How To Use These Notes

These study notes are strategically broken down into the most important topics related to Business Structure on the Regulation (REG) section of the CPA Exam.

There are 3 popular ways people use these notes:

1. Read a section before watching your CPA review videos to get an understanding of the topic
2. Review a section periodically as a refresher to keep the material fresh
3. Review / rewrite all the notes in the 2 weeks leading up to your exam date to ensure the material is fresh in your mind

If you would like more helpful review materials, check out www.pedersoncpareview.com for MP3 audio notes, flashcards, videos and live, one-on-one help from me.

If you find these notes valuable, please consider buying the full set of REG Study Notes or signing up for my review course at Pederson CPA Review.

Best of luck with the exam.

Rob Pederson, CPA, CMA, CFM

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Business Structure

Sole Proprietor – An individual engaging in a business.

No federal or state filings are required but proprietor may decide to make a fictitious name filing

Not a separate legal entity

Capital is limited to owner's funds

Simplest business structure

General Partnership – Has 2 or more partners.

Treated as a pass-through entity for tax

Written articles are not required

Cannot be a not-for-profit

General Partner – Manages the partnership and has unlimited personal liability.

Can be a general partner and limited partner at the same time

Limited Partnership – Must have at least 1 general partner.

Death of a limited partner does not cause dissolution of partnership

Limited Partner – Partner in a partnership whose liability is limited to the extent of his/her share of ownership.

If a limited partner acts like a general partner and a 3rd party does not know the partner is a limited partner, the limited partner has unlimited liability relative to dealings with that 3rd party

Can act as an agent of a partnership or vote on removal of a general partner without losing limited liability
Limited partners do not owe a fiduciary duty to the partnership

**Silent Partner** – Does not help manage the partnership – usually just provides cash.

Still has unlimited liability

**Partnership Agreement** – Can be express or implied.

Can be oral or in writing

A partnership whose activities cannot be completed in 1 year must be in writing

**Partner Capital Contributions** – Consist of assets, cash, services performed, or promises to give or perform at a future date.

**Partnership Obligations** – Paid first from partnership capital and then from the personal assets of general partners if partnership capital is not enough.

**Revised Uniform Partnership Act (RUPA)** – Establishes that partners have joint and several liability.

A partnership is an entity that can own property

- Partnership property is property bought in the partnership’s name plus property bought by a partner using partnership funds

- Property can be used in a partnership without being partnership property

**Partnership Profit And Loss** – Partners can agree to share profit and losses unequally.

- Generally sharing is equal unless otherwise agreed

- Losses are shared in proportion to profits unless otherwise specified

**Revised Uniform Limited Partnership Act (RULPA)** – When there is no agreement on splitting profits and losses, they are split based on relative contributions.

- No names of limited partners need to be listed in the certificate of limited partnership filed with the secretary of state
New partners require the approval of all partners, even limited partners

**Negative Capital Balance** - If 1 partner has a negative capital balance, the partner can invest more cash or assets or the deficit gets allocated to the other partners based on the profit and loss sharing ratio.

**New Partner** – Has all the same rights of existing partners.

General partnership requires unanimous consent of all partners before admitting a new partner

**Partnership Dissolution** – Any partner can cause a partnership dissolution by withdrawing from the partnership.

A partner can withdraw at any time irrespective of the terms of the partnership agreement

Remaining partners must decide to continue if they want to continue the partnership

Death or bankruptcy of a general partner causes dissolution of limited partnership

Death or bankruptcy of a limited partner does **not** cause dissolution

**Assigning Partnership Rights** – A partner can assign partnership rights to a 3rd party, but that 3rd party does not become a partner.

**Partner Apparent Authority** – Partners can legally bind the partnership to obligations if a 3rd party makes reasonable assumptions about the partner’s authority.

Authority is limited if the 3rd party knows there is a formal agreement that limits the partner’s authority

**Partner Implied Authority** – All partners have the authority to buy and sell goods, hire employees and enter into contracts.

Partners do not have the authority to make the partnership a surety or to add partners
**Joint Venture** – Similar to a partnership in that the venturers are personally liable, owe each other a fiduciary duty and participate in management of the venture.

    Death of a venturer does not cause dissolution of the venture

**Limited Liability Company (LLC)** – Structure that has similarities to both corporations and partnerships.

    Members have limited personal liability

    LLC’s have a limited duration of existence

    Death or withdrawal of 1 member causes dissolution of the LLC unless the remaining members choose to continue

    Can be taxed as a partnership or a corporation

    Separate legal entity from its members

    LLC’s can sue others or can be sued

    Members have a voice in management

    Owners or members owe a duty of care and a duty to be loyal to the LLC

    LLC interests are not transferrable

    LLC members have to agree on adding new members

**Limited Liability Partnership (LLP)** – Protects partners from personal liability including liability related to contracts or tort.

    Partners have unlimited liability for their own torts

    Certificate of Limited Partnership must be filed with Secretary of State

**Corporations** – Legally separate entities from their owners (shareholders).

    Shareholders have limited personal liability – limited to the amount of investment in the corporation
Managers have unlimited liability for their own actions

Managers may or may not be shareholders

Corporations have unlimited life that is not terminated by death of shareholders

Shares of corporation stock are freely transferrable to others

**Corporate Liability** - Corporations are liable for torts committed by employees while acting as employees.

Corporations are typically not liable for torts intentionally committed by employees unless the employee is an agent or appears to be an agent

Corporations can be liable for foreseeable violence (i.e. violence from employees with a history of violence)

**Employee Liability** – Employees can be held liable for crimes committed while acting as employees.

The corporation and the employee can both be liable for the same tort committed by the employee

**Shareholder Liability** – If a corporation is used to defraud people, the court can “pierce the corporate veil” and hold shareholders personally liable.

Likely if shareholders combine personal assets and records with corporate assets and records

**S Corporation (S Corp)** – Taxed differently than a C Corp.

Acts as a pass-through entity

The corporation is not taxed – income and losses pass through to the shareholders even if cash is not distributed

Any corporation that does not make the election to be an S corp is a C corp

**Domestic Corporation** – A corporation that does business in the state it is incorporated in.
Foreign Corporation – A corporation that does business in states it is not incorporated in.

There is no need for a corporation to incorporate in more than 1 state, but it must file documents to be approved to do business in other states

Professional Corporation – A corporation for professionals like accountants and attorneys.

There is limited personal liability for debt but unlimited personal liability for professional damage

Only licensed professionals can own shares

Corporate Formation – Corporations are formed according to state law.

Articles of Incorporation are filed with the Secretary of State

Revised Business Model Corporation Act – Articles of Incorporation must include the name, purpose, powers, name of incorporator, registered agent and number and type of shares authorized.

Corporations can indemnify officers for expenses, legal fees, judgments, and fines for shareholder lawsuits

As long as the officer was acting in good faith and did not act with negligence

Shareholder may dissent from corporate actions that are detrimental to his/her ownership and can get paid for the value of shares

Detrimental actions may be an amendment to the Articles of Incorporation that remove preferential rights or acquisition by another company

Shareholders have the right to inspect corporate records if done in good faith and for a good reason

Shareholders elect the Board of Directors and the Board elects officers
If a subsidiary is 90% or more owned, the 90% owners may merge the subsidiary without approval of the shareholders of the parent or the subsidiary.

Dissenting shareholders can get paid fair value for shares.

**Merger Of Public Companies** – Requires a formal merger plan and approval of the majority of both Boards of Directors and groups of shareholders.

Shareholders of both companies must be given notice, usually through a special meeting.

**Consolidation** – One new corporation comes from joining 2 or more corporations.

Assets and liabilities go into the new corporation.

**Voluntary Dissolution** – Corporations can be voluntarily dissolved with a resolution of the Board and the approval of the majority of shareholders.

File a certificate of dissolution, cease operations, finish up affairs and publish notice.

**Preemptive Rights Articles** – Allow shareholders to buy a proportionate number of shares of new stock issuance to prevent dilution.

The right to a proportionate share of corporate assets upon dissolution is a right of all shareholders, not just for those who have preemptive rights.

**Powers Of The Board Of Directors** – The Board can adopt, amend or repeal bylaws, declare dividends, and set director and management compensation.

Cannot affect Articles of Incorporation.

Articles can only be amended by the shareholders.
**Director Conflicts Of Interest** – Transactions with directors are **not** conflicts of interest if 3 criteria are met:

1. The transaction is fair and reasonable
2. Shareholders are given all the facts and the majority approve
3. The Board is given all the facts and the majority approve

If the transaction is fair and reasonable, there is no breach of fiduciary duty

**Fiduciary Duty** – Officers and directors owe a fiduciary duty to act in the best interest of the corporation.

Majority shareholders owe a fiduciary duty to minority shareholders

**Director Liability** – Directors can go to jail for crimes committed by their corporations.

Corporations can purchase insurance to cover lawsuits against directors and officers

**Promoter** – Solicits people to invest money in a corporation when the corporation is being formed.

Promoters are **not** agents of the corporation

Promoters can be liable for contracts of the corporation if the promoter is incorrectly acting as an agent

**Stock** – Corporations can have many different classes of common and preferred stock.

**Shareholders** – Unsecured creditors.

Shares can be purchased using cash, assets, services or services yet to be performed

Shareholders must approve loans to directors
**Par Value** – Lowest amount a share of stock may initially be sold for.

- Does not apply to re-sales of treasury stock
- Stockholders who buy for less than par are liable for the difference between the sale price and par value
- Not applicable to treasury shares

**Watered Stock** – Stock acquired by exchanging cash or property worth less than par value.

**Stock Split** – In a stock split, the number of shares increases and the par value decreases so that the total par value is the same before and after the split.

**Stock Subscription** – A stock subscription is a binding contract.

- Creditors can collect on the subscription contract if the company goes bankrupt

**Treasury Stock** – Shares repurchased by the company that issued them.

- Not voting
- Shares are considered issued but not outstanding
  - **No** shareholder approval needed to buy back or retire shares

**Corporate Debt** – Includes:

- Registered bonds
- Bearer bonds
- Debenture bonds
- Mortgage bonds
- Redeemable bonds
- Convertible bonds

- Does not include warrants
- A bond is long-term secured debt
A debenture is long-term unsecured debt

Cash dividends declared on preferred stock become legal debt of the corporation

Unpaid dividends are not debt unless they have been declared

**Short Form Merger** – Merger between a parent company and its subsidiary.

Example – The parent owns 90% of a subsidiary. It can use a short form merger to buy out the remaining 10%. No shareholder vote of the subsidiary is required.