

BMGT 299: Entrepreneurship Capstone

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Legal Forms of Business Ownership

Selecting the legal form of business ownership is the next big step you will take before beginning the operations of your business. Being a sole proprietor has liability risks you need not take, a corporation has tax liabilities to be considered, what do you do? Here is the start of the conversation that should help narrow your choices. We will take them one at a time – read through each before continuing your search. Ultimately you will need to seek advice from your accountant, banker, or your attorney to make the best decision for your situation. Don't take shortcuts – your future success is dependent on your research and decision.

Sole Proprietorship

This is the easiest form of business ownership to start – and close. In the simplest terms, you hang out a shingle (Obtain your local business license and any health dept. requirements met) – and begin. If you choose to close, simply pay your bills and cease operations. There may be some reporting requirements depending upon your specifics – but relatively simple. What is most important to note here is the “Unlimited Liability” involved in operating as a “Sole Proprietor.” That means that legally any action taken against the business is taken against you personally as well. Not only are your business bank accounts at risk, so are your personal accounts. Even your real assets, (home, autos, etc...) are at risk. For this reason alone I suggest that *NO ONE* become a sole-proprietorship. What your option should be is more “situation specific” – but either a Limited Liability Company or Corporation (S-Corp?) will provide more personal asset protection. They are also more credible to a bank or other potential financiers. (Some of this credibility comes at the cost of privacy since corporations make many documents, such as board meeting notes, public as required by law. This can provide a strategic disadvantage since your competitors know what you are investing money into.

Wikipedia States:

Sole proprietorship

From Wikipedia, the free encyclopedia

A **sole proprietorship**, also known as the **sole trader** or simply a **proprietorship**, is a type of [business entity](#) that is owned and run by one natural person and in which there is no legal distinction between the owner and the business. The owner is in direct control of all elements and is legally accountable for the finances of such business and this may include debts, loans, loss etc.

The owner receives all profits (subject to taxation specific to the business) and has unlimited responsibility for all losses and debts. Every asset of the business is owned by the proprietor and all debts of the business are the proprietor's. It is a "sole" proprietorship in contrast with [partnerships](#) (which have at least 2 owners).

A sole proprietor may use a [trade name](#) or business name other than his, her or its legal name. They will have to legally trademark their business name, the process being different depending upon country of residence.^[1]

Advantages and disadvantages of Sole Proprietorship

A permitted exception to the sole proprietor (single owner) stipulation is made by the [Internal Revenue Service](#) (IRS) permitting the spouse of a sole proprietor to work for the business. They are not classified as

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a partner in the enterprise, or an [independent contractor](#), enabling the business to retain its sole proprietorship status and not be required to submit a partnership income tax return.

Registration of a business name for a sole proprietor is generally uncomplicated, unless it involves the selection of a name that is fictitious, or “assumed.” The business owner is required to register with the appropriate [local authorities](#), who will determine that the name submitted is not duplicated by another [business entity](#). Furthermore, the business owner must complete a form of “DBA” or “[doing business as](#)” for the acting authority, or in some states, the Secretary of State.

The license for a sole proprietary business entitles the owner to hire employees or enlist the services of independent consultants. Although an employee or consultant may be requested by the owner to contribute to a business related decision, it is considered to be only a recommendation. It is not possible for the owner to renounce or [apportion](#), responsibility for any decision arising from such recommendations.

This is transposed by the unlimited liability attached to a sole proprietary business. The owner carries the financial responsibility for all [debts](#) and/or losses suffered by the business, to the extent of using personal or other assets, to discharge any outstanding [liabilities](#). The owner is exclusively liable for all business activities conducted by the sole proprietorship and accordingly, entitled to full control and all earnings associated with it. The general aspect according to general business law is that this type of business ownership does not embody a “[legal entity](#)” Furthermore, any attempted and unreliable distinctions of the business do not change the classification under this title.

According to the [Small Business Administration](#) (SBA) a sole proprietor and their business are considered as one and the same; therefore, the business is not subjected to separate taxation and regarded as the direct income of the owner. Income, losses and expenses may be listed on a Schedule C Download, which is then transferred to the personal tax return of the owner. It is the responsibility of the owner to ensure all due income taxes and self-employment contributions are paid.

Available from the Montana Secretary of State’s Office, (See “Forms” for Registration)
(<http://sos.mt.gov/Business/Models/index.asp#sole>)

Sole Proprietorship

This type of business is owned by a single individual. A sole proprietor has total control of and responsibility for his or her business, receives all profits, and can make important decisions quickly. The sole proprietor is also responsible for all taxes and liabilities of the business.

If you plan to start a sole proprietorship and you are not planning to do business under your full, true, and correct name, you must file an [Application for Registration of Assumed Business Name](#) with the Secretary of State's Office. Otherwise, no registration is required.

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Partnerships

Partnerships come in all shapes and sizes. There are many “kinds” of partners, but all partnerships must have 1 “general” partner. (Meaning, has liability in the business) Other types of partners I will explain below. First let me discuss the concept of “partnerships” so that you give this decision the full respect it deserves. Partnerships have about the same mortality rate as marriages. (About 60%) – Why? There are many reasons “why”, but most are due to the reasons they become “partners.” Typically a business idea becomes the topic of conversation between 2 or more friends. These friends follow through with the idea, becoming “partners” in the business. In this case, it is likely for morale support. It is worse when the skills of each partner replicate the others. (For example; Each partner were former classmates in a marketing & management program at their local college.) Both of these reasons for becoming partners represent a recipe for disaster. The appropriate reason for 2 or more people to start a business is that one has money – the other possesses management skills. The third partner is an attorney and accountant who has many years of accounting/legal experience with small businesses. See the difference?

Types of Partners (Brief Descriptions)

General Partner

All partnerships must possess one or more “general partner.” They typically have active participation in the daily operations and have unlimited liability in the business.

Limited Partner

This partner can possess any number of job descriptions, but is considered a “Limited” partner in that their liability is “limited” to the amount they have invested in the business.

Silent Partner

This partner is either known or unknown to the public and does not participate in the daily operations of the business. (Hence “Silent”)

Secret Partner

This partner is “secret” to the public in that they are not publically known as an owner. This occurs in a variety of situations, but if their name, or association to the business may appear to be a conflict of interest, or not helpful to the business other than their investment. In one small Montana town, the owner of the states’ largest porn business was a major financier to a multiple storefront high-end restaurant business, which would not have been helpful in promoting customers to the restaurant.

Dormant Partner

This is a partner that has no say in the business, is typically not known to the public and simply receive a percentage of the profits of the business. This usually occurs when the spouse of a business partner inherits their percentage of the business at his/her death. The spouse may have been an active partner, but the dormant partner lacks the skillset or desire to operate the business. They may actually be a major issue for the business should an unskilled partner suddenly changes the successful business model.

**This is a good point to identify an important arrangement for any new partnership. You should consider a clause that states a predetermined buy-out for a partner in the event of their death. These clauses typically include a paid life insurance policy that pays their respective premiums.*

Available from the Montana Secretary of State’s Office, (See “Forms” for Registration)

General Partnership

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A partnership is an association of two or more people acting as co-owners of a for-profit business. Individuals may create a partnership by oral or written agreement. Under this arrangement, the partners share personal liability for all claims against the partnership, as well as share all profits and losses. Profits are taxed as personal income for each individual partner.

A partnership agreement is generally maintained by the partnership itself. However, if you choose, you may file a partnership agreement with the Secretary of State's Office. There is a \$20 filing fee. This fee is in addition to the \$20 registration fee necessary for filing an [Application for Registration of Assumed Business Name](#) with the Secretary of State's Office.

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Limited Partnership

Limited Partnership is a business entity with one or more general partners, who manage the business and assumed legal debts and obligations while limiting the liabilities of the limited partners.

Limited Liability Company

A limited liability company is derived from "partnership" law, but do allow for one-owner LLC's. These forms of business ownership cost as little as \$70 (Montana) – and provide the advantages of a Sole Proprietorship with the liability protection similar to a corporation. They are perfect for many business owners and increasingly popular with professional partnerships like accountants and attorneys.

Available from the Montana Secretary of State's Office, (See "Forms" for Registration)

Limited Liability Company

Limited Liability Company is a business entity that differs from a corporation because it offers advantages of a partnership while limiting the liabilities of the members.

Series Limited Liability Company

Series Limited Liability Company has the ability to partition its assets and liabilities among a set of separate limited liability companies. Each limited liability company may have different assets, economic structures, members, and managers. The profits, losses, and liabilities of each are legally separate from the others in the series, thereby creating a firewall between each entity. It also offers advantages of a partnership while limiting the liabilities of the members and series members.

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Corporations (S-Corps)

Most attorneys would recommend a Corporation (or S-Corp) for most businesses. It provides a “separate identity” from the business owner providing the highest level of liability protection. It also provides more opportunities for raising capital for the business. It also has the most complex tax code and seeking the help from your personal accountant or attorney is well advised.

If you know you will benefit most from a corporation, using a document preparation company like LegalZoom.com will save you a great deal of money. They are not attorneys, so advice is not their strong suit, but if filing the paperwork with step-by-step instructions can be welcome. Creating a Montana Corporation may cost from \$2-5,000.00 using an attorney, or \$700-1,000.00 using LegalZoom.com. Please remember, they may advertise the cost to use their service to form a corporation may be \$250.00, but the filing fees add hundreds to that price.

Research everything you can about incorporating if that’s the direction you are heading. This is a complex subject with serious financial implications, so the more learned you become the better. This is just an introduction into corporations, not the conclusion.

Finally, a word about “foreign” corporations. No, not off-shore, just “foreign.” This means that your corporation is created in a state other than your own. Many company’s incorporate in Nevada or Delaware because of their favorable tax code. Montana is better because we don’t have a sales tax – but where you incorporate is a serious business decision.

Available from the Montana Secretary of State’s Office, (See “Forms” for Registration)

Corporation

Corporation is a business entity set up for profit or nonprofit purposes and one which is chartered by a state and given many legal rights as an entity separate from its owners.

Wikipedia (Corporations)

Corporation

From Wikipedia, the free encyclopedia

A **corporation** is a company or group of people authorized to act as a single entity (legally a person) and recognized as such in law. Early incorporated entities were established by charter (i.e. by an *ad hoc* act granted by a monarch or passed by a parliament or legislature). Most jurisdictions now allow the creation of new corporations through registration. Registered corporations have [legal personality](#) and are owned by [shareholders](#)^{[1][2]} whose liability is [limited](#) to their investment. Shareholders do not typically actively manage a corporation; shareholders instead elect or appoint a [board of directors](#) to control the corporation in a [fiduciary](#) capacity.



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In [American English](#) the word *corporation* is most often used to describe large [business corporations](#).^[3] In [British English](#) and in the Commonwealth countries, the term *company* is more widely used to describe the same sort of entity while the word *corporation* encompasses all incorporated entities. In American English, the word *company* can include entities such as [partnerships](#) that would not be referred to as companies in British English as they are not a [separate legal entity](#).

Despite not being human beings, corporations, as far as the law is concerned, are [legal persons](#), and have many of the same rights and responsibilities as natural persons do. Corporations can exercise [human rights](#) against real individuals and the state,^{[4][5]} and they can themselves be responsible for human rights violations.^[6] Corporations can be "dissolved" either by statutory operation, order of court, or voluntary action on the part of shareholders. [Insolvency](#) may result in a form of corporate failure, when creditors force the liquidation and dissolution of the corporation under court order,^[7] but it most often results in a restructuring of corporate holdings. Corporations can even be convicted of criminal offenses, such as [fraud](#) and [manslaughter](#). However corporations are not considered living entities in the way that humans are.^[8]

S-Corps

An **S corporation**, for [United States federal income tax](#) purposes, is a [closely held corporation](#) that makes a valid election to be taxed under Subchapter S of Chapter 1 of the [Internal Revenue Code](#). In general, S corporations do not pay any federal income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. The shareholders must then report the income or loss on their own individual income tax returns.

Forms and Registration with the State of Montana

<http://sos.mt.gov/Business/index.asp>

All of the information you could possibly require to form and register your business in the State of Montana can be located at this website. The Montana Secretary of State, Linda McCulloch deserve a great deal of credit for providing the services available for entrepreneurs. Search this site, explore it, locate information, find out if a business name is available within the state – explore!