**CHAPTER 21-STARTING A BUSINESS: LLCS AND OTHER OPTION**

**TRUE/FALSE**

1. Corporations have perpetual existence.

2. The most dominant form of business ownership is the corporation.

3. To be a close corporation, the business must not have publicly traded stock.

4. Limited liability is a major advantage of a partnership as compared to a corporation.

5. Shareholders of S corps have the tax status and advantage of a corporation but non of the protection from liability.

6. Alan, a dentist, and his wife Martha, an attorney, can protect their personal assets with limited liability from their business dealings by creating and operating a professional corporation together.

7. A partnership is a taxable entity, separate from the partners.

8. Corporations have a distinct advantage over other forms of business organization in the area of taxation.

9. Franchise fees can be costly, but they are usually payable over a number of years, after profits are generated from the business.

10. A limited liability company, unlike a Subchapter S corporation, can have members that are corporations, partnerships, or nonresident aliens.

11. To form an LLC, a charter but not an operating agreement must be filed with the Secretary of State in the jurisdiction where the business will operate.

12. Filings are required to form and operate a limited liability partnership.

13. Nicholas and Holly are partners in a toymaking shop. If Rudolph obtains a judgment against Nicholas for injuring Rudolph while Nicholas was on partnership business, Rudolph must try to collect from the partnership before going after Nicholas’ personal assets.

14. Alicia and Ted have a written agreement wherein they will share the losses of their joint business. This agreement is strong evidence they are partners.

15. The dissolution of a partnership means the same as its termination.

**MULTIPLE CHOICE**

1. Debra and Lawrence have an equal partnership. This year, after expenses, the partnership had a profit of $200,000. Debra and Lawrence will each pay taxes on:

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| a. | whatever they receive from the partnership. |
| b. | $50,000. |
| c. | $100,000. |
| d. | None of the above. The partnership itself will pay the taxes on the business’s profit. |

2. All the business forms listed below have limited liability except the:

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| a. | limited liability company. |
| b. | general partnership. |
| c. | Subchapter "S" corporation. |
| d. | corporation. |

3. Rachel and Cyndi started a retail business called Zebra Toy Company. The business is operated as a partnership. Under partnership law:

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| a. | Rachel is personally liable for any business contracts entered into by Cyndi. |
| b. | Rachel is personally liable for any business debts, regardless of whether she or Cyndi created the obligation. |
| c. | Rachel is personally liable for any negligent act committed by Cyndi in the scope of the business activity. |
| d. | All the above. |

4. When can shareholders of a corporation be held personally liable for the liabilities of the corporation.

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| a. | if corporate shareholders do not comply with the technicalities of corporation law. |
| b. | If they are corporate officers |
| c. | If they are corporate stockholders |
| d. | If they form an S corporation |

5. The importance of a Subchapter S corporation is:

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| a. | its organizational structure. |
| b. | its treatment of shareholders for income taxation purposes. |
| c. | its requirement of restrictive transfer rights of the shares. |
| d. | its small cost of formation. |

6. The business form that is taxed as a partnership and gives all owners limited liability, is:

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| a. | a close corporation. |
| b. | a limited partnership. |
| c. | a limited liability company. |
| d. | a general partnership. |

7. Which of the following transactions would be considered by the IRS to be a taxable sale of assets? Changing the form of business from:

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| a. | a corporation to an LLC. |
| b. | a partnership to an LLC. |
| c. | an LLC to a corporation. |
| d. | All of the above. |

8. All of the following are characteristics of a closely held corporation EXCEPT:

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| a. | the shares are publicly traded. |
| b. | the corporation can typically operate without a board of directors. |
| c. | the shareholders usually restrict share transfer. |
| d. | minority shareholders are provided more protection than in regular corporations. |

9. Which of the following would *not* be personally liable for the debts of the business?

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| a. | A sole proprietor. |
| b. | A partner in a general partnership. |
| c. | A general partner in a limited liability limited partnership. |
| d. | A general partner in a limited partnership. |

10. James was a partner in a large firm. He died unexpectedly. His son, Frank, wanted to take over for his father in the partnership and was well qualified to do the work his father had done. Which statement best describes Frank's rights in the partnership if he inherits the interest?

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| a. | Frank has a right to take over for his father in the partnership. |
| b. | Frank is entitled to the value in the partnership, but not to become a full partner. |
| c. | Frank has no rights to his father's partnership interest. |
| d. | None of the above. |

11. Jill was a limited partner in a retail business that was sued by a customer who fell in the store. The customer claimed the business was negligent in caring for its floors. Which statement best describes Jill's potential liability?

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| a. | Jill has no potential liability to the customer. |
| b. | Jill can be held personally liable to the customer since she is a partner. |
| c. | Jill can only be liable to the amount of her investment. |
| d. | Jill is personally liable, but the woman must first collect from the general partners before collecting from Jill. |

12. The form of business ownership that is the most easily transferable is the:

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| a. | general partnership. |
| b. | corporation. |
| c. | limited liability company. |
| d. | limited partnership. |

13. Under the Uniform Limited Partnership Act a limited liability limited partnership may be formed.

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| a. | filing an application with the secretary of state. |
| b. | They are not allowed |
| c. | declaring so in its certificate of formation. |
| d. | None of the above. |

14. The advantage of a corporation over a partnership is:

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| a. | shares are easily transferable to another person. |
| b. | perpetual existence. |
| c. | it is easier to raise funds. |
| d. | All the above. |

15. What federal agency requires that the seller of a franchise give the potential buyer an offering circular and audited financial statements?

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| a. | The Securities and Exchange Commission (SEC). |
| b. | The Interstate Commerce Commission (ICC). |
| c. | The Federal Trade Commission (FTC). |
| d. | The Franchise Sales Commission (FSC). |

16. Which of the following forms of organization would a Lawyer most likely form to avoid liability?

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| a. | Partnership |
| b. | LLC |
| c. | Close corporation. |
| d. | Professional corporation. |

17. Harold and Zack have pooled their money together to buy real estate but have filed no formal papers to form a business. Harold, a lawyer, handles all the legal matters and Zack, a real estate broker, finds buyers for the property they have subdivided. Harold and Zack are engaged in a:

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| a. | partnership. |
| b. | close corporation. |
| c. | limited liability company. |
| d. | business trust. |

18. Charles and Ellen, an unmarried couple, run an ice cream store. The business is not incorporated and they have filed no formation papers with the state. Their business is a:

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| a. | sole proprietorship. |
| b. | partnership. |
| c. | joint venture. |
| d. | limited liability company. |

19. E. I. James is a writer with a best selling novel. He wishes to create a corporation called “James, Inc.” He will be the only shareholder. Can James incorporate his business of writing?

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| a. | Yes, this would be the incorporation of a sole proprietorship. |
| b. | No, the law requires at least two people to be shareholders of a corporation. |
| c. | No, the law does not permit a person to, in effect, incorporate himself. |
| d. | Only if he forms an S Corporation. |

20. Daniel, his parents, and three brothers own all the stock of their family farm corporation. This corporation, which is taxed as a corporation, is probably:

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| a. | an S corporation. |
| b. | a C corporation. |
| c. | a closely held corporation. |
| d. | an LLC. |

21. An S Corporation cannot have more than \_\_\_\_ shareholders.

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| a. | 100 |
| b. | 75 |
| c. | 50 |
| d. | 25 |

22. LLC’s have legal uncertainty because

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| a. | they are relatively new forms of business |
| b. | There is not a widely developed body of law to look to for legal guidance in setting them up and enforcing them. |
| c. | There is no defined duty of managers to members of the LLC. |
| d. | all of the above |

23. Martin, Leah, and Pablo are considering forming a business. What factors should they consider in making a choice of organization?

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| a. | Ease of creation and operation. |
| b. | Whether there is personal liability for the owners. |
| c. | How the owners will be taxed. |
| d. | All of the above. |

24. Jackie and Robert own an apartment building as partners. Cyndi, one of their tenants, gives Robert written notice she will be moving out at the end of the following month. Robert did not tell Jackie that Cyndi was moving. Has Cyndi properly given notice to the partnership?

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| a. | Yes. Notice to Robert was notice to the partnership. |
| b. | Yes, if it is determined that Robert acted negligently in failing to notify Jackie. |
| c. | No. Cyndi has an obligation to notify both Robert and Jackie. |
| d. | No. Jackie was not notified since Robert never told her Cyndi was moving. |

25. At what stage are the partnership debts paid and the proceeds distributed to the partners?

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| a. | During dissolution. |
| b. | During winding up. |
| c. | During termination. |
| d. | During dissociation. |

**ESSAY**

1. What is a limited liability company? Explain the advantages and disadvantages of this type of business ownership?

2. Compare and contrast the following forms of business organization: sole proprietorship, general partnership, limited partnership, limited liability company, and corporation as to ease of formation, liability of owners, management, and tax implications.

3. Andy wants to start his own business. He has decided to rent space in a "strip mall" and open a pet shop. Additionally, he will provide dog grooming services. He figures he can do almost everything himself, though he will need to hire a part-time employee on an "as needed" basis. His friend, Lacy, has agreed to work when needed.

Andy is considering operating his business as a sole proprietorship. What are the primary legal advantages and disadvantages to this form of business ownership for Andy's pet shop?

4. Briefly discuss the limitations on a corporation electing Subchapter "S" status.

5. In order to obtain limited liability, Tom and Doris formed an LLC to operate their catering business. They sometimes deposited the proceeds from catering jobs into their personal checking accounts and if they needed to pay personal bills and were short of funds, they used the business account. If creditors of the business cannot get payment for their invoices, is there anything a court can do to help the creditors?

6. Jack and Jill were living together. Jack wanted to start a small retail store, but did not have good credit. Jill, whose credit was excellent, signed loan agreements with Jack so he could borrow the money to start the business. Jack used business cards that stated he was the "owner" of the business. He and Jill filed separate tax returns. Jack stated he was self-employed and claimed the business was a sole proprietorship. The money that was earned from the store was placed into a joint checking account owned and used by Jack and Jill. When there were significant decisions to be made about the business, such as deciding to franchise the business, the decision was made jointly by Jack and Jill.

Five years after the business was started, Jill left Jack. She claimed she was entitled to one-half the business's profits since she and Jack were partners. Jack disagreed and claimed they never had a partnership. Discuss Jill's claim.