

Question 8 – February 2013 – Selected Answer 1

I would advise Bernard and Beulah to form a Limited Liability Corporation (LLC), because it meets all of their needs with very few disadvantages. At issue here is which form of a business organization most adequately meets the needs of two individuals interested in easy formation, limited personal liability, favorable tax treatment and flexibility in management. The advantages and disadvantages of each type of business organization will be discussed by type, concluding with an explanation as to why an LLC is most favorable.

Corporation: A corporation will not serve Bernard and Beulah's purposes of restoring a slaughterhouse and operating a business of raising and slaughtering cattle for profit. Texas laws expressly prohibit the use of a corporation for this purpose of farm/agricultural meat processing. Even if they were able to form a corporation, it is unlikely that doing so would be the most advantageous for their stated goals. Corporations, unless formed as a close corp, require more formalities (filing with the secretary of state, creating a board, establishing the financial structure of the company, selling stock, managing shareholders, holding annual meetings, etc.). These formalities would not serve the couple's interest in flexibility well. Alas, the point is moot because they are not allowed to legally form a corporation.

General Partnership: A general partnership would meet some, but not all, of Bernard and Beulah's needs. While it is extremely easy to form a partnership (no formal steps are required -- two people merely need to agree to conduct business for profit), the two would be held personally liable for any debts the partnership was unable to satisfy. This would be contrary to their stated desire of limiting personal liability for debts and other financial obligations of the business. Still, partnerships do meet their last two needs: i) they receive favorable tax treatment, as the profits are merely taxed as they pass through to the individual instead of on two levels (income to the company and individual); and ii) management is flexible -- the partners are entitled to create their own agreement for management, offering flexibility they desire. Due to the personal liability Bernard and Beulah would incur should they start a partnership, I would advise against it. The slaughter company, which they hope to open for profit, would likely subject itself to various lawsuits arising out of production or unmet financial obligations, and the partners would not be shielded from personal liability. This outweighs the benefits of flexibility.

Limited Liability Partnership: A limited liability partnership is similar to a partnership, but it shields its partners from personal liability for financial obligations the LLP cannot meet. Being shielded from personal liability is certainly important to Bernard and Beulah, and this makes the LLP a more advantageous option for the couple. However, the LLP carries with it disadvantages for the prospective slaughter-house as well. To create a limited liability partnership, the couple would have to follow a more formatted, formal procedure -- it's not very difficult, it's simply less flexible than forming a general partnership. Beulah and Bernard would need to file an application with the secretary of state in Texas, in Austin to be specific, and they would need to designate their company as an LLP by adding the phrase "limited liability partnership" or "LLP" to the company's title in its application for formation. Further, they would need to pay a filing fee and an added insurance requirement that may be difficult for them to meet at this early stage in the game. The advantage, however, is that Beulah and Bernard would avoid the personal liability for financial obligations by forming an LLP. Additionally, they would receive more favorable tax treatment because the income flows through the company to the partners and they are only taxed once, and they would be able to establish the management of their business in an agreement created by the two of them. Regardless of the advantages, given the startup cost of the LLP, I would recommend a LLC to the couple.

Limited Liability Corporation: The limited liability corporation is Beulah and Bernard's best option. It satisfies all of their needs by being easy to form, limiting the personal liability of the members, offering favorable tax treatment, and flexibility in management. To form an LLC, Beulah and Bernard would need to file an application with the Secretary of State in Austin and pay the filing fee. Similarly to the LLP, their name would need to include the phrase "limited liability corporation" or "LLC" to be valid. The advantage of the LLC over the LLP is that the LLC does not require the additional insurance payment, which would save Beulah and Bernard a significant amount of money. Moreover, the LLC shield Beulah and Bernard from any personal liability for the LLC's debt. If they were to run into problems, they could simply cease operations without having any personal liability. Finally, the LLC receives the same tax treatment as the general partnership, and the limited partnership. The only way this would change is if Beulah and Bernard chose to be taxed as a corporation, but they have the option not to, and would be able to elect which treatment was most favorable for their slaughterhouse purposes. Finally, the LLC allows its members to create its own management agreement, offering flexibility that they couple desires.

For the above reasons, the Limited Liability Corporation best serves Beulah and Bernard's needs in their attempt to begin a slaughter-house for profit.

Question 8 – February 2013 – Selected Answer 2

1. Below I will discuss the requirements for forming each entity: corporation, general partnership, limited liability partnership, and limited liability company. And I will discuss the advantages and disadvantages for each based upon Bernard and Beulah's(B&B's) wishes of (i) ease of formation, (ii) limitation to the extent possible, of personal liability for debts or other financial obligations of the business, (iii) favorable federal tax treatment and (iv) flexibility in management of the business.

Corporation: B&B cannot form a valid corporation because in Texas there is an exception to the "any lawful purpose" element of formation whereby a corporation cannot be formed that raises and slaughters cattle for profit. Nevertheless, I will discuss the elements of formation and the advantages and disadvantages of forming a corporation for the sake of thoroughness.

(i) If B&B did have a valid lawful purpose (and did not want to be in the business of raising and slaughtering cattle), in Texas, a corporation may be formed for any lawful purpose. You must file a certificate of formation with the secretary of state detailing things such as: the name of the corporation to be formed, the purpose, the name and addresses of all initial directors, the number of shares to be authorized and par value for stock, a designated registered agent for the corporation, etc. Proper filing of these things forms a de jure corporation meaning that the corporation will be treated as a valid entity on its own; it can sue and be sued. Formation of a corporation is not as easy as some other entities.

(ii) Shareholders and directors are generally shielded from personal liability. So this would be ideal based upon B&B's wishes.

(iii) A corporation is taxed twice (double taxation); both at the corporate level as a corporate entity and also at a shareholder level. This is not ideal if you are looking for favorable tax treatment and is something that might deter people from forming a corp.

(iv) A corporation is managed by a board of directors, officers and shareholders. Management within a corporation is probably the most complicated of all the entities B&B could form.

Again, B&B cannot form a valid corporation because Texas exempts "raising and slaughtering cattle" from being a lawful purpose for the sake of formation. Accordingly, B&B will have to look into other options.

General Partnership: A general partnership may be ideal as it meets several of B&B's requirements, but it does not shield personal liability.

(i) A partnership can be formed when two or more people agree to carry on a business for profit. A general partnership does not require any formal filing or even any written agreement by the partners. It can be formed orally, or more simply, by the conduct of the partners.

(ii) A general partnership leaves the partners exposed as they each have personal liability for the debts of the partnership. This would not be ideal if one was seeking to limit liability.

(iii) Partnerships are only taxed at one level. This is an advantage to forming a partnership over a corporation.

(iv) The general partners are jointly liable for the management of the partnership. This is flexible and would be fair if B&B seek equal rights to manage their entity.

Limited Liability Partnership:

(i) A Limited Liability Partnership is formed by filing with the Secretary of the State indicating a LLP, you must include LLP with the name of your partnership (e.g. B&B, LLP) and you must pay a fee. Also, an LLP is required to carry \$100,000 in liability insurance.

(ii) Partners within an LLP escape personal liability, except for that of the individual torts of a partner, which both he and the partnership would be liable for. This would likely be attractive to B&B.

(iii) LLPs have more favorable taxation than a corporation.

(iv) There are no managing partners in a LLP. The partnership would be equally managed.

Limited Liability Company:

A LLC operates much like a LLP with respect to items (i), (ii), and (iii). With respect to item (iv), a LLC can be managed like a corporation or a partnership; it is flexible in this regard. This would be attractive to B&B.

Question 8 – February 2013 – Selected Answer 3

Under the Texas Business and Organization Code, a corporation may be for any lawful purpose. However the TBOC explicitly states that a corporation cannot be formed for the purpose of slaughtering. Bernard and Beulah would not be able to form a corporation because it would not be considered a "lawful purpose" under the TBOC. However, if they could form a corporation, as between a general partnership

(GP), a Corporation, or LLP or LLC, a corporation would still not be the best entity for their purposes, instead a Limited Liability Partnership (LLP) or a Limited Liability Company (LLC) would for the following reasons.

(i) Ease of formation:

Corporations can be easily formed. All they need to do is file a certificate of formation with the secretary of state that includes the name of the corporation followed by a word like "inc." or "corp." to indicate that it is a corporation. They must also pay the filing fee. The certificate of formation must also state the corporation's purpose, a generic term like any lawful purpose, is acceptable. It must give the name and address of the officers and directors, and the address of the corporation.

Limited Liability Partnerships or a LLC can also be easily formed. They simply need to file a certificate of formation with the Secretary of state and state that this is a limited liability partnership or a limited liability company. The certificate of formation needs to include the partnership name. The name in the Certificate need to include the phrase "limited liability" They also need to maintain partnership liability insurance of \$100,000.

A general partnership is the easiest type of formation. They simply need to file a certificate of formation that includes the name and states that this is a general partnership.

(ii) Limitation of personal liability of debts of the business.

IN Texas, the officers, shareholders, and directors are not personally liable for the debts of the corporation. Forming a corporation would give them the most protection from personal liability, unless the claimant can pierce the corporate veil and recover individually from Bernard and Beulah.

If they were to form a LLP or an LLC, they can limit their liability so that they would not be personally liable for the conduct of other partners or for the debts of the partnership. In order to limit their personal liability they would have to be limited, and not general, partners.

If they formed a general partnership, they would be personally liable for the acts and debts of the other partners and for the debts of the partnership.

(iii) The corporation is the entity with the least favorable tax treatment. As shareholders, Beulah and Bernard would have to pay double taxation. Once for the income generated by the corporation and another time when they receive distributions.

The in the LLP, LLC and a general partnership the partners are not taxed twice, but only once.

(iv) Flexibility of management

If Bernard and Beulah formed a corporation, they would have a lot of flexibility in managing the corporation if they were directors, because directors are charged with the day to day activities of running the corporation. However, if they were shareholders, they would be given very limited management rights. Shareholders are only allowed to vote and approve certain director activities and hire and fire directors. They are not allowed to run the day to day affairs of the corporation.

If they formed a general partnership, they could control who (or both) would be the general (managing) partner with management authority and who (or both) would be the limited partner with limited duties.

If they formed a LLC or an LLP they could have this same type of control with regard to who (or) both controlled the management of the partnership as a general partner, and who (or both) had only limited responsibilities as a limited partner.

Because the LLC or LLP gives Beulah and Bernard the most management flexibility, allows them to limit their liabilities, avoids double taxation, and is easy to form, those would be the entities most suitable for their purposes.