

Deborah E. Bouchoux

FUNDAMENTALS OF BUSINESS ORGANIZATIONS FOR PARALEGALS

SEVENTH EDITION

Deborah E. Bouchoux

In a readable and concise format, *Fundamentals of Business Organizations for Paralegals* discusses the nature of each form of business; the advantages and disadvantages of each type of organization, business operation and management; transferability of ownership; formation and dissolution of the business; and the tax implications for each type of organization. With a straightforward treatment of all pertinent topics, Deborah E. Bouchoux expertly balances substantive discussion with practical guidance for the paralegal. Enhanced by excellent pedagogy, the text engages students with the material and ensures comprehension of key topics.

***Fundamentals of Business Organizations for Paralegals, Seventh Edition* features:**

- Thoughtful text tailored to a shorter course
- Timely coverage of new trends and topics
- Excellent pedagogy and well-written text make a dense topic accessible
- Helpful visual aids and charts that illustrate and highlight important topics
- Sample forms that appear in context throughout the book
- Discussion of the role of the paralegal in each chapter

Highlights of the Seventh Edition include:

- All new case illustrations and end-of-chapter discussion and Net Worth questions
- New and updated charts
- Discussion of the Corporate Transparency Act of 2021
- Discussions of the shift away from the shareholder primacy doctrine to a new standard for corporate responsibility in which the interests of other stakeholders are considered when corporations take action
- Examination of green and social bonds, by which corporations fund eco-friendly projects or raise funds for social projects such as affordable housing
- An entirely new section in Chapter Ten on governance trends, especially ESG issues, such as improving diversity in the boardroom and proposals to combat climate change
- The effect of the #MeToo and Black Lives Matter movements on businesses
- The significance of the COVID-19 pandemic on various business-related issues

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 Wolters Kluwer

Fundamentals of Business Organizations for Paralegals

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Seventh Edition

Deborah E. Bouchoux, Esq.

Georgetown University
Member, California (inactive) and District of Columbia bars



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*In honor of my colleague, mentor, and friend,
Frederick G. Tellam
(1929–2019)*

Summary of Contents

<i>Contents</i>	xi
<i>Preface</i>	xxvii
<i>Acknowledgments</i>	xxxix

1	Introduction to Business Organizations and Agency Law	1
2	Sole Proprietorships	15
3	General Partnerships	27
4	Limited Partnerships	47
5	Limited Liability Partnerships	63
6	Limited Liability Companies	77
7	Introduction to Corporations	97
8	Formation of Corporations	111
9	Corporate Financial Structure	133
10	Corporate Management	155
11	Corporate Dividends	187
12	Changes in the Corporate Structure and Corporate Combinations	201
13	Qualification of Foreign Corporations	221
14	Termination of Corporate Existence	233
15	Corporate Variations	245



Appendix A	Secretaries of State and State Corporations Statutes	265
Appendix B	General Partnership Agreement	271
Appendix C	Corporate Bylaws	275
<i>Glossary</i>		285
<i>Index</i>		303

Contents

<i>Preface</i>	xxvii
<i>Acknowledgments</i>	xxx

1



Introduction to Business Organizations and Agency Law

A.	Introduction	1
1.	Sole Proprietorship	1
2.	General Partnership	1
3.	Limited Partnership	2
4.	Limited Liability Partnership	2
5.	Limited Liability Company	2
6.	Business Corporation	2
7.	Professional Corporation	2
8.	S Corporation	3
9.	Close Corporation	3
B.	Considerations in Selection of Business Enterprise	3
C.	How Business Is Conducted in This Country	4



D. Agency in Business Organizations	5
1. Formation of Agency Relationship	5
2. Authority of Agents	7
3. Duties of Agents and Principals	8
4. Liability for Agent's Torts	9
5. Termination of Agency	9
6. Agency in Business Relationships	9
E. Role of Paralegal	10
Case Illustration: Commuting as Outside the Scope of Employment	10
Key Features of Agency Relationships	11
Internet Resources	11
Key Terms	12
Discussion Questions	12
Net Worth	13

2



Sole Proprietorships

A. Introduction	15
B. Advantages of Sole Proprietorships	15
C. Disadvantages of Sole Proprietorships	16
D. Formation of Sole Proprietorships	17
1. Licensing Considerations	17
2. Name Considerations	17
3. Business and Sales Tax Permits and Other Formalities	18
E. Taxation of Sole Proprietorships	20
F. Role of Paralegal	20
Case Illustration: Use of a Fictitious Business Name Does Not Create a Separate Entity	22
Key Features of Sole Proprietorships	23
Internet Resources	23



Key Terms	24
Discussion Questions	24
Net Worth	25

3



General Partnerships

A. Introduction	27
B. Partnership Property	29
1. Contributions to the Partnership	29
2. Property Rights of the Partnership and of Partners	29
C. Advantages of General Partnerships	30
D. Disadvantages of General Partnerships	31
E. Formation of General Partnerships	32
F. Operation of General Partnerships	32
1. Duties and Rights of Partners	32
2. Management of the Partnership	33
3. Compensation, Profits, and Accounting	34
G. The Partnership Agreement	34
H. Transferability of Partnership Interest	38
I. Dissolution and Winding Up	38
1. UPA Approach	38
2. RUPA Approach	39
3. Winding Up	40
J. Taxation of Partnerships	40
K. Joint Ventures	40
L. Role of Paralegal	41
Case Illustration: A Mere Collaboration Is Not a Partnership	41
Key Features of General Partnerships	42
Internet Resources	44



Key Terms	44
Discussion Questions	44
Net Worth	45

4



Limited Partnerships

A. Introduction	47
B. Rights and Duties of Partners	48
1. General Partners	48
2. Limited Partners	49
C. Advantages of Limited Partnerships	50
D. Disadvantages of Limited Partnerships	50
E. Formation of Limited Partnerships	51
1. Contents of the Limited Partnership Certificate	51
2. Filing the Certificate of Limited Partnership	53
3. Amending the Certificate of Limited Partnership	54
4. Foreign Limited Partnerships	54
F. Limited Partnership Agreement	54
G. Transferability of Limited Partnership Interests	56
H. Dissolution and Winding Up of Limited Partnerships	56
I. Taxation of Limited Partnerships	57
J. The 2001 Uniform Partnership Act and Limited Liability Limited Partnerships	57
K. Role of Paralegal	59
Case Illustration: Liability of Limited Partners in Limited Partnership	60
Key Features of Limited Partnerships	60
Internet Resources	61
Key Terms	61
Discussion Questions	62
Net Worth	62

5



Limited Liability Partnerships

A. Introduction	63
B. Advantages of LLPs	64
1. Partial Shield States	65
2. Full Shield States	65
C. Disadvantages of LLPs	67
D. Formation of LLPs and Doing Business in Other States	68
E. Operation of LLPs	70
F. Transferability of Interest and Admission of New Partners	70
G. Dissolution and Liquidation of LLPs	72
H. Taxation of LLPs	72
I. Growth and Trends in LLPs	72
J. Role of Paralegal	73
Case Illustration: Full Liability Shield for LLP Partners	73
Key Features of LLPs	74
Internet Resources	74
Key Terms	75
Discussion Questions	75
Net Worth	75

6



Limited Liability Companies

A. Introduction	77
1. Characteristics of Limited Liability Companies (LLCs)	77
2. Distinguishing LLCs from LLPs	78



B.	Advantages of Limited Liability Companies	79
1.	Limited Liability and Full Management	79
2.	Flexible Management	79
3.	One-Person LLCs	80
4.	Pass-Through Tax Status	80
C.	Disadvantages of LLCs	80
D.	Formation of LLCs	81
1.	Articles of Organization	81
2.	Operating Agreement	81
E.	Transferability of Interest	86
F.	Doing Business in Other States	86
G.	Dissociation and Dissolution of LLCs	86
1.	Events Causing Dissociation	87
2.	Events Causing Dissolution and Winding Up	87
H.	Conversions, Mergers, and Domestications	88
I.	Taxation of LLCs	88
J.	LLC Variations	88
K.	Growth and Trends in LLCs	89
1.	Popularity of LLCs	89
2.	The Commission's Harmonized Business Code	90
3.	LLCs Versus Other Business Structures	91
L.	Role of Paralegal	92
	Case Illustration: Piercing the Veil of an LLC	92
	Key Features of LLCs	93
	Internet Resources	93
	Key Terms	94
	Discussion Questions	94
	Net Worth	94

7



Introduction to Corporations

A. Introduction	97
B. Corporate Powers and Purposes	98
1. Corporate Powers	98
2. The <i>Ultra Vires</i> Doctrine	99
3. Inroads on the Shareholder Primacy Doctrine	99
C. Types of Corporations	100
1. Domestic Corporations	100
2. Foreign Corporations	100
3. Federal or State Corporations	101
4. Public Corporations	101
5. Privately Held Corporations	101
6. Nonprofit Corporations	101
7. Benefit Corporations	101
8. Close Corporations	102
9. Professional Corporations	102
10. S Corporations	102
11. Parent and Subsidiary Corporations	102
D. Advantages and Disadvantages of Incorporation	102
1. Advantages	102
2. Disadvantages	103
E. Role of Paralegal	106
Case Illustration: Broad Powers of a Corporation	107
Key Features of Corporations	107
Internet Resources	108
Key Terms	108
Discussion Questions	109
Net Worth	109



8



Formation of Corporations

A.	Introduction	111
B.	Preincorporation Activities	111
1.	Activities by Promoters	111
2.	Preincorporation Share Subscriptions	112
C.	Selection of Jurisdiction in Which to Incorporate	112
1.	Delaware Incorporation	113
2.	Factors in Selecting a Jurisdiction	113
D.	The Corporate Name	114
1.	Selection	114
2.	Name Availability, Reservation, and Registration	114
E.	Articles of Incorporation	117
1.	Elements of Articles of Incorporation	117
2.	Optional Provisions in Articles of Incorporation	119
3.	Preemptive Rights	119
4.	Filing of Articles of Incorporation	121
F.	Post-Incorporation Activities	122
1.	Bylaws	122
2.	Corporate Supplies	123
3.	Organizational Meeting	123
4.	Annual Report	125
G.	Defects in Incorporation Process	127
H.	Role of Paralegal	127
	Case Illustration: Preemptive Rights to Purchase Stock	128
	Key Features in Forming Corporations	129
	Internet Resources	129
	Key Terms	130
	Discussion Questions	130
	Net Worth	131

9



Corporate Financial Structure

A. Introduction	133
B. Equity Securities	134
1. Introduction	134
2. Par Value Stock	135
3. Consideration for Shares	135
4. Stock Certificates and Stock Issuance	136
5. Classes of Stock	137
C. Debt Securities	141
1. Introduction	141
2. Unsecured Debt	141
3. Secured Debt	141
4. Common Features of Debt Securities	143
5. Green and Social Bonds	143
D. Taxation of Corporations	144
1. Introduction	144
2. Double Taxation	145
3. Avoiding Double Taxation	146
4. State and Other Taxes	150
E. Role of Paralegal	150
Case Illustration: Corporate Latitude in Creating Classes of Stock	150
Key Features of Corporate Financial Structure	151
Internet Resources	152
Key Terms	152
Discussion Questions	153
Net Worth	154

10



Corporate Management

A.	Shareholders' Rights and Responsibilities	155
1.	Introduction	155
2.	Inspection Rights	155
3.	Voting Rights	156
4.	Shareholders' Meetings	156
5.	Shareholder Action Without a Meeting	161
6.	Other Shareholder Rights	162
7.	Modern Trends	163
8.	Shareholder Actions	164
9.	Piercing the Corporate Veil	165
B.	Directors' Rights and Responsibilities	166
1.	Introduction	166
2.	Functions of Directors	167
3.	Election, Term, Vacancies, and Removal of Directors	167
4.	Directors' Meetings	168
5.	Meeting Requirements	168
6.	Directors' Action Without a Meeting	169
7.	Compensation and Inspection Rights	169
8.	Directors' Standards of Conduct, Liability, and Indemnification	169
9.	Delegation of Authority	172
C.	Governance Guidelines and Trends	172
1.	Governance Guidelines	172
2.	Trends in Governance	173
3.	Environmental, Social, and Governance ("ESG") Issues	174
4.	Election of Directors: Types of Voting	175
D.	Corporate Scandals, the Sarbanes-Oxley and Dodd-Frank Acts, Proxy Access, and Proxy Advisors	176
E.	Officers' Rights and Responsibilities	179



1. Introduction	179
2. Appointment, Tenure, and Functions of Officers	179
3. Titles of Officers	180
4. Authority of Officers	181
5. Officers' Standards of Conduct, Liability, and Indemnification	181
F. Role of Paralegal	181
Case Illustration: Piercing the Corporate Veil	182
Key Features of Corporate Management	182
Internet Resources	183
Key Terms	184
Discussion Questions	184
Net Worth	185

11



Corporate Dividends

A. Introduction	187
B. Restrictions Relating to Dividends	188
1. MBCA Approach	188
2. Legally Available Funds	189
3. Miscellaneous Restrictions	189
C. Procedure for Declaring and Paying Dividends	190
1. Procedure	190
2. Amending the Articles	190
3. Right to Dividends	191
4. Effect of Illegal Dividends	191
D. Tax Considerations	192
E. Stock Splits	194
F. Purchase by a Corporation of Its Own Shares	195
G. Role of Paralegal	195



Case Illustration: Board's Dividend Decisions Are Protected Under Business Judgment Rule	196
Key Features of Corporate Dividends	197
Internet Resources	197
Key Terms	198
Discussion Questions	198
Net Worth	199

12



Changes in the Corporate Structure and Corporate Combinations

A. Introduction	201
B. Amending the Articles of Incorporation	201
1. Reasons for Amending Articles	201
2. Procedure for Amending Articles	202
3. Articles of Amendment	202
C. Restating the Articles of Incorporation	204
D. Amending the Bylaws of the Corporation	204
E. Corporate Combinations	204
1. Introduction	204
2. Mergers and Consolidations	205
3. Share Exchanges	208
4. Purchase of Assets	210
5. Purchase of Stock	211
6. Hostile Takeovers	212
7. Government Regulation	214
F. Domestication and Entity Conversion	214
1. Domestication	215
2. Entity Conversion	215
3. Process of Domestication and Conversion	215

G. Role of Paralegal	215
Case Illustration: Merger Agreement Can Be Terminated If a Material Adverse Effect Occurs	216
Key Features of Corporate Changes and Combinations	217
Internet Resources	218
Key Terms	218
Discussion Questions	219
Net Worth	220

13



Qualification of Foreign Corporations

A. Introduction	221
B. Basis for Qualification	221
C. Transacting Business	222
D. Procedures in Registration or Qualification	223
E. Effects of Qualifying	224
F. Effects of Failure to Qualify	226
G. Effects of Changes to Domestic Corporation	226
H. Withdrawal of Foreign Qualification	227
I. Revocation of Qualification by State	227
J. Role of Paralegal	227
Case Illustration: Maintaining an Action Does Not Constitute Doing Business	229
Key Features of Foreign Qualification	230
Internet Resources	230
Key Terms	231
Discussion Questions	231
Net Worth	231



14



Termination of Corporate Existence

A. Introduction	233
B. Dissolution	233
1. Voluntary Dissolution	233
2. Articles of Dissolution	234
3. Revocation of Dissolution	236
4. One-Step and Two-Step Dissolutions	236
5. Administrative Dissolution and Reinstatement	236
6. Involuntary Dissolution	237
C. Liquidation	239
1. Introduction	239
2. Nonjudicial Liquidation	239
3. Judicial Liquidation	239
4. Claims Against the Corporation	239
D. Distributions to Shareholders	240
E. Role of Paralegal	240
Case Illustration: Barring of Claims Against Dissolved Corporations	241
Key Features of Corporate Dissolution and Liquidation	241
Internet Resources	242
Key Terms	243
Discussion Questions	243
Net Worth	244

15

Corporate Variations

A.	Introduction	245
B.	Close Corporations	245
1.	Introduction	245
2.	Characteristics of Close Corporations	246
3.	Formation of Close Corporations	246
4.	Operation of Close Corporations	247
C.	Nonprofit Corporations	247
1.	Introduction	247
2.	Formation of Nonprofit Corporations	248
3.	Operation and Governance of Nonprofit Corporations	248
4.	Exemption from Taxation for Nonprofit Corporations	248
D.	Benefit Corporations	249
E.	Parent and Subsidiary Corporations	250
1.	Introduction	250
2.	Formation and Characteristics of Subsidiary Corporations	250
3.	Liability of Parent for Subsidiary's Debts	251
F.	Professional Corporations	251
1.	Introduction	251
2.	Characteristics of Professional Corporations	252
3.	Formation, Operation, and Liability of Professional Corporations	252
G.	S Corporations	253
1.	Introduction	253
2.	Formation, Operation, and Termination of S Corporations	253
H.	Publicly Traded Corporations	255
1.	Introduction to Investor Protection	255
2.	Securities Act of 1933	255
3.	Securities Exchange Act of 1934	256



4. State Securities Regulation	257
5. The Securities Markets	257
6. Stock Market Indexes	258
I. Role of Paralegal	258
Case Illustration: Personal Liability of Professionals in Professional Corporations	259
Key Features of Other Forms of Corporations	259
Internet Resources	260
Key Terms	261
Discussion Questions	261
Net Worth	262
Appendix A Secretaries of State and State Corporations Statutes	265
Appendix B General Partnership Agreement	271
Appendix C Corporate Bylaws	275
<i>Glossary</i>	285
<i>Index</i>	303

Preface

Concepts relating to business organizations surround us every day. News reports often begin with a report on stock prices, corporate accounting or compensation scandals, or the latest corporate mergers. The ups and downs of major companies such as Microsoft and General Motors are analyzed in depth. Commercials promote brokerage companies that facilitate stock purchases. Newspapers often devote a separate section to business and financial news. Nevertheless, many of us have only a vague notion of the import and effect of the news of business organizations that we hear about every day. Some individuals are intimidated by the financial sections of newspapers and periodicals, assuming that only those with degrees in business or finance are capable of understanding the business news.

This text is intended to provide readers with a fundamental understanding of the various types of business organizations that operate in the United States. Learning about the advantages and disadvantages of different forms of business entities will provide you with the knowledge necessary to understand the business concepts that surround us. Equally important, understanding the various ways in which business is conducted in this country will enhance your ability to perform as a paralegal.

Although the study of business organizations is undoubtedly most useful for paralegals intending to work in the corporate field, the concepts discussed in this text cross over to many other practice fields. For example, litigation paralegals will need to know whether partners in a partnership may be personally sued for partnership obligations, whether members in a limited liability company are liable for the company's debts, and under which circumstances corporate directors may be sued for negligence in managing their corporations. Paralegals working with general practitioners will need to know how to form the business organizations described in this text, draft resolutions, and prepare minutes for corporate meetings.

Each of the varieties of business organizations is discussed thoroughly. The nature of the entity, its advantages and disadvantages, the relative ease with



which the entity may be formed, its dissolution, and its tax consequences are all addressed. Each chapter includes a discussion of the pertinent topic, a section devoted to the possible tasks to be performed by paralegals relating to that business enterprise, a brief summary of a case illustrating a topic discussed in the chapter, references to Internet resources enabling you to locate additional materials of interest, a brief summary of the key features covered in the chapter, a list of key terms in the chapter, discussion questions challenging you to apply the concepts discussed in the chapter to fact patterns, and questions requiring you to locate information accessing commonly used business-related Internet sites.

The text begins with an introduction to the various business entities and then progresses from the simplest, the sole proprietorship, through partnerships, to the most complex, the business corporation. The newest forms of business entities, the limited liability partnership and limited liability company, are also discussed. Chapters include sample forms to illustrate the principles discussed and key terms to highlight the terms discussed. Appendices provide additional forms, and a glossary is included for easy reference to the many and often difficult terms used in the law of business organizations. Additional resources to accompany this text are available at the product page at wklegaledu.com.

This seventh edition of the text includes the following new features:

- New and updated charts and all new case illustrations and end-of-chapter discussion and Net Worth questions
- Discussion of the Corporate Transparency Act of 2021, which requires corporations, limited liability companies, and perhaps even certain partnerships to disclose information about their owners to the Department of the Treasury
- Discussion of the shift away from the *shareholder primacy doctrine* (in which the interests of shareholders are given top priority in corporate decision-making) to a new standard for corporate responsibility in which the interests of other stakeholders (employees, customers, and the local community) are considered when corporations take action
- Examination of green and social bonds, by which corporations fund eco-friendly projects or raise funds for social projects such as affordable housing
- An entirely new section in Chapter Ten on governance trends, including the following:
 - ESG (environmental, social, and governance) proposals;
 - California's new laws requiring diversity and inclusion on corporate boards;
 - Shareholder proposals urging corporations to combat climate change; and
 - The SEC's newly created Climate and ESG Task Force
- The effect of the #MeToo and Black Lives Matter movements on businesses, such as the use of "Weinstein Clauses" in merger agreements by which companies represent that there are no pending sexual misconduct actions against senior executives as well as shareholder lawsuits alleging that corporate managers failed to promote diversity as promised

- The effect of the COVID-19 pandemic on various business-related issues, including the following:
 - The immediate shift to virtual shareholder meetings with record shareholder participation; and
 - The suspension of dividend payments as companies sought to stabilize their finances in an uncertain time
- Updated forms

At the time of the writing of this seventh edition of the text, legislation was pending that would change many tax provisions relating to business organizations, including those for individuals and pass-through entities as well as those for corporations. Always check the Internal Revenue Code for current tax rates and provisions. Changes to the tax rates discussed in this text will be posted to the product page at www.wklegaledu.com.

When you begin reading this text, you might be unfamiliar with most of the business enterprises and concepts discussed. As you move forward in class and through the chapters and discussion questions, you will readily be able to measure your progress. When you complete this text and your class, you will have gained a thorough introduction to business organizations as well as familiarity with the terms and concepts required by paralegals in the business or corporate fields and those that we hear and read about each and every day.

Deborah E. Bouchoux
Summer 2021

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I would like to express my sincere appreciation to the many individuals who contributed greatly to the development of this text. As always, my first thoughts and gratitude go to Susan M. Sullivan, former Program Director of the Paralegal Program at the University of San Diego, who gave me my first teaching job and opened a door to an exciting and challenging field. Sue has been a valued friend as well as a respected colleague.

A special thank you to my family: my husband, Donald, and my children Meaghan, Elizabeth, Patrick, and Robert for their patience and understanding while I completed this text and its seventh edition.

Many thanks also to the various reviewers who evaluated the manuscript on behalf of the publisher. I have also received continuing evaluation from my students throughout my more than twenty-year career as a paralegal educator. Their comments and insights regarding methods of teaching, productive assignments, and effective class discussion have been a great help.

The author wishes to expressly acknowledge the following states for use of their state forms in this textbook: California, Delaware, Florida, Georgia, Nevada, New York, and Oregon.

Some of the numbering and wording in the Revised Uniform Partnership Act, Revised Uniform Limited Partnership Act, and Uniform Limited Liability Company Act were revised as part of the Uniform Law Commission's Harmonization of Business Entity Acts Project. Thus, the numbering and wording of some provisions discussed in the text may vary from the provisions of the pertinent Acts shown on the Commission's website at www.uniformlaws.org.

Finally, a special thank you to the individuals at Wolters Kluwer and Aspen Publishers who generously provided guidance and support throughout the development of this text, including Joe Terry, Publisher; Jordan Jepsen, Managing Editor; and Stacie Goosman, Managing Editor. Thank you also to Kaesmene Banks, Project Manager; and Lauren Arnest, copyeditor; as well as everyone at The Froebe Group, especially Betsy Kenny.

Fundamentals of Business Organizations for Paralegals

1



Introduction to Business Organizations and Agency Law



A. Introduction

This text will discuss the nine most common ways of doing business in this country. While each type of business structure will be described in detail in the chapters to come, a brief overview follows. Other enterprises, such as joint ventures and nonprofit corporations, will also be discussed in later chapters.

1. Sole Proprietorship

In a **sole proprietorship**, one individual owns all of the business assets and is the sole decision-maker. The sole proprietor has unlimited **personal liability** for business obligations, meaning that liability for business debts extends beyond business assets to the sole proprietor's personal assets, such as savings accounts, furniture, and other personal belongings.

Sole proprietorship
Business owned and operated by one person

Personal liability
Liability extending beyond business assets to personal assets

2. General Partnership

In a **general partnership**, two or more persons co-own all of the business assets and share decision-making, profits, and losses. All general partners have unlimited personal liability for the business obligations.

General partnership
A voluntary association of two or more persons to carry on a business for profit



3. *Limited Partnership*

Limited partnership

Business created under a state statute in which some partners have unlimited personal liability and others have no liability beyond the amount contributed to the business

A **limited partnership** is managed by one or more general partners, all of whom have unlimited personal liability for business obligations, and one or more limited partners, who do not manage the business and have no liability beyond the amount contributed to the business.

4. *Limited Liability Partnership*

Limited liability partnership

Business entity providing limited liability for its partners

This newer form of business enterprise alters a basic principle of partnership law: Partners are not liable for the torts or wrongful acts of their co-partners. Moreover, in more than 45 jurisdictions, the partners are not personally liable for contractual obligations incurred by the entity or other partners. These entities are ideally suited for professionals, such as doctors, lawyers, and accountants.

5. *Limited Liability Company*

Limited liability company

Business entity providing limited liability for its members

Another newer form of business structure is the **limited liability company**. In all states, this business entity provides limited liability for its members whether obligations arise in tort or contract. These entities may be managed by their members or by designated managers. The LLC form is the most popular form of business entity in the United States, dominating even corporations. All states now permit a one-member LLC. A new type of LLC, the low-profit LLC, engages in profit-making activities to achieve its social goals; profit making is secondary to its stated social mission.

6. *Business Corporation*

Business corporation

Legal entity existing under the authority of the state legislature

A **business** (or *for-profit*) **corporation** is an entity created under state statute. This legal entity may own property, enter into contracts, and sue and be sued. Because the business corporation is a “person,” it is subject to taxation. In what is referred to as *double taxation*, its owners, called *shareholders*, also pay tax on cash distributions made to them.

Shareholders are protected from personal liability, and their loss is limited to their investment in the corporation. Although the shareholders own the corporation, the corporation is managed by its board of directors, who typically appoint officers to carry out the directors’ policies and goals.

Benefit corporation

A new hybrid corporation that combines profit making with social good

A new form of corporation, the **benefit corporation**, recognized only since 2010 but already allowed in nearly three-fourths of U.S. jurisdictions, is a hybrid: It combines profit making with social good. Examples of benefit corporations include Kickstarter PBC and Patagonia, Inc.

7. *Professional Corporation*

Professionals, such as doctors, lawyers, and accountants, may incorporate to obtain certain tax and other benefits available to business corporations.



Nevertheless, these **professionals** remain personally liable for their own negligence and the negligence of those they supervise.

Professional corporation
Corporation formed by professionals

8. *S Corporation*

Certain small business corporations are provided relief against double taxation. Called an **S corporation** after the original subchapter of the Internal Revenue Code providing such relief, the corporation itself does not pay taxes and all income earned is passed through to the shareholders who pay tax at their individual rates (after a 20 percent deduction, and subject to certain income thresholds and other restrictions).

S corporation
Corporation that passes all income to its shareholders, who pay tax on income

All shareholders (who must not number more than 100) must agree to the election of S status, and only eligible corporations may apply for this status. A typical business corporation is referred to as a *C corporation* to distinguish it from an S corporation.

9. *Close Corporation*

Close corporations are generally corporations owned by small numbers of family members and friends, who are active in operating the business. Only certain types of corporations can qualify to be treated as close corporations. The shareholders in a close corporation are allowed more flexibility in operating the corporation and usually function without adhering to all of the formalities required of other business corporations.

Close corporation
Small corporation whose shareholders are active in managing the business and that operates informally

PRACTICE TIP

It can be difficult to understand the various types of business structures and their features. Consider keeping a “cheat sheet” or index card near your desk on which you describe the most prominent features of each form of entity. After you refer to this several times, you will likely have no difficulty remembering the differences between a general partnership, a limited partnership, and a limited liability partnership. Alternatively, access the site “My Corporation” at www.mycorporation.com and search for “Comparison Chart,” or refer to the inside cover of this text for a chart comparing and contrasting business structures.

B. Considerations in Selection of Business Enterprise

Although a sole proprietorship or other business entity may be ideal for one individual, it may be inadvisable for another. Determining which form of business structure is the most appropriate for a client involves evaluation of a number of factors. The attorney you work with will counsel the client to consider the following factors:



- **Ease of Formation.** The ease with which a business can be formed should be carefully considered. For example, a sole proprietorship is easy and inexpensive to form, whereas a corporation requires compliance with state statutes and can be expensive to form and maintain.
- **Management.** Some individuals prefer to manage their business themselves, and others prefer to partner with colleagues to manage the enterprise.
- **Liability.** The liability an individual faces is one of the most critical factors to consider in selecting a form of business enterprise. Some enterprises shield the individuals involved from any personal liability, whereas others expose the business owner to greater risk.
- **Continuity of Existence.** Some enterprises, such as corporations, are capable of existing perpetually. Others, such as sole proprietorships, do not have such continuity of existence. Thus, consideration should be given to the intended duration of the enterprise.
- **Transferability.** Clients must consider how easy it is to “get into” and “get out of” the business enterprise. It may be difficult to withdraw from a partnership, but it is usually easy to sell stock and transfer out of a corporation. If clients foresee a need to liquidate their investment in a business for cash, they should consider how easy or difficult it will be to transfer into and out of the enterprise.
- **Profits and Losses.** A sole proprietor retains all business profits, but she is also solely liable for all losses. Partners share profits and losses with each other, but some losses suffered by a partner might arise due to another partner’s actions. Clients should evaluate the allocation of profits and losses when considering business enterprises.
- **Taxation.** Clients should always consider applicable tax requirements. For some, the individual tax rates may be best; for others, the current corporate tax rate of 21 percent may yield the best advantage (although at the time of this writing, proposals were pending to revise the tax rate). Many entities (in fact, about 90 percent of U.S. businesses) afford single or pass-through taxation (meaning their owners pay tax according to individual tax rates or brackets, subject to certain income thresholds and other restrictions, as described in Chapter Two); corporations are burdened by double taxation. In fact, the Tax Foundation, a tax policy research organization, reported in mid-2019 that the vast majority of businesses in the United States are organized as pass-through entities. See Figure 2-4 in Chapter Two for a discussion of the specific tax provisions applicable to these pass-through entities and Figure 9-5 in Chapter Nine for a summary of the 2017 Tax Cuts and Jobs Act.

C. How Business Is Conducted in This Country

Many individuals perceive that business in the United States is conducted by huge corporations that affect every aspect of financial growth and development. Most would be surprised to discover that sole proprietorships (businesses conducted by one person) dominate the business landscape.

According to the Small Business Administration, more than 70 percent of business in this country is conducted by sole proprietors. Moreover, about 90 percent of all business establishments in the United States employ fewer than 20 employees. Nevertheless, business corporations account for a disproportionately high share of revenue. In 2015, IRS business receipts showed the following approximate amounts:

- Sole proprietorships: \$1.4 trillion
- Partnerships (including LLCs): \$5 trillion
- Business corporations: \$28 trillion

See Figure 1-1 for a chart showing where individual employees work.

D. Agency in Business Organizations

Understanding the concepts of agency is necessary to knowing how business enterprises operate. In brief, an **agent** is someone who agrees to act for or represent another, called the **principal**. Because businesses rely on people to accomplish tasks, it is important to determine whether these third parties have the authority to obligate or bind the business and its partners or members.

Agency relationships arise in a variety of settings. When an employee of a store sells goods, he does so as the agent of the store owner, the principal. When a partner in a partnership signs a contract, she may bind the partnership under the principles of agency law. When the president of a corporation signs a lease, he binds the corporation under agency principles. Agency relationships permeate almost all forms of business enterprise. Thus, a thorough understanding of some of the basic principles of agency law is critical to comprehending the various forms of business enterprise to be discussed in this book.

Agent

One who acts for or represents another

Principal

The person for whom an agent acts

1. Formation of Agency Relationship

There are two primary ways in which an agency relationship can be created: by express agreement (whether written or oral) and by implied agreement. In addition to express and implied agency relationships, obligations associated with agency relationships also may arise under estoppel principles.

Agreement. Most agency relationships are created by mutual agreement: One party agrees to act for the other, either orally or in writing. For example, if a home owner decides to sell her home and lists it with a real estate company, the parties will set forth their relationship and duties in a written agreement. An agreement by which one party agrees to act for the other is an **express agency**, whether it is written or oral.

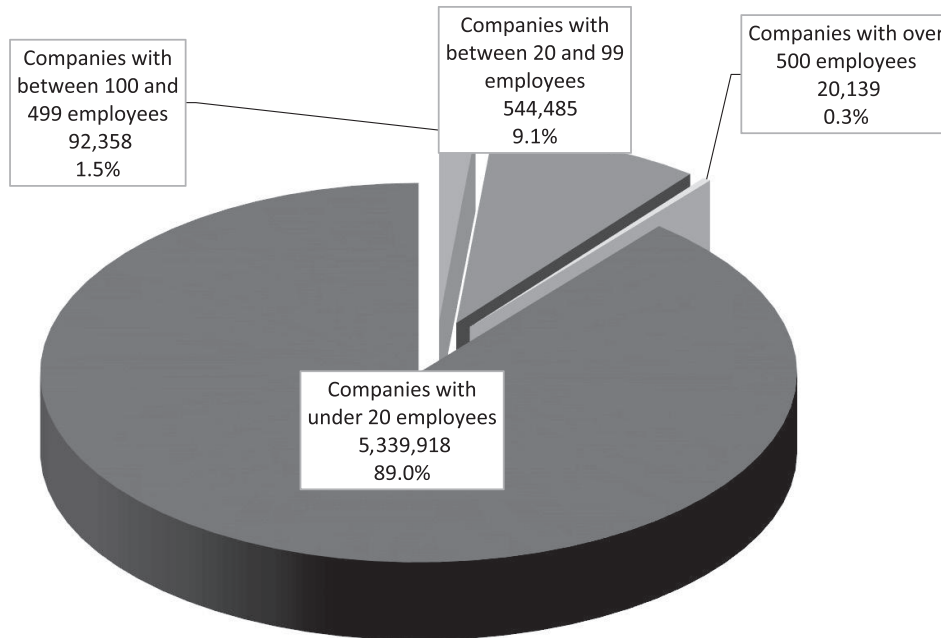
Agency relationships can also be implied. For example, individuals who work in small retail shops seldom have written agreements detailing their duties. Yet the acts they perform on behalf of their employers (ordering goods, accepting returns, selling goods) bind their employers, the principals. These are examples of

Express agency

An agency agreement, written or oral



FIGURE 1-1
Companies Indexed by Numbers of Employees (2017) (in thousands)



Source: U.S. Census Bureau, www.census.gov/data/tables/2014/econ/susb/2014-susb-annual.html

Implied agency

An agency relationship in which there is no express agreement, but the parties' words, conduct, or prior dealings show the existence of their agency relationship

Agency by estoppel

An agency arising from acts that lead others to believe an agency relationship exists

implied agency; there is no formal agreement, yet the parties' words, conduct, or prior dealings show the existence of their agency relationship.

Estoppel. Sometimes an agency relationship arises because it would be inequitable to allow the principal to deny the relationship. Thus, if a principal creates the reasonable impression that another is authorized to act for the principal, an **agency by estoppel** has been created, and the principal is precluded or estopped from denying the existence of the agency relationship.

Contractual Terms. Just as agency can arise from agreement (whether express or implied), parties may attempt to disclaim the existence of agency by including various provisions in their agreements. Thus, an agreement may recite that the parties agree that neither is an agent for the other (or vice versa). Although such

provisions are relevant in determining whether an agency relationship exists, they are not conclusive, and a court is free to determine that an agency relationship exists (or does not exist), regardless of what the parties have agreed or stated in their agreements.

2. *Authority of Agents*

Often a third party desires to hold a principal liable for the acts of an agent. A principal may then attempt to avoid liability by distancing herself from the agent's acts and claiming the agent had no authority to act for the principal. Generally, the third party will allege that the agent had the authority to act for the principal and thus the agent's acts bind the principal.

An agent has the ability to bind the principal in three ways: by being granted actual authority to do an act, by apparent authority, or through ratification.

Actual Authority. Generally, a person may properly appoint another to perform any act he could perform. Thus, a principal may grant actual authority to an agent to act for him. This actual authority can be express or implied. **Express authority** may be given in writing or orally and refers to those acts the principal specifically directs the agent to perform. An agent also has **implied authority** to perform acts customarily performed by an agent or those acts that are reasonably necessary to allow the agent to perform her duties. For example, a manager hired by a restaurant has not only the express authority to do acts directed by the restaurant's owner, but has the implied authority to do any acts reasonably necessary to operate the restaurant, such as hiring and firing employees, ordering supplies, and giving free meals to unhappy customers.

Express authority
Actual authority granted by one to another, in writing or orally

Implied authority
Power to perform acts customarily performed by agents

Apparent Authority. Apparent authority arises when by his conduct, a principal causes a third person reasonably to believe the agent has the authority to act for the principal. Assume that an employee always accompanies her employer, the owner of a dress shop, to New York City to the annual fashion shows to order new fashions for the shop. If one year only the employee attends and orders the new stock, the store owner would be bound to pay for the employee's orders because the store owner's previous conduct reasonably led others to believe the employee had the authority to make orders. The store owner will be precluded or estopped from asserting that the employee, her agent, lacked authority to make orders, and the store owner is thus bound by the agent's conduct.

Apparent authority
Authority that arises through words or conduct of principal, leading others reasonably to believe agent has authority to act for principal

As discussed below, the principal may always ratify previous action by the agent and thereby become obligated by the agent's actions, whether authorized or not.

Ratified Authority. Even if an agent has neither express nor implied authority to perform an act, the principal can nevertheless ratify or accept the agent's act and thereby become obligated by the agent's actions. For example, assume Candy has retained a real estate agent to sell her house. If the real estate agent has been instructed to present no offer to Candy for her house under \$300,000, and yet presents an offer to Candy for \$290,000, which Candy accepts, Candy has ratified this unauthorized act by her agent. Ratification thus occurs when the principal

Ratification
Acceptance of an act



accepts the agent's act even though the agent had no authority to do the act or the act exceeded the scope of the agent's authority. Ratification may be express or implied.

3. *Duties of Agents and Principals*

Fiduciary duties

Duty to act loyally and in utmost good faith

Agency relationships are fundamentally **fiduciary** in nature. As fiduciaries, agents must act with due care and loyalty for the principal's benefit in all matters connected with the agency relationship. The duty of loyalty ensures that the agent does not usurp business opportunities from the principal, does not compete against the principal, and avoids conflicts of interest. The principal's duty is to deal with the agent fairly and in good faith. Other duties also arise from the agency relationship.

Agent's Duties. Generally, an agent owes four duties to her principal:

- **Performance.** An agent must perform the work or duties required by the principal, whether set forth in a written agreement, included in an oral agreement, or implied from the nature of the agency relationship. The agent must perform these duties with reasonable diligence and due care.
- **Notification and Disclosure.** An agent must disclose all information relating to the agency to her principal. An agent selling a house for home owners may not decide for herself, "This offer is so low I won't bother telling the owners about it." In agency law, it is presumed the principal knows all that the agent knows.
- **Loyalty.** The agent must act solely for the benefit of the principal and may not engage in any transaction that would be detrimental to the principal or that would conflict with the principal's interest. The agent's loyalty to the principal must be total and undivided.
- **Accounting.** An agent must account to the principal for all money or property paid out or received on the principal's behalf. The principal's funds must be maintained separately from the agent's; the funds may not be commingled.

Principal's Duties. Principals owe three duties to their agents:

- **Compensation.** Principals must pay agents for their services. If no fixed compensation is agreed upon, the agent is entitled to compensation in a reasonable and customary amount.
- **Reimbursement and Indemnification.** The principal must reimburse the agent for costs and expenses incurred on the principal's behalf. For example, employers routinely reimburse employees for their travel expenses incurred on behalf of the employer. The principal is also generally required to indemnify or compensate the agent for liability incurred by the agent while performing duties for the principal. The agent will not be indemnified for fraud, illegal acts, or for reckless or willful misconduct, but the agent will be indemnified for acts directed or authorized by the principal.

- **Cooperation.** The principal must not hinder the agent in the performance of her duties. This duty to cooperate includes a duty to provide the agent with what she will need to perform duties, such as a credit card, an office, necessary equipment, and so forth.

4. *Liability for Agent's Torts*

An agent is liable for her own torts or civil wrongs. Such torts might include assault, battery, negligence, fraud, or malpractice. The question often arises whether the principal is liable for torts committed by the agent. The general rule is that a principal is liable for the torts of his agent committed in the course and scope of the agency. However, if the agent is on a “frolic” or “detour,” or performing a personal endeavor, the principal is not liable. Thus, a trucking company may be liable for accidents caused by its drivers while they are performing their duties for their employer-principal. On the other hand, if a driver leaves his designated route to visit a friend and in the course of this visit causes an accident, the employer-principal will likely not be held liable because the employee-agent was engaged in activities on his own behalf.

This liability theory is called *respondeat superior* (literally, “let the master answer”) and results in liability being imposed on the employer-principal even though she did not actually commit the wrong. This doctrine imposes **vicarious liability** on the employer-principal, meaning that liability is imposed without regard to actual fault and is based on the relationship of the parties.

Employer-principals may also be liable for failure to supervise an employee properly, for improper selection of an employee (as is the case when an employer hires an obviously unqualified employee), or for wrongful retention of an employee (as is the case when the employer does not terminate employment even though grounds for termination exist, such as acts of violence and threats by the employee). Generally, a principal is not liable for torts committed by an independent contractor.

Respondeat superior
Liability imposed on employers for acts of employees

Vicarious liability
Liability imposed on one for another's acts, without regard to actual fault

5. *Termination of Agency*

Agency relationships may be terminated when the stated time period expires if the agreement provides a period of duration (such as a six-month listing period for a real estate agent), when the purposes of the agency have been accomplished, by mutual agreement, by death or bankruptcy of either party, or by either party by reasonable notice to the other. Upon termination of the agency relationship, the agent no longer has any authority to bind the principal. If no stated period for termination exists, the agency relationship will expire after a reasonable time.

6. *Agency in Business Relationships*

This overview of the relationship, duties, and obligations of agents and principals is fundamental to an understanding of many forms of business enterprise.



For example, you will see in Chapter Two that a sole proprietor is vicariously liable for the acts of her employees. In Chapter Three, you will see that any partner in a general partnership has the ability to sign contracts, hire employees, and perform other acts; and these acts bind the other partners and the partnership. You will learn that directors and officers are agents of a corporation and thus owe fiduciary duties to the corporation.

E. Role of Paralegal

Before a business is formed, the role of a paralegal will likely be limited to researching various types of business entities, gathering forms and fee schedules from secretaries of state so that forms will be ready for preparation once the client and attorney determine the appropriate form of entity for the client, collecting tax forms, and interviewing clients to gather some initial information from them as to their business needs and goals.

Case Illustration

Commuting as Outside the Scope of Employment

Case Name:	<i>Ducey v. Argo Sales Co.</i> , 602 P.2d 755 (Cal. 1979)
Facts:	The plaintiffs brought an action for personal injuries against several defendants for injuries sustained when their car was struck by that driven by Dolores Glass. At the time, Glass was returning home after performing her job for Argo Sales Co.
Holding:	Generally, and although there are exceptions, an employer is not liable for torts committed by an employee who is going to or coming from work. The rationale for the “going and coming” rule is that the employment relationship is suspended from the time the employee leaves employment until he or she returns, and that during commuting the employee is not rendering service to the employer. Thus, the employer was not liable under a <i>respondent superior</i> theory.

Key Features of Agency Relationships

- ◆ Formation of agency occurs through agreement (which may be express or implied) or it may arise by estoppel.
 - ◆ Agents have actual authority or apparent authority to act for their principals. Principals may always ratify the unauthorized acts of their agents.
 - ◆ Agents owe fiduciary duties of loyalty and care to their principals.
 - ◆ Agents are liable for their own torts, and principals are liable for an agent's torts and acts committed in the course and scope of the agency.
-

Internet Resources

State statutes:	www.law.cornell.edu www.justia.com
Tax information:	www.irs.gov
General information:	www.sba.gov (This website of the U.S. Small Business Administration offers excellent information on starting a business.) www.nass.org (The website of the National Association of Secretaries of State allows direct linking to each state's secretary of state home page for easy access to forms and general information on business entities; select "Membership.") www.dnb.com/business-directory.html (This website offers addresses, phone numbers, and brief capsules on hundreds of companies doing business in the United States.)
Forms:	https://forms.justia.com www.ilrg.com/forms



Key Terms

Sole proprietorship	Principal
Personal liability	Express agency
General partnership	Implied agency
Limited partnership	Agency by estoppel
Limited liability partnership	Express authority
Limited liability company	Implied authority
Business corporation	Apparent authority
Benefit corporation	Ratification
Professional corporation	Fiduciary duties
S corporation	<i>Respondeat superior</i>
Close corporation	Vicarious liability
Agent	

Discussion Questions

1. Indicate one way in which an LLC is the same as and differs from a corporation.
2. Distinguish between limited partners and general partners in a limited partnership.
3. Paige owns a valuable gold bracelet. She has engaged Adam to sell it for her and has told Adam that she will not accept less than \$20,000 in cash for the bracelet. Discuss whether any of the following events involve a breach of any duty by either Paige or Adam.
 - a. Paige has begun placing ads on social media websites in order to sell the bracelet by herself.
 - b. Adam has informed Brady, a potential buyer, that he thinks Paige will accept an offer of \$15,000 and has told Brady to submit an offer in this amount.
 - c. Adam has received an offer for the bracelet for \$10,000 in cash, with the remainder to be paid over one year. Adam rejected the offer without telling Paige about it.
4. Progressive Plastic Surgery is a medical practice operating as a professional corporation. The practice recently hired a new surgeon, Daniela, after checking one reference. While operating on Penny, Daniela committed an act of medical malpractice. Discuss any liability the parties may have.
 - a. Penny has discovered that Daniela has been sued in numerous malpractice actions.
 - b. Would your answer be different if the practice had hired Daniela through a placement agency to work for the practice for two weeks while another surgeon was vacationing?
 - c. Daniela has begun giving Botox injections at at-home parties hosted in her apartment, and an individual suffered a serious injury as a result of Botox injected by Daniela.



Net Worth

1. Access the website for the SBA. Select “Business Guide” and then “Choose a Business Structure.” What is the simplest structure for two or more persons to own a business together?
 2. Access the website for the National Association of Secretaries of State.
 - a. Who is the current Secretary of State for Florida?
 - b. Access the website for the Delaware Division of Corporations. Review the Secretary of State’s report (located at <https://corp.delaware.gov/stats>). How many corporations were formed in Delaware in 2020? How many limited liability companies were formed that year?
-

2



Sole Proprietorships



A. Introduction

Many people dream of owning their own business. For most of these entrepreneurs, the sole proprietorship is an ideal way of pursuing this dream. The **sole proprietorship** is an unincorporated business owned and operated by one person, who is generally called the **sole proprietor** (or the *individual proprietor*). Almost any kind of business can be conducted as a sole proprietorship: a retail toy shop, a restaurant, or a law office. The key feature of a sole proprietorship is that it is managed and owned by one person. This person may hire managers and employees to assist her in running the business, but the business is characterized by a sole decision-maker.

Sole proprietorship
A business owned and operated by one person

Sole proprietor Owner of a sole proprietorship

In a family-run business it may be difficult to determine whether the business is a partnership or a sole proprietorship. If family members share decision-making, the business is likely a general partnership. If only one person makes decisions, then the business is likely a sole proprietorship. It does not matter what the parties call their enterprise; courts are free to examine the business and determine its true nature.

Sole proprietorships are governed exclusively by state and local laws (except for laws relating to taxes, civil rights, and so forth). Most sole proprietorships are governed solely by state or local laws, and no permission is required from the state to form a sole proprietorship.

B. Advantages of Sole Proprietorships

There are several advantages in operating as a sole proprietorship, including the following:

- **Ease of Formation.** The sole proprietorship is easily and inexpensively formed and operated.



- **Managerial Discretion.** The sole proprietor is free to make all decisions regarding the business. The sole proprietor may select the name of the business, establish its location, hire employees, and decide what products and services will be offered. The owner is not vulnerable to the negligence of a partner and may sell the business without securing approval from anyone.
- **Retention of Profits.** The sole proprietor may keep all profits generated by the business.
- **Pass-Through Tax Status.** After taking a 20 percent deduction (and subject to certain income thresholds and limits), the sole proprietorship's income is passed through to the sole proprietor, who pays taxes at her appropriate individual rate. The business itself pays no tax.

C. Disadvantages of Sole Proprietorships

There are some disadvantages in operating a business as a sole proprietor, including the following:

- **Unlimited Personal Liability.** The chief disadvantage of a sole proprietorship is that the sole proprietor is personally liable for the debts and obligations of the business. This is because the sole proprietor (the person) and the sole proprietorship (the business) are viewed as the same legal entity. For example, if rent is owed to a landlord or money is owed to a supplier, these creditors are not limited to seizing money in the business accounts. The sole proprietor's liability extends beyond what has been invested in the business to her personal assets. Those assets may include money in bank accounts, art collections, and furniture. Although state statutes allow some exemptions (for example, certain jewelry and heirlooms may not be seized by creditors in most states, homestead exemptions may exist to protect one's personal residence, and retirement plans may be protected), the front door of the sole proprietor's house is virtually wide open and the contents therein available for picking by business creditors. Moreover, the sole proprietor is liable not only for business debts, but also for the torts or civil wrongs committed by employees in the course and scope of their employment. To protect against the disadvantage of unlimited **personal liability**, the sole proprietor may seek to obtain insurance; however, insurance is not available for all risks. The sole proprietor may also try to negotiate agreements with third parties whereby they agree not to seize his personal assets.
- **Lack of Continuity.** Because the sole proprietorship is so closely affiliated with the sole proprietor, the sole proprietorship generally terminates upon the death of the sole proprietor. If the business assets descend to an heir who continues to operate the business, a new sole proprietorship has been created.
- **Difficulties in Raising Capital.** If a partnership needs to raise additional **capital**, or money, there may be several partners who contribute the needed funds. Corporations raise money by selling stock. The sole proprietor, however, is limited in the methods of obtaining additional funds. The sole proprietor is limited to her own personal funds or may attempt to borrow money. If the sole proprietor has no money and a bank or other lender refuses to lend funds, the sole proprietorship may well collapse.

Personal liability

Liability extending beyond what is invested in a business to an individual's personal assets (also called *unlimited liability*)

Capital

Money used to form and operate a business

FIGURE 2-1
Sole Proprietorships

<i>Advantages</i>	<i>Disadvantages</i>
Easy to form and maintain	Unlimited personal liability
Inexpensive to form	Limited ways to raise capital
Owner is sole decision-maker	Lack of continuity
Management is informal and flexible	Possible lack of expertise in management
All profits retained by owner	
Pass-through tax status	

- **Management Vulnerabilities.** The sole proprietor has the flexibility of making all business decisions, but this may be a disadvantage as well. As the business grows, special expertise may be needed. A partnership may admit new partners, and a corporation may rely on its board of directors and officers to provide this business expertise. The sole proprietor, as the sole decision-maker, however, may need to expend funds to hire outside consultants and advisors. (See Figure 2-1 for a comparison of the advantages and disadvantages of sole proprietorships.)

D. Formation of Sole Proprietorships

One of the greatest advantages of a sole proprietorship is the lack of formalities in forming and organizing this enterprise. Most of the requirements involved in creating the sole proprietorship are common to almost any business.

1. Licensing Considerations

If the sole proprietor will be engaged in a business that has licensing requirements, he will need to comply with these. For example, a real estate or insurance agent must pass a test to become licensed, and a restaurant that serves alcohol requires a liquor license. To determine whether the business is one that requires a license, review your state's statutes and administrative codes, or contact any association that may govern the profession, such as a department of real estate. Sole proprietors may conduct business in other localities or states as well, so long as those states' requirements are followed.

2. Name Considerations

Many sole proprietors choose to operate their business under a name other than their own. For example, Kevin Harris might operate his auto repair shop as

**Fictitious name**

Name that must be registered with state or local officials because it does not disclose the surname of the business owner

Fictitious business name statement

Record filed with public officials to identify the owner of a business operating under a name other than the owner's surname

DBA

Doing business as; another name for a fictitious business name statement

“Car Care.” Such a name is called an *assumed name*, *trade name*, or **fictitious name**. Generally, if a sole proprietor intends to operate under a fictitious name, the name must be registered with the local or state authority, usually in the county in which the business will be conducted. An example of a **fictitious business name statement** is shown in Figure 2-2. The fictitious business name statement allows consumers to determine the actual owner of a business if litigation must be brought against the owner. The statement is sometimes called a **DBA** (meaning “doing business as”), because it identifies that the true owner is doing business as or under another name.

Although standards vary from state to state, the general rule in determining whether the fictitious business name statement must be filed is as follows: If the business name includes the sole proprietor's last name and does not imply that others are involved (by using terms such as “and Company” or “Associates”), no statement need be filed. Thus, “Tammy's Crafts” is fictitious, whereas “Smith's Repairs” is not. Filing the statement is inexpensive and easy; thus, when there is any doubt, the fictitious business name statement should be filed. Failure to file the statement may result in a fine or refusal to allow the sole proprietor to initiate litigation (although most states allow the sole proprietor to cure the defect by filing the statement in order to litigate). The statement is usually valid for a few years and can be renewed. Some states, including California, also require that the name be published in a newspaper to provide wider public notice.

Finally, the sole proprietor must operate under a name that is distinguishable from that used by another enterprise. The state or local agency that accepts the fictitious name statement may check to see if the name is available in that locality. For a more thorough check (for example, for a business that intends to operate in several jurisdictions or nationwide), the sole proprietor should have searches of business names conducted throughout the nation. This will ensure that the name is available nationwide and that it does not infringe the name of another party. Two companies that specialize in such comprehensive name searches are the following: Corsearch (<https://corsearch.com>) and CompuMark (<https://clarivate.com/compumark>).

Some searching may also be done of registered trademarks through the database of the U.S. Patent and Trademark Office at www.uspto.gov.

3. *Business and Sales Tax Permits and Other Formalities*

Some jurisdictions require that the sole proprietor obtain a basic license to do business. Additionally, if the sole proprietor will be making sales, arrangements must be made to pay sales tax to the appropriate authority, such as the municipality or state. A sole proprietor who hires employees must apply for an employer identification number to withhold federal income tax, using Form SS-4, available from the Internal Revenue Service (IRS) at www.irs.gov. Arrangements will also need to be made to contribute to Social Security and worker's compensation funds.

FIGURE 2-2

Fictitious Business Name Statement

TTX Cert#: _____ Current: _____ ID _____ MAIL _____ <small>ABOVE FOR OFFICE USE ONLY</small> FILING FEE: (See website for methods of payment) \$58.00 For 1 st Business Name and 1 st Registrant \$14.00 For each additional business name or each additional registrant (owner) on <u>SAME statement</u> ITEMS #1 THROUGH #6 MUST BE LEGIBLE AND FULLY COMPLETED; SUBMIT FORM IN DUPLICATE	THIS STATEMENT IS A PUBLIC RECORD <small>(SEE REVERSE SIDE FOR LEGAL REQUIREMENTS AND INSTRUCTIONS)</small> Office of the County Clerk 1 Dr. Carlton B. Goodlett Place, Room 168 San Francisco, CA 94102-4678 www.sfgov.org/countyclerk	FILING STAMP ONLY Any alterations, deletions, or other format to this two-page form will not be accepted for filing by the Office of the SF County Clerk.
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FICTITIOUS BUSINESS NAME STATEMENT

1. Fictitious Business Name(s)/Trade Name (DBA): _____

2. Street Address, City, State and Zip code of Principal Place of Business (P.O. Box **NOT** allowed) MUST ENTER COUNTY OF FBN ADDRESS:

3. Full name of registrant/owner #1 (If Corporation or Limited Liability Company, also indicate State of incorporation or organization, e.g. (CA), (DE), etc) Residence Address (P.O. Box NOT allowed) City, State and Zip Code	Full name of registrant/owner #2 (If Corporation or Limited Liability Company, also indicate State of incorporation or organization, e.g. (CA), (DE), etc) Residence Address (P.O. Box NOT allowed) City, State and Zip Code
Full name of registrant/owner #3 (If Corporation or Limited Liability Company, also indicate State of incorporation or organization, e.g. (CA), (DE), etc) Residence Address (P.O. Box NOT allowed) City, State and Zip Code	Full name of registrant/owner #4 (If Corporation or Limited Liability Company, also indicate State of incorporation or organization, e.g. (CA), (DE), etc) Residence Address (P.O. Box NOT allowed) City, State and Zip Code

4. The business is conducted by: ☐ an individual ☐ a general partnership ☐ a corporation ☐ a limited partnership
☐ an unincorporated association other than a partnership ☐ a trust ☐ co-partners ☐ a married couple
☐ joint venture ☐ a limited liability company ☐ state or local registered domestic partners ☐ a limited liability partnership

5. The registrant commenced to transact business under the fictitious business name or names listed above on: (**enter EXACT date OR if future date, enter "not applicable"**) ▶

6. I declare that all information in this statement is true and correct. (A registrant who declares as true any material matter pursuant to Section 17913 of the Business and Professions Code that the registrant knows to be false is guilty of a misdemeanor punishable by a fine not to exceed one thousand dollars (\$1,000).)

ORIGINAL/WET SIGNATURE REQUIRED. If registrant other than Corp. or LLC, sign below Signed _____ Printed Name _____	If registrant is a Corporation or Limited Liability Company, sign below Corporation or LLC Name: _____ Signature _____ Printed Name & Title _____
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This statement was filed with the San Francisco County Clerk on date indicated by the file stamp above.

NOTICE—IN ACCORDANCE WITH SUBDIVISION (a) OF SECTION 17920, A FICTITIOUS NAME STATEMENT GENERALLY EXPIRES AT THE END OF FIVE YEARS FROM THE DATE ON WHICH IT WAS FILED IN THE OFFICE OF THE COUNTY CLERK, EXCEPT, AS PROVIDED IN SUBDIVISION (b) OF SECTION 17920, WHERE IT EXPIRES 40 DAYS AFTER ANY CHANGE IN THE FACTS SET FORTH IN THE STATEMENT PURSUANT TO SECTION 17913 OTHER THAN A CHANGE IN THE RESIDENCE ADDRESS OF A REGISTERED OWNER. A NEW FICTITIOUS BUSINESS NAME STATEMENT MUST BE FILED BEFORE THE EXPIRATION. THE FILING OF THIS STATEMENT DOES NOT OF ITSELF AUTHORIZE THE USE IN THIS STATE OF A FICTITIOUS BUSINESS NAME IN VIOLATION OF THE RIGHTS OF ANOTHER UNDER FEDERAL, STATE, OR COMMON LAW (SEE SECTION 14411 ET SEQ., BUSINESS AND PROFESSIONS CODE).

CERTIFICATION

I hereby certify that the foregoing is a correct copy of the original on file with the San Francisco County Clerk.

By _____, Deputy County Clerk



PRACTICE TIP

After your first experience helping to form a sole proprietorship, prepare a file folder with your notes and with a list of useful phone numbers, contacts, and websites. The next time you need to form a sole proprietorship or file a fictitious business name statement, your own form files will provide an easy-to-follow blueprint.

E. Taxation of Sole Proprietorships

The sole proprietorship itself does not pay federal income tax at the entity level (because there is no entity as a legal matter). Pursuant to the 2017 Tax Cuts and Jobs Act, and effective after December 31, 2017 (and expiring December 31, 2025), business owners can take a 20 percent deduction on their pass-through qualified business income before paying taxes according to the individual tax rates and brackets (see Figure 2-3). As of 2021, once single filers make more than \$164,925, and joint filers make more than \$329,850, the deduction begins to phase out, and for those in certain service professions, such as doctors, lawyers, accountants, and financial advisors, the deduction is lost completely once those business owners make more than \$214,925 (for single filers) and \$429,850 (for joint filers). See Figure 2-4 for a more thorough explanation of tax treatment for sole proprietors and other pass-through businesses. The sole proprietor may declare and deduct various business expenses, such as advertising costs, insurance premiums, and interest paid, and may use these to offset income. The sole proprietor pays tax on all net earnings, even money retained for anticipated business needs. The sole proprietor may be required to pay state and local taxes.

F. Role of Paralegal

Paralegals are involved in the following tasks:

- Determining whether the business is one requiring a license;
- Reviewing state statutes to determine requirements for fictitious business names and preparing and filing a fictitious business name statement, if needed (see Figure 2-2);
- Considering whether a full name search should be conducted for the business name; and
- Obtaining appropriate tax forms and business permits.