

## CHAPTER 12

# ANALYZING LEGAL RISKS AND BENEFITS

### Author's Note

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A feasible concept needs an organizational structure as part of its business plan. The determination of a legal form of organization is an important part of that organizational structure and is a decision that affects the company's legal liability, tax ramifications, and the cost of creating the business. Entrepreneurs have many choices of legal form, and it's highly likely that an entrepreneur will start with one form and evolve into one or more different forms.

### Learning Objectives

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This chapter will give students an understanding of:

- How to decide the best legal form for the new venture
- Sole proprietorships and how they work
- Partnerships
- Corporations
- Hybrid forms like S-Corporations and Limited Liability Companies
- The nonprofit corporation

### Supplemental Lecture Material

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#### ***Professional Advisors Are Worth Their Weight***

Perhaps the first place an entrepreneur should go before launching the business is his or her accountant. The reality is that the decision about which legal form of organization to use is more a tax issue than anything else (although liability protection is important, too). An accountant will consider the specifics of the entrepreneur's business and suggest the structure that makes most sense and provides the most benefits.

Then the entrepreneur should visit a business attorney who can advise on the cost of setting up a particular form of organization, suggest the best way to protect against liability, and help the entrepreneur move through the process. Next it's important to check with the state franchise tax board to find out how it deals with corporations and LLCs.

If the entrepreneur starts with one form and then moves to another, the change is fairly simple. The entrepreneur would contribute the assets and liabilities of the previous company to the new company form (generally LLC or corporation) in exchange for 100 percent of the shares or membership interests as in the case of an LLC. If the owners remain the same, there is typically no tax liability.

*Source: Karen E. Klein, "The Company You Keep," Business Week Online, November 14, 2000.*  
[http://www.businessweek.com/smallbiz/content/nov2000/sb20001114\\_418.htm](http://www.businessweek.com/smallbiz/content/nov2000/sb20001114_418.htm)

## Cases Relevant to This Chapter

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Mrs. Gooch's

Franchising a Dying Business

## Answers to Issues to Consider

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1. *Assuming you were running a successful business as a sole proprietorship, what would induce you to change the legal form to a corporation?*

You might want to change to a corporate form if you were planning to grow the business by issuing and selling shares of stock, if you needed the liability protection, or if you wanted to ensure that the business survived your death.

2. *Why would you choose an LLC form over a partnership or an S-corporation?*

The LLC benefits from continuity of life and free transferability of interests. As a limited member in an LLC, you don't have to forfeit the right to participate in the management of the organization to retain limited liability status. You can have more members than in an S-corporation, and you have liability protection that you don't have in a partnership.

3. *What kinds of businesses are well suited to the nonprofit legal structure?*

Businesses that are created for the public good, socially responsible businesses, educational businesses, and others that would likely be able to receive grants from corporations.

## Suggestions for Experiencing Entrepreneurship

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1. *Interview an attorney about the various forms of legal ownership. Using a business that you might want to start, get his or her advice about the best form to use for your type of business.*

Alternatively, you may want to invite an attorney or a panel of attorneys to speak in your class and provide several examples of businesses for them to analyze.

2. *Visit an entrepreneur whose business is set up as a partnership. What kind of experience has setting up the business been for the partners? How have they divided the duties and responsibilities? What key issues have they covered in their partnership agreement?*

You might want to expand on this to include a visit to a company that is using the LLC form of organization to compare pros and cons.