Question 6 – February 2014 – Selected Answer 1

1a) A corporation would not satisfy both objectives. Under the TBOC, corporations are subject to double taxation, or taxation at the entity level and at the shareholder level; so that would not satisfy the first objective. In corporations, shareholders are not personally liable on the corporation's obligations unless they pierce the corporate veil. A shareholder pierces the corporate veil if they take advantage of the corporation status and it would be unjust to provide them protection. Directors are liable for willful and want on actions of the Board if they are in attendance and do not abstain from the action. Therefore, a corporation will not satisfy the objectives.

(1b) A general partnership will not satisfy the objectives. Under the TBOC, general partnerships enjoy pass-through taxation, or no taxation at the entity level. But, all the partners are personally liable for the obligations of the partnership whether arising in tort or contract. The person seeking damages must first exhaust all partnership assets, but then may go after the partner's debts to satisfy the judgment. Therefore, a general partnership does not satisfy both objectives.

(1c) A limited partnership will not satisfy both objectives. Under the TBOC, a limited partnership must include one general partner and one limited partner. The limited partner is protected from personal liability for the partnership's obligations or torts or malpractice committed by other partners. However, the general partner is personally liable on the partnerships obligations. Limited partnerships do enjoy pass-through taxation, or not taxation at the entity level. Therefore, a limited partnership will not satisfy both objectives.

(1d) A limited liability partnership will satisfy both objectives. Under the TBOX, LLPs enjoy pass-through taxation, or no taxation at the entity level. LLP's partners also are not personally liable for the partnership's obligations or torts committed by other partners. Partners are only personally liable for their own tortious conduct. Therefore, a limited liability partnership satisfied both objectives.

(2) Fred, Barney, and Christina cannot lawfully practice together as members of a professional limited liability company. Under the TBOC, a PLLC is a limited liability company for professionals. The members are not personally liable on the company's obligations. Only one profession can be represented in a PLLC. Here, Fred and Barney are accountants and Christina is an attorney. Therefore, Fred, Barney, And Christina cannot lawfully practice together as members of a PLLC.

Question 6 – February 2014 – Selected Answer 2

1. The best entity form for Fred and Barney to practice under to both avoid federal income taxation at the entity level and not expose each other to personal liability for mistakes an malpractice committed by the other would be a Limited Liability Partnership.

a. A corporation primarily has the least benefit in terms of avoiding federal income taxation. A corporation is subject to taxation essentially twice...once at the entity level for any dividends issued to shareholders and once again taxed at the personal level for the income received by the members. Thus, it will not be a good choice for Fred and Barney in that regard. However, a corporation offers the most protection of the entities as far as protecting the members from personal liability of mistakes and malpractice committed by other members. Under the Texas Business and Commerce Code (TBOC), a corporation that is properly formed is owned by shareholders and managed and run by a board of directors elected by the members. The benefit of this is that under Texas law, the member shareholders are not personally liable for any liabilities of the corporation. Neither are the Board of Directors. Thus, the shield from personal liability will be at a maximum under this form of business.

b. A general partnership would not be a good choice for them for the reason that general partners are always jointly and severally liable for both the liabilities incurred by the partnership itself and for the personal liabilities of other general partners and members. However, the general partners get their taxes passed through the partnership and taxed only once at the individual level. So in that regard it would be a great choice.

c. A limited Partnership would be a bad choice for Fred and Barney as well, because while it gains the same beneficial tax treatment as a General Partnership, there always has to be a general partner who is subject to personal liability of both the partnership itself and the other members. Really the protection is only beneficial to limited partners, who aren't personally liable for any obligations of the limited partnership. However, since one of the members would still be personally liable, this form is not a good option for Fred and Barney.

d. A Limited Liability Partnership would be the best option for Fred and Barney. A Limited Liability Partnership offers the benefits of pass through federal income tax protection as well as the limited personal liability of its members for the torts and negligence committed personally by the other members. thus, this is the entity form that Fred and Barney should form to satisfy their primary objectives.

2. No. Fred, Barney, and Christina cannot lawfully practice together as members of a professional limited liability company. In Texas, the rule is that professionals may only partner up to create a professional partnership if all of the members are practicing the same form of profession. Here, Fred and Barney are professional accountants while Christina is a practicing tax attorney. Both of these professions require licensing by the state of Texas and thus they are not permitted to form a professional limited liability company together per the rules. Any attempt to form such a mixed professional company would be void in Texas.

Question 6 – February 2014 – Selected Answer 3

1 a. A corporation is a state sanctioned entity that limits the personal liability of its shareholder and directors and allows the corporation to more effectively raise capital. A corporation would not be the best option for Fred and Barney because while it would insulate them from personal liability for the other's acts, it would not provide the tax treatment they are looking for. A corporation is a double taxed entity, which means that its own income is taxed at the corporate level and then when the corporation makes distributions, the shareholders are again taxed on these distributions. Since Fred and Barney would be directors and shareholder of the corporation, the income derived from the business would subject them to double taxation, which is not what they want.

b. A general partnership is a good option for the taxation portion of Fred and Barney's goals, but not for the liability portion. A partnership is an association of two or more entities that agree to engage in a business for profit. A partnership does not provide the partners with limited liability; in fact, partners are personally liable for the debts of the partnership. Therefore, if either Fred or Barney commits malpractice, the other partner(s) will be personally liable for the claim regardless of fault. The strength of this option for Barney and Fred, however, is the pass thru taxation option that allows the partnership income to pass through to the partners individually via distributions and is subject to taxation at the partner's individual tax level. However, because of the personal liability imposed on the general partners this option is not the best for Fred and Barney.

c. A limited partnership is a state sanctioned entity that provides limited liability to the limited partners but not limited liability to the general partners. To exist, the LP must have at least one general partner. In this case, as there are only two members, either Fred or Barney must assume the general partnership role. As discussed above, this is not favorable to either one of their goals of limiting liability for third party claims against the other. They could form a corporation to be the limited partner, since a corporation is an entity that may be a general partner in a limited partnership, but this would subject them to the same taxation problem discussed in (a). Therefore, while a limited partnership would provide both the general partners and limited partners with pass through taxation, it is not the best option for Fred and Barney, since the structure cannot be accomplished without sacrificing one of their goals.

d. A limited liability partnership is a state sanctioned entity that limits the liability of the general and limited partners and provides the desirable pass through taxation option to its members. Recent TBOC law has made this option an even better choice since it has eliminated tort liability for management for torts committed by their employees. This options is the best option for Fred and Barney's goals because the income from the business will be taxed at their individual tax levels, which is usually lower than the 35%

corporate taxation rate, and they benefit from limited liability status against claims on one partner by third parties.

2. No, Cristina would not be permitted to lawfully practice law in a PLLC with Fred and Barney as accountants. A Professional limited liability company is a state sanctioned entity that entitled members to limited liability benefits of a corporation; however while any professional group may form a PLLC, the members must all practice the same profession. Because Cristina is a lawyer and Fred and Barney are accountants, they cannot permissibly form a PLLC under the current TBOC rules.