

BUSINESS ORGANIZATIONS

OVERVIEW

Under Oklahoma law, there are a number of choices the businessman has to select from when determining what the appropriate structure he or she should use to establish a business. This paper is intended to be an overview of the choices presently available in Oklahoma but should not be considered legal advice or a comprehensive discussion of each point to consider in making a decision as to which organization is better to use.

CHOICES

The following is a list of the legal (not tax) choices currently available to you in Oklahoma:

- Sole proprietorship
- General Partnership
- Joint Venture
- Limited Partnership
- Limited Liability Partnership
- Limited Liability Company
- Corporation

SOLE PROPRIETORSHIP

The simplest form to conduct business under is a sole proprietorship in which there is no legal entity established, there is no formal requirements for maintenance, no registration requirements (unless operating under a fictitious name) and the owner simply reports his or her income and expenses on Schedule C of their personal tax return (Form 1040).

The advantages are that this is a simple way to start a business and there are no ongoing maintenance problems or costs. The disadvantages are that the owner has unlimited liability, the assets are owned by the owner and to sell the business, the owner must transfer each asset, the business ceases when the owner dies and the tax favored fringe benefits such as deductible life and health insurance and a number of benefit plans are not available to the business.

PARTNERSHIPS

When using the term “Partnership” it is important to distinguish between a partnership as a legal entity and a partnership for tax purposes. Under Oklahoma law, there are three types of legal

partnership – a general partnership, a limited partnership and a limited liability partnership. Each is governed by a separate set of statutes. For tax purposes, general partnerships, limited partnerships and limited liability partnerships are all taxed as partnerships, but so can limited liability companies (if the company qualifies and elects to be so treated).

General Partnership

A general partnership under Oklahoma law has no filing requirements to operate as a business (unless it is operating under a fictitious name in which case there are certain filing requirements). A general partnership must have at least 2 owners and each has unlimited liability for the debts and obligations of the partnership.

Partnerships are managed by the partners – each partner generally having the authority to bind the partnership. Transferability is generally restricted unless the other partners consent.

For income tax purposes, a general partnership files federal and state partnership tax returns but the income, gains, losses, etc. flow-through or pass-through to the individual partners without being taxed at the entity level. The partners report the information received on their partnership K-1's and pay any taxes that might be due.

Joint Venture

A joint venture is a general partnership and subject to the general partnership laws of Oklahoma unless the partners elect out of partnership tax treatment (often the case in drilling an oil well). Joint ventures are often described as single purpose partnerships and might be used to own a single piece of property or conduct a certain limited purpose business.

Limited Partnership

A limited partnership is created when a Certificate of Limited Partnership is filed with the Oklahoma Secretary of State. There are two types of partners in a limited partnership – general partners and limited partners. General partners have unlimited liability and manage the partnership, limited partners have liability limited to their investment and have little or no say in the management of the partnership. Transferability is generally restricted unless the general partner consents.

For income tax purposes, a limited partnership files the same returns and is taxed the same as a general partnership.

Limited Liability Partnership

A limited liability partnership is a relatively new type of entity in Oklahoma and has been used mostly for professional organizations such as law firms, accounting firms and medical practices. A LLP is created when a statement of qualification is filed with the Oklahoma Secretary of State.

All partners of an LLP are limited in their liability to their investment in the partnership.

Governance is determined by the partnership agreement.

For income tax purposes, an LLP files the same returns and is taxed the same as a general partnership.

Limited Liability Company

A limited liability company is created when Articles of Organization are filed with the Oklahoma Secretary of State. Owners are called members and there can be one or more under Oklahoma law. *However*, if there is only one member, then it cannot elect partnership tax treatment and must either elect to be taxed as a corporation or as a disregarded entity.

Technically, under Oklahoma law, a limited liability company can conduct business through its members with nothing more than its Articles being filed (although it is highly recommended that an operating agreement governing the operations of the company be adopted). There is no requirement for a written operating agreement or for managers to be appointed to run the business. Liability of the owners is generally limited to their investment in the company.

LLC's are managed by the members unless they appoint managers to run the business. The duties and responsibilities of the managers would generally be defined under the operating agreement along with other governance issues such as capital requirements, buy-sell provisions, meeting and other requirements.

Generally, two or more member LLC's are taxed as a partnership for federal and state income tax purposes. As such, the same restrictions apply as to benefit plans, distributions, etc. as it applies to partnerships. LLC's in Oklahoma are not subject to corporate franchise taxes but are required to file annual reports with the Secretary of State and pay a \$25 fee. LLC's can have a perpetual existence.

CORPORATIONS

Under Oklahoma corporate law there is only one type of corporation used for businesses – a for-profit corporation. Many people believe that there is a corporate difference between a C corporation and an S corporation but there is not – the distinction is a *tax* difference not a *corporate* difference.

A corporation is created when a Certificate of Incorporation is filed with the Oklahoma Secretary of State. The corporation must then adopt by-laws to direct governance of the corporation and elect a board of directors which will appoint officers and oversee the operation of the corporation. Corporations are required to have annual meetings of the stockholders and directors and must file franchise tax returns in Oklahoma to remain in good standing. Corporations can have a perpetual existence.

Stockholders have limited liability to the extent of their investment in the corporation. Ownership can be in different types of stock such as preferred or common. Absent restrictive buy-sell agreements or the securities laws, transferability of ownership is not generally restricted. The

corporation has centralized management with its appointed officers.

Differences Between a C and an S Corporation

	S Corporation	C Corporation
<u>Business Income and Loss</u>	Shareholders report and pay tax on most income	Corporation reports and pays tax
<u>Distributions of Cash to Owners</u>	No gain is recognized if the distribution does not exceed basis and gain on excess is generally capital gain	Dividends are generally not deductible to the corporation and are taxed to the shareholders as ordinary income
<u>Owners Interest</u>	Only one class of stock can be issued and each share must represent the same interest in capital, profits and distributions	Multiple classes of stock may be issued and each class may have different rights and preferences
<u>Type of Owners</u>	Generally, only individuals and certain types of trusts can own stock in an S corporation	No restrictions
<u>Number of Owners</u>	one to 75	No Restrictions

ADVICE OF COUNSEL

The foregoing summary is necessarily abbreviated, and some would say too brief. Accordingly, the reader would be well advised to consult with counsel (and their accountant) when deciding what is the best entity to conduct business under.

For further information, contact:

ROBERTSON & WILLIAMS, INC.
9658 North May Avenue, Suite 200
Oklahoma City, Oklahoma 73120-2718
(phone) 405-848-1944 ♦(fax) 405-843-6707