

*Over 45,000 Arizona LLCs were formed in 2010 compared to roughly 7,000 Business Corporations; do you know why LLCs have become so popular?*

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## Arizona Business Entities Compared

	Proprietorship	Partnership	LLC	Corporation
<b>Control</b>	Owner has complete control.	General Partners have control rights.	Members have control unless management is given solely to the managers.	Shareholders elect directors who have control, including hiring of the officers.
<b>Controlling Documents</b>	Business Plan	Partnership Agreement	Articles of Organization, Operating Agreement, Buy/Sell Agreement.	Articles of Incorporation, Bylaws, Shareholders Agreement.
<b>Double Taxation</b>	No	No	Generally No	Generally Yes
<b>Liability</b>	Owner is personally liable.	General partners are liable. Limited partners are liable to the extent of their investment.	All members are generally protected and are only liable to the extent of their investment in the LLC.	All shareholders and directors are individually protected.

### What is a Sole Proprietorship?

A sole proprietorship is a form of business where one individual is the sole owner of all the business' assets. A sole proprietorship does not offer limited liability to its sole member and the life of the business cannot be extended beyond the life of the sole owner. Although this form of business does not provide limited liability, it does avoid double taxation with the IRS.

Generally, a sole proprietorship is used by an individual looking to:

- Start a business that is easy to form as there are no state filing requirements;
- Avoid double taxation issues; and the
- Individual is willing to risk personal liability as a sole proprietorship does not provide limited liability for business obligations.

### **What is a Partnership?**

A partnership is similar to a sole proprietorship except that a partnership requires the presence of at least two individuals or entities in the partnership. In a partnership, the partners are personally liable for the partnership's obligations. When compared to an LLC, the fact that partnerships generally do not provide limited liability makes them less desirable for liability purposes.

Management of a partnership is spread among the partners. However, a partner's management rights cannot be transferred without the consent of the other partners. A partnership does not usually continue after the death of its last partner. Partnerships can own property and partnerships can bring lawsuits in a court of law.

### **What is a Limited Liability Company (LLC)?**

A limited liability company, or LLC, is a business entity which combines the benefits of a corporation with those of a partnership. **Specifically, an LLC provides limited liability to its members and managers, like a corporation, while avoiding the double taxation aspects of certain corporations. An LLC avoids double taxation by having the income it earns pass directly to the LLC's members, like a partnership or sole proprietorship.**

Further, the limited liability aspect of an LLC generally prevents the LLC's creditor from being able to seize property or assets the members or managers of the LLC may own personally in order to satisfy the obligations of the LLC.

Example: John and Jane Doe form ABC, LLC and enter ABC, LLC into a lease agreement with 123, LLC. Unfortunately, ABC, LLC goes out of business prior to the expiration of the lease agreement. Since John and Jane formed ABC, LLC and had ABC, LLC enter into the lease agreement with 123, LLC, John and Jane Doe cannot generally be held personally liable for the unpaid term of the lease. Conversely, had John and Jane Doe not formed ABC, LLC to enter into the lease agreement with 123, LLC, 123, LLC could have held John and Jane Doe personally liable to pay the remaining lease term. If personal liability had been imposed upon John and Jane Doe, 123, LLC could have come after John and Jane Doe's personal bank accounts to collect the funds. As a result, it is generally advisable to form a limited liability entity to enter into contracts when conducting business.

While an LLC does provide limited liability to its members and managers, the members and managers may be held personally liable for the LLC's debts and obligations, if the members and managers fail to maintain certain administrative and operating formalities.

Examples of proper administrative formalities include, but are not limited to:

- Keeping personal and business bank accounts separate;
- Conducting annual meetings;
- Keeping corporate minutes;
- Maintaining company records; and
- Making mandatory updates to the Arizona Corporation Commission.

An LLC can generally be formed to conduct any lawful business. However, *an LLC should likely be formed upon the occurrence of any of the following:*

- Starting a business;
- Upon the purchase/ownership of rental property;
- Segregating multiple real estate assets to avoid overlapping liability from one property to another; or
- Becoming a real estate licensee.

Because of its hybrid nature, the LLC has become a very popular form of business entity for individuals looking to start a business or own a rental property. In addition, a valid LLC can own property and can bring a lawsuit in a court of law.

### **What is a Professional Limited Liability Company (PLLC)?**

A professional limited liability company, or PLLC, is a business entity much like a limited liability company (LLC). However, a PLLC generally differs from an LLC in the following ways:

- A PLLC can only have members who are certified by an officer, agency, court or other authority in Arizona empowered by law to license or otherwise authorize the rendition of a professional service (i.e. the regulatory boards governing lawyers, medical doctors or real estate agents.)
- A PLLC can only conduct business in the field its members are licensed.

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Example: Licensed real estate agents who form a PLLC can only use the PLLC for business related to being a real estate licensee.

- A PLLC can hire non-licensed employees so long as those non-licensed employees:
  - a) Work at the direction or under the supervision of persons who are licensed;
  - b) Do not hold themselves out to the public as being licensed to perform the professional services rendered by the professional limited liability company; and
  - c) The board governing the PLLC has not prohibited the hiring of non-licensed employees.
  
- A PLLC can generally only issue an ownership or membership interest to:
  - a) Individuals who are licensed under Arizona or another state's law to render the professional service set forth in the Articles of Organization of the professional limited liability company;
  - b) General partnerships in which all partners are licensed by the profession to be conducted; and
  - c) Professional corporations authorized by law to conduct professional services.

In summary: the primary difference between a PLLC and an LLC is that a PLLC can only engage in the professional services that its members are licensed to conduct. Further, ownership in a PLLC is generally limited to persons who are licensed to perform the professional services the PLLC was created to perform. (Example: lawyers, doctors, accountants, real estate agents.)

#### **What is a Corporation (S-Corp; C-Corp)?**

A corporation is a business entity where the business is treated as being separate from its stockholders and directors. Additionally, corporations have centralized management which means management power is vested in the corporation's board of directors and not shared amongst the company's stockholders. A corporation's existence may be perpetual regardless of any changes in the corporation's ownership or management.

As a result of corporate stockholders and directors being treated as separate from the business entity, a corporation's stockholders and management personnel are generally not personally liable for corporate obligations. Specifically, a corporation's stockholders and managers risks are usually limited to the amount of their investment in the company.

Exceptions: Although the general limited liability rule is that shareholders and directors cannot be held liable for corporate obligations, exceptions do exist!

Example: Shareholders and managers of a corporation can be held personally liable for corporate obligations, if the corporation was undercapitalized at formation or if the corporation fails to maintain proper administrative formalities.

Examples of proper administrative formalities include, but are not limited to:

- Keeping personal and business bank accounts separate;
- Conducting annual meetings;
- Keeping corporate minutes;
- Maintaining company records; and
- Making required annual updates to the Arizona Corporation Commission.

#### **About the Author**

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Scott F. Burns, Esq. is an Arizona attorney whose clientele includes professional athletes, business owners, and families desirous of protecting their personal and professional legacies through the use of asset protection strategies, estate planning and business consulting.

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