

A Newsletter from **Foley & Foley, A Professional Corp.**

# Generations

For our clients and our professional estate planning partners

## Business Entities

### *Choosing the Right Form of Business for Your Operations*

By Richard H. Foley, Jr.

*Whether you are starting a new business or running an existing business, it is important to select the proper legal entity for your business operations. This article looks at four standard legal structures that might be selected for your business operations.*

There are four basic choices for establishing a business entity: sole proprietorship, partnership, corporation or limited liability company (LLC). Each form has different legal requirements for creation and operation. Each offers different levels of protection from the debts and liabilities of the business. And each type of business results in different income tax treatment for the business income. Let's consider each of these forms separately.

#### **Sole Proprietorship**

A *sole proprietorship* is the simplest



form of business. You can select a business name for your business, but a sole proprietorship is not a separate legal entity from the person operating the business. All of the income earned by the business and all of the liability for the business operation falls upon the owner/operator. Bank accounts held in the name of the business simply use the Social Security number of the owner/operator as the tax identification number for the business.

***There are four basic choices for establishing a business: sole proprietorship, partnership, corporation, or LLC.***



### *Estate Planning Workshops*

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Don't forget that Foley & Foley offers two workshops every month for people who want to know more about wills, trusts, insurance, probate, estate taxes, children's trusts, and more.

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There is no charge and no obligation.

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You can check our schedule, times, and location online at [www.foleyfoley.com](http://www.foleyfoley.com).

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Call us to RSVP at 522-2272.

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## Forms of Business

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### Partnership

When two or more people come together to form a business association, the entity is considered a *general partnership*. Even if no formal written partnership agreement is signed, the law often will presume that the operators are partners.



In a general partnership, responsibility for the debts and liabilities of the company are “joint and several” among the partners. This means that each partner is 100 percent liable for the liabilities of the business, regardless of the percentage of the partnership owned by each partner. Profits, losses and income taxes are allocated according to the percentage of ownership of each partner.

Two or more people may also form a *limited partnership* in order to protect non-active partners from business liability. Limited partnerships are taxed just like general partnerships, but the limited partners are only liable for their own financial contribution to the business. Limited partners typically have limitations on their ability to control the business operations. General partners

manage the business and are still personally liable for business debts.

### Corporation

A *corporation* is organized and owned by one or more people who are called *shareholders*. Shareholders are only liable for their own financial contributions to the corporation and do not take on further liability for corporate debts or tort damages.

A corporation is established by filing *Articles of Incorporation* with the state where the business is to be formed. Shareholders are also required to adopt formal *Bylaws* for the corporation and elect a *board of directors* that is responsible for running the company. The board of directors in turn elects *officers* of the corporation to run daily operations. In small, closely held corporations, the shareholders, directors and officers are often the same people.

Upon formation and in order to remain in good standing with the state, corporations require strict adherence to state statutes. Failing to follow formal state law corporate requirements can lead to dissolution or personal liability by the directors and shareholders for the debts of the company. This is called “piercing the corporate veil.”

Corporations are subject to different income tax treatment depending upon the election of the organizers of the company. A *C-Corporation* is taxed by the IRS as a separate and distinct entity from its shareholders. The C-Corporation files its own separate tax return and

pays taxes on its own profits. When profits are passed on to shareholders in the form of *dividends*, there is a second taxation on the money earned at the shareholder level.

An *S-Corporation* is taxed in a manner similar to a partnership—that is, the profits of the S-Corporation are “passed through” the entity to the shareholders according to their percentage of ownership of the corporation. There is no taxation of income at the corporate level.

### Limited Liability Company

*Limited Liability Companies* were first authorized as a type of business entity in the United States in 1977 by the State of Wyoming. Since then, every state has passed laws allowing the creation of LLCs. LLCs have become popular for every type of business, including professional services, real estate investment and development, construction, manufacturing, retail sales, personal services and just about all other types of business operations imaginable.



There are a number of reasons why LLCs have become so popular. These include:

→ LLC owners, called *members*,

enjoy the same limited liability protection as corporation shareholders.

→ LLC members can elect any income tax treatment they desire. Profits and losses can pass through the business and be taxed on the owners' individual tax returns—just like a sole proprietorship, partnership or S-Corporation—or an LLC can elect to be taxed like a C-Corporation.

→ LLCs are simpler than corporations to set up and operate. LLCs are formed by filing *Articles of Organization* with the state. Typically, the members also adopt an *Operating Agreement* to govern the operations of the company. The LLC is not required to elect directors or officers or to hold annual meetings of its members.

→ LLCs can be more flexible in the way that they are structured and operated. Management and control does not have to be tied strictly to the percentage of ownership of the members. LLC members are not required to divide profits in the same proportion as the capital contributions of each member. Instead, profits can be split in any manner that the members agree upon.

Foley & Foley recommends that you consult a lawyer and a CPA to help you select, organize and operate the business form that is right for you.

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## Alaska LLC Law

### *Alaska Offers LLCs Favorable Protection from Creditors*

By Richard H. Foley, Jr.

*Alaska law offers one of the strongest Limited Liability Company (LLC) asset protection provisions of any state in the country. All corporations and LLCs are intended to protect company owners by limiting their liability to the capital that each of them has contributed to establish the company. But Alaska statutes also have unique provisions that can prevent a creditor from seizing or foreclosing upon ownership (membership) interests of an LLC. How does it work?*

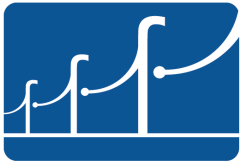
Let's say that Robert owns a 4-plex that is worth \$400,000. The property generates \$40,000 in annual income. Robert has transferred the 4-plex into a single-member LLC, so that if someone is injured on the property, his liability is limited to the policy limits of the company liability insurance plus the value of the 4-plex. But now imagine that Robert defaulted on a \$2 million loan on a separate major real estate development when the real estate market crashed. The bank is looking to seize Robert's assets to satisfy the loan. If Robert owned the 4-plex in a Sub-S

corporation, the bank could seize his stock, take over the corporation, and liquidate the 4-plex for its own account.

However, under Alaska's LLC statutes, the bank cannot foreclose upon or seize Robert's membership interest in his LLC. The bank can only obtain a "charging order" from the court, which allows the bank to receive distributions only from the LLC. Since Robert is the sole member and manager of the LLC, he can simply choose **not** to make any distributions from the LLC while the charging order is in effect. To make matters worse for the bank, a creditor who has obtained a charging order is legally responsible for paying all income taxes on earnings of the LLC, even if no distributions are made by the LLC. Not only does the bank fail to seize the 4-plex, it also fails to receive any income and is required to pay income taxes for the LLC.

Although these provisions of the Alaska LLC statute have never been tested in an Alaska court, the strong protections offered by the LLC law can buy Robert some time and give him some leverage in his negotiations to settle the bank debt.

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## *Common Trust Funding Issues Explained*

# Refinancing Your Home while Titled in a Trust

By Sarah M. Teel

*We often hear from our clients that they are having trouble with their bank or mortgage company when trying to refinance their home while it is titled in their living trust. Here's the scoop!*

Many of our clients are taking advantage of the current low interest rates to refinance mortgages on their properties. What our clients often don't realize is that lenders may not allow a mortgage on a property owned by a living trust; instead, the property must be titled under the names of the individuals applying for the mortgage.

Consequently, if you refinance your property, it may need to be transferred by deed out of your living trust and into your personal names for the refinance to be completed. Once the new mortgage is in place, the property can be transferred back into the name of your living trust.

This is a fairly straightforward procedure requiring two deeds. Some lenders are willing to prepare the deeds in these situations, but others are not. Fortunately, preparation for these deeds is covered by the Foley & Foley **Generations** Maintenance Plan!

Feel free to call our Funding Coordinator, Sarah M. Teel, if you have any

questions about refinancing a property owned by a living trust or if you need us to assist you with a current refinance.

Also, don't forget to see our website—at [www.foleyfoley.com](http://www.foleyfoley.com)—if you want to learn more about all the benefits of being a **Generations** member.

