<table>
<thead>
<tr>
<th>Format</th>
<th>Sole Prop</th>
<th>Gen Partner</th>
<th>Limited P</th>
<th>LLP</th>
<th>S Corp</th>
<th>C Corp</th>
<th>LLC</th>
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</thead>
<tbody>
<tr>
<td>Liability</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Unlimited for GP, Limited for LP</td>
<td>Unlimited for general obligations, limited for partners acts</td>
<td>Limited</td>
<td>Limited</td>
<td>Limited</td>
</tr>
<tr>
<td>Formalities</td>
<td>None. But need to file ABN</td>
<td>None. But need to file ABN</td>
<td>Comply with law of state. File w/SS</td>
<td>Comply with law of state. File w/SS</td>
<td>Comply with law of state. File w/SS</td>
<td>Comply with law of state. File w/SS</td>
<td>Comply with law of state. File w/SS</td>
</tr>
<tr>
<td>Financing</td>
<td>Poor. Based upon credit of owner</td>
<td>Poor. Based upon credit of owner</td>
<td>Better. Can obtain investors</td>
<td>Better. Can obtain investors</td>
<td>Poor to average</td>
<td>Better, Public financing</td>
<td>Average. Allow Investors</td>
</tr>
<tr>
<td>Management</td>
<td>Owner 100%</td>
<td>All partners can manage</td>
<td>GP manage, LPs may not</td>
<td>All manage or by agreement</td>
<td>Board manages</td>
<td>Board manages</td>
<td>Member or Manager by agreement</td>
</tr>
<tr>
<td>Life of Entity</td>
<td>Ends on death</td>
<td>Dissolves on death of partner</td>
<td>Dissolves on death or retirement</td>
<td>Dissolves on death or retirement</td>
<td>Perpetual</td>
<td>Perpetual</td>
<td>Perpetual</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Poor to average. Must sell to new operator</td>
<td>Poor. Must find a new partner to carry on</td>
<td>Poor to average</td>
<td>Poor to average</td>
<td>Better</td>
<td>Better to easy</td>
<td>Poor to average</td>
</tr>
</tbody>
</table>
Liability Features of the Basic Forms of Business Organization

**Sole Proprietorship**

- Claims of Sole Proprietor's Creditors
  - Sole Proprietor's Personal Assets (includes the sole proprietorship)

**General Partnership**

- Claims of Partnership Creditors
  - Partner's personal property
  - Partnership Assets (includes partners' contribution)
  - Partner's personal property

**Limited Partnership**

- Claims of Partnership Creditors
  - General Partner's personal property
  - Partnership Assets (Includes general partners' contributions and limited partner's investments)

**Corporation**

- Claims of Corporate Creditors
  - Shareholder's personal property
  - Corporate Assets (includes shareholder's investments)
  - Shareholder's personal property
A. GENERAL FORMS OF BUSINESS ENTITIES

There are a number of different factors that should be considered in the choice of business entity. While tax and legal ramifications are the primary variables which govern the ultimate choice of business entity, other factors must also be taken into account. In this summary outline, we will explore the various characteristics of the following general forms of business entities:

1. Sole Proprietorship
2. General Partnership
3. Limited Partnership
4. Limited Liability Company
5. Subchapter C Corporation
6. Subchapter S Corporation

B. BASIC CHARACTERISTICS OF THE VARIOUS BUSINESS ENTITIES

1. Sole Proprietorship
   a. Definition. A sole proprietorship encompasses any business owned and operated by a single individual.
   b. Formation. A sole proprietorship may be organized without any formalities or legal documentation. In the event that a sole proprietorship operates under an assumed business name, the name must be registered with the Secretary of State and updated yearly.
   c. Management. A sole proprietorship is managed entirely by an individual owning the business.
   d. Liability. Unlimited liability.
   e. Fiduciary Duties. None.
   f. Business Transferability. The sole proprietorship in and of itself, is not transferable, but the assets of the business, including tangible and intangible assets, can be sold by the sole proprietor.
   g. Duration. Death of the sole proprietor generally results in the business assets being subject to probate.
   h. Taxation (Organizational Issues). None.
   i. Taxation (Operational Issues). The sole proprietor reports business gains/losses on his/her individual income tax return.
2. General Partnership

a. **Definition.** An association of two or more persons to carry on as co-owners of a business for profit. (This definition excludes an association formed under any other Oregon statute.)

b. **Formation.** It is not necessary for a general partnership to take formal action to organize. Typically, general partners will enter into a written agreement and may register an assumed business name.

c. **Management.** Unless otherwise provided for in a written partnership agreement, all partners have equal rights in the management and conduct of the partnership business. Further, general partners have a statutory right to participate in management decisions.

d. **Liability.** General partners are jointly and severally liable for all liabilities chargeable to the partnership under ORS 67.105.

e. **Fiduciary Duties.** General partners’ duties include the duty to account for profits made from the partnership business without the consent of the other partners, the duty to render information with respect to the partnership business and the duty to refrain from engaging in grossly negligent or reckless behavior or knowing violations of the law.

f. **Business Transferability.** With some exceptions, any person or organization may be a general partner. Interests in a general partnership are transferable. In the absence of agreement, such a transfer does not entitle the assignee to interfere in the management or administration of the partnership business or affairs or require any information or account of partnership transactions nor partnership books. Rather, such a transfer merely entitles the assignee to receive the profits to which the assigning partner would otherwise be entitled.

g. **Duration.** Generally, a partnership may be dissolved upon the termination of a definite term or particular undertaking specified in the agreement, by the express will of the partners, by the death of any partner or by the bankruptcy of any partner or partnership. Upon dissolution, the partnership will continue until the “winding up” of partnership affairs is completed.

h. **Taxation (Organizational Issue).** Partners are generally not taxed on the contribution of property to a partnership unless the amount of the contributor’s liability undertaken by the partnership exceeds the basis of the property contributed. Also, a partnership will not recognize gain on the receipt of property in exchange for the partnership interest. Upon organization, only an employee identification number is required. A partnership files IRS Form 1065 and distributes IRS Form K-1 to its partners.
i. **Taxation (Operational issues).** Generally, partners include proportionate shares of income, loss, deduction and credit of the general partnership for the year in which such item is earned. Partners are entitled to use the losses of the general partnership to offset other income as limited by basis, at-risk rules and passive loss rules. Any distribution of cash to partners will be tax free to the extent of the distributees' basis in the general partnership, and thereafter, will be treated as capital gain.

j. **Governing Law.** New partnerships are governed in Oregon by the Uniform Partnership Act, ORS Chapter 67. Provisions of this law may be varied by the partnership agreement.

3. **Limited Partnership**

   a. **Definition.** A partnership formed by two or more persons under the laws of the State of Oregon and having one or more general partners and one or more limited partners.

   b. **Formation.** A certificate of limited partnership must be signed and submitted for filing to the Secretary of State.

   c. **Management.** Under Oregon Law, general partners may participate in management decisions, but limited partners are prohibited from participating in the control of the business.

   d. **Liability.** General partners' liability is identical to the liability they would have in a general partnership. A limited partner's liability is limited to the amount of that partner's investment in the partnership provided the limited partner does not participate in the control of the business.

   e. **Fiduciary Duties.** General partners' fiduciary duties are similar to those owed by general partners in a general partnership. Limited partners may not profit from confidential information.

   f. **Business Transferability.** The interests of both general and limited partners are transferable. Assignees of such interests may only be admitted as substituted partners if provided for in the partnership agreement or with the consent of all partners. As in a general partnership, an assignment legally entitles the assignee to receive only the distribution to which the assignor would have been entitled.

   g. **Duration.** A limited partnership shall be dissolved upon reaching the time of dissolution specified in the certificate, upon the happening of events specified in the partnership agreement, by written consent of all partners or upon the disassociation of a general partner unless there are other general partners who continue the business of the partnership.
h. **Taxation (Organizational and Operational Issues).** Limited partnerships will generally be treated as partnerships for taxation purposes.

i. **Governing Law.** A limited partnership is governed by ORS 70.

4. **Limited Liability Company**

a. **Definition.** A Limited Liability Company (LLC) is a hybrid form of business that combines the protection from personal liability for business debts enjoyed by corporate shareholders with the pass-through of income, gains and losses from the business enjoyed by partners.

b. **Formation.** An LLC is organized by filing Articles of Organization with the Secretary of State. In addition, an operating agreement also plays a role in governing the activities of the LLC. Generally, the title of an LLC must include the words A Limited Liability Company or an appropriate abbreviation.

c. **Management.** Unless the Articles of Organization provide for a manager or managers, the business and affairs of a limited liability company are managed by its members.

d. **Liability.** While members are generally liable for breaches of fiduciary duties and failure to make agreed contributions, members or managers are not personally liable for any debt, obligation or liability of the LLC merely by reason for their position.

e. **Fiduciary Duties.** Members and managers owe fiduciary duties similar to those owed by a general partner to a partnership.

f. **Business Transferability.** Generally, there are no limitations on ownership of an LLC. As a result, membership interests are freely transferable. Until the assignee of a membership interest becomes a member, the assignor continues to be a member and continues to possess the power to exercise any rights a member may have. Finally, an assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled.

g. **Duration.** LLCs can have a specific term or can be perpetual in nature.

h. **Taxation (Organizational Issues).** Generally, for purposes of taxation, LLCs may be treated as corporations, partnerships, or sole proprietorships. Under the default rules, an LLC made up of two or more members will generally be taxed as a partnership, unless an election is made to be taxed as a corporation. An LLC made up of only one member will generally be taxed as a sole proprietorship.

i. **Taxation (Operational Issues).** If treated as a partnership, the losses of an LLC are passed through to the owners. If treated as a corporation, losses do not pass through. This is true with respect to other taxation issues faced by the organization.
j. **Governing Law.** Limited Liability Companies in Oregon are subject to ORS Chapter 63.

5. **Subchapter C Corporation**

a. **Definition.** An organization carrying on a business for profit which is not a foreign corporation and which is organized under the laws of this state.

b. **Formation.** Generally, a corporation is formed by filing Articles of Incorporation with the Secretary of State. The Articles of Incorporation along with the corporate bylaws are the principal governing documents of the corporation. A corporation must contain within its title the word “Incorporated”, “Corporation”, “Company”, “Limited” or an appropriate abbreviation.

c. **Management.** A corporation is managed by its board of directors, who are elected by corporate shareholders. The board of directors is generally responsible for appointing corporate officers, who assume the actual day-to-day operations of the corporation’s business.

d. **Liability.** A shareholder of a corporation enjoys limited liability. A shareholder is liable for his or her own acts and conduct, however. A shareholder is also liable in the event the corporate veil is pierced. The corporate entity may be disregarded for several reasons, including failure to follow corporate formalities, under-capitalization and intertwining of business and shareholder activities.

e. **Fiduciary Duties.** Majority shareholders owe fiduciary duties to minority shareholders. In addition, directors owe fiduciary duties to shareholders.

f. **Business Transferability.** Absent certain exceptions, shares of stock in a corporation may be freely transferred from one person to another, and even to a trust or another corporation.

g. **Duration.** Corporations have perpetual duration.

h. **Taxation (Organizational Issues).** No filing (other than a request for an employer identification number) is required upon organization. Thereafter, a corporation files IRS Form 1120. A corporation other than an "S" corporation or personal service corporation may adopt any taxable year it chooses.

i. **Taxation (Operational Issues).** A “C” corporation is subject to tax on its taxable income at the organizational level. Owners will not recognize loss, and will have ordinary income on distributions, other than distributions in redemptions or liquidation. Further, liabilities of the organization do not affect the basis of the owner in the organization. Upon liquidation or dissolution, a double tax will be imposed. Distributions of cash to shareholders will be treated first as ordinary income to the extent of current and accumulated earnings, then as a return of basis in stock, then as gain from the sale or exchange of stock.
j. **Annual Meeting/Minute Requirements.** Under Oregon statutes, an annual meeting of the shareholders of a corporation is required. In addition, to avoid personal liability, it is important to show that the corporation is functioning appropriately. As a result, annual minutes of shareholders and board of directors meetings should be prepared.

k. **Governing Law.** Private corporations are governed by ORS Chapter 60.

### 6. Subchapter S Corporation

a. **In General.** From a corporate law point of view, a Subchapter "S" Corporation is essentially identical to a Subchapter C Corporation. By a special "S" election filed with the IRS, the shareholders elect to be taxed in a special manner known as "flow through" taxation.

b. **Stock Ownership.** Stock ownership is restricted to domestic corporation; no more than 75 shareholders; only individuals; estates or certain trusts; and no nonresident alien shareholders are permitted.

c. **Taxation.** In a Subchapter S Corporation, items of income, gain, loss, deduction and credit pass through the corporate entity to the shareholders, much like a partnership. Thus, an "S" corporation avoids the corporate double tax upon liquidation.

### C. TAXATION OF VARIOUS BUSINESS ENTITIES


Generally speaking, "C" corporations are subject to tax at the organizational level. The entity itself recognizes income and pays taxes. All other types of entities: sole proprietorships, partnerships, "S" corporations, and limited liability companies, generally do not pay tax on an entity level, but instead, taxable income or losses are passed through to the individual owners of the business entity.

#### 2. Deductibility of Fringe Benefits

The provision of certain types of fringe benefits, including meals and lodging, accident and health plans, medical reimbursement plans and cafeteria plans, are tax deductible expenses if paid by any of the entities discussed for its non-owner employees. Such benefits paid for owner-employees in a sole proprietorship, partnership, limited partnership, "S" corporation, or limited liability company, are only partially tax deductible. Such benefits paid for owner-employees in "C" corporations are fully tax deductible.

#### 3. Self-Employment Tax

a. Sole proprietors, general partners, and most members of limited liability companies must pay self-employment tax on their share of income from a
sole proprietorship, partnership, or limited liability company. Self-
employment tax is currently 15.3 percent, consisting of Social Security Tax at
the rate of 12.4 percent, and Medicare at the rate of 2.9 percent. For 2001,
the maximum net earnings subject to the Social Security Tax portion was
$80,400. There is no wage base cap on the Medicare portion.

b. If a partnership, LLC, or sole proprietorship is not carrying on an active trade
or business, for example, if the entity is engaged only in the passive rental or
real property, the earnings could be considered investment income and not
subject to Social Security and Medicare Taxes.

c. There are also limitations on self-employment taxes for certain members of
limited liability companies who do not actively participate in management and
control of the LLC, and who do not spend much time working for the LLC.

d. Generally, the pro rata share of an “S” corporation’s income, attributed to a
shareholder, is not subject to self-employment tax. However, for this
general rule to apply, the shareholder must take a reasonable salary from the
corporation, considering the service the shareholder provides to the
corporation. This salary is subject to Social Security and Medicare Taxes.

D. OTHER MISCELLANEOUS MATTERS

1. Getting out of Business/Minority Interest Holders Beware

a. It is in everyone’s best interest to decide, at the onset of any business
enterprise, what will happen if someone wants out or if the majority of the
owners want another owner out of business. This can be accomplished
through the use of buy-sell agreements, provisions in a partnership
agreement, or a limited liability company operating agreement.

b. If there is no written plan for someone to leave a business entity, Oregon
statutes apply in determining what rights individuals have. These rights are
very limited.

2. Employee Matters

a. **Workers’ Compensation Coverage.** Workers’ compensation claims can be a
huge source of liability to owners of a business. Workers’ compensation
claims pass through the corporate and limited liability company shield directly
to officers, directors, and members of a limited liability company. If
employing independent contractors, make sure the individual qualifies as an
independent contractor pursuant to Oregon law ORS 670.700. There are
separate rules for determining independent contractors for tax purposes.

b. **Employment “At-Will.”** The starting point under Oregon law is that of
employment at-will, which means that an employer can hire and fire at will,
and has no obligation to continue to employ an individual. However, beware, because an employer can inadvertently contractually obligate itself through verbal or written promises, to do certain things.

c. **Discrimination.** Additionally, an employer cannot discriminate against individuals based on sex, race, religion, family characteristics, age, or disability.

d. **Employee Handbooks.** It is beneficial for most employers to have employee handbooks.

3. **Non-Competition Agreement/Trade Secret**

4. **Securities Laws**

5. **Contracts, Invoices, Leases**

**Corporation Division Web Site**

http://www.filinginoregon.com