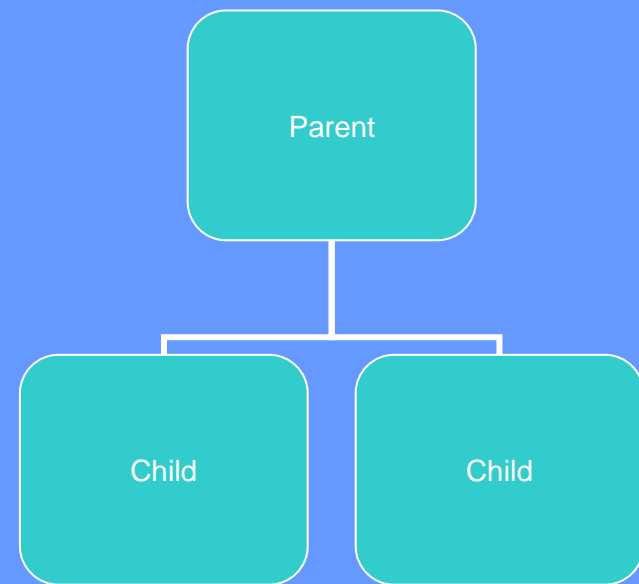
Joint Ventures

- The combination of two or more persons or corporations
- Usually formed for a large project or specific contract.
- Usually dissolves after project is done.



Parent-Subsidiary Relationships

- If a corporation owns more than 50 percent of the stock of another corporation then they are said to be the parent of its subsidiary.



Mergers and Consolidations

- Can be done in two ways
 - Stock buy out where stock in one company is exchanged for stock in the other company. One Corporation survives, the other is dissolved. **Merger**
 - A new corporation is formed. Stock from the new corporation is issued to the stockholders from the two previous Corporations. The two old corporations are dissolved. **Consolidation**