

## *The Estate Planning Advisor*

### **Choosing a Business Entity**

**By Richard J. Shapiro, J.D.**

It is increasingly common for people to start their own businesses, often as a “second career.” Whether it’s opening a restaurant, starting a landscaping or contracting business, or some other venture, forming the appropriate type of business entity may be critical for protecting your personal assets. This article presents a *brief* description of the most popular forms of business ownership.

Many people start their new business as a **sole proprietorship**. This is the simplest form of business, as the individual owns all the business assets. Sole proprietorships are often set up under an assumed name, such as “John Smith, d/b/a Smith’s Lawn Care.” In New York, an assumed name certificate must be filed with the county clerk. The primary disadvantage of a sole proprietorship is that there is no separation of the business assets from the individual, and the owner retains full personal liability for the debts and liabilities of the business.

Another type of business entity is the **general partnership**. A general partnership is automatically formed when any two or more people engage in business together without forming a formal business structure (i.e., a corporation, limited partnership or limited liability company). Like a sole proprietorship, no formal agreements or state filings are required to form a general partnership, and general partnerships can also do business under an assumed name. From a liability standpoint, *each* partner is jointly and personally liable to third parties for the entire sum of the partnership’s debts, and for torts committed by a partner or any employee. So, if one partner has the “deep pocket,” the general partnership’s creditors may collect the entire debt against that single partner, leaving the paying partner to try to collect reimbursement from his “deadbeat” partner.

**Limited partnerships** are specialized types of partnerships formed pursuant to state law. These entities have two classes of partners, general partners and limited partners. Limited Partnerships must file certificates with the Secretary of State to be deemed validly formed, and must comply with other requirements set forth in the state statutes. The general partner(s) retains sole management authority for the business, and retains personal liability for the partnership’s debts. The limited partners have no management authority or control, but also retain no personal liability for the partnership’s debts or obligations. While limited partnerships are less often used since the advent of the limited liability company (see below), they are still useful in certain selected situations.

**Corporations** have historically been the most popular entity for business owners. A corporation is established by filing a Certificate of Incorporation with the Secretary of

State. Interests in a corporation are owned by one or more shareholders. Corporations enable the shareholders to protect their personal assets from the claims of the corporation, *provided* that the business has been operated by observing the requisite corporate formalities (i.e., having annual meetings, keeping minutes, not commingling a shareholder's personal assets with the corporation's assets). If the corporate formalities have not been maintained, then a court might "pierce the corporate veil" and allow a corporate creditor to seize a shareholder's personal assets.

Since their introduction in New York State in 1994, **Limited Liability Companies** ("LLC's") have rapidly become the entity of choice for business owners in New York and throughout the nation. LLC's combine the liability protections of corporations with the flexibility of partnerships (or sole proprietorships if there is only one member). LLC's are established in New York by filing Articles of Organization with the Secretary of State, and by completing certain notice publication requirements. LLC's can be managed by the members, or by one or more managers designated in the entity's operating agreement. LLC's have far fewer operating formalities than corporations, thus leaving them less vulnerable to judicial attack by a creditor. The members can elect to have the LLC taxed as either a partnership (if there is more than one member) or a corporation, which can provide additional planning flexibility. LLC's also make ideal estate planning vehicles, allowing for creative gifting of membership interests during a member's lifetime and the easy disposition of a member's interests after their death.

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*Richard J. Shapiro is a partner with the Middletown law firm of Blustein, Shapiro & Rich, LLP. Mr. Shapiro is a member of the National Network of Estate Planning Attorneys, the National Academy of Elder Law Attorneys, the New York State Bar Association (Trusts and Estates and Elder Law Sections), and the Hudson Valley Estate Planning Council. He can be reached at (845) 692-0011 or at [rshapiro@mid-hudsonlaw.com](mailto:rshapiro@mid-hudsonlaw.com). The information in this article is for general information purposes only and is not, nor is it intended to be, legal advice, including legal advice for Internal Revenue Code purposes as described in IRS Circular 230.*