

SELECTING THE FORM OF OHIO BUSINESS ENTITY

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A wide variety of business entities exist for doing business in the State of Ohio. A number are by definition not appropriate to a given business due to the focused purpose of their existence. Selecting among the appropriate available forms is the result of considered discussion between business management and ownership with tax and legal advisors.

To aid your understanding of the available Ohio business organizations, here are the primary forms available:

1. Sole Proprietorship

A. Formation: Does not require any additional steps to form, nor are any asset transfers required. A fictitious name may be registered from the Ohio Secretary of State as a “dba,” but is not required.

B. Ownership/Tax Treatment: The individual who establishes the business is by definition the owner. There is no separation between the sole owner’s personal affairs, including assets and liabilities, and the business’s affairs.

For federal tax purposes, profits and losses are reported on the individual’s personal tax return. Additional taxes for Social Security and Medicare are the responsibility of the owner.

C. Management: The Sole Proprietor may hire employees, or delegate responsibility, but is personally liable to those individuals.

D. Foreign Entity or Individual Ownership: Since no new entity is formed, it is permitted so long as the individual owner is permitted to work in the United States.

E. Limitation of Personal Liability: None.

2. General Partnership (“GP”)

A. Formation: A partnership is defined as “an association of two or more persons to carry on as co-owners of a business for profit.” There are no single facts or circumstances that provide conclusive evidence as to the existence of a partnership. Nonetheless, the receipt of profits of a business is prima-facie evidence of a partnership, unless those profits were received in payment of a debt. Moreover, the sharing of profits is not alone conclusive of the existence of a partnership in the absence of other essential elements of partnership. Among these essential elements are: a contractual agreement, mutual agency and control, and co-ownership. No filings are required for formation. No maximum number of partners is imposed by law.

B. Ownership/Tax Treatment: The persons who establish the GP are the owners. A written partnership agreement is often prepared, defining terms of transfer of ownership, or termination of same.

For Federal tax purposes, a separate GP tax identification number should be obtained. Partner gains and losses are communicated by a “K-1” for including on individual tax returns, with no federal income taxes being levied on the GP level, only on the individual level. Hence, a GP is known as a “pass through entity.” Self employment taxes are due from the individual partners.

C. Management: The partners may determine the method of management formally through a written agreement, or informally.

D. Foreign Entity or Individual Ownership: Permitted.

E. Limitations of Personal Liability: None.

3. **Limited Liability Partnership (“LLP”)**

- A. **Formation:** A form of business entity first permitted in Ohio in 1994. Must be created through filing a registration form with accompanying fee with the Ohio Secretary of State. Technical requirements, *e.g.*, use of the letters “LLP,” “PLL,” etc. in the name of the LLP are required.
- B. **Ownership/Tax Treatment:** Persons owning LLP members units are owners in the relative proportion of their unit ownership. From the point of view of federal taxes, the LLP can be considered as a partnership and be taxed the same as a GP.
- C. **Management:** The partners may determine the method of management formally through a written agreement, or informally.
- D. **Foreign Entity or Individual Ownership:** Permitted, but a foreign LLP must register as such with the Ohio Secretary of State.
- E. **Limitation of Personal Liability:** The purpose of an LLP is to create a hybrid entity with the benefits of a GP in terms of being a pass through entity, while shielding the partners from personal responsibility beyond their investment in the LLP for debts, obligations or other liabilities of the partnerships or other partners from the ordinary operation of the LLP. Fraud, tortious acts and other bases exist to avoid this limit to personal liability. The LLP is a popular form of business for a law or accounting firm.

4. Limited Partnership (“LP”)

A. Formation: An LP is formed by two or more persons, who include one or more general partners, and one or more limited partners. A certificate of LP must be filed with the Ohio Secretary of State, with the accompanying fee.

B. Ownership/Tax Treatment: Ordinarily a written agreement is prepared to establish an LP, defining the rules of the general and limited partners. Depending on the terms of the agreement, an LP can be treated for federal income taxes as a partnership and therefore a pass through entity, or as an association with tax treatment as a corporation.

C. Management: Ordinarily management is defined by a written agreement. The general partner ordinarily has all the rights and responsibilities of a general partner, but the limited partners typically only have an obligation of contribution with no right of management.

D. Foreign Entity or Individual Ownership: Permitted.

E. Limitation of Personal Liability: None for the general; limitation of liability to the extent of financial contribution by the limited partner, unless the limited takes an active role in management, or in the case of fraud, tortious conduct, etc.

5. Limited Partnership Association (“LPA”):

A. Formation: Formed by between three and twenty-five people for the purpose of conducting any business or occupation anywhere (except real estate or banking) with a place of business in Ohio. Formed by filing a written statement in a proper Ohio County Recorder’s Office.

B. Ownership/Tax Treatment: This entity creates something similar to an LP, except there are no general partners in an LPA. Provides the same tax pass through results as a Limited Liability Company.

- C. Management: At least an annual meeting required where three to five managers are elected for managing of the business.
- D. Foreign Entity or Individual Ownership: Permitted, subject to registration requirements.
- E. Limitation of Personal Liability: While the enabling statute provides a limitation of liability to members, no court has enforced these provisions, rendering the limits of personal liability beyond individual contributions unknown.

6. Joint Venture

A. Formation: A joint venture is an association of persons with intent, by way of contract, express or implied, to engage in and carry out a single business adventure for joint profit, for which purpose they combine their efforts, property, money, skill and knowledge, without creating a partnership, and agree that there shall be a community of interest among them as to the purpose of the undertaking, and that each co-venturer shall stand in the relation of the principal as well as agent, as to each of the other co-venturers.

The major distinction between joint ventures and partnerships is that a joint venture typically relates to a single enterprise, whereas a partnership relates to a continuing business. No separate filing is required. Essential to the creation of a joint venture is a contract, a community of interest in the purpose of the undertaking, equal authority to direct and govern the conduct of each other in connection therewith, and a sharing of losses as well as profits.

B. Ownership/Tax Treatment: A joint venture is characterized by the common control over the means of accomplishing the specified purpose by the participants of the joint venture. For purposes of federal income taxation, joint ventures are treated as partnerships, and therefore are pass through entities.

C. Management: The members of the joint venture typically define the method of management through the written joint venture agreement.

D. Foreign Entity or Individual Ownership: Permitted.

E. Limitation of Personal Liability: None.

7. **Limited Liability Company(“LLC”)**

A. Formation: A form of business entity first permitted in Ohio in 1994. An LLC must be created through filing Articles of Organization with the Ohio Secretary of State with the accompanying fee. Technical requirements for the name of the entity include, *e.g.*, the use of the initials “LLC,” “LTD,” etc. in the name of the LLC. The statute defines “members” as those who may be persons who may be owners of an LLC. “Persons” are defined as any natural person, partnership, limited partnership, trust, estate, association, limited liability company, or corporation, custodian, nominee, trustee, executor, administrator, or other fiduciary, or any other individual or entity in its own or any representative capacity. Certain forms of professional associations and other specifically designated corporations are prohibited from forming or acting as members of an LLC.

B. Ownership/Tax Treatment: For purposes of tax treatment, the LLC may be treated either as a partnership, with flow-through tax treatment, or as an association, taxable as a corporation. This is determined by the tax classification elected by the LLC when it notifies the IRS of its form of entity.

C. Management: An operating agreement defines the relationships of the members, including designating a person(s) who will serve as managing member and tax managing member. The document is critical to proper functioning of the LLC, and for dispute resolution as between members.

D. Foreign Entity or Individual Ownership: Permitted.

E. Limitation of Personal Liability: The LLC is a hybrid entity that combines the limited liability attributes of corporations, and the flow-through tax treatment of partnerships. In this respect it is identical to the LLP. Conduct that is fraudulent, tortious acts, and other bases exist to avoid these limits on personal liability. The LLC permits a methodology for establishing value of a member's membership units, and therefore a relatively inexpensive and efficient method for allowing the members to add additional members, substitute members through the purchase of membership units, or buy out membership units from members. The LLC is the most popular form of business entity in the State of Ohio for most business transactions.

8. Corporations

A. Formation: A corporation is formed in the State of Ohio by the filing of Articles of Incorporation with the required fee to the Ohio Secretary of State (a separate statute exists with different procedures for the formation of a not-for-profit corporation within the State of Ohio). The purpose of a corporation is to create a separate legal entity distinct from shareholders and managers, and to shield those owners and managers from personal liability beyond their investment made through capital contribution.

B. Ownership/Tax Treatment: Corporations may be treated as pass through entities by virtue of the filing of an "S" Election with the IRS. Through an "S" Election, the corporation itself does not pay federal income taxes, but instead, its income, losses, gains, deductions and credits are passed through to shareholders for use by the shareholders in their individual computation of federal tax liability. The maximum number of shareholders for an S-Corporation is thirty-five. Further, only individuals and certain trusts and estates may be

shareholders of S-Corporations. Finally, only one class of stock is available in an S-Corporation, although it is possible to have both voting and non-voting common shares. If an “S” election is not made, an Ohio corporation is deemed to be a “C” Corporation. While the C-Corporation creates a limit on personal liability, it is taxed at both the corporate and the shareholder level. The size and type of enterprise, as well as its number of shareholders, will often define whether a corporation may elect or remain as an S-Corporation.

C. Management: Management of a corporation is ordinarily established by a code of regulations of the corporation, which are approved by shareholders. Corporations may include as few as one individual as a shareholder, with that same individual acting as the only director, as well as holding the minimum number of offices required to operate the corporation, *i.e.*, president and secretary.

D. Foreign Entity or Individual Ownership: Permitted for C-Corporation purposes; not for S-Corporation purposes.

9. Close Corporation

A. Formation: This form of corporation does not vary in its formation from that of the corporations referenced above.

B. Ownership/Tax Treatment: The close corporation differs to the extent that it is focused on an entity with a relatively small number of shareholders who wish to minimize corporate formalities pertaining to ownership and management. Should a corporation become publicly-traded, then it can no longer operate under a close corporation agreement.

C. Foreign Entity or Individual Ownership: No different from the S or C Corporation referenced above.

E. Limitation of Personal Liability. Yes.

10. Professional Association

A. Formation: This form of corporation incorporates by reference all of the corporation requirements under Ohio law, with the exceptions outlined below.

B. Ownership/Tax Treatment: A professional association is designed for statutorily defined professional occupations, such as lawyers, accountants, defined medical professionals, osteopaths, therapists, pharmacists, etc. Tax treatment for the corporation is the same as any other S or C-Corporation based upon election of the shareholders. Ownership is limited to professionals licensed in the occupation for which the corporation was formed to provide service.

C. Management: Management is limited to those persons licensed in the occupation for which the professional association was formed to provide service.

D. Foreign Entity or Individual Ownership: Yes, to the extent that the individual is licensed as is required for purposes of the service which the association was formed to provide.

E. Limitation on Personal Liability: Yes with respect to the business operation; no with respect to professional liability with respect to the profession which was formed to provide.

11. Miscellaneous Other Legal Forms

Additional forms of corporate entity exist, but are not likely to be utilized. Those forms include publicly-traded partnerships, the “Massachusetts Business Trust,” the real estate investment trust (“REIT”) and the personal service corporation. These forms of entity are designed for specific purposes not likely to be utilized by manufacturing or distribution business operations.