

Business Entities(Sole Proprietorship, Partnership, Corporation, Limited Partnership, LLC, LLP) See Chart on p. 457-458 in Text(no chapters to read for this material) & Chapter 28: Investor Protection and Corporate Governance.

I. Entities Defined

- A. Sole Proprietorship: The simplest form of business where the owner is the business. The owner reports income on his/her personal income tax return and is legally responsible for all debts and obligations incurred by the business.
- B. Partnership: An agreement by 2 or more parties to carry on, as co-owners, a business for profit.
- C. Corporation: a legal entity formed in compliance with statutory requirements. The entity is distinct from its shareholders-owners
- D. Limited Partnership: a partnership consisting of one or more general partners (who manage the business and are liable to the full extent of their personal assets for debts of partnership) and one or more limited partners (who contribute only assets and are liable only to the extent for their contributions).
- E. Limited Liability Company (LLC): A hybrid form of business enterprise that offers the limited liability of the corporation but the tax advantages of a partnership.
- F. Limited Liability Partnership (LLP): A form of partnership that allow professionals to enjoy the tax benefits of a partnership while limiting their liability for the malpractice of the other partners.

II. Examples:

- A. Friend of mine sells custom made jewelry. She operates as a sole proprietorship. She has a website and takes orders in person and over the internet. She pays taxes on the income at the personal income tax rate. She has shown once a year and participates in other people's home shows. She only wants to work part time. A sole proprietorship is perfect for her needs. - Sole proprietorship.
- B. 2 guys named Dave Attending UT in the 80's have an idea for a pizza restaurant and their signature food is hand-tossed pepperoni pizza rolls. Anyone know who I'm talking about? Double Dave's. This is a partnership. They can take out liability insurance for the risk and the agreeing to share profits and losses equally. They pay income tax based on their pro rate share of profits. *Double Dave's may or may not still be owned as a partnership today.
- C. A blank owned wholly by one family but who wants to open up ownership to its employees through a profit sharing plan (benefits plan) and eventually sell shares of stock publicly would want to be a corporation.
- D. Real Estate deal: A young, unestablished entrepreneur, Joe Bob, has an idea to develop 500 acres into subdivision. He has no money and goes in search of wealthy individuals to invest in his venture. He will want to set up a limited partnership. He is general partner with all the liability and responsible for management decisions. His wealthy investors are the limited partners who are liable to the extent of their investment.

Also, some LP set up a corporation as the general partner and then the individual who actually own the company are the limited partners. This is also done in a lot of family limited partnerships.

- E. 2 financial planners wish to start a company for wealth management. They will be equal partners in this venture and contribute equal capitals. Because the liable risk, but the desire for personal taxation rates, an LLC is the way to go. They also wish to buy a building for the business. So, another LLC can be set up to purchase the building and the wealth management LLC pays rent to the building LLC. This allows the liability associated with wealth Management Company to be separated and apart from the building. Also, in the future when the wealthy management LLC wishes to add members (like partners –other co-owners), these do not have ownership interest in the building – only the wealth management business.
- F. In 1991, Texas became the first state to enact an LLP statute. These are designed mostly for professionals who normally do business as partners in a partnership, but need/wish to limit liability. Doctors and attorneys use LLP a lot, as do accounting firms, including Ernst & Young, LLP and PricewaterhouseCoopers, LLP.

III. C-Corporation, Stock Offerings and the SEC

A. Formation of C-Corps

1. File Articles of Incorporation with Secretary of State
2. Stock Offerings
 - a. If you own shares of stock, you own the company –or a portion
 - b. Shareholders (SH) have NO responsibility of management (Management is left to the Directors and Officers- Who cd also be SH)
 - c. SH have meetings
 - d. SH vote on issues and business proposals
 - e. SEC- Securities and Exchange Commission regulates the purchase and sale of securities such as shares of stock in corporations.
 - f. SEC Requires certain disclosures of information in meetings and notices and has rules on SH voting- all designed to protect SHs rights/interests

B. Basic Function of SEC (created in 1934) (starts material in Chapter 28 of text)

1. Interprets federal securities laws and investigates securities law violations.
2. Issues new rules and amends existing rules.
3. Oversees the inspection of securities firms, brokers, investment advisers and ratings agencies.
4. Oversees private regulatory organizations in the securities, accounting and auditing fields.
5. Coordinates U.S. securities regulation with federal, state, and foreign authorities.

C. The Securities Act of 1933

- Governs initial sales of stock by business
 - Prohibits fraud
 - Requires investors (SH) receive financial and other significant info concerning securities being offered for public sale.
 - Purpose is to require disclosure.
1. What is Security? Section 2(1) of the Securities Act of 1933 contains a broad definition of securities, which generally include the following:

- a) Instruments and interest commonly known as securities, such as preferred and common stocks, treasury stocks, bonds, debentures, and stock warrants.
 - b) Any interest commonly known as securities, such as stock options, puts, calls, or other types of privilege on a security or on the right to purchase a security or a group of security in a national security exchange.
 - c) Notes, instruments, or other evidence of indebtedness, including certificates of the interest in a profit-sharing agreement and certificates of deposit.
 - d) Any fractional undivided interest in oil, gas, or mineral rights.
 - e) Investment contracts, which include interests in limited partnerships and other investments and schemes.
2. What is an Investment Contract? The Howey Test is the definition of what types of contracts are securities.
- An Investment Contract according to the Howey Test is: any transaction in which a person
 - a) Invests
 - b) In a common enterprise
 - c) Reasonably expecting profits
 - d) Derived primarily or substantially from others' managerial or entrepreneurial efforts.
 - e) Example: Alpha Telecom promised a 14 percent annual return to its buyers. They were operating at a net loss and continually borrowed funds to pay investors their return. They filed bankruptcy and were accused of violating the security act.
3. Examples of Securities: stocks, bonds issued by corporations. Also, interest in whiskey, cosmetics, worms, beavers, boats, vacuum cleaners, muskrats, and cemetery plots, almost any stake in ownership or debt of a company, investment contracts in condominiums, franchises, limited partnerships in real estate, and oil or gas or mineral rights.
4. Registration of Securities governed by the Act of 1933
- Unless exempt securities must be registered with the SEC before offering the security to the public
 - File a registration statement with SEC
 - Provide all investors a Prospectus: a disclosure document that describes the security being sold, the financial operations of the issuing corporation, the investment or risk attaching to the security. It is also a selling tool for issuing corporation.
 - Registration of securities is VERY expensive and burdensome process-paying attorneys, brokers, underwriters, etc.
5. Exempt Securities: There are certain types of securities exempt from the registration process. We'll discuss only 1 example:
- Regulation D Offerings: An issuer's offering of up to \$5 million in securities in any 12-month period is exempt from registration. Regulation A provides a simplified process of registration in this situation designed for issues of securities by small businesses of less than \$25 million annual revenues. The issuer files a notice the