To: Carrie and Samantha

From: Nicole Bilder, Linda Chen, David Donchez, Sarah Misiano

Date: April 10, 2015

Re: Stylish in the City

Thank you for the information you provided.  We have identified a few possible options for your business based on this information.  However, by answering a few additional questions, we may be able to better assist you.  After assessing your profile, creating a Limited Partnership seems like it could be the best option.

By choosing a limited partnership as the entity for your business, you would be able to manage your business as a typical partnership, but also have other partners that would have limited liability (called limited partners). In other words, the other people investing in your business would only be involved through their investments and would not be involved in the actual management of your business.  This type of business is great for attracting investors because the investors’ personal assets would not be at risk.  These partners are only liable for their investments while the general partners, you both, would have unlimited liability of your assets. The partners will report their shares of the profits and losses on their individual tax returns.  As noted on www.smallbusiness.chron.com, a limited partnership avoids being double taxed, as profits are passed to the partners and not taxed at the company level.  To create a limited partnership, you would need to file for a Certificate of Limited Partnership with the State of Pennsylvania. Along with filing the Certificate of Limited Partnership, the name of your business would need to include “Limited Partnership”. This would be a great option for your business because you expressed that there would be multiple partners involved with investments, but not involved in managing the business.  The drawback to this business form is that you two would have unlimited liability if the business were to fail.

Another business form that should be considered for Stylish in the City is a Limited Liability Company (LLC). This is a fairly new, but popular, business form that offers the limited liability of a corporation, yet has the tax advantages of a partnership. This is beneficial for your both you and your investors, which would both would be called “members”, because you would both have limited liability.  The tax implications also fit your situation because all profits and losses are listed on the members’ individual tax returns. To form an LLC in Pennsylvania, Penn State Law provides that you must file a Certificate of Organization and a Docketing Statement with the Corporation Bureau of the Pennsylvania Department of State.  Also, your business name must include “LLC”.  LLCs also do not require you to write operating agreements, though it is wise for multi-member LLCs because they include many important details, such as money allocation and interest.  An LLC could be a good fit for Stylish in the City because it is going to be funded by friends and family investments, who would want limited liability, and you both would have all the power to run it.  As you mentioned in your original memo, you may want to hire other people to manage your business, due to your limited experience.  If you decided to go through with this, you and your investors would mutually approve of someone else to manage the company, which would create a Manager-Managed LLC.  Having to allow your investors’ input on appointing a manager for the company could be a potential downside to this business form.

The other option to consider is forming a Subchapter S Corporation.  A Subchapter S Corporation could be good for Stylish in the City because your business would [essentially] pay no taxes.  Instead of filing taxes for the business, profits and losses would go on the personal tax returns of your stockholders, who would be yourselves and the friends and relatives that you mentioned are interested in investing.  In order to form this type of business entity, all of your stockholders (investors) must agree to form an S Corporation, and they must all be United States citizens.  Like a limited partnership, an S Corporation’s stockholders cannot be held personally liable as they have limited liability.  A Subchapter S Corporation is probably not the best option because, in Pennsylvania, the business must first be registered as a regular corporation before applying for S Corporation status, which is a very costly and complex process.  Also, there are many restrictions, guidelines, and rules for forming an S Corporation, which can be found at www.irs.gov/pub/irs-pdf/i2553.pdf.  Due to cost restrictions, we do not recommend an S Corporation as a top option.

Some options to avoid include corporation, partnership, limited liability partnership and sole proprietorship. With the information you provided, we have concluded that a corporation would not be suitable for your situation because of the high start-up costs. It is very expensive to start a corporation and as you expressed, you do not have a lot of funds for start-up. In addition, you should avoid a regular partnership of the difficulty to raise funds.  Also, partnerships typically terminates with the death of a partner.  It would not be wise to choose a limited liability partnership because all partners are involved in managing the business, which you expressed that you may not want in your business. Limited liability partnerships are usually used by professionals, such as doctors and lawyers, and in some states, limited liability partnerships are strictly reserved for these types of firms.  Finally, you cannot create a sole proprietorship because since you are two people, you will not be owning and/or operating the business solely.

To determine the best option for Stylish in the City, it is important to consider what you would both want in regarding termination.  A major questions to answer is whether or not the business should dissolve when either partner dies?  In addition to determining your desires for dissolution, you should consider how you both feel about liability and taxes.  Would you prefer to file taxes for Stylish in the City separately from your personal tax returns?  In your original memo, you noted that you do not have much in terms of assets; are you comfortable with having personal liability for the business?  If you feel that limited liability is necessary, a limited partnership is not an option for you, and therefore we would highly recommend the limited liability company.  Another thing to consider is whether or not you plan on having internet sales.  If you are, www.pabizonline.com instructs that you should contact the Pennsylvania Department of Revenue for information regarding taxes and regulations.

Because Stylish in the City is considered a fictitious name (not the name of the owners), www.pabizonline.com notes that you must register this name in order to enforce a contract in a Pennsylvania court.   It is also extremely important to have a business plan for Stylish in the City.  More information about business plans can be found on the Small Business Administration’s website, www.sba.gov.  An agreement between you both is necessary as well.  An operating agreement between should spell out both of your expectations now to avoid arguments and uncertainty later.  Having a well-written and well thought-out operating agreement can help prevent the need for costly litigation later.

Thank you again for contacting us.  As described above, a limited partnership or a limited liability company seem to be the best options for you.  To assist you with more personalized legal counseling, please respond with any additional details you may be able to provide, as well as the answers to the few above questions.  We look forward to working with you further.