



---

**GREEN·SEIFTER**  
ATTORNEYS, PLLC

# LLCs, LLPs and Partnerships: Organization and Operation in New York

Overview: Formation, Choice of Entity, Management

Presented By

Kathleen Faulkham Centolella, Esq.

July 8, 2008



## Discussion Outline

- Types of entity forms available
  - Organization
  - Tax status
  - Ease of formation
  - Structure of Management
  - Advantages and Disadvantages to each form
- Choosing the Entity
  - How do the goals of the business client impact the choice of entity
    - Number of owners
    - Type of business
    - Location of business
    - Goals of the owners
    - Exit strategies



GREEN·SEIFTER  
ATTORNEYS, PLLC

# Entity Forms

Advantages and Disadvantages



## Entity Forms – the Choices

- Sole Proprietorship
- General Partnership
- Registered Limited Liability Partnerships
- Corporations (includes S Corporations)
- Limited Partnerships
- Limited Liability Companies/Professional Limited Liability Companies



## Entity Forms – Sole Proprietorship

- A business owned by a single person
- Advantages
  - No filing requirements, unless using an assumed name or have employees and/or sales
    - If using an assumed name, must register with the County where the business is located
    - Register with IRS for EIN if the business has employees and with NYS for a Certificate of Authority if there will be sales
  - No fees or entity-level tax
  - No formalities (no meetings, voting, minutes)
- Disadvantages
  - Provides no liability protection to the owner
  - Terminates upon the death of the owner



## Entity Forms – General Partnership

- An association of two or more persons (includes another entity) who carry on a business for profit as co-owners
- Must file certificate of doing business in each county where the partnership does business (\$25)
- No requirement of a written partnership agreement (although not advisable)
- Unless a Partnership Agreement provides otherwise:
  - Each partner is an agent of the GP with the power to bind the partnership
  - Decisions made by majority vote – one vote per partner
  - Profits and losses of partnership shared equally among partners



## Entity Forms – General Partnership (cont'd)

- Advantages
  - No entity-level tax
  - Minimal filing fees and no annual fees
  - Minimal formalities
- Disadvantages
  - No limited liability for partners
  - Joint and several liability
    - Mandatory capital contributions
  - Death or withdrawal of a partner causes immediate dissolution
    - Requirement to contribute additional capital if upon dissolution there are not sufficient assets to pay creditors



## Entity Forms – Registered Limited Liability Partnerships

- LLP is limited to professionals such as attorneys, licensed physicians, and others designated in Title 8 of the Education Law
- Must file a Certificate of Registration with state and file certified copy with licensing authority (often Dept of Education) plus publishing requirement (\$300-400)
- Follow all filing requirements of a GP
- The general rule is that a partner in a registered limited liability partnership is not personally liable for obligations of the partnership.
  - A partner is, however, liable for his or her own negligence or wrongful conduct and for the negligence or wrongful conduct of a person under such partner's direct supervision and control while rendering professional services.



## Entity Form - Corporation

- General Characteristics

- A corporation is a distinct legal entity, separate from its owners, formed by filing of a Certificate of Incorporation with the Secretary of State.
- Managed by a board of directors pursuant to bylaws
  - In general, shareholders have no direct say in the management of the affairs of the corporation unless BCL section 620 provisions are included in the certificate of incorporation.
- Ownership of a corporation is through the holding of shares of authorized stock (common or preferred)
  - In general, differentiation in shares of stock relate to two issues: (1) voting rights and (2) dividends and distribution rights.



## Entity Form – C Corporation

- General Characteristics
  - A corporation is a taxpayer separate from its owners for both state and federal tax purposes. As such, a corporation is subject to direct taxation under both state and federal tax law
  - Shareholders taxed on money and property distributed by the corporation (results in Double-taxation of the corporation's earnings and profits)



## Entity Form – C Corporation

- Formation
  - Filing of Certificate of Incorporation
  - Must include words “Incorporated”, “Corporation”, “Limited” or an abbreviation thereof
  - Can operate under assumed name



## Entity Form – C Corporation

- Advantages
  - Liability shield for owners (as long as corporate formalities are maintained)
  - Requires little involvement from owners
  - Flexible ownership structure with different classes of stock
  - Form is easily understood by client, other countries
  - Rich case law base
  - Section 118 (nonshareholder contributions to capital) income exclusions
  - FICA tax limitations
- Disadvantages
  - Double taxation on earnings and profits of business
    - Impacts current distributions, dissolutions and liquidations
  - Corporate formalities must be maintained



## Entity Form – S Corporations

- Must qualify as a “small business corporation”
  - 100 or fewer shareholders
  - All shareholders must be individuals or qualifying trusts
  - All shareholders must be citizens or resident aliens
  - One class of stock
- Generally pass-through taxation – profits and losses are allocated to shareholders rather than being recognized by the corporation
- Distinguishable from a partnership generally because different rules apply with respect to contributions and distributions of property and basis
- Requires a formal election



## Entity Form – S Corporation

- Advantages
  - Liability shield for owners (as long as corporate formalities are maintained)
  - Pass-through taxation – no entity level tax
  - It's a corporation - often more easily understood by the client
  - Section 118 (nonshareholder contributions to capital) income exclusions
  - FICA tax limitations



## Entity Form – S Corporation

- Disadvantages
  - Less flexible than C Corp because limited to one class of stock
    - As a result, no special allocations
  - Requires a timely election; unwitting revocation of election can have disastrous effects
  - Annual state level tax
  - Limited eligible shareholders
  - Contributions and/or distributions of appreciated property may trigger recognition of gain



## Entity Form – Limited Partnerships

- Formation
  - Filing of Certificate of Limited Partnership
  - Publication requirement
  - Name of LP must contain “Limited Partnership” or “LP”
  - Written LP Agreement required
- On Going Requirements
  - Must maintain:
    - a list of each partner (including address, capital contribution and allocations of P/L)
    - Copies of organizational docs
    - Copies of LP tax returns for past 3 years



## Entity Form – Limited Partnerships

- Management of the limited partnership is vested in the general partner.
  - Unless otherwise provided in the limited partnership agreement, certain key items require consent of limited partners such as:
    - Admission of additional general partners;
    - Dissolution;
    - Merger or consolidation;
    - Amendments to the partnership agreement that have an economic effect on the limited partners (e.g. increase the obligation of a limited partner to make contributions)



## Entity Form – Limited Partnership

- Advantages
  - General rule is that a limited partner is not liable for the debts and obligations of the limited partnership
    - An exception to this general rule exists if a limited partner participates in the control of the limited partnership's business
  - Limited partnership will not dissolve on the death, bankruptcy or withdrawal of a limited partner
  - Pass-through taxation/no annual State fees
- Disadvantages
  - a general partner is fully liable for the debts and obligations of the limited partnership
  - a limited partner may not withdraw from a limited partnership prior to the dissolution and winding up of the limited partnership (although a general partner may withdraw upon written notice to the LPs)



## Entity Form – Limited Liability Company

- An LLC comes into existence when its "Articles of Organization" are filed in the New York Department of State or such later date.
- Publication requirements
- Owned by Member(s) – may be single member
- Written Operating Agreement required
- Managed by members or by one or more managers in accordance with Operating Agreement



## Entity Form – Limited Liability Companies

- Management and Ownership Structure
  - Exceptionally flexible with respect to structuring the voting rights of members and managers and with respect to the economic interests of the members
  - Almost unlimited power to
    - structure the interests of the members in capital and profits
    - structure the rights with respect to management of the LLC
  - Management authority can be divided with respect to specified matters and voting power can be modified with respect to specified matters



## Entity Form – Limited Liability Companies

- Advantages
  - Limited liability for all members;
  - Tax Treatment – Check the Box regulations default rules
    - Disregarded entity (single member LLC only);
    - Partnership (default rule);
    - Corporation/Association (may elect to be taxed as a corp)
  - Flexibility
    - voting rights, allocations, distributions
  - Generally, the death, retirement, resignation, expulsion, bankruptcy or dissolution of any member will not dissolve the LLC
  - Distribution of appreciated property (such as real estate)



## Entity Form – Limited Liability Companies

- Disadvantages
  - Fees
    - Approx. cost of filing and publishing is \$700
    - Annual fee to NYS (\$50 per member generally)
  - Uncertainty of state law (this concern diminishes with time)
  - Operating Agreements can become complex
    - Not as easily understood by the client
      - E.g. W-2 wages v. estimated tax payments



GREEN·SEIFTER  
ATTORNEYS, PLLC

# Choosing the Entity

Matching the Goals of the Business Client to the Type of Entity



## Choosing the Entity

- One size does not fit all - Consider needs of the client:
  - Will the business have more than one owner
  - Will there be debt assumed by the business
  - Is the business a type with liability exposure
  - Where is the business located
- Consider both immediate and long term goals
  - Will there be a change in ownership in the foreseeable future
  - Succession planning
  - Potential growth



## Choosing the Entity - LLC

- Pass through entities generally the most tax advantaged
- LLCs generally preferred form of pass-through entity because an S Corp:
  - Lacks flexibility of LLC
    - One class of stock rule
      - Restricts variety of capital structures most closely-held businesses require
  - Requires a timely election
  - Has a restriction on the number of shareholders (100) and the type
  - Liquidation and distribution rules and basis rules limit tax free distributions from S Corps
  - Contribution/distribution of appreciated property may trigger tax
- An LP or GP does not provide the complete limited liability the LLC provides



## Choosing the Entity – S Corp

- An S Corp may be advantageous for some clients:
  - S Corp less complex and easier for clients to comprehend (e.g., wage withholding vs. estimated payments)
  - More certainty in self-employment tax area
  - Reorganization provisions more friendly than with LLCs
  - More favorable rules for recognition of income from discharge of indebtedness
  - More rights for minority interests
  - FICA tax considerations
  - State and local grants



## Choosing the Entity – C Corp

- There are rare occasions when you would use a C Corp:
  - May need to capture tax impact – whether accelerated depreciation or capturing state/federal tax credits (perhaps for security purposes for benefit of lender)
  - If doing business in foreign country may not wish to use an LLC unless limited liability is respected
  - If foreign shareholders, cannot use an S Corp – need to examine the tax treatment of US corp rather than US LLC for the foreign shareholder in their home country – sometimes treated differently under tax treaties



## Choosing the Entity – NY or DE LLCs and Corps

- New York
  - Generally requires greater formalities
  - Less flexibility
  - Higher fiduciary standards for managers (limits on indemnifications)
  - Higher franchise taxes
- Delaware
  - Pro-management
  - Less rights to dissenters
  - Actions can be approved by less than unanimous written consent
  - No shareholder liability for wages



GREEN·SEIFTER  
ATTORNEYS, PLLC

# Conclusions

Key Points to Remember



## Choice of Entity: Pros/Cons

	Sole Proprietorship	C Corp	S Corp	GP	LP	LLC	RLLP
Limited Liability	NO	YES	YES	NO	YES*	YES	YES*
Flow-through taxation	YES	NO	YES	YES	YES*	YES	YES*
Simplicity/Ease of Understanding	YES	YES	NO	YES	NO	NO	NO
Low cost of formation	YES	YES	YES	YES	NO	NO	NO
Limitations on Eligibility	YES	NO	YES	NO	NO	NO	YES
Limitations on Capital Structure	YES	NO	YES	YES	NO*	NO*	NO*
Flexibility	YES	NO	NO	YES	YES	YES	YES*
Ability to change structure without tax	YES	NO	NO	YES	YES	YES	YES
Favorable Employee incentives	NO	YES	YES*	NO	NO	NO*	NO
Tax free in-kind contributions	YES	NO	NO	YES	YES	YES	YES
Special allocations	NO	NO	NO	YES	YES	YES	YES
Self-employment tax savings	NO	YES	YES	NO	NO	NO	NO

\*with exceptions



## Conclusion: Do not box clients in with a bad initial choice of entity

- Start with most flexible form of entity
- Make adjustments to entity form as needed
- Protect owners from personal liability for debts, obligations, and acts of business
  - Not always possible - personal guaranties often required
- Generally, can go from flexible entity (LLC) to less flexible entity (S Corp or C Corp) without adverse tax consequences
  - Substantial cost to going from corporation to flow-through entity



## Key Points

- Think strategically
- Anticipate the needs of the client
- Project where the business is headed
- Choose entity accordingly



---

**GREEN·SEIFTER**  
ATTORNEYS, PLLC

Kathleen Faulkham Centolella, Esq.  
110 West Fayette Street  
One Lincoln Center, Suite 900  
Syracuse, New York 13202  
(315) 422-1391

[www.GSLAW.com](http://www.GSLAW.com)