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Lawmakers vote: estate tax repeal not permanent

Under the 2001 tax act signed into law by President Bush on June 7, 2001, the estate tax is scheduled for elimination effective January 1, 2010; however, due to a provision in that law, the estate tax repeal is only for a period of one year. On June 12, 2002, the Senate, by a vote of 54-44, struck down a bill which would have made the scheduled repeal of the federal estate tax permanent. The Senate needed 60 votes to clear the bill, which had already been approved by the House. At the same time, the Senate also disposed of two Democratic alternatives that attempted to increase the current estate tax exemption amount without eliminating the estate tax altogether. As of this point in time, the Senate has effectively buried this centerpiece of the Republican push for tax cut permanency.

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Timely News and Information from Mason, Griffin & Pierson, P.C.

PROTECTING YOUR PERSONAL ASSETS FROM BUSINESS DEBT

by Raymond M. Kang, Esquire

LIMITED LIABILITY COMPANY – THE PREFERRED CHOICE

When you select the structure under which you will operate your business, you are making one of your most important business decisions. The basic organizational structures available to entrepreneurs today are sole proprietorships, partnerships, corporations, and limited liability companies.

The type of business organization you choose will depend on many factors, including the nature of the business operation, legal restrictions, capital needs, tax advantages, number of owners, planned life of the business, and whether you need to protect personal assets from business liabilities.

The most formal business structure available to business owners is the corporation. One reason why business owners frequently choose the corporate business structure is because the corporation provides limited liability for its owners. Another reason the corporate form is most frequently chosen, however, is simply because business owners are not aware of the alternatives.

The limited liability company, or LLC, is an increasingly popular alternative to the corporation. Like the corporation, an LLC offers the same limited liability to its owners. This means that the owners' personal assets are protected from business liabilities and other legal obligations such as court judgments and legal settlements obtained against the business. An investor in an LLC normally has at risk only his or her share of capital paid into the business. The following are three of the most frequently asked questions by business owners when deciding on whether to structure their business as an LLC.

1. Why do you recommend the LLC over the Corporation?

Just like the corporation, the LLC provides its owners with limited liability. In this respect, both the corporation and the LLC are equally effective if the business owner's primary concern is to protect his or her personal assets from business debts or other legal obligations of the business.

The corporation and the LLC are also equally effective from a tax perspective, since the IRS treats both the corporation with "S" election and the LLC as "pass-through" type tax entities. That is, the profits or losses of the business pass through the business and are reflected and taxed on the individual tax returns of the owners, rather than being reported and taxed to the business.

For the small business owner, however, despite these similarities, the LLC is more often recommended because it has an advantage over the corporation from an administrative standpoint. For the average small business owner, operating a business as an LLC is much simpler and costs less to maintain because there are fewer legal

formalities with which to comply. The LLC is relatively easy to form and requires minimal administrative work to maintain its status.

2. Why is the LLC superior to a Limited Partnership?

There are two major differences between the LLC and the limited partnership. First, a limited partnership must have at least one general partner that will have liability for the debts and other legal obligations of the business. This differs from the LLC since all members of an LLC are protected from the debts and liabilities of the business.

Second, limited partners, who are provided with limited liability, are prohibited from managing the business. If a limited partner is active in the business of the limited partnership, he or she typically loses the limited partner status with its attendant limited liability protection. This makes it more risky for investors who must turn over management of the business to a general partner. In contrast, all the LLC members have the opportunity to be involved in managing and running the business without losing the limited liability protection.

3. What types of businesses benefit the most from the LLC structure?

Actively run businesses with a limited number of owners. Owners numbering between one to about twenty keep the logistics of making collective business decisions manageable. With the LLC structure, all owners of the business enjoy limited liability and the flexibility of pass-through (partnership) tax treatment.

Small startup companies. New businesses generally wish to pass possible early-year losses along to owners to deduct against other income, such as salary, from other employment or income earned from investments.

Any business thinking of forming an "S" corporation. Like the LLC, the "S" corporation allows corporate profits or losses to pass through the business and be taxed to the individual shareholders. The "S" corporation tax election, however, comes at a fairly heavy price: "S" corporations must limit the number and types of shareholders. They are restricted as to (i) how they allocate profits and losses among the owners, (ii) the types of losses they can pass along to owners, and (iii) the kinds of stock they can issue to investors. Even if a business meets the "S" corporation tax requirements, it can inadvertently lose its eligibility, for example, when a disqualified shareholder inherits or purchases the stock.

Existing partnerships. Only the LLC provides the same tax treatment of business income as a partnership while insulating all owners (not just limited partners as in the case of a limited partnership) from personal liability for business debts and other legal obligations.

Businesses planning to hold property that will appreciate, such as real property. Because the LLC is a true pass-through tax entity, it allows a business that holds appreciating assets to avoid double taxation. In other words, when the business is sold, just the owners, not the entity itself, pay taxes on the profits from the sale.

Conclusion

The first and most important business decision a business owner must make is choosing the type of business structure under which to operate. Many factors must be considered in making this decision. In most cases, the primary objective of a business is to generate a profit while limiting exposure to liability. Because the LLC offers both legal and financial advantages, it has recently emerged and become the business structure of choice for businesses seeking to minimize risk. For businesses all over the nation, the LLC has become the preferred choice.

Raymond M. Kang, Esquire, is an associate at Mason, Griffin & Pierson, P.C. He is a graduateof Boston University and received his law degree from Rutgers Law School, Camden. Mr. Kang served as Law Clerk to the Honorable Edmund R. Bernhard, New Jersey Superior Court-Law Division, from 2000 to 2001. He is a member of the Mercer County and New Jersey State Bar Associations, and practices in the areas of Business and Banking law. Mr. Kang is admitted to practice law in New Jersey and Pennsylvania, and is an active member of the Korean-American community in New Jersey.