

An Introduction To Business Organizations

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The following outline is intended to acquaint the reader with the different forms in which businesses are commonly conducted. It is greatly simplified.

I. COMMON FORMS OF BUSINESS ORGANIZATIONS

The seven most common forms of business organizations are:

1. the sole proprietorship;
2. the general partnership;
3. the limited partnership;
4. the business trust with transferable shares;
5. the business corporation;
6. the limited liability company; and
7. the limited liability partnership.

Each of these forms of business organizations differs from the others in terms of (a) governing law, (b) the formalities of organization, (c) control and management of the business, (d) personal liability of the owners, (e) continuity of legal existence and (f) transferability of interests in the business. Each has distinctive tax advantages and disadvantages.

The distinguishing characteristics of each form of business organization under Massachusetts law are discussed in Sections II-VIII below. The principal tax consequences of each form of business organization are discussed in summary fashion in Section IX.

II. THE SOLE PROPRIETORSHIP

The simplest form of a business organization is the sole proprietorship. A sole proprietorship consists of an individual doing business for himself or herself. For example, an individual attorney, practicing alone or with a hired associate, paralegal, or secretary, is a sole proprietor.

A. Governing Law

No specific statute governs the formation of a sole proprietorship. A sole proprietorship, like every other form of business organization, is, of course, subject to any licensing or other requirements applicable to the kind of business or the particular activities in which it may engage. Sole proprietorships, like any other form of business not specifically exempted, must comply with the "business name statute," G. L. c. 110. The business name statute is discussed in greater detail in Section XI infra.

B. Formalities of Organization

No formal document or filing is required for the creation of a sole proprietorship.

C. Control and Management

The owner of a sole proprietorship is in full and absolute control of the business. No one else has a right to participate in management, although the owner may by contract delegate authority to employees or agents. A sole proprietor does not share profits and must bear all losses of the business.

D. Liability of Owner

In the absence of a contract to the contrary, a sole proprietor is personally liable for all obligations of the business to the full extent of his personal and business assets. He or she is also liable for any torts which he personally commits, as well as for those committed by his employees within the scope of their employment. Certain potential tort liabilities may, of course, be covered by insurance.

E. Continuity of Existence

A sole proprietorship terminates on the death of the proprietor. Thus, a sole proprietorship, technically, has no continuity of existence.

F. Transferability of Interests

The business of a sole proprietor may be transferred as a whole. However, fractional interests in the business may not be transferred to others without adopting a new form of organization.

III. THE GENERAL PARTNERSHIP

A partnership is an association of two or more persons to carry on as co-owners, a business for profit. (G. L. c. 108A, §6). Two or more attorneys, for example, may conduct their practice as a general partnership.

A. Governing Law

General partnerships are governed by the Uniform Partnership Act (G. L. c. 108A), which has been adopted, with some variations, in 48 states.

B. Formalities of Organization

A partnership may be formed either by agreement or by conduct of the parties, express or implied. Although no written agreement is necessary to establish a general partnership, it is usually desirable to define the rights and duties of the partners to one another in a written partnership agreement.

C. Control and Management

In the absence of an agreement to the contrary, each partner has an equal voice in the management and control of the partnership; in the event of disagreement, a numerical majority of the partners controls. This general principle may be varied by agreement.

D. Liability of Owners

Each partner in a general partnership has full personal liability for all partnership obligations. The partners are jointly and severally liable for the damages caused by any tort or breach of trust committed by a partner within the scope of the partnership business and are jointly liable for all other partnership obligations. (G. L. c. 108A, §15). Newly admitted partners are liable only for future obligations; retired partners only for past obligations. (G. L. c. 108A, §§17 and 36).

E. Continuity of Existence

When any partner ceases to be a member of the firm, whether through withdrawal, expulsion or death, a technical dissolution of the partnership occurs. (G. L. c. 108A, §§29 and 31). Dissolution may also be occasioned by a number of other events, including, in some instances, a court decree. (See G. L. c. 108A, §§31 and 32 for the causes of dissolution.) Thus, like the sole proprietorship, the partnership does not, at least theoretically, possess perpetual life.

F. Transferability of Interests

Partners have three types of property rights:

1. rights in specific partnership property;
2. interests in the partnership (i.e., their respective shares of partnership capital and profits); and
3. rights to participate in management. (G. L. c. 108A, §24).

A partner's rights in specific partnership property are not assignable except in connection with the assignment of the rights of all the parties to the same property. (G. L. c. 108A, §25(2)(b)).

A partner's interest in the partnership (i.e., his share of the partnership capital and profits) may be assigned; but, in the absence of agreement by the other partners, the assignment does not entitle the assignee to participate in the management or administration of the partnership business, or to require any information or account of partnership transactions, or to inspect the partnership books. It merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled. (G. L. c. 108A, §27(1)). Thus, general partnerships have only limited transferability of interests.

IV. THE LIMITED PARTNERSHIP

A limited partnership is a partnership formed by two or more persons under a special statute, having as members one or more "general partners" and one or more "limited partners." The basic distinction between a general partnership and a limited partnership arises from the presence and status of limited partners. The status of a limited partner differs from that of a general partner in two principal respects: (i) the liability of each limited partner is limited to the amount of his capital contribution to the partnership; and (ii) a limited partner may not participate in the control and management of the partnership. A limited partnership thus encourages capital investment by persons not wishing to risk more than the amount they invest.

A. Governing Law

In Massachusetts, limited partnerships are governed by the Revised Uniform Limited Partnership Act. (G. L. c. 109).

B. Formalities of Organization

A limited partnership is formed by substantial compliance with two requirements:

1. each of the general partners desiring to form a limited partnership must execute a certificate containing the information set forth below; and
2. the certificate must be filed in the office of the Secretary of the Commonwealth. (G. L. c. 109, §8). The current filing fee in Massachusetts is \$200.

Most limited partnerships are governed by a comprehensive limited partnership agreement which need not be a part of the public record.

C. Control and Management

Except for the exercise of certain limited rights, a limited partner may not take part in control and management of the partnership without risking the loss of limited liability. (G. L. c. 109, §19). Accordingly, virtually all limited partnership agreements vest exclusive power over the business in the general partners. The general partners of a limited partnership have all the powers and duties of partners in a general partnership. (G. L. c. 109, §24).

D. Liability of Owners

In every limited partnership there must be at least one general partner with full personal liability. (G. L. c. 109, §1(7)). A limited partner is not liable to the creditors of the partnership beyond the amount of his contribution to the partnership unless, as indicated above, he takes part in the control of the business. (G. L. c. 109, §19).

E. Continuity of Existence

Under G. L. c. 109, §44, a limited partnership is dissolved and its affairs shall be wound up upon the happening of the first to occur of the following:

1. at the time or upon the happening of events specified in the certificate of limited partnership;
2. written consent of all partners;
3. an event of withdrawal of a general partner unless at the time there is at least one other general partner and the certificate of limited partnership permits the

business of the limited partnership to be carried on by the remaining general partner and that partner does so, but the limited partnership is not dissolved and is not required to be wound up by reason of any event of withdrawal, if, within 90 days after the withdrawal, all partners agree in writing to continue the business of the limited partnership and to the appointment of one or more additional general partners if necessary or desired; or

4. entry of a decree of judicial dissolution. (G. L. c. 109, §45).

Unless the certificate provides otherwise, however, the withdrawal of a limited partner does not bring about a dissolution of the partnership. (G. L. c. 109, §44).

F. Transferability of Interests

Except as provided in the limited partnership agreement, a partnership interest is assignable in whole or in part. An assignment of a partnership interest does not dissolve a limited partnership or entitle the assignee to become or to exercise any rights of a partner (G. L. c. 109, §40). The assignee, may, however, be substituted as a limited partner only if and to the extent that (1) the assignor gives the assignee that right in accordance with authority described in the certificate of limited partnership, or (2) all other partners agree. Unless the assignee is substituted as a limited partner, an assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled. Except as provided in the partnership agreement, a partner ceases to be a partner upon the assignment of all his partnership interest. (G. L. c. 109, §§ 40 and 42).

V. THE BUSINESS TRUST

The business (or "Massachusetts") trust is, essentially, a business organization in the form of a trust. More precisely, the business trust is an unincorporated business organization created by an instrument by which property is held and managed by trustees for the benefit of the holders ("shareholders") of transferable certificates evidencing the beneficial interests in the trust estate. Many public utility holding companies in Massachusetts (for example, NStar, the parent holding company for Boston Edison and Commonwealth Energy System) are organized as business trusts.

A business trust partakes of many of the characteristics of a trust, a corporation, and of a partnership. For example, as a general rule, the instrument creating the business trust should be executed to conform to the law of trusts. Like a corporation, however, the shares of beneficial interest in the trust corpus may be made fully transferable and shareholders may elect the trustees. In addition, like a limited partnerships, the beneficial owners of the trust may not engage in the management and control of the business without risking personal liability for debts of the trust.

A. Governing Law

Business trusts are governed by Chapter 182; but this statute is far less comprehensive than those governing partnerships or corporations. Most of the attributes of a business trust are defined by Massachusetts case law.

B. Formalities of Organization

A business trust is formed under a written declaration or agreement of trust. The declaration of trust and amendments thereto should be recorded in the registry of deeds (if the trust owns real estate), and copies must be filed with the Secretary of the Commonwealth and with the clerk of every municipality where the trust has a usual place of business. (G. L. c. 182, §2).

C. Control and Management

The trustees are, customarily, the body charged with the control and management of the business trust. Management responsibilities may, of course, be delegated to one or more officers or employees. If shareholders participate in control and management, they risk being subjected to personal liability for the debts of the trust, on the analogy of limited partners who participate in control of a limited partnership. A specific stipulation to the contrary is frequently included in contracts signed by the trust. Unfortunately, the degree of control that will subject shareholders to personal liability is rather unclear. Some Massachusetts cases speak of "ultimate power of control" as the test, while others have held business trusts to be, in fact, partnerships by virtue of indirect control no greater than that available to corporate stockholders, such as the power to elect trustees or to terminate the trust. Hence, shareholders in a business trust always face the danger, however remote, of being held personally liable for the debts of the trust if they do anything more than act as mere beneficiaries to receive the income distributed to them. For this reason, many declarations of trust frequently provide that the beneficiaries have no power to elect the trustees.

D. Liability of Owners and Trustees

Unlike a corporation, a business trust cannot, in Massachusetts, own property or make contracts as an artificial person. Legal title to all trust property is in the trustees, and the trustees alone have power to make contracts. The rule in regard to such contracts is that debts may be enforced against the trust assets, but not against the trustee personally, nor against the shareholders. G. L. c. 182, §6 allows suit against the trust itself, as though it were a corporation. Shareholders who participate in the exercise, control or management of the trust may be subject to personal liability for the debts of the trust (see discussion in Section IV(C), supra).

E. Continuity of Existence

The existence of a business trust, unless the declaration of trust provides otherwise, is not interrupted by death or withdrawal of a shareholder.

F. Transferability of Interests

Shares of a business trust are freely transferable, subject to any restrictions that the declaration of trust may impose upon their transfer.

VI. THE BUSINESS CORPORATION

A corporation is a special legal entity created by statute. Its principal characteristics are centralized management in a board of directors, limited liability of stockholders, free transferability of interests by stockholders and perpetual existence. Most large business organizations, and many small ones, are conducted in the corporate form.

A. Governing Law

Each state has its own separate corporation law. In Massachusetts, business corporations are governed by G. L. c. 156B, the Massachusetts Business Corporation Law. "Foreign" corporations organized under the laws of other states must qualify to do business in Massachusetts under Chapter 181. Effective July 1, 2004, Massachusetts business corporations will be governed by new Chapter 156D, the Massachusetts Business Corporation Act. Qualifications of foreign corporations will be Part 15 of the new Act.

B. Formalities of Organization

A business corporation is created by the filing of articles of organization with the Secretary of the Commonwealth. (G. L. c. 156B, §13; G.L. c. 156D, § 2.01).

C. Control and Management

Theoretically, the board of directors is responsible for the governance of the corporation, the officers carry out the directives of the board, and the stockholders elect the directors to manage the corporation's business. In most small corporations, however, the owners actively participate in the management of the corporation. Furthermore, the articles of organization, by-laws or separate agreements among stockholders, such as voting agreements or voting trusts, may vary the traditional roles of the players. For example, stockholder agreements or voting trust agreement may limit the ability of the stockholders to exercise free choice in the election of directors and officers, or the articles of organization may require a stockholder vote for matters which in the absence of a requirement, could be determined by the board of directors without stockholder approval (such as the mortgage of substantially all of the assets of the corporation).

D. Liability of Owners

Liability of stockholders is generally limited to the consideration paid for their stock, provided that shares are fully paid and the corporation is adequately capitalized. Limited liability can be eroded by business necessities (e.g. banks may require stockholders to co-sign notes or guarantee corporate debts). In some cases, neglect of corporate recordkeeping or procedures, severe undercapitalization, or fraudulent conduct can result in loss of limited liability, a phenomenon called "piercing the corporate veil."

To maintain limited liability, corporate formalities must be observed, including the maintenance of corporate minutes, the holding of meetings, and the separation of financial records. Additional costs may be involved in establishing a business as a corporation, including incorporation and filing fees, legal and accounting expenses and the cost of preparing and filing separate tax returns.

E. Continuity of Existence

A corporation has perpetual life unless otherwise provided in its articles of organization. (G. L. c. 156B, §9; G.L. c. 156D, §3.02). The death or incapacity of a stockholder does not terminate a corporation's existence.

F. Transferability of Interests

Shares of corporate stock are freely transferable. Capital formation by corporations is thus facilitated since evidence of ownership can be transferred or pledged. The transferability of shares is, however, limited by federal and state securities laws and may be restricted by agreements among the stockholders. In a large, publicly traded company, free transferability of shares is essential; in a small corporation, transferability of shares may be disadvantageous, as when it is considered desirable to keep control within a small number of persons.

VII. THE LIMITED LIABILITY COMPANY

A limited liability company ("LLC") is a special unincorporated legal entity organized under a state statute that offers limited liability to all of its owners. The LLC form is flexible and can provide for centralized or decentralized management, free or restricted transferability of interests, and perpetual or limited existence. Accordingly, LLCs may have both partnership and corporate characteristics. LLCs were first authorized by statute in Massachusetts effective January 1, 1996 (St. 1995, c. 281, §18).

A. Governing Law

LLCs are governed by the Massachusetts Limited Liability Company Act (G. L. c. 156C). All fifty states have now enacted LLC statutes. "Foreign" LLCs organized under the laws of other states must register to do business in Massachusetts under G. L. c. 156C, §48.

B. Formalities of Organization

An LLC is created by the filing of a certificate of organization with the Secretary of the Commonwealth. (G. L. c. 156C, §12). Like limited partnerships, most LLCs are governed by a comprehensive written operating agreement, which need not be part of the public record.

C. Control and Management

An LLC may be managed by its owners, or "members", in a manner similar to a general partnership, or by one or more "managers", who may or may not be members. The degree of centralization of management of a given LLC is therefore subject to the choice of the persons organizing the LLC.

D. Liability of Owners

None of the members or managers of an LLC is personally liable for any debts, obligations or liabilities of the LLC. (G. L. c. 156C, §22). Unlike a limited partner of a limited partnership, a member of an LLC may take part in the operation of the business of the LLC without becoming personally liable for its debts.

E. Continuity of Existence

Under G. L. c. 156C, §43, an LLC is dissolved and its affairs wound up upon the first to occur of the following:

1. the time specified in the operating agreement;
2. the happening of any event specified in the operating agreement;
3. written consent of all members;
4. except as otherwise provided in a written operating agreement, the death, insanity, retirement, etc., of a member which terminates his membership in the LLC, unless the LLC is continued either by the consent of the remaining members within 90 days after the withdrawal or pursuant to a right to continue stated in a written operating agreement; or
5. a decree of judicial dissolution.

The existence of an LLC is therefore limited in the same manner as a limited partnership (see Section IV(E) above), unless the parties otherwise provide in a written operating agreement. By eliminating the events of dissolution in the operating agreement, it is possible for an LLC to have in effect a perpetual existence.

F. Transferability of Interests

A member's interest in an LLC is freely assignable in whole or in part except as provided in a written operating agreement, but an assignee has no right to participate in the management of the LLC or otherwise exercise a member's rights except upon compliance with procedures set forth in a written operating agreement or with the approval of all members. (G. L. c. 156C, §39).

Thus, the operating agreement can provide for complete or limited freedom of transferability of interests. An LLC interest may be evidenced by a transferable certificate similar to a stock certificate. (G. L. c. 156C, §39(c)).

VIII. THE LIMITED LIABILITY PARTNERSHIP

A registered limited liability partnership ("LLP") is a general partnership which files with the Secretary of the Commonwealth a brief registration form. (G. L. c. 108A, §45). An LLP is basically a general partnership in all respects, except that the partners in an LLP are not liable for the debts, obligations or liabilities of the LLP. LLPs were first authorized in Massachusetts by legislation effective January 1, 1996 (St. 1995, c. 281, §13). Many law firms and accounting firms formerly organized as partnerships have converted to the LLP form.

A. Governing Law

LLPs are governed by various provisions of the Uniform Partnership Act (G. L. c. 108A), particularly §§45-47. "Foreign" LLPs organized under the laws of other states are recognized in Massachusetts and are required to register with the Secretary of the Commonwealth in the same manner as domestic LLPs.

B. Formalities of Organization

An LLP must file a simple registration form with the Secretary of the Commonwealth and pay a \$500 filing fee. In order to retain its status, an LLP must also file an annual report with the Secretary of the Commonwealth and pay an annual \$500 fee (G. L. c. 108A, §45). Special requirements apply in the case of an LLP which provides professional services, including a requirement that such LLPs carry professional liability insurance or provide an escrow or letter of credit in an amount designated by the appropriate regulatory board. (G. L. c. 108A, §45).

C. Control and Management

Identical to a general partnership. (See Section III(C) above).

D. Liability of Owners

The partners in an LLP, unlike those in a general partnership, have no personal liability for any of the debts, obligations or liabilities of the LLP so long as it is registered. (G. L. c. 108A, §15(2)).

E. Continuity of Existence

Identical to a general partnership. (See Section III(E) above).

F. Transferability of Interests

Identical to a general partnership (see Section III(F) above).

The following table summarizes the various characteristics of the common forms of business organizations.

<i>Form of Business</i>	<i>Governing Law</i>	<i>Formalities of Organization</i>	<i>Control of Management</i>	<i>Liability of Owner(s)</i>	<i>Continuity of Existence</i>	<i>Transferability of Interests</i>
Sole Proprietorship	None (see G. L. c. 110 re: business name)	None	Vested in owner	Full personal liability	Terminates on death	None
General Partnership	G. L. c. 108A	None	Each general partner	Full personal liability of all partners	Terminates on death, withdrawal or change of partner	Limited
Limited Partnership	G. L. c. 109	File with Secretary of State	General partner(s)	Full personal liability of general partner	Terminates on withdrawal of general partner	Limited
Business Trust	G. L. c. 182	File with Secretary of State	Trustee(s)	Potential liability of beneficiaries	Rule against perpetuities	Free transferability of shares
Corporation	G. L. c. 156B; G.L. c. 156D	File with Secretary of State	Board of directors	None	Perpetual	Free transferability of stock
LLC	G. L. c. 156C	File with Secretary of State	Manager(s) or member(s)	None	Perpetual or limited	Free or limited transferability of interests
LLP	G. L. c.108A, §45	File with Secretary of State	Each general partner	None	Terminates on death, withdrawal or change of partner	Limited

IX. TAX CHARACTERISTICS OF THE COMMON FORMS OF BUSINESS ORGANIZATIONS

A. Sole Proprietorship

Because no separate entity is involved in the operation of a sole proprietorship, all items of income, gain, loss, deduction and credit for tax purposes are directly reported by a sole proprietor on Schedule C of his or her Federal and Massachusetts income tax returns.

Individuals are taxed on their taxable income at graduated rates for Federal income tax purposes, with a maximum rate for 2004 of 35% on ordinary income and 15% on most dividends and capital gains. For 2004, Massachusetts imposes a 5.3% tax on earned income, interest, dividends and long-term capital gains and a 12% tax on short-term capital gains.

B. General Partnership

A general partnership is a "pass through" entity for Federal and Massachusetts income tax purposes. Thus, a partnership does not itself pay income taxes. Instead, each partner reports his or her share of the partnership's income or loss on his or her individual return. A partnership files a Federal information return on Form 1065 and distributes to each partner a Schedule K-1 containing the tax information each partner needs to complete his or her personal return. Massachusetts partnerships must file a Form 3 with the Department of Revenue and distribute a Schedule 3K-1 to its partners.

A non-resident partner of a partnership doing business in Massachusetts is taxable on his or her share of income received by the partnership and allocable to Massachusetts.

C. Limited Partnership

Generally speaking, a limited partnership is taxed in the same manner as a general partnership for Federal and Massachusetts income tax purposes. Until the adoption of the "check-the-box" regulations by the IRS on January 1, 1997, some limited partnerships could be treated as corporations for tax purposes, if corporate characteristics (limited liability, centralization of management, free transferability of interests and continuity of life) predominated. See §7701 of the Internal Revenue Code of 1986. However, these new regulations—summarized in Section X(B) below—eliminate this risk.

D. Business Trust

A business trust is usually taxed as a corporation for Federal income tax purposes. It may, if qualified, elect to be an S corporation.

Under Massachusetts law, business trusts are subject to a special tax system applicable to "corporate trusts". (G. L. c. 62, §8). Corporate trusts with certain exceptions are subject to taxation in Massachusetts on the same basis as individuals, (i.e., 5.3% on earned income, interest,

dividends and long-term capital gains and 12% on short-term capital gains). Certain corporate trusts, such as mutual funds, REITs, REMICs and holding companies are exempt from Massachusetts tax. Corporate trusts file Form 3F with the Massachusetts Department of Revenue. Significantly, shareholders of corporate trusts are not taxed in Massachusetts on dividends received from the trust. (G. L. c. 62, §8). For Massachusetts purposes, therefore, a corporate trust is not subject to double taxation and is the "mirror image" of an S corporation, taxable on the corporate level, but not on the shareholder level.

E. Business Corporation

For Federal income tax purposes, business corporations can be classified as "S corporations" (those qualifying corporations electing favorable tax treatment under Subchapter S of the Internal Revenue Code) or "C corporations" (all others).

C corporations are subject to a Federal income tax at graduated rates with a maximum rate of 38% for 2004. Since a C corporation's shareholders are taxed again on the distribution of corporate earnings in the form of dividends, C corporation income is subject to "double taxation", first at the corporate level, and then at the shareholder level. For this reason, many corporations elect to be taxed as S corporations, which, generally speaking, are treated as "passthrough" entities similar to partnerships. S corporation income is thus subject to a single tax at the shareholder level. S corporation elections are discussed in greater detail in Section X(D) below.

C corporations doing business in Massachusetts are subject to the Massachusetts corporation excise tax under Chapter 63. This tax consists of two components: a 9.5% tax on corporate net income attributable to Massachusetts plus a tax equal to \$2.60 per \$1,000 of tangible property not subject to local taxation and situated in Massachusetts. A minimum tax of \$456 per year is imposed.

Under Massachusetts law, "large" S corporations are subject to tax on their net income at a 3% rate if their total receipts exceed \$6 million, 4.5% if total receipts exceed \$9 million.

F. Limited Liability Company

Under the "check-the-box" regulations described in Section X(B) below, an LLC will be classified as a partnership for Federal and Massachusetts income tax purposes, unless it elects to be taxed as a corporation.

G. Limited Liability Partnership

Under the "check-the-box" regulations described in Section X(B) below, an LLP will be classified as a partnership for Federal and Massachusetts income tax purposes, unless it elects to be taxed as a corporation.

X. SOME IMPORTANT TAX CONSIDERATIONS

A. Federal Employer Identification Number

Every business organization must obtain from the Internal Revenue Service a Federal employer identification number ("EIN"). This involves the filing with the Internal Revenue Center in Andover of an IRS Form SS-4 (Application for Employer Identification Number). Massachusetts business organizations will receive a nine-digit number. In the past, EINs for Massachusetts taxpayers were assigned the prefix "04." For this reason, EINs are sometimes still referred to in Massachusetts as "04 numbers."

As a practical matter, you should ascertain at the time of formation of any business entity whether the taxpayer, its lawyer, or its accountant will be applying for the EIN. Failure to coordinate the process can result in embarrassing situations where the client has either no EIN or more than one.

The IRS Service Center will usually process a Form SS-4 application received by mail in 4 to 5 weeks. It is possible to obtain an EIN on an expedited basis by calling the IRS's "Tele-TIN" phone number ((800) 829-4933). However, the person calling the IRS must be authorized to sign Form SS-4 (i.e., the president, vice president, or "other principal officer" of a corporation, or a person authorized as a "Third-Party Designee" by the officer signing Form SS-4).

B. "Check-the-Box"

For many years, the question of whether a non-corporate entity with limited liability (e.g., a limited partnership or LLC) should be classified as a corporation or a partnership for Federal income was a complex one, depending upon an evaluation of the four corporate attributes (limited liability, continuity of life, free transferability of interest and centralization of management) of the entity.

New IRS regulations effective January 1, 1997 eliminated the four factor test and substituted a simple elective system, under which most business organizations other than corporations may elect to be classified either as a partnership or a corporation for Federal income tax purposes. (Treas. Reg. §§301.7701-1 et seq.).

These regulations provide clear rules for classifying domestic business organizations. Certain entities are always taxable as corporations: these include domestic corporations, certain entities engaged in specialized industries (such as banking and insurance) and certain foreign entities. Business organizations that are not so classified as corporations (so-called "eligible entities") can elect their tax classification. An eligible entity with more than one member (such as a partnership, limited partnership or LLC; can elect either to be taxed as a corporation or a partnership. An eligible entity with only one member can elect either to be taxed as a corporation or to be disregarded for tax purposes. Significantly, the regulations contain certain "default" rules under which a domestic eligible entity will be deemed to be a partnership if it has more than one member.

IRS Form 8832 (Entity Classification Election) may be used by an eligible entity to elect classification as a corporation or partnership by "checking-the-box" on the form. An election on Form 8832 may be made any time, but an election can take effect no earlier than 75 days prior to filing and no later than 12 months thereafter.

Since the default rules provide that partnerships, limited partnerships, LLC's and LLP's will automatically be classified as partnerships, it is necessary to file Form 8832 only if you wish to have an eligible entity classified as a corporation.

C. Section 1244 Stock

Section 1244 of the Internal Revenue Code permits an individual or partnership investing in certain corporations to claim any loss on an investment in corporate stock as an "ordinary loss" fully deductible against taxable income, rather than a "capital loss," deductible only against capital gain or a very limited amount of ordinary income (\$3,000 per year for Federal income tax purposes).

Stock issued by a corporation will qualify as Section 1244 stock if:

1. the corporation is a domestic business corporation which has issued \$1,000,000 or less in capital stock;
2. the stock is common stock issued for money or other property (but not for stock, securities or services);
3. the stock is issued to an individual or partnership;
4. the corporation has derived less than 50% of its gross receipts from investment activities for the previous five years (or such shorter period as the corporation is in existence); and
5. the taxpayer claiming loss is an original investor and not a transferee of the stock.

A shareholder filing an individual tax return may not deduct more than \$50,000 of ordinary loss per year (\$100,000 for a husband and wife filing jointly). If the loss exceeds this amount, it is treated as a capital loss.

No formal "plan" to issue Section 1244 stock is required, as was the case under the law prior to the Revenue Act of 1978.

D. S Corporation Elections

In order to secure the benefits of S corporation status, an election on Form 2553 must be filed with the Internal Revenue Service.

Under tax legislation effective January 1, 1997, a corporation must meet certain tests in order to qualify for S corporation status:

1. it must have 75 or fewer shareholders (a husband and wife are treated as one shareholder);
2. all stockholders must be individuals (or certain permitted trusts, estates or tax-exempt organizations);
3. no shareholder may be a non-resident alien; and
4. the corporation may have only one class of stock (differences in voting rights are permissible).

The previous rule that prevented an S corporation from owning more than 80% of the stock of another corporation has been repealed. S corporations can now have subsidiaries.

An S corporation election must be filed on or before the 15th day of the third month of its tax year. A corporation's first fiscal year is considered to start on the date on which the corporation (a) has shareholders, (b) acquires assets, or (c) begins doing business, whichever is earliest.

An S corporation, in general, must adopt a calendar year as its taxable year. For example, if an S corporation is incorporated and commences business on January 25, 2004, its first fiscal year will be a "short year" of eleven months and seven days ending December 31, 2004. In this example, Form 2553 must be filed by April 9, 2004. If the form is filed on a later date (say, April 10, 2004), the election will not be effective until the following tax year (ending December 31, 2005).

Note that Form 2553 must be signed by all shareholders of the corporation, a requirement which is sometimes overlooked.

E. Qualified Small Business Stock

For non-corporate investors who hold stock of a "qualified small business corporation" ("QSB Stock") for five years or more, the Federal capital gain rate is effectively reduced to 14%, rather than the normal 20% (§1202). In addition, gain on the sale of QSB Stock held for more than six months may be rolled over tax-free into another QSB stock within 60 days (§1045).

In order to qualify for special tax treatment as QSB Stock, the following requirements must be met:

1. stock of a domestic C corporation;
2. issued after August 10, 1993;
3. original issue only (may be issued for cash, property, services or other QSB stock);
4. gross assets of corporation must not be in excess of \$50 million immediately after issue of QSB stock;
5. corporation must be in the active conduct of a "qualified business" (definition excludes most service businesses, banking and finance, farming, extractive industries, hotels and restaurants); and
6. corporation may not make certain stock redemptions.

F. Massachusetts Taxpayer Registration

Every corporation which is required to withhold income, employment or sales taxes must file with the Department of Revenue an Application for Registration on Form TA-1. The Department will assign the corporation a special Massachusetts identification number which must be used for filing tax returns.

G. Massachusetts Manufacturing Corporations

Corporations which have manufacturing operations in Massachusetts may request "manufacturing corporation" classification on Form 355Q. This classification exempts the corporation's property from local taxation by the municipality in which the corporation is located. These assets are instead included in the tangible property measure of the corporation excise tax base and are taxed at a rate usually much less than the local property tax rate. A corporation with manufacturing corporation classification is also eligible for the Massachusetts investment tax credit.

XI. SELECTING A BUSINESS NAME

A. In General

The overriding legal concern in selecting a name for a corporation or other business organization is whether the name selected conflicts with a name used by another business organization. The consequences of carelessly selecting a name which infringes on the rights of another person are all unpleasant and range from embarrassment at one extreme to significant legal liability at the other.

The task of selecting a "free" name is complicated by the fact that infringement may arise by "confusing similarity" of names that are not identical, and by the fact that there exists no infallible central register of available names to guide the conscientious businessman.

In thinking about adopting a corporate name, it is important to distinguish several categories of business names:

- A corporate name identifies a corporation and distinguishes it from all other corporations. The Massachusetts Secretary of State requires that corporate names for business corporations in most cases include the word "incorporated," "corporation", "limited," or their abbreviations. 950 CMR 104.03(1)(b). The new Business Corporation Act will allow the use of the word "Company." G. L. c. 156D, §4.01(a)
- A trade name, in contrast, identifies an incorporated or unincorporated business and may be different from the corporate name of the business. For example, "Bank of Boston" was for many years the well-known trade name for the business conducted by the corporation known as The First National Bank of Boston. Any type of business organization may call itself a "company."
- A trademark is a name or symbol which is used to identify and distinguish goods sold by a business. For example, "Cadillac" is a trademark for certain automobiles manufactured by General Motors Corporation. A service mark is a name or symbol which identifies services provided by a business. For example, "Greyhound" is a service mark for the transportation services provided by Greyhound Lines, Inc.

Selecting a name for a business corporation requires an awareness of several systems of regulation applicable to the different types of names.

B. Corporate Names

Under G. L. c. 156B, §11, c. 156D, §4.01(b) and 950 CMR 104.03-104.06, the Massachusetts Secretary of State will not permit a corporation to adopt a corporate name which is (a) the same as any corporate name or trade name of any corporation, firm, association or person carrying on business in Massachusetts at present or within the past three years, or

(b) under reservation with the Secretary of State, or (c) so similar to the foregoing as to be likely to be mistaken for it, unless (d) the corporation, firm, association or person consents in writing.

In practice, this statute provides only limited protection against adopting the name of another entity. This is because the Secretary of State's Corporations Division, in approving corporate names, checks the proposed corporate name only against its database of Massachusetts corporations and foreign corporations doing business in Massachusetts. The Corporations Division does not as a rule check its records of names of limited partnerships, business trusts, or trade marks and service marks filed in Massachusetts. Moreover, the Secretary of State's records would not necessarily show trade names adopted by individuals, partnerships, business trusts or corporations unless filed as trade marks or service marks. In addition, the Secretary of State's records will not show names used in other states.

Thus, the "clearance" by the Secretary of State of a corporate name provides only partial protection against the possibility of infringement.

C. Limited Partnership Names

Under G. L. c. 109, §2(1), the name of each Massachusetts limited partnership must contain the words "limited partnership" without abbreviation ("L.P." will not suffice). A limited partnership name may not contain the name of a limited partner (unless it is also the name of a general partner or the limited partnership's name existing prior to the admission of the eponymous limited partner. (G. L. c. 109, §2(2)). A limited partnership name may not contain any word or phrase implying that it is organized for a purpose other than that stated in its certificate of limited partnership (G. L. c. 109, §2(3)), or be the same as or deceptively similar to the name of any Massachusetts corporation or limited partnership or any foreign corporation or limited partnership registered in Massachusetts, without the consent of that entity. (G. L. c. 109, §2(4)). A foreign limited partnership may do business in Massachusetts under any name which could be assumed by a Massachusetts limited partnership (G. L. c. 109, §51).

D. LLC Names

Under G. L. c. 156C, §3(1), the name of any LLC must contain the words "limited liability company", "limited company", or the abbreviation "L.L.C.", "L.C.", "LLC" or "LC". The name of an LLC may contain the name of any member or manager (G. L. c. 156C, §3(2)), but may not be the same as or deceptively similar to the name of any Massachusetts corporation, limited partnership or LLC or any foreign corporation, limited partnership or LLC registered in Massachusetts, without the consent of that entity. (G. L. c. 156C, §3(3)). A foreign LLC may register under any name that could be assumed by a Massachusetts LLC. (G. L. c. 156C, §50).

E. LLP Names

Under G. L. c. 108A, §46, the name of every registered LLP shall end with the words "registered limited liability partnership," "limited liability partnership," or the abbreviation "L.L.P." or "LLP".

F. Trade Names

G. L. c. 110, §§4-6 (the "Business Name Statute") regulates the use of trade names by business organizations in Massachusetts.

Section 4 of the Business Name Statute provides that a person shall not use in its business the name of a person formerly connected with him in partnership or the name of another person, alone or in connection with his own or another name, without the consent of that person.

Section 4A provides that no individual, unincorporated association, or partnership shall use a name including the words "corporation" or "incorporated" or abbreviations thereof, or any other word or phrase which would lead the public to believe the business is a corporation.

Section 4B provides that no business may use the words "Army", "Navy", "Marine Corps", "Coast Guard", "Government", "Post Exchange", "P.X.", or "G.I.", or other name which may lead the public to believe the business is owned or operated by the U.S. Government or an agency thereof. It also provides that no business may use the words "Massachusetts State Fair."

Section 5 is the heart of the statute. It provides that any person conducting business in Massachusetts, whether individually or as a partnership under any title other than his or its real name, must file in the office of the clerk of every city and town where an office of the person or partnership is situated a certificate stating:

- (a) the full name and residence of each person conducting the business, and
- (b) the place, including street and number, where the business is conducted and the title under which it is conducted.

This "business certificate" must be executed under oath by each person whose name appears thereon as conducting the business.

A person who has filed such a certificate must, upon discontinuing, retiring or withdrawing from the business, or upon changing his residence, file a statement under oath to that effect. Changes in the location where the business is conducted must also be filed. A business certificate is effective for four years and may be renewed indefinitely for additional four year periods.

Violations of the filing provisions are punishable by a fine of not more than \$100 for each month during which the violation continues.

Section 6 provides that the filing requirements of §5 shall not apply to:

- (a) any corporation doing business under its true corporate name;
- (b) any partnership doing business under any title which includes the true surname of any partner;
- (c) any business trust, provided that a business certificate is filed containing the names of such trustees with a reference to the relevant instrument or declaration of trust; or
- (d) any limited partnership doing business under its true name which contains (without abbreviation) the words "limited partnership."

The following table, adopted from the Secretary of State's useful publication, "Choosing a Name for Your Business", summarizes the applicable filing requirements for business names.

<u>Type of Business</u>	<u>Filing</u>	
	Secretary of State	Local City or Town Hall
Sole Proprietorship	X(1)	
General Partnership	X(1)	
Limited Partnership	X	
Business Trust	X	X(2)
Corporation	X	X(3)
Limited Liability Company	X	X(3)
Limited Liability Partnership	X	X(1)

Note 1: No filing required unless business name is different from true surname of proprietor or does not contain surname of any partner.

Note 2: Names of trustees must be filed.

Note 3: No filing required unless business name is different from corporate or LLC name.

G. Trademarks and Service Marks

1. Common Law Protection

Trade names, trademarks and service marks are protected by the state common law of "unfair competition." Generally speaking, common law rights are determined by actual use of the name or mark in commerce.

2. Federal Registration

No federal or Massachusetts registration is available for trade names, as opposed to trademarks and service marks. No federal or state registration is necessary to acquire rights to a trademark or service mark, but registration has some advantages.

Recent amendments to the Lanham Act permit the owner of trademark or service mark to apply for federal registration prior to actual use, provided he has a "bona fide intention" to use the mark in commerce within six months. Federal registration also gives constructive notice of the registrant's claims, permits nationwide enforcement of rights and after five years grants so-called "incontestable" rights (subject to certain exceptions) to use of the mark.

Federal trademark or service mark registration is obtained by filing with the U.S. Patent and Trademark Office (the "PTO") of an application form and the payment of a \$335.00 registration fee. The PTO will examine the application and, upon proper compliance with procedural steps, will issue a certificate of registration.

3. State Registration

Numerous states, including Massachusetts, permit registration of trademarks and service marks. Trademark registration in Massachusetts is governed by G. L. c. 110B and is administered by the Trademark Division of the Secretary of State. Applicable regulations are contained at 950 CMR 62.01 et seq.

Trademark and service mark registration in Massachusetts is very simple process, involving the filing of a simple form and payment of a \$50.00 fee. Registration is effective for ten years and is renewable. Although the benefits of registration in Massachusetts are limited, state registration does provide evidence of use of the mark and can be helpful.

H. Trade Mark and Trade Name Searches

There are a number of service companies which will perform searches of various databases for prospective trade names or marks.

For example, a "full search" performed by Thompson & Thompson, a large international trademark research company based in Quincy, involves the search of trademark records in the PTO, all fifty states and Puerto Rico, trade journals, telephone directories, catalogs, and other sources, including the index of 9,000,000 company names maintained by Dun & Bradstreet. Even so, Thompson & Thompson's report does not cover corporate names filed with the various secretaries of state.

A company seeking maximum protection against infringement would be well advised to perform a full trademark search as well as a corporate name check with the Secretary of State.

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