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BUSINESS ENTITIES IN COLORADO

Types of Colorado Business Entities

When starting a business there are many different formats available. In fact, there are so many choices it can be quite dizzying. In general the types of businesses can be broken down into two distinct groups Corporations, and Unincorporated Associations. Most people recognize a corporation when they see one. Unincorporated Associations are sometimes a bit less familiar to the general public, but actually can offer a better choice of business entity than your standard corporation in some situations. Unincorporated Associations are all based on a partnership format. The last 10 to 15 years have seen an explosion of new forms of unincorporated associations (namely Limited Liability Companies) that meld together traditional concepts of partnership law with some of the more desirable features of corporations. The following is a brief discussion of the types of entities a business can be organized as in Colorado.

Unincorporated Associations

Sole Proprietor

Technically speaking a sole proprietorship is not a business entity - it is merely an individual engaged in a business activity. Therefore, it is the simplest way to organize a business. All revenues and expenses of your business operations are reported on schedule C to your individual tax return. You do not pay social security tax, but are subject to a 15% self employment tax in addition to federal and state income tax on all income. If you are going to transact business under any name other than your own, you will need to obtain a trade name. The advantage of a sole proprietorship is it is the simplest structure possible. Likewise it is the most simple to administer and includes virtually no set up costs. The downside to a sole proprietorship is the fact that it offers absolutely no liability protection. There is no distinction between the company and the individual. Therefore the sole proprietor is personally liable for all debts and acts of the company. If a sole proprietor defaults on a debt or is sued and the plaintiff prevails, the plaintiff or lender can satisfy the judgment with the sole proprietor's personal assets (home, car, bank accounts, investment accounts and other personal property).

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Partnerships

Partnerships are technically defined as an association of two or more persons to carry on as co-owners of a business for profit, excluding an association formed under any other statute. Partnerships come in several different "flavors", each with its own set of pros and cons.

General Partnership

The General Partnership can be considered the baseline for all of the different types of partnerships. All partnerships are formed by an agreement among the partners. In a general partnership this agreement may be very simple and unwritten or be very complex governed by lengthy written contracts. Because partnerships are created and governed by contracts they are very flexible and can be created in such a manner to meet the individual needs of each partnership. There are no official filing requirements with the state in order to form a General Partnership. Partners in a general partnership may be individuals, corporations, other legal entities (such as trusts) or other partnerships. Management of the partnership is done by the partners, and unless the partnership agreement states otherwise, decisions are made by a majority vote of the partners. Unless otherwise provided for in the partnership agreement, general partners share profits and losses equally. For tax reporting, the partnership files a form 1065 with the IRS and issues each partner a K-1 allocating to that partner their share of the profits or losses. Unless operating under the names of the partners, a partnership must file for a trade name with the state. Similar to a sole proprietorship, each partner in a general partnership is personally liable for the partnership liabilities. In fact type of liability for general partners is called "Joint and Several", which means that any one partner can be held responsible for the full amount of the partnership's liabilities. Additionally, unless otherwise stated in the partnership agreement a General Partnership is dissolved upon the disassociation (willful withdrawal, death, or filing a voluntary or involuntary petition of Bankruptcy) of any partner.

Limited Partnership

A Limited Partnership (LP) is a partnership in which there is at least one general partner who actively manages the business and who is personally liable for the obligations of the business and one or more limited partners who have no liability for the obligations of the business but cannot have an active role in managing the company. Only the general partner has the authority to bind or take action on behalf of the partnership. LP's are formed by filing a certificate of limited partnership with the state. As with all partnerships they are governed by a partnership agreement among all of the partners. Unlike a general partnership, unless otherwise modified in the partnership agreement the allocation of profits and losses in

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a LP is based on each partner's contributions (value of cash, personal property or services) to the partnership. Unless provided for in the partnership agreement, a LP will survive the disassociation of a general partner or a limited partner. Upon the disassociation of the last remaining general partner, the limited partners may continue on, or may choose to dissolve the partnership by a majority vote of the remaining limited partners.

Limited Liability Partnership

A Limited Liability Partnership (LLP) is a General Partnership in which the partners are not personally liable for the debts and obligations of the General Partnership. LLP's are formed by filing a Certificate of Limited Partnership and registering a Limited Liability Partnership registration statement with the Secretary of State's office. LLP's must also appoint a registered agent that is on file with the Secretary of State of Colorado. As with a General Partnership, decision making in a LLP is done by a majority vote of the partners, and all partners have a statutory right to participate in the management of the business. Unless otherwise provided in the partnership agreement, all profits and losses are shared equally among the partners. The disassociation of a partner will not dissolve the partnership unless the disassociation will leave the partnership with only 1 partner. Unlike the other partnerships discussed so far LLP's by statute are subject to the theory of piercing the corporate veil where the individual partners may be responsible for partnership obligations and liabilities in certain situations. The theory of Piercing the Corporate Veil is discussed more in the description of corporations.

Limited Liability Limited Partnership

A Limited Liability Limited Partnership is defined as a LP (see above for requirements) that has registered as a LLLP under the Colorado Uniform Partnership Act with the State of Colorado. The attributes and restrictions of a LP will apply, except that all partners not just the limited partners are shielded from personal liability for the obligations of the partnership. However, the theory of Piercing the Corporate Veil applies to the General Partners, which would allow personal liability against the general partners in certain situations. Lastly, it is currently unclear as to how a LLLP will be treated in a bankruptcy context valid arguments could be made for treating it as a partnership as well as a corporation.

Limited Liability Company

A Limited Liability Company ("LLC") is a quasi corporate, quasi partnership entity. It allows for limited liability of the owners ("Members") and the ability to separate ownership from management of the

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company similar to a corporation, while allowing for the recognition of profits and losses to be passed through directly to the individual Members and the flexibility of having the relationship of the members to each other and the LLC being defined and governed by contract, similar to partnerships. Management of the LLC can range from informal arrangements to very complex agreements similar to partnerships. The Members may manage the LLC themselves or appoint independent managers to run the day to day operations. This aspect makes LLC's good for passive investment situations such as land deals or restaurants where the financial backers may not have the necessary skills to run the day to day operations of the company. There are no limitations on the number or type of Members a LLC may have, as is the case with a S Corporation. In Colorado this includes single member LLC's. In addition, the individual creditors of a Member may not obtain ownership of the LLC interest, but can only obtain a charging order which will entitle them to the respective Member's distributions from the LLC.

Corporations

Most people are familiar with the concept of a corporation. The first thoughts that come to mind are usually very large Fortune 500 companies whose stock is publicly traded. While this is certainly one incarnation of a corporation, corporations come in various sizes and can be publicly or privately held. In general, there are two types of for profit corporations C-Corps and S-Corps. Each type is discussed in more detail below.

C- Corporation ("C-Corp.")

A C-Corp is your standard variety corporation. It is a separate and distinct legal entity apart from its owners. Corporations are authorized by state statute and are formed by filing articles of incorporation with the Secretary of State in the state of incorporation. The owners of the corporation are called shareholders. The shareholders elect a board of directors annually who are in charge of the operation of the company. The board of directors appoints officers (CEO, President, Treasurer, Secretary etc.) who are in charge of the day to day operations of the company and report to the board of directors. Most decision making power lies with the board of directors, except for certain major decisions which need to be ratified by the shareholders. Shareholders are only liable for the obligations of the company up to their investment (assuming that the corporation is following the required corporate formalities). C-Corps are taxed federally and at the state level on any profits they generate. Shareholders are also taxed on the dividends they receive (if any) and on any gain they receive from the sale of their stock. This is usually referred to as double taxation, which is usually undesirable for small closely held businesses.

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S-Corporation ("S-Corp.")

All S-Corps start out life as a C-Corp. In order for a C-Corp to become an S-Corp, the corporation must file a S-Corp election with the IRS (Form 2553). The only difference between a S-Corp and a C-Corp is how the entities are treated for tax purposes and the fact that a S-Corp has restrictions on the number of classes of stock it can issue and the number and type of shareholders it may have. If a corporation elects to be classified as a S-Corp, the profits of the corporation will not be taxed at the corporate level, but will be passed through to the individual shareholders and taxed at their individual tax rate. In some instances owner/employees may have certain tax benefits by being able to take a salary and receiving the rest as dividends which would be taxed at the capital gains rate. In order to qualify for the S election, a corporation must be a domestic corporation and have less than 75 shareholders and have only one class of stock. All shareholders must be individuals, tax exempt organizations or certain allowable trusts, and there cannot be any non resident alien shareholders (foreign nationals, temporary visa holders or illegal immigrants). Additionally, corporations in certain business sectors, such as insurance companies cannot be S-Corps.

Leyendecker & Lemire, LLC is a Denver-based law firm offering a full spectrum of Intellectual Property, Business and Entertainment related legal services for entrepreneurs, individual inventors, and businesses of all sizes. We pride ourselves in providing large firm quality, but with personalized service and attention the large firms do not provide to their smaller clients. Our strength is working with a client from the beginning of his/her venture to maximize the venture's value and potential, as well as, help minimize the risk of legal disputes. Call (303) 768-0123 or e-mail us at info@coloradoiplaw.com today to see how we can help you!

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