



# Business Entities: Control, Liability, and Professional Business Associations

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Course #3102A

Taxes

2 Credit Hours

Support@PacificCPE.com | (800) 787-5313

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# BUSINESS ENTITIES: CONTROL, LIABILITY, AND PROFESSIONAL BUSINESS ASSOCIATIONS

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This course covers the level of participation and personal liability characteristics for managers and owners of various entity forms. It also includes information on the basic restrictions of professional business associations.

## LEARNING ASSIGNMENTS AND OBJECTIVES

*As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.*

### SUBJECTS

**Management and Control of Business Entities**  
**Liability of Owners**  
**Professional Business Associations**

Study the course materials from pages 1 to 58

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

### Objectives:

- Recognize the level of participation in management and personal liability of various multi-owner business entities.
- Identify personal liability characteristics of various business forms.
- Identify the basic restrictions of professional business associations.

### NOTICE

This course is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice.

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## EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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# CHAPTER 1: MANAGEMENT AND CONTROL OF BUSINESS ENTITIES

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## Chapter Objective

### After completing this chapter, you should be able to:

- Recognize the level of participation in management and personal liability of various multi-owner business entities.

## I. SINGLE-OWNER ENTITIES

One of the key factors in choosing an appropriate business form when there are two or more owners is the level of desire each owner has for participating in the management of the enterprise.

Single-owner entities do have some flexibility in selecting a business structure: the traditional sole proprietorship, a corporation or a limited liability company. In each of these options, the owner retains ultimate responsibility for managing the enterprise whether or not they elect to engage employees or other agents in the running of their business. The only real differences for the single owner – other than tax issues – is whether he or she is subject to personal liability and the amount of formalities involved in the management of the enterprise.

**TABLE 4.1 OPTIONS FOR THE SINGLE-OWNER**

Issue	Sole Proprietor	Corporation	LLC
<b>Taxation</b>	Income and losses flow through to the individual; there is no separate legal entity for the business	Income is taxed at the entity level and then again if distributions other than wages or other benefits are made	Single-member LLC has option of being taxed as a corporation or having income and losses passed through to the member
<b>Formalities</b>	There are no legal formalities for either formation or operation of the business	Significant state law formalities for both formation and operation	State law formalities for formation, significantly less than corporation
<b>Liability</b>	The owner is personally liable for all the debts and obligations of the business	Shareholder not personally liable for the debts and obligations of the business	Members not personally liable for debts and obligations of the business*

\* This rule can be broken by legal doctrine called “piercing the corporate veil,” discussed in detail in Chapter 2.

For multi-owner businesses, the issue becomes more complex. The issue is not only whether or not a particular owner wants to be involved in the active management of the business, but also the degree of personal liability the owner is comfortable subjecting himself to. Table 4.2, next, compares the potential personal liability of each owner with the level of participation each wants to have in management of the business.

**TABLE 4.2 LEVEL OF PARTICIPATION IN MANAGEMENT AND PERSONAL LIABILITY OF VARIOUS MULTI-OWNER BUSINESS ENTITIES**

<b>Business Entity</b>	<b>Management Rules</b>	<b>Liability of Owners</b>
<b>General Partnership</b>	Each general partner has an equal right to manage the enterprise	Each general partner is jointly and severally liable for the debts and obligations of the partnership
<b>Limited Partnership</b>	Each general partner has equal right to manage the enterprise; limited partners risk losing limited liability status by participating in management and are usually “passive” investors	Each general partner is jointly and severally liable for the debts and obligations of the partnership; limited partners are not personally liable so long as they remain “passive” investors
<b>Limited Liability Partnership</b>	All general partners have equal right to participate in management of the enterprise	All general partners are jointly and severally liable for the debts and obligations of the partnership; limited partners not personally liable so long as they are not actively involved
<b>Limited Liability Company</b>	Right to manage is vested in all of its members unless provided otherwise in articles of organization	Every member retains limited liability regardless of whether they actively participate in management of the company
<b>Corporation</b>	Management and control normally vested in the board of directors, elected by the shareholders of the corporation	Shareholders retain limited liability in the absence of special facts; directors can be personally liable for certain breaches of duty

**II. PARTNERSHIPS**

**A. GENERAL PARTNERSHIPS**

The general rule of law is that, absent a contrary provision in a written partnership agreement, all partners in a general partnership have an equal right to manage the enterprise. Texas law, for example, Business Organizations Code § 152.203, provides: “Each partner has equal rights in the management and conduct of the business of a partnership. A partner’s right to participate in the management and conduct of the business is not community property.”

Absent a contrary agreement, each partner has a continuing right to participate in the management of the partnership and to be informed about the partnership business, even if his assent to partnership business decisions is not required.

### 1. Resolving Disputes

Every state has a default rule that governs partners in the event of a dispute when resolution is not governed by a written partnership agreement. Most states provide when there are differences between partners in the ordinary course of business, the matter is to be decided by a majority of the partners. If the dispute concerns a matter that is beyond the scope of the partnership's normal business affairs, e.g., whether to dissolve, most courts have held that the matter must receive the consent of all of the partners. In general, each partner has a single vote regardless of the contribution provided at the time of formation.

### 2. Voting Classes

Under most circumstances, partners are free to establish classes of partners which can, for example, give preferential voting rights to certain partners.

## **B. LIMITED PARTNERSHIPS**

The general rule of law is that limited partners do not have a right to actively participate in the management of the partnership.

Limited partners are, by their nature, passive investors. As a practical matter, a limited partner does not generally want to participate in the management of the company, because to do so normally results in the loss of their limited liability status. Although not generally entitled to manage, state laws generally have provisions that protect the interests of limited partners, including the right to access the books and other records of the partnership.

According to the Revised Uniform Limited Partnership Act, a general partner of a limited partnership has the same rights and powers as a partner in a general partnership, absent an express provision to the contrary in a partnership agreement. This means the general partners of a limited partnership likewise have equal rights in the management of the enterprise.

Other than the limits on limited partnership participation, the partnership as a whole is fairly flexible with respect to the allocation of management authority. State law generally gives general partners freedom in selecting a management structure and, as noted above, in even creating classes of partnership interests. The draw-back, of course, is that general partners remain personally liable for the obligations of the partnership.

## **III. LIMITED LIABILITY COMPANIES**

### **A. DESIGNATING MANAGEMENT OF A LIMITED LIABILITY COMPANY**

One of the many advantages of a limited liability company over other business forms is the flexibility in