



***A GUIDE TO CREATING
A BUSINESS ENTITY IN NEW YORK***

**111 John Street, Suite 510
Tel: +1-212-619-4500
zara@zaralawny.com**

**New York, NY 10038, USA
Fax: +1-212-619-4520
www.zaralawny.com**

Introduction

If you plan to invest in or operate a business in the United States, you should be aware of the possible forms the business can assume. Each of these forms has distinctive benefits and drawbacks, which require careful consideration.

Even if you do not intend to operate any business in the United States yourself, you may find yourself dealing with American business entities. Your rights as a creditor of an American firm depend to some extent on the nature of the entity. In addition, if you at any time need to bring a lawsuit in the United States against an American business, you may find that the venue of your suit, and the mechanics of serving process on the Defendants, may be governed in part by the type of entity involved.

This Guide has been prepared for the foreign or domestic businessman that seeks to set up a business in the State of New York. However some of the information here provided may be also somewhat relevant to those seeking to set-up a business outside New York, as many US states' laws provide for the same or comparable forms of corporate/business entities.

BASIC CHARACTERISTICS OF BUSINESS ORGANIZATIONS

	No Formalities of Formation	Single Level of Taxation	No Personal Liability
Limited Liability Company		X	X
C-Corporation			X
S-Corporation		X	X
Partnership	X	X	
Limited Partnership		X	X*

* For limited partners only.

THE LIMITED LIABILITY COMPANY

A newer form of entity that has attracted much interest is the limited liability company ("LLC"). In New York, LLCs have been around since 1994. Today LLCs can be formed in any US state. The LLC's popularity greatly increased following the IRS's 1997 "check the box" option on LLC Tax Returns, allowing them to elect to be taxed as a partnership. The owners of an LLC, called the Members, receive the tax benefits of the partnership as well as the shield from personal liability that Corporations provide. For this reason, the LLC is of all available entities, the one (1) that we generally recommend to our Clients.

The organization of the LLC is in some respects similar to that of the Corporation. The basic structure of the LLC is set forth in the Articles of Organization. The Operating Agreement, a contract signed by the LLC's Members, sets forth in greater detail, the workings of the LLC, and their respective rights and obligations.

The Members of an LLC can operate the company themselves; or they can by the terms of the Articles of Organization, delegate the powers of management to one or more members, called Managers. The New York Limited Liability Company Law ("LLC Law") provides that unless otherwise provided in its Articles of Organization, management of the LLC is vested in its members who shall manage it in accordance with the LLC Law subject to any provisions in the Articles of Organization or in the Operating Agreement.

The LLC Law also provides that each member of a member-managed LLC -as well as managers clothed with management authority in the Articles of Organization-may bind the LLC in its everyday business operations. We therefore carefully restrict the scope of their respective authority in the Operating Agreement, and we note the fact of any such restrictions in the Articles of Organization. As it is a publicly filed document, any third party is by operation of law deemed to have notice of any restrictions on the members' or managers' authority to bind the LLC, noted in the Articles of Organization.

Depending on the client's objectives, we sometimes set up the LLC as a manager managed -as opposed to member managed, the default set up- but with the core members being the initial managers. Since the LLC will not be member managed, this prevents additional members of the LLC from having the management and agency powers of members automatically vested in them by virtue of the LLC Law.

Advantages:

- 1.** Limited liability—the owners and managers of a limited liability company are generally not personally liable for the debts of the LLC.
- 2.** One level of taxation—unlike Corporations, the profits and losses of the LLC are like those of partnerships, passed along tax-free to the members.

3. Personal tax advantages for the members and managers-unlike Corporations, if the LLC incurs losses, and assuming they have a capital basis, paid-in capital, or retained earnings, members of an LLC may like partners in a partnership and to the extent allowed by the tax law, deduct the LLC's losses from their personal income taxes.

4. Financing options-The LLC can sell membership interests, in smaller or larger portions, to prospective investors. In addition, banks and other financial institutions are more willing to extend loans to LLCs with a track-record, because of the permanence of existence, and the formality of organization of these entities.

Drawbacks:

1. Organizational formalities-the LLC cannot begin to operate until its Articles of Organization have been filed with the New York Secretary of State, or the appropriate authority in its home state.

2. Expenses-There are fees for filing the LLC's Articles of Organization at the office of the Secretary of State in Albany, as well as to satisfy the publication requirement.

3. Publication Requirement-like the Limited Partnership, all LLCs except certain theatrical production companies, must within 120 days of their formation, publish in two (2) local newspapers designated by the County Clerk in which the office of the LLC is located, each week for six (6) consecutive weeks, a copy of their Articles of Organization, or a notice containing the substance of the information thereof. By reason of Amendments to the LLC Law effective June 1, 2006, failure to so comply with the publication requirements results in the automatic suspension of the LLC's right to carry on, conduct or transact any business in the State of New York.

4. Time needed to complete formalities-This office can complete the filing needed for creating an LLC in about five (5) days. If there is urgent need, we can complete the incorporation process in a single day, assuming the client is willing to assume additional costs of expedited service with hand delivery of the Articles of Organisation to Albany/NY. The publication of the required notice and the filing of the required Certificate of Publication will take six (6) to eight (8) weeks. However satisfaction of the publication requirement is not necessary prior to commencement of the LLC's operations.

5. Lack of portability-The LLC must separately file for authority to do business in each additional state, beyond its home state.

When one of our clients requests our help in forming a LLC, we normally request certain information concerning the proposed business; please see the Information Checklist below.

THE CORPORATION

Until the LLC dethroned it, the Corporation was the preferred entity for most businesses in the United States, from the smallest to the largest.

The corporate form of business organization is based on the separation of ownership and management. It is true that a single individual can incorporate a business, and act as its sole shareholder, director, and officer. However, many if not most Corporations have multiple owners, the shareholders. At their annual meeting, the shareholders elect a board of directors, which is the policy-making body for the Corporation. The directors in turn choose a president, secretary, treasurer, and other officers to implement their decisions and run the day-to-day operations of the Corporation.

The basic organizational structure of the Corporation and its stock capitalization, are set forth in the Certificate of Incorporation, or Charter, a document that is filed with the state authorities. In addition, a Corporation's inner workings is set forth in its Bylaws, which detail the mechanics of its operation.

In small Corporations, sometimes referred to as "Closely held Corporations", the shareholders can agree to customize the operation of their Corporation to suit their needs. This is done by a Shareholders' Agreement, a formal document which governs both the ownership and the management of the Close Corporation. For instance, the Shareholders' Agreement will frequently name the persons who are to act permanently as directors, or as officers. It will also typically define how the shareholders can sell their shares, to whom, and under what circumstances. In Close Corporations, the shareholders usually prefer to buy back the stock of a departing shareholder rather than allow it to be sold to an outsider.

The basic type of Corporation is known as the C-Corporation, because it is governed for federal tax purposes by Subchapter C of the Internal Revenue Code ("IRC"). A Corporation that meets the requirements of IRC's Subchapter S can file to be treated as a S-Corporation. The following discussion of benefits and drawbacks applies to both C-Corporations and S-Corporations.

Advantages:

- 1. Lack of personal liability**—The owners and managers of a Corporation will generally not be personally liable for the debts of the Corporation.
- 2. Financing options**—The Corporation can sell its own stock, in smaller or larger portions, to prospective investors. In addition, banks and other financial institutions are more willing to extend loans to Corporations with a track-record, because of the permanence of existence, and the formality of organization of these entities.

3. Unlike Limited Liability Companies, and Limited Partnerships, see below, there is no publication requirement for Corporations, which results in cost-savings.

Drawbacks:

1. Organizational Formalities–The Corporation must file its certificate of incorporation, or Charter, with the appropriate state officials (in New York, the Secretary of State in Albany).

2. Time for Incorporation–A Corporation cannot operate as such until its Certificate has been filed; to do so may result in personal liability for the officers who so acted. The time needed to incorporate is generally the same as that for LLCs.

3. Lack of Portability–Like the LLC, in order to operate in states other than its state of incorporation, the Corporation must file for permission to do business in each additional state, and pay a fee.

4. Expense–The expense of filing a Corporation’s Certificate depends in part on the number and par value of its shares of stock. In addition there is an annual tax, called the franchise tax, imposed each year of continued corporate existence.

5. Double taxation–Unless the Corporation is organized as an S–Corporation (see below), the income of the Corporation is taxed twice: Once as corporate income, and a second time as dividends, salaries, distributions etc... to the shareholders, officers, and directors.

Special Consideration: The S–Corporation and taxation

The major difference between C–Corporations and S–Corporations is their tax treatment. The income of the C–Corporation is taxed at the corporate level. Subsequently, when transferred to the stockholders as dividends or to the officers as salary, this income is taxed *again* at the individual level.

By comparison, the income of the S–Corporation is taxed only once. The S Corporation is a pass–through tax entity– this means that the income or loss generated by the business is reflected pro-rata on the personal income tax return of its owners. Shareholders in S–Corporations are treated essentially as partners, for tax purposes.

However in order to gain the benefits of Subchapter S, the Corporation must meet certain requirements. The most important of these are that:

1. It must have fewer than 100 shareholders;
2. All shareholders must be individuals;
3. No shareholder may be a non–resident alien for purposes of the IRC;
4. It must make a timely election of S–Corporation status; and
5. It must not have more than one (1) class of stock.

When our clients request our help in forming a Corporation, we normally request certain information and certain documents concerning the proposed business; please see the Information Checklist at the last section of this Guide.

THE PARTNERSHIP

Thirdly, if more than one owner will be involved, the business may operate as a partnership. If the partnership will use an assumed name, a "Business Certificate for Partners" must be filed in the County Clerk's Office¹, in the county where the business will be located.

Whenever the ownership of a business is to be shared by more than one (1) individual, the partnership is a possible choice of entity. The ordinary partnership (not to be confused with the limited partnership discussed separately below) is made up of individuals who contribute assets or services to a commonly-owned business, act as general partners with full personal liability for the business's debts, and share the profits and losses of the business.

An important tax consideration for some partners is that they can under certain circumstances deduct from their personal income tax returns, their share of the business losses of the partnership.

The partnership does not have the formal organizational hierarchy of the Corporation, and all partners are entitled to a share in the management of the partnership. Under New York law, each partner is an agent of the partnership, authorized to bind the partnership by contract. This fact illustrates the importance of choosing partners with great care.

Advantages:

- 1. Limited formalities of commencement**—Under New York law, a partnership can be created simply by agreement between the partners, without filing or notice to governmental agencies of any kind, except if it will use an assumed name, see previous page. However, it is unwise for partners to commence operation without a written Agreement of Co-Partnership, which should be drafted by a lawyer. This agreement will set forth the division of ownership, responsibilities, profits and losses between the parties.
- 2. Immediate operation**—There is no required waiting period before the partnership can commence operations.
- 3. No required fees for commencing operation**— but note comment, above, about the advisability of a partnership agreement.

4. One Level of Taxation–The partnership must file a tax return but its profits or losses are passed on to the partners without taxation at the partnership level.

5. Portability-The partnership does not have to file for authority to do business in another state.

Drawbacks:

1. Personal Liability–All the partners are personally liable for the debts of the partnership.

2. Deadlock–Partnerships are peculiarly subject to problems of deadlock, when there is disagreement as to fundamental, or even trivial questions of operation. A partnership usually cannot oust a dissatisfied partner, and may be forced by the courts to dissolve at the petition of the minority partners.

THE LIMITED PARTNERSHIP

A less commonly–used form of business operation is the limited partnership ("LP"), which offers some of the benefits of corporate existence without all its drawbacks.

In order to create a LP, the members are required to file with the New York Department of State², a Certificate of Limited Partnership, containing inter–alia the name of the partnership, the character of the business, the name and place of residence of each member, general and limited partners being respectively designated, the property, money or other, contributed to the partnership by each limited partner, etc.

Being strictly a creature of statute, a LP resembles a Corporation more closely than it does an ordinary partnership.

The membership of a LP consists of at least one (1) general partner, and any number of limited partners. A limited partner is only allowed to contribute cash or other property, but not services, to the partnership.

A LP is best suited for an entity that needs large amounts of capital, and that will be operated by a single person or small group with special experience in a certain industry. It is also a recognized way of capitalizing on tax loss benefits. In Manhattan, LPs are common in the real estate and entertainment industries, but not in ordinary commercial enterprises, where the LLC reigns supreme.

Advantages:

- 1.** No personal liability for the limited partners—A limited partner is not personally liable for the debts of the partnership, unless in addition to exercise of his/her rights and powers of limited partners, he/she takes part in control of the business, or actively participates in the business. But the general partner is personally liable for all the debts of the Limited Partnership.
- 2.** One level of taxation—the partnership must file a tax return but its losses and profits are passed on tax-free to the partners.
- 3.** Financing opportunities—LP interests can be bought and sold like corporate stock.

Drawbacks:

- 1.** Organizational formalities—Like a Corporation, and a LLC, a LP must initially file (Certificate of Limited Partnership) with the authorities, in New York State, the New York Department of State.
- 2.** Unlimited liability for the general partner(s).
- 3.** Publication—like the LLC, all Limited Partnerships except certain involved in theatrical production publish in two (2) local newspapers designated by the County Clerk in which the office of the LP is located, each week for six (6) consecutive weeks, a copy of their Certificate of Limited Partnership, or a notice containing the substance of the information thereof. By reason of Amendments to the LP Law effective June 1, 2006, failure to so comply with the publication requirements results in the automatic suspension of the LP's right to carry on, conduct or transact any business in the State of New York.
- 4.** Time needed to complete formalities—The time needed to complete the organization of a LP includes not only the preparation and filing of the necessary documents, but also the publication period, same time periods as for LLCs. As with LLCs, satisfaction of the publication requirement is not necessary prior to commencement of the LP's operations.
- 5.** Lack of portability—Like the Corporation and the LLC, the LP must separately file for authority to do business in each additional state, beyond its home state.

When our clients request our help in forming a LP, we normally request certain information concerning the proposed business, please see the Information Checklist at the last section of this Guide.

Finally please note that you may also operate your business as a Sole Proprietorship. It may be tempting to forgo setting-up any any of the entities described hereof, as well as the attending costs and delays involved and immediately start operating your business as a Sole Proprietor. However, you should know that a Sole Proprietor is personally liable for all the debts and liabilities of the business. Moreover, operating your

business as a Sole Proprietor will not necessarily convey the most professional image, an important consideration particularly when starting out.

For both of those reasons, in most instances we do not recommend that you operate your business as a sole proprietorship.

OBTAINING AN EIN NUMBER:

For all entities described hereof, we will in most instances³ also need to file an SS-4, Application for an Employer Identification Number (EIN). The EIN is required by law, and moreover without it, US Banks will not open a bank account for the business. To obtain an EIN, we will need the US Social Security Number (SSN) of one (1) of the owners of the entity. If our client does not have such a SSN, we first have to obtain an Individual Taxpayer Identification Number (ITIN) for the foreign owner. Once we have obtained the foreign owner's ITIN, we can then obtain the entity's EIN.

SPECIAL CONSIDERATION: USING AN ASSUMED NAME

All entities described in this Guide may operate under an Assumed Name, however the filing requirements differ: Corporations, LPs and LLCs may use an Assumed Name, by causing the New York Department of State to file the requisite Certificate of Assumed Name setting forth:

1. The name or designation under which business is carried on or conducted or transacted,
2. The Corporation's, LP's or LLC's name,
3. The location including number and street, if any, of its principal place of business in New York state,
4. The name of each county in New York State in which it does business or intends to do business,
5. The location including number and street, if any of each place where it carries on or conducts or transacts business in the state.

General Partnerships and Sole Proprietorships need to file their Certificate of Assumed Name, directly with the County Clerk in each of the New York State Counties in which they will conduct business.

THE IMPORTANCE OF KEEPING GOOD CORPORATE RECORDS

For the entities described hereof, another point that cannot be stressed too strongly is the importance of keeping timely and accurate, formal written records (called "minutes" and "resolutions") of the entity's decisions and activities, and to strictly respect its separate juridical existence. Sometimes owners, directors or even officers of small businesses neglect these formalities. They may also treat their entity's assets like their personal assets, and in a financial crisis for example, intermingle their personal bank accounts with those of their entity.

One danger in such circumstances is that New York Courts may be called upon to disregard the separate juridical existence of the entity which even its owners, directors or officers failed to respect, and "pierce its corporate veil."

For example aggrieved creditors of the entity sometimes bring an action for "corporate waste", alleging the Officers or Directors neglected or failed to perform, their respective duties in the management and disposition of corporate assets; or that they acquired for themselves, or transferred to others, or caused the loss or waste of corporate assets due to their neglect of their respective duties. If successful, the Court will place personal liability for the entity's debts on the shoulders of the individuals involved. Keeping clear, written, formal corporate records helps defend against "piercing the corporate veil."

Another danger when no corporate records are kept, is the inability to prove the owners' agreed-to changes to the entity's ownership or operating structure.

THE IMPORTANCE OF RETAINING A GOOD TAX ADVISOR

The US taxes its citizens, green-card holders, as well as those foreigners that are deemed to be US persons, on their worldwide income. Complex tax rules e.g. US source income, or income effectively connected with the operation of a US trade/business, apply to foreigners' business operations. In addition your country is likely to have a Bilateral Income Tax Treaty with the US under which you may be entitled to certain tax benefits including the avoidance of double-taxation. Finally the entities hereof described need to make periodic tax filings with US, State, and Local taxing authorities, or risk hefty penalties and interest. For all these reasons when planning the creation of a new entity, this office strongly recommends that an experienced tax advisor versed with the tax laws applicable to your particular situation, be employed to assure tax compliance. Sometimes the tax advisor will also be an accountant, and therefore he or she will be able to actually prepare your entity's tax returns. At other times, you may also need an international tax lawyer, who often will not be an accountant. Working with them, we will help you structure your business in a way that is most-tax efficient.

INFORMATION CHECKLIST:

In order to assist our clients in setting up their business in the most expeditious way, we request the following information of all clients. If we receive all of this information at the first contact with our clients, we will be able to assist you more efficiently.

1. The client's name, and coordinates, and the name of any business the client is presently operating.
2. If the new business is to be a branch of a foreign business, whether and where the foreign business is incorporated.
3. The name of the new entity to be created, and if available, its intended address in the United States.
4. The type of business to be commenced, including the type of product or service to be sold or produced, and whether the sales will be wholesale or retail.
5. How many people will be employed at the United States address.
6. The U.S. Social Security number, if any, of one of the owners. If the owner has no US Social Security Number, we will obtain an Individual Taxpayer Identification Number (ITIN), for which we will need a copy of one (1) owner's passport.
7. The date the client wishes to commence operations in the United States.
8. If the business is to be a partnership:
 - The names, addresses, and citizenship of all partners;
 - The share of partnership interest each is to have;
 - The amount each partner is to contribute;
 - The partners' agreement as to management of the business; and
 - The partners' agreement as to the division of profits and losses.
9. If the business is to be a LP, all the information in paragraph 8, plus the names of the General Partners, and those of the Limited Partners.
10. If the business is to be a LLC or a Corporation:
 - The names, addresses, and citizenship of all the parties who will be shareholders or members–managers;
 - The share of ownership in the Corporation or LLC of each such shareholder or member;
 - If a Corporation, the names of the persons who will be directors if a Corporation (must be at least two (2), unless there is only one (1) shareholder);

- If a Corporation, the names of the persons who will be president, treasurer, and secretary (if only one shareholder, he or she may hold all these posts);
- If an LLC, the names of the members who will be managers of the LLC.

11. If a Corporation is desired, whether it is to be an S–Corporation or a C–Corporation.

12. If a Corporation is desired, the number and par–value of stock the Corporation will be authorized to issue. Unless our clients desire a different arrangement, this office normally incorporates Corporations with 200 shares of no–par stock. No–par stock is stock that does not have a stated (usually nominal) value, set forth in the Charter of the Corporation.

13. Whether the business entity is to have an accounting year beginning other than on January 1.

14. If a Corporation is desired, and the client wishes a shareholders’ agreement, we will discuss various other questions, including restrictions on transfer of stock, and control of the voting of stock for management.

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