

# CHOOSING A BUSINESS ENTITY

## I. INTRODUCTION

The Texas Business Corporation Act (TCBA) provides the legal requirements for establishing a business entity in Texas. However, other Texas or Federal laws may also be implicated depending on the type of business.

## II. TYPES OF BUSINESS ENTITIES – AN OVERVIEW

The form of business entity most advantageous in a particular situation depends on the objectives of the business for which the entity is being organized. In most situations, the focus will be on how the entity and its owners will be taxed and the extent to which the entity will shield the owners of the business from liabilities arising out of its activities.

The following entities should be considered:

- A. ***Sole Proprietorship***—single individual operates a business owning all assets, is personally liable for all debts and business ownership is non-transferable.
- B. ***General Partnership***—two or more individuals or businesses join to operate a business.
- C. ***Limited Partnership (LP)***—two or more persons or entities, and having one or more general partners and one or more limited partners.
- D. ***Registered Limited Liability Partnership (LLP)***—a general partnership registered with the Texas Secretary of State.
- E. ***Limited Liability Company (LLC)***—unincorporated entity that shares some aspects of a Subchapter S corporation and limited partnership.
- F. ***Corporation (Subchapter C or S)***—one or more individuals, partnerships, or entities join together to form a separate entity for the purpose of operating a business.

### 1. Advantages/Disadvantages of Entity Type

<i>Entity</i>	<i>Advantages</i>	<i>Disadvantages</i>
<u>Sole Proprietorship</u>	-Easiest and least expensive form of ownership to organize -Limited to life of the individual proprietor -Owner receives all income	-Unlimited liability -Personally liable for all debts -No legal distinction between personal and business debts

	<ul style="list-style-type: none"> <li>generated to keep or reinvest</li> <li>-Does not require a separate income tax return</li> <li>-Not subject to state margin taxes</li> <li>-Easy to dissolve</li> </ul>	-Business ownership is non transferable
<u>General Partnership</u>	<ul style="list-style-type: none"> <li>-Relatively easy to establish</li> <li>-No organization costs</li> <li>-A separate legal entity exists</li> <li>-General partners share equally in assets, liabilities, and management</li> <li>-Pass-through taxation</li> </ul>	<ul style="list-style-type: none"> <li>-Unlimited liability</li> <li>-General partners share equally in assets, liabilities, and management</li> <li>-Partners are jointly and individually liable for the actions of other partners</li> <li>-Creditors can still look to partners' personal assets</li> <li>-Disputes between partners may arise</li> </ul>
<u>Limited Partnership (LP)</u>	<ul style="list-style-type: none"> <li>-General partners share equally in assets and debts</li> <li>-Limited partners have limited liability</li> <li>-Do not pay taxes, but must file a return for informational purposes</li> <li>-Partners report share of profits and losses on personal tax returns</li> </ul>	<ul style="list-style-type: none"> <li>-General partners have unlimited liability</li> <li>-Subject to state margin tax</li> </ul>
<u>Registered Limited Liability Partnership (LLP)</u>	<ul style="list-style-type: none"> <li>-A partner is not individually liable, under some circumstances, for debts and obligations of the partnership</li> <li>-Partners report their share of profits and losses on personal tax returns</li> </ul>	<ul style="list-style-type: none"> <li>-\$100,000 of insurance or reserve funds required</li> <li>-Has a duration of one year/must file annual renewal application</li> </ul>

<p><u>Corporation (Subchapter C or S)</u></p> <p>(C Corporation)</p> <p>(S Corporation)-a tax election only</p>	<ul style="list-style-type: none"> <li>-Has its own legal identity, separate from its owners</li> <li>-All shareholders have limited liability protection from debts or judgments against the corporation</li> <li>-Does not dissolve when ownership changes</li> <li>-Flexibility in capital structure</li> <li>-Can raise funds through sale of stock</li> <li>-Centralization of management</li>   <li>-Owners are not taxed personally for profits</li>   <li>-Avoid double taxation of C Corporation</li> <li>-Income flows through to shareholders for reporting on individual tax returns</li> <li>-Owners may personally deduct losses (similar to partnership)</li> <li>-Offers alternative methods for distributing income to owners</li> </ul>	<ul style="list-style-type: none"> <li>-Subject to state margin tax</li> <li>-Process of incorporation requires more time and money</li> <li>-More paperwork to comply with regulations</li> <li>-Could result in higher overall taxes</li> <li>-Must observe corporate formalities</li>   <li>-Taxed at a higher rate than an individual</li> <li>-More restricted in ability to issue equity for property other than cash because transaction is taxable</li> <li>-Shareholders may not deduct any of corporation's losses</li> <li>-Owners pay personal taxes on salaries and dividends</li> <li>-Corporation taxed on dividends (double taxation)</li>   <li>-Limited to U.S. residents and citizens of certain U.S. trusts</li> </ul>
<p><u>Limited Liability Companies (LLC)</u></p>	<ul style="list-style-type: none"> <li>-More flexibility than traditional business entities</li> <li>-All members have limited</li> </ul>	<ul style="list-style-type: none"> <li>-Formation is more complex than that of a general partnership</li> </ul>

	liability protection from debts (like corporation) -Provides pass-through tax advantages to owners (like partnership) -May exercise option of being taxed as corporation or partnership -Does not have stock	-Subject to state margin tax
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## 2. Taxes

A new business needs to determine its federal, state, and local tax obligations.

- a. Federal Income Tax – Depending on individual income, the tax ranges from zero to 35% of one’s taxable income.
- b. Social Security Tax – This contribution or tax is 6.2% of an employee’s income paid by the employer, and 6.2% paid by the employee.
- c. Medicare Tax – Funds a health insurance program for the elderly and disabled. 1.45% of employee income is paid by employer, and 1.45% is paid by the employee.
- d. Margin Tax – The “Margin Tax” is imposed on all business entities other than sole proprietorships, general partnerships wholly owned by individuals, and certain “passive entities.” The Margin Tax is generally 1% of a statutorily defined gross receipts calculation less either: (i) compensation or (ii) costs of goods.
- e. Sales & Use Tax – Tax is imposed on all retail sales, leases and rentals of most goods, as well as taxable services.
- f. Unemployment Taxes – All employers are subject to the tax and must register with the Texas Workforce Commission.
- g. Property Taxes – If the business owns tangible personal property that is used to produce income, the property must be reported on a rendition form to the local county appraisal district. Business owners must report all inventories, equipment, and machinery.
- h. State Income Tax – There is no state income tax in Texas.

### **3. Business Formation Requirements**

#### **a. Business Name**

A business name must be registered with the county clerk's office and/or the Texas Secretary of State. The name must not include words or phrases that imply a business purpose not contained within the articles of incorporation. Further the name cannot be deceptively similar to an existing corporation's name in the state. The name must show the business is incorporated.

A sole proprietorship and general partnership need to file an Assumed Name Certificate or d.b.a. (doing business as) for each name that will be used as a business name with the clerk of the county where the principal office and registered office are located.

A corporation, LP, or LLP must provide the name to the Secretary of State. If a different name will be used, an Assumed Name Certificate must be filed with the Secretary of State and in each county in which the business will have a registered or principal office.

#### **b. Registration & Licenses**

All limited partnerships, registered limited liability partnerships, limited liability companies, and corporations must register with the Texas Secretary of State.

#### **c. Articles of Incorporation**

The fee for filing articles of incorporation with the Secretary of State is \$300. The corporation acquires its existence upon the date of the issuance of the "certificate of incorporation." The articles of incorporation must contain the following:

- Name of corporation
- Proposed duration
- Corporate purpose
- Name and address of registered office/agent
- Names and address of directors serving on the initial board
- Name and address of incorporator
- Information about shares
- Statement that the corporation will not perform any business until it has received consideration of the value of at least \$1,000 for the issuance of shares

- Any provision limiting or denying to shareholders the right to acquire additional or treasury shares of the corporation

d. Certificate of Authority

A foreign corporation, not establishing a domestic subsidiary corporation, must obtain a certificate of authority from the Secretary of State. The filing fee is \$750. The requisite information on a certificate of authority is as follows:

- Corporate name and assumed name (if corporate name is not available)
- Jurisdiction of incorporation
- Name and address of registered office/agent
- Address of principal office
- Business purpose
- Names and addresses of officers and directors
- Information about shares
- Amount of stated capital

e. Registered Agent

A registered agent is a business or individual designated to receive service of process when a business entity is a party in a legal action. Additionally, registered agents receive license renewals, margin tax notices, annual reports, and other notices for the organization. All corporations, limited liability companies, and registered limited partnerships doing business in Texas must have a registered agent with a legal Texas address.

f. Maintain Legal Status/Observe Corporate Formalities

A newly created business entity in Texas may be required, depending on the type of entity, to observe certain corporate formalities in order to maintain its legal status in Texas. These may include:

- Pay margin taxes
- Identify limited liability status
- Observe the separateness of the entity (bank accounts, phone numbers, post office boxes, etc.)
- Apply appropriate designations at end of company's name in all public documents (Inc., Corp., LLC, LP, etc.)
- Issue stock certificates
- Hold annual meetings
- Formally elect officers, directors, or managers

- Record board or manager meetings with minutes

g. Other Legal Requirements

Other legal requirements may include:

- Obtaining an employer identification number
- U.S. Customs law 31 C.F.R. §103.23 (declaration necessary if funds exceed \$10,000 at one time into U.S.)
- Obtain a state unemployment tax account number from the Texas Workforce Commission
- Determine with the Comptroller of Public Accounts if required to pay margin taxes
- Federal, state and local environmental laws and regulations
- The Texas Department of Economic Development offers a Comprehensive Application Form that may be used where multiple state permits may be required

### **III. GENERAL PARTNERSHIP**

A partnership is defined as an association of two or more persons to carry on a business for profit, whether they intend to create a partnership and whether they call their association a partnership, joint venture, or other name. The term “person” includes corporation, organization, government or governmental subdivision or agency, business trust, estate, trust, partnership, association, and any other legal entity.

#### **A. Taxation**

A general partnership is basically a conduit for purposes of the liability of its members and the payment of income taxes. The Margin Tax is not applicable to a general partnership if all of its partners are individuals. The Margin Tax is imposed on a general partnership that has a business entity as a partner. Partners of a general partnership generally will be subject to self-employment tax on their share of the net earnings of trade or business income of the partnership and any guaranteed payments for personal services.

#### **B. Liability Issues**

A general partnership as an entity is typically liable for loss or injury to a person, as well as for a penalty caused by or incurred as a result of a wrongful act or omission of any of its partners acting either in the ordinary course of the business of the partnership or with authority of the partnership. Generally, all partners of a general partnership are jointly and severally liable for all debts and obligations of the partnership unless otherwise agreed by a claimant or otherwise provided by law. Generally, Texas statute requires that there be a judgment against the partnership and that the individual partner be

served in that action; however, a judgment against a partnership is not automatically a judgment against its partners. The unlimited liability exposure of partners in a general partnership provides the most disadvantageous element of doing business in a form of a general partnership.

### **C. Management**

Partners have wide latitude to provide in the partnership agreement how the partnership is to be managed. Unless provided for otherwise, each partner has an equal right to participate in the management of the business. Often, partners will designate a managing partner or partners who have authority to manage the business of the partnership, creating a more centralized management structure. As an agent of the partnership, a partner may bind the partnership in the ordinary course of business unless the partner has no authority to so act and the third party with whom the partner is dealing has knowledge that the partner has no authority to so act.

### **D. Fiduciary Duties**

A partner owes duties of loyalty and care to the partnership, the other partners, and the heirs, legatees or personal representatives of a deceased partner to the extent of their respective partnership interests. The duty of loyalty requires a partner to account for any partnership asset received or used by the partner and prohibits a partner from competing with the partnership or dealing with the partnership in an adverse manner. The duty of care requires the partner to act as an ordinarily prudent person would act under similar circumstances. A partner is liable to the partnership and the other partners for violation of a statutory duty that results in harm to the partnership or the other partners and for a breach of the partnership agreement.

### **E. Formation**

A general partnership can be one of the simplest, least expensive business entities to form because the existence of a partnership does not depend on the existence or filing of any particular document, but rather depends on the existence of an association of two or more persons carrying on, as co-owners, a business for profit. Partners should have the relationship governed by a partnership agreement rather than relying on the default statutory provisions. A partnership agreement governs the relationship between partners and between the partners and the partnership. Unless the partnership agreement provides otherwise, profits and losses of a general partnership are shared per capita. Due to the potential complexity of a partnership agreement, the time and expense needed to organize a partnership may potentially exceed that of organizing a corporation.

## **IV. LIMITED PARTNERSHIP**

A limited partnership is a partnership formed by two or more persons, with one or more general partners and one or more limited partners.

### **A. Taxation**

A limited partnership would ordinarily be treated as a partnership for federal income tax purposes. The Margin Tax is imposed on limited partnerships. A limited partner's share of income of the limited partnership is generally not subject to the self-employment tax. Guaranteed payments made to a limited partner by the partnership for services rendered and the general partner's share of the net earnings of trade or business income of a limited partnership generally will be subject to self-employment tax.

### **B. Liability Issues**

A general partner of a limited partnership has the same unlimited liability as does a partner of a general partnership. A limited partner's liability for debts of or claims against the partnership is limited to the limited partner's capital contribution to the partnership. However, a limited partner may lose this limited liability if he or she participates in the management of partnership business.

### **C. Management**

Control of the limited partnership rests with the general partner or partners, who have all the rights and powers in a general partnership. Management of a limited partnership tends to be centralized in the general partner(s).

### **D. Fiduciary Duties**

General partners are subject to the same fiduciary standards of duty of care and loyalty applicable to partners in a general partnership. General partners may be subject to an even higher fiduciary standard with respect to limited partners. Limited partners generally do not owe fiduciary duties to the partnership or to other partners. There is an exception to this general rule where a limited partner actually has or exercises control in management matters. Texas law requires a limited partnership to keep in its registered office, and make available to the partners for copying and inspection, certain minimum books and records of the partnership.

### **E. Formation**

A certificate of formation containing (1) the name of the entity; (2) a statement that it is a limited partnership; (3) the name and address of each general partner; (4) the address of the registered office and the name and address of the registered agent for service of process; and (5) the address of the principal office where books and records are to be kept, must be filed with the Secretary of State along with a filing fee of \$750. Similar to a general partnership, a limited partnership should be governed by a partnership agreement. Partners generally have the freedom to contract around the default provisions of the Texas Business Organizations Code and to provide for the rights and obligations of the partners in the partnership agreement. The name of the limited partnership must contain the word "limited," the phrase "limited partnership," or an abbreviation of either.

## **V. LIMITED LIABILITY PARTNERSHIP**

A Limited Liability Partnership (“LLP”) is a general partnership in which the individual liability of partners for partnership obligations is substantially limited. Although an LLP is a general partnership, the general partnership joint and several liability scheme is dramatically altered. The LLP relieves a partner from individual liability for partnership obligations, except to the extent that they are attributable to the fault of the partner. The Texas statutes expressly do not relieve a partner for any liability imposed by law or contract independently of his status as a partner, including torts committed by him while acting on behalf of the partnership. LLP status does not relieve a partnership itself from liability for misconduct of its partners or representatives or prevent its assets from being reached to satisfy partnership obligations. The LLP shield only applies to the liability of partners for the covered partnership obligations incurred while the partnership is an LLP.

### **A. Formation**

There are three requirements that must be satisfied in order for the LLP shield to be in place in Texas. First, Texas requires that an LLP must include in its name the words “limited liability partnership” or an abbreviation thereof. Second, to achieve domestic LLP status, a partnership must file an application with the Secretary of State along with a fee of \$200 for each partner. The application must (a) state the name of the partnership, the address of its principal office, the number of partners and the business in which the partnership engages, plus the federal tax identification number of the partnership, and (b) be executed by a majority in interest of the partners or by one or more partners authorized by a majority in interest of the partners. The partnership agreement should ordinarily contemplate LLP status. The application must be renewed on an annual basis. The third requirement for LLP status is that the partnership must carry at least \$100,000 of liability insurance of a kind that is designed to cover the kind of error, omission, negligence, incompetence, or malfeasance for which liability is limited or provide \$100,000 specifically designated and segregated for the satisfaction of judgments against the partnership for the kind of error, omission, negligence, incompetence, or malfeasance for which liability is limited.

### **B. Taxation**

If a domestic LLP has two or more members, it can be classified as a partnership for federal income tax purposes. The Margin Tax may be imposed on LLPs although the LLP is a species of general partnership to which the Margin Tax is generally not applicable. Partners in an LLP generally will be subject to self-employment tax on their share of the trade or business income of the LLP.

### **C. Fiduciary Duties**

Partners in an LLP are in a fiduciary relationship and owe each other fiduciary duties just as in any other partnership.

## **VI. LIMITED LIABILITY COMPANY**

The allure of the Limited Liability Company (“LLC”) is its unique ability to bring together in a single business organization the best features of all other business forms. If properly structured, an LLC allows its owners to obtain both a corporate styled liability shield and the pass-through tax benefits of a partnership. All equity shareholders of an LLC have the limited liability of corporate shareholders even if they participate in the business of the LLC.

### **A. Taxation**

Domestic LLCs that have two or more members ordinarily will be classified as partnerships for federal income tax purposes, unless the LLC makes an election to be classified as an association taxable as a corporation. LLCs are subject to the Margin Tax. In each other state in which an LLC does business it will be necessary to ascertain the franchise and income tax treatment of foreign LLCs doing business therein. An LLC is generally treated as a partnership for purposes of state income tax. Individuals are subject to a self-employment tax on self-employment income. The tax rate aggregates up to 15.3% and consists of (i) a 12.40% social security equivalent tax on self-employment income up to a 2007 contribution base of \$97,500 (adjusted annually for inflation), plus (ii) a 2.9% Medicare tax on all self-employment income (there is no ceiling). Self-employment generally means an individual’s net earnings from the individual’s trade or business. An individual’s self-employment income includes his distributive share of the trade or business income from a partnership of which he is a partner (including an LLC classified as a partnership for federal income tax purposes).

### **B. Management**

The owners of an LLC are called “Members” and are analogous to shareholders in a corporation or limited partners of a limited partnership. The “Managers” of an LLC are generally analogous to directors of a corporation and are elected by the Members in the same manner as corporate directors are elected by shareholders. An LLC may be structured so that management shall be by the Members as in the case of a close corporation or a general partnership. In other words, an LLC may be Manager-managed or Member-managed. An individual, corporation, partnership, LLC or other person may become a Member or Manager. An LLC has all the powers of a Texas corporation or limited partnership, subject to any restrictions imposed by statute or its governing documents. Managers may function as a board of directors and may designate officers and other agents to act on behalf of the LLC.

### **C. Fiduciary Duties**

Texas statutes implicitly recognize that fiduciary duties for Managers or Members exist in statutory provisions, which permit them to be expanded or restricted in the Company Agreement. Analogous to duties of corporate directors, Managers would have the duties of obedience, care, and loyalty. Additionally, a Manager should be deemed to

have a fiduciary duty to all the Members. Absent controlling provisions in the certificate of formation or Company Agreement, Members may have a fiduciary duty to the other Members and the LLC.

#### **D. Formation**

An LLC is formed when one or more persons file a certificate of formation with the Texas Secretary of State along with a \$300 filing fee. The initial certificate of formation must contain (1) the name of the LLC, (2) a statement that it is an LLC, (3) the period of its duration, unless such duration is perpetual, (4) its purpose, which may be any lawful purpose for which LLCs may be organized, (5) the address of its initial registered office and the name of its registered agent, (6) if the LLC is to have a Manager(s), a statement to that effect and the names and addresses of the initial Manager(s), or if the LLC will not have Managers, a statement to that effect and the names and addresses of the initial Members, (7) the name and address of each organizer, (8) specified information if the LLC is to be a professional LLC, and (9) any other provisions not inconsistent with law. The name of the LLC must contain the words “Limited Liability Company”, “Limited Company”, or an abbreviation of either phrase. Most of the provisions relating to the organization and management of an LLC and the terms governing its securities are to be contained in the LLC’s Company Agreement, which will typically contain provisions similar to those in limited partnership agreements and corporate bylaws.

#### **E. Foreign LLCs**

A foreign limited liability company can qualify to do business in Texas as a foreign limited liability company. Such entities may register directly to transact business in Texas under Texas Business Organizations Code Chapter 9 and be afforded the limited liability shield. The foreign LLC must file an application to do business in Texas with the Secretary of State. For matters affecting intrastate business in Texas, a foreign LLC is subject to the same duties, restrictions, and liabilities as a domestic LLC. The failure of a foreign LLC to qualify to do business in Texas will not impair the limitation on liability of its Members or Managers.

### **VII. CORPORATIONS**

The primary advantages of operating a business as a corporation are generally considered to include:

- Limited liability of shareholders
- Centralization of management
- Flexibility in capital structure
- Status as a separate legal entity

The primary disadvantages of operating a business as a corporation are generally considered to be as follows:

- Expense of formation and maintenance
- Statutorily required formalities
- Tax treatment-double taxation for the C-corporation

### **A. Taxation**

Federal taxation of a corporation in the United States depends on whether the corporation is a regular C-corporation, or has instead qualified for and elected S-corporation tax status. An S-corporation is not available to foreign corporations.

C-corporations are separately taxable entities under the Internal Revenue Code. C-corporation earnings are subject to double taxation—first at the corporate level and again at the shareholder level upon distribution of dividends. Corporate tax rates vary depending on the level of income generated. Based on revenues of \$335,000 to greater than \$18,333,333, the marginal tax rate would generally be from 34%-38%.

A corporation may reduce its taxable income by paying salaries to its officers, directors, or employees, which may help to minimize the effects of double taxation. However, unreasonable compensation may be recharacterized by the IRS as a constructive dividend, which is not deductible by the corporation. There is no flow-through from the corporation to the shareholders of income, deductions, or capital losses. C-corporation shareholders are not subject to self-employment tax on distributions they receive. A C-corporation can carry forward any unused losses or credits, but if it distributes appreciated assets to its shareholders, it will recognize a taxable gain.

The Margin Tax applies to entity income commencing January 1, 2007, and is payable annually commencing May 15, 2008. The Margin Tax is imposed on all business entities other than sole proprietorships, general partnerships wholly owned by individuals, and certain “passive entities.” Thus, corporations, limited partnerships, certain general partnerships, limited liability companies, business trusts and professional associations are subject to the Margin Tax. Taxable entities that have \$300,000 or less in gross revenue in a year, or whose Margin Tax liability is less than \$1,000, are also exempt for that year. The calculation of the new Margin Tax is based on a taxable entity’s gross receipts after deductions for either (x) compensation or (y) cost of goods sold, provided the “tax base” for the Margin Tax may not exceed 70% of the entity’s total revenues. The Margin Tax is generally 1% of a statutorily defined gross receipts calculation less either: (i) compensation or (ii) costs of goods.

### **B. Owner Liability Issues**

Limited liability is one of the most important advantages of doing business as a corporation. In corporate law, it is fundamental that shareholders, officers, and directors are ordinarily protected from personal liability arising from the activities of the corporation. However, there are circumstances under which personal liability may be

imposed. Generally, shareholders will not be personally liable for debts and obligations of the corporation in excess of the shareholder's investment in the corporation.

### **C. Management**

A corporation allows for an efficient and flexible management structure. Shareholders elect directors who are given the power to manage the affairs of the corporation generally and to formulate corporate policies and objectives. Directors appoint officers, who are delegated the authority to manage the corporation's day-to-day affairs and to implement the policies and objectives set by the directors. The management structure of a corporation is flexible enough to allow both centralized and decentralized management.

### **D. Fiduciary Duties**

Directors of a corporation owe fiduciary duties of care, loyalty and obedience to the corporation. Controlling shareholders owe a fiduciary duty to minority shareholders to deal fairly with them. A director shall not be liable to the corporation or its shareholders for an act in the director's capacity as a director, except to the extent that the director is found liable for (i) a breach of the duty of loyalty to the corporation or its shareholders, (ii) an act or omission not in good faith that constitutes a breach of duty to the corporation or that involves intentional misconduct or a knowing violation of law, (iii) a transaction from which the director received an improper personal benefit, or (iv) an act or omission for which the liability of the director is expressly provided by statute.

The business judgment rule provides a degree of protection to decisions made by corporate directors. Directors are presumed to have satisfied their fiduciary duties in making a business decision. Under Texas law, director's actions are presumed to be valid if no conflict of interest exists and the action is not ultra vires or tainted by fraud. Ultra vires refers to acts taken by a corporation or officers of a corporation that are taken outside of the powers or authority granted to them by law or under the corporate charter. If this presumption is overcome, the burden shifts to the director to justify the fairness of the transaction to the corporation.

### **E. Ability to Raise Capital**

A corporation provides as much financing flexibility as any type of business entity. Different classes and series of common stock and preferred stock may be utilized to accommodate the desires of various types of investors. Equity can be levered through financing devices, such as stock options, warrants, and other forms of securities.

### **F. Formation**

The formation of a corporation requires certain legal formalities and the preparation of certain documents. Under the Texas Business Organizations Code, Articles of Incorporation is the proper filing document. The Articles of Incorporation establishes the initial board of directors and capital structure of the corporation. After the

Secretary of State officially acknowledges the filing of the corporation’s governing document, there should be an organizational meeting for purposes of adopting bylaws, electing officers, and transacting such other business that may come before the meeting.

### Business Entity Comparison Chart

<b>Item</b>	<b><i>General Partnership</i></b>	<b><i>Limited Partnership</i></b>	<b><i>Limited Liability Partnership (General or Limited)</i></b>	<b><i>Limited Liability Company</i></b>	<b><i>Corporation</i></b>
<b>Limited liability of owners for entity obligations</b>	No	Yes	Yes	Yes	Yes
<b>Name</b>	No Requirements	Must contain “Limited Partnership”, “Limited”, or an abbreviation of either.	General Partnership LLP must contain “Limited Liability Partnership” or an abbreviation thereof. Limited Liability Partnership includes “Limited Liability Partnership”, “Limited Liability Limited Partnership”, or an abbreviation of either.	Must contain “Limited Liability Company”, “Limited Company”, or an abbreviation of either.	Must contain “Corporation”, “Company”, “Incorporated”, or an abbreviation of any of these.
<b>Formation Requirements</b>	Partnership Agreement (may be oral agreement)	Partnership Agreement (may be oral agreement)	Partnership Agreement (may be oral agreement)	Articles of Organization, adopt regulations (may be oral)	Articles of Incorporation, adopt bylaws
<b>Filing Requirements</b>	Assumed Name	Certificate of	Annual Registration	Certificate of Formation	Certificate of Formation

	Certificate Filing and Payment of Applicable Filing Fees	Formation and Filing Fee of \$750	and Filing Fee of \$200 per General Partner; Must maintain liability insurance or meet alternative financial responsibility test.	and Filing Fee of \$300	and Filing Fee of \$300
<b>Designation of Owner</b>	Partner	Partner (General or Limited)	Partner	Member	Shareholder
<b>Ownership Types</b>	Individual or any entity	Individual or any entity	Individual or any entity	Individual or any entity	Individual or any entity
<b>No. of Owners</b>	Two or more	Two or more	Two or more	Single Member LLCs permitted in Texas	One or more
<b>Ownership Classes</b>	Multiple Classes Allowed	Multiple Class Allowed but must have at least 1 general partner and 1 limited partner.	Multiple Classes Allowed	Multiple Classes Allowed	Multiple Classes Allowed
<b>Transferability of Interests</b>	Economic Interest is transferable unless restricted by Partnership Agreement; However, the status of partner is not transferable without consent of all partners.	Economic Interest is transferable unless restricted by Partnership Agreement; However, the status of partner is not transferable without consent of all partners.	Economic Interest is transferable unless restricted by Partnership Agreement; However, the status of partner is not transferable without consent of all partners.	Economic Membership interest freely transferable unless restricted by Articles of Organization or Regulations; However, unless otherwise.	Freely Transferable unless restricted by Articles of Incorporation, Bylaws or Shareholder Agreement.

<b>Continuity of Life</b>	Typically limited by Partnership Agreement	Typically limited by Partnership Agreement	Typically limited by Partnership Agreement	May be perpetual	Typically perpetual unless limited in articles of incorporation
<b>Income Tax</b>	Partner level only	Partner level only, unless elected corp. for tax purposes	Partner level only	Member level only, unless elected corp. for tax purposes	Corporate and shareholder level
<b>Self-Employment Tax</b>	Yes	Yes for general partner, but not for limited partners	Yes	Unclear	No
<b>Margin Tax</b>	Depends; Imposed on general partnership which has a business entity as a partner	Yes	Depends; Imposed on general partnership which has a business entity as a partner	Yes	Yes