

Understanding Partnerships Limited Liability Companies & Corporations



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Opening a practice or embarking upon a new business venture can be an exciting and anxiety provoking experience. Often professionals spend too little time considering what business structure would maximize their profit and minimize their exposure to liability. Partnerships, limited liability companies and corporations are three of the most common types of business entities and each poses different advantages and disadvantages.

Any physician contemplating a new venture would be well advised to assess the needs of the venture and choose the structure that best suits its likely needs. In doing so, consider how many investors will have an ownership interest in the business and the extent of their respective ownership, control, and liability. Also, consider the time and cost associated with setting up a business entity, tax consequences, the transferability of ownership and management interest and the intended lifespan of the entity.

The Partnership

A partnership is an organization composed of two or more persons or entities that join forces for the purpose of running a business for profit. Its owners or “partners” share the ownership and management interest of the partnership. While a partner can freely assign her profits (ownership interest) to another, she may not assign her control (management interest) without the consent of all of the partners, unless agreed upon in writing. Partnerships enjoy limited life and dissolve upon the death, bankruptcy or withdrawal of any partner.

While a partnership may be formed without a written agreement, the failure to do so is a recipe for disaster. Written partnership agreements should spell out the financial and managerial responsibilities of each partner, including the requisite capital contributions of each and how profits and losses will be apportioned. The partnership agreement may also provide guidelines for the transfer of ownership interest and the dissolution of the business. Despite any such agreement, New York law holds each partner liable for acts performed on behalf of the partnership *by any partner or employee*. Partnership liability is unlimited and can place personal assets at risk.

Significantly, partnership income is not subject to taxation. Rather, each partner is taxed individually for his own income. However, by filing certain forms, a partnership can elect to be taxed like a corporation if this arrangement will create a tax savings.

The Corporation

A corporation is a legal entity owned by one or more persons (or other business entities). Owners are issued stock (i.e. shares of corporate ownership). Shareholders elect directors

who set corporate policy and appoint officers responsible for the actual operation of the business. Through its officers or directors, a corporation may enter into contracts, own property, sue or be sued, pay taxes and conduct business. Shareholders enjoy limited liability and a shareholder's risk is generally limited to the value of his or her stock.

Corporations have many rules associated with formation and maintenance. A corporation must file a certificate of incorporation setting forth its name and corporate purpose. In order to assure limited shareholder liability, corporations are required to obey a strict set of rules and maintain particular business records.

Unlike partnerships, corporations are separate and distinct legal entities from their shareholders. Consequentially, corporations can enjoy perpetual life and its stock may be freely transferred. Also, corporate income is taxed twice. A corporation is taxed on its income and its shareholders are taxed on the dividends they receive. However, shareholders that also work for the corporation may enjoy tax free fringe benefits such as health and life insurance. Entities known as "S" corporations are taxed like partnerships but enjoy the limited liability and other advantages of incorporation. With some exceptions, "S" corporations cannot have more than 100 shareholders, all of which must be U.S. residents, qualifying trusts or certain tax exempt individuals.

The LLC

A limited liability company or LLC is an entity owned by one or more natural persons or entities, known as "members" or "managers." It is formed by filing an article of organization with the state in conformance with the requirements of New York's Limited Liability Company Law. Significantly, members are not personally liable for the business debts of the company, unless specified by the articles of organization. The entity may elect whether it will be treated like a corporation or a partnership for tax purposes, without being subject to the liability of a partnership or the restrictions imposed on an "S" corporation. An LLC must adopt a written operating agreement setting forth how and by whom the company is to be managed, how ownership interests may be transferred, the obligations of the members with respect to each other and the circumstances under which it may be dissolved.

Formation of an LLC may be expensive and technical. New York law provides minimum requirements for a business to receive limited liability company treatment. Like a partnership, an LLC has limited life. The operating agreement must specify an outside date for the dissolution of the company. Absent a contrary provision in the operating agreement, an LLC will dissolve upon the death, withdrawal or bankruptcy of a member. Like a partnership, a member's financial interest in the LLC is freely transferable, but her management interest is not absent the consent of the other members.

There are many different ways to structure a business venture and the nuances of formation are rife with benefits and consequences. As such, these considerations should first be discussed and analyzed with a knowledgeable attorney and tax advisor before going forward. If you have any questions about transactional matters of any kind, please contact Mathew J. Levy, Esq. at 1-800-445-0954.