

CITY OF HOUSTON GUIDE TO STRUCTURING A BUSINESS



CITY OF HOUSTON
OFFICE
of
BUSINESS OPPORTUNITY



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MISSION STATEMENT

The Office of Business Opportunity is committed to creating a competitive and diverse business environment in the City of Houston by promoting the growth and success of local small businesses, with special emphasis on historically underutilized groups by ensuring their meaningful participation in the government procurement process.



OVERVIEW

OVERVIEW

The Structuring Your Houston Business Guide is designed to provide basic information on some of the legal and practical issues to consider when setting up a business. Information contained herein applies only to Texas business governed by the laws and regulations of the State of Texas, the City of Houston, and Texas counties.

THIS GUIDE DOES NOT CONSTITUTE LEGAL ADVICE NOR IS IT A SUBSTITUTE FOR LEGAL OR PROFESSIONAL ADVICE. PERSONS CONSIDERING STARTING A BUSINESS ARE ENCOURAGED TO CONSULT PROFESSIONAL LEGAL ASSISTANCE, FINANCIAL ADVISORS AND TAX PROFESSIONALS. YOU SHOULD ALSO CONTACT THE TEXAS SECRETARY OF STATE FOR DETAILED REQUIREMENTS, FORMS AND FILING INFORMATION AT:

www.sos.state.tx.us/corp/index.shtml

THIS BUSINESS GUIDE PROVIDES INFORMATION ON THE FOLLOWING LEGAL STRUCTURES:

- **Sole Proprietorship**
- **General Partnership**
- **Corporation**
- **Limited Liability Company**
- **Limited Partnership**
- **Limited Liability Partnership**
- **Business Entities for Professionals**

Decisions regarding business structure should be made in consultation with an attorney and accountant, other business professionals, partners, investors, and family, and taking into consideration tax liability, management, continuity, transferability of ownership interests, and formality of operation.

BASIC LEGAL AND PRACTICAL ISSUES TO CONSIDER

One of the first decisions that you should make is how to structure your business. No one legal structure fits all Texas businesses. Whether your company is best served as a sole proprietorship or as one of the more complex organizational structures such as a partnership, corporation or limited liability company depends on several factors. In making a business entity decision, take into account the following (as well as other issues and factors):

RELEVANT ISSUES TO CONSIDER

- Your vision regarding the size and nature of your business
- Number of co-owners of the business
- Relationship between owners and management
- Extent to which you will seek outside investors
- Level of “structure” and formality you are prepared to manage
- Expenses, in time and money, of forming and maintaining the business entity
- The business’s vulnerability to lawsuits and other liabilities or obligations
- Tax implications of the different ownership structures
- Expected profit (or loss) of the business
- Whether you will need to re-invest earnings into the business
- Your need for access to cash from the business for personal use

Generally, businesses are created and operated in one of the following forms:

SOLE PROPRIETORSHIP

The most common and simplest form of business is the Sole Proprietorship. In a sole proprietorship, a single individual engages in the business activity without necessity of formal organization. If the business is conducted under an assumed name (a name other than the surname of the individual), then an Assumed Name Certificate, commonly referred to as a DBA, should be filed with the office of the County Clerk in the county where a business premise is maintained. If no business premise is maintained, then an Assumed Name Certificate should be filed in all counties where business is conducted under the assumed name.

SOLE PROPRIETORSHIP PROS & CONS

PROS

- Simple and inexpensive to create and operate.
- Owner reports profit or loss on personal tax return.
- Easy to start up and discontinue.
- Can be converted easily to another business entity.

CONS

- Owner personally liable for business debts.
- Owner responsible for raising capital.
- Insurance risks are personally held.
- Health or personal issues can negatively affect the business.



RELEVANT ISSUES TO CONSIDER
SOLE PROPRIETORSHIP



GENERAL PARTNERSHIP CORPORATION

GENERAL PARTNERSHIP

Partnership is created when two or more persons carry on a business for profit. This type of business generally operates in accordance with a partnership agreement, but there is no requirement that the agreement be in writing and there are no state-filing requirements. If the business of the partnership is conducted under an assumed name (a name that does not include the surname of all of the partners), then an Assumed Name Certificate, commonly referred to as a DBA, should be filed with the office of the County Clerk in the county where the business premise is maintained. If no business premise is maintained, then an Assumed Name Certificate should be filed in all counties where business is conducted under the assumed name. A General

GENERAL PARTNERSHIP PROS & CONS

PROS

- Simple and inexpensive to create and operate.
- Owners (partners) report share of profit or loss on personal tax returns.
- Creates multiple options for financing and managing the business.
- Partners are taxed on the income they receive from the partnership.

CONS

- Owners (partners) are personally liable for business debts.
- Issues can negatively affect the company and the owners' personal finances.
- Difficult to prove legality if not filed or notarized correctly.
- Limited lifespan based on the presence of the original partners.

CORPORATION

A Texas Corporation is created by filing a Certificate of Formation with the Texas Secretary of State. The Secretary of State provides a form that meets minimum State law requirements. A corporation is a company recognized by law as a single entity with the characteristics of limited liability, centralization of management, perpetual duration, and ease of transferability of ownership interests. The owners of a corporation are called "shareholders." The persons who manage the business and affairs of a corporation are called "directors." However, state corporate law does provide for shareholders to enter into shareholders' agreements to eliminate the directors and provide for shareholder management. Choosing the best management structure for your corporation is a decision you should make with the advice of an attorney. The Secretary of State cannot assist you in making this type of determination. An "S" Corporation is not a matter of state corporate law but rather a federal tax election. A for profit corporation elects to be taxed as an "S" Corporation by filing an election with the Internal Revenue Service. Please contact the IRS or competent tax counsel regarding the decision to be taxed as an "S" Corporation and to learn more about the requirements for filing the election. This is not a matter with which the Texas Secretary of State provides assistance.

CORPORATION PROS & CONS

PROS

- Owners have limited personal liability for business debts.
- Fringe benefits can be deducted as business expense.
- Owners can split corporate profits among themselves and the corporation, paying lower overall tax rates.
- Owners only pay taxes on corporate profits paid to them through salaries, bonuses and dividends.

CONS

- More expensive to create.
- Paperwork can seem burdensome to some owners.
- Separate taxable entity.
- Some corporations are taxed on the company's profits and again on any dividends paid to the shareholders.

LIMITED LIABILITY COMPANY (LLC)

A Texas Limited Liability Company is created by filing a Certificate of Formation with the Texas Secretary of State. The Secretary of State provides a form that meets minimum State law requirements. The Limited Liability Company (LLC) is not a partnership or a corporation but rather is a distinct type of entity that has the powers of both a corporation and a partnership. Depending on how the LLC is structured, it may be likened to a general partnership with limited liability- or to a limited partnership where all the owners are free to participate in management and all have limited liability, or to an "S" Corporation without the ownership and tax restrictions imposed by the Internal Revenue Service. Unlike the partnership, where the key element is the individual, the essence of the limited liability company is the entity, whereby its creation demands more formal requirements. The owners of an LLC are called "members." A member can be an individual, partnership, corporation, trust, and any other legal or commercial entity. Generally, the liability of the members is limited to their investment and they may enjoy the pass-through tax treatment afforded to partners in a partnership. As a result of federal tax classification rules, an LLC can achieve both structural flexibility and favorable tax treatment. Nevertheless, persons contemplating forming an LLC are well advised to consult competent legal counsel. A Limited Liability Company can be managed by managers or by its members. The management structure must be stated in the Certificate of Formation. Management structure is a determination that is made by the LLC and its members. The Secretary of State cannot give advice regarding management structure.

LIMITED LIABILITY COMPANY PROS & CONS

PROS

- Owners have limited personal liability for business debts, even if they participate in management.
- Profit and loss can be allocated differently than ownership interests.
- IRS rules now allow LLCs to choose between being taxed as a partnership or a corporation.
- The liability of a member of an LLC is limited to the member's personal investment in the company.

CONS

- More expensive to create.
- State laws for creating LLCs may not reflect latest federal tax changes.
- Tax and liability treatment of LLCs is not uniform across State lines.
- LLCs may have some restrictions placed on the transfer of ownership.



LIMITED LIABILITY COMPANY



OTHER TEXAS BUSINESS ENTITIES:

LIMITED PARTNERSHIP

A Texas Limited Partnership is a partnership formed by two or more persons; having one or more general partners; and one or more limited partners. The limited partnership operates in accordance with a partnership agreement, written or oral, of the partners as to the affairs of the Limited Partnership and the conduct of its business. While the partnership agreement is not filed for public record, the Limited Partnership must file a certificate of formation with the Texas Secretary of State. The Secretary of State provides a form that meets minimum State law requirements.

LIMITED LIABILITY PARTNERSHIP:

In order to limit the liability of its general partners, a general or limited partnership may opt to register as a Limited Liability Partnership. The Secretary of State provides the required form to register as a limited liability partnership on its website.

BUSINESS ENTITIES FOR PROFESSIONALS

A Professional Corporation (P.C.) is a corporation that is formed for the purpose of providing a professional service that by law, a for-profit or nonprofit corporation is prohibited from rendering. A “*professional service*” means any type of service that requires, as a condition precedent to the rendering of the service, the obtaining of a license in the State of Texas. A professional corporation is governed by the Texas Business Organizations Code (BOC). The BOC governs the formation of a professional corporation and sets forth the provisions required or permitted to be contained in the certificate of formation.

FOREIGN ENTITIES

The determination of whether or not an entity is domestic or foreign does not depend on the location of the principal business office. Instead, it depends on where the entity was formed and what laws govern its internal affairs. If an organization was formed under, and the internal affairs are governed by, the laws of a jurisdiction other than Texas, the organization is a “foreign entity.” We sometimes refer to foreign entities as out-of-state entities to reinforce the concept that entities formed in other U.S. states are foreign entities, as well as entities formed outside of the United States.

A foreign filing entity must file an application for registration, previously known as an application for Certificate of Authority, if it “transacts business” in Texas. Texas statutes do not specifically define “transacting business;” however, it does list 15 activities that do *not* constitute “transacting business.” Generally, a foreign entity *is* transacting business in Texas if it has an office or an employee in Texas or is otherwise pursuing one of its purposes in Texas. The Secretary of State cannot give a legal opinion as to whether a particular foreign entity is “transacting business” in Texas. If you are unsure about whether or not registration is required, you should consult with your legal counsel.

NON-PROFIT TEXAS CORPORATION

Not all non-profit organizations are filed with the Secretary of State. Many, but not all, non-profit organizations choose to incorporate. A Non-Profit Corporation is created by filing a Certificate of Formation with the Texas Secretary of State in accordance with the Texas Business Organizations Code (BOC). "Non-Profit corporation" means a corporation in which no part of the income is distributable to members, directors, or officers. Non-profit corporations may be created for any lawful purpose- or purposes as permitted by the BOC. Not all non-profit corporations are entitled to exemption from State or federal taxes. This does NOT include non-profit filings with the U.S. Internal Revenue Service. **Name Registrations- State of Texas**

A filing entity cannot have a name that is the same as or deceptively similar to another filing entity, foreign filing entity, name reservation, or name registration filed with the Secretary of State. Also, a filing entity cannot have a name that is similar to an existing name on file with the Secretary of State unless the existing entity consents in writing to the use of the similar name.

ASSUMED NAMES / DBA'S FILED WITH TEXAS COUNTIES

Assumed names /DBA's filed in Texas counties are not incorporated entities, nor are business names considered unique those counties. Assumed names filed with County Clerks are valid for 10 years from date of issuance, and expire without written notice. Assumed names can be modified or withdrawn by the applicant by contacting the appropriate County Clerk and paying applicable fees. There is no requirement that business be actively transacted after the filing of an assumed name.

Entities filed with the Texas Secretary of State carry an obligation to also file in the Texas counties in which they transact business and have a significant presence.

NON LEGAL BUSINESS ENTITIES

Business names appended with the words "Company" or "Enterprises" need not file with the Texas Secretary of State.



NON-PROFIT TEXAS CORPORATION
ASSUMED NAMES / DBA'S FILED COUNTIES



LEGAL TERMINOLOGY

CORPORATE AND RELATED ENTITIES

AGENT

Anyone who is authorized to act on behalf of another. A corporation acts only through its agents. Therefore, it is important to define what actions an agent is authorized to perform.

ARTICLES OF INCORPORATION

The title of the document filed in many states to create a corporation. Also known as the certificate of incorporation or corporate charter.

BYLAWS

The regulations of a corporation that, subject to statutory law and the articles of incorporation, provide the basic rules for the conduct of the corporation's business and affairs.

CAPITAL

Financial capital or just capital in finance and accounting, is funds provided by lenders (and investors) to businesses to purchase real capital equipment for producing goods/services. Real capital or economic capital comprises of physical goods that assist in the production of other goods and services, e.g. shovels for gravediggers, sewing machines for tailors, or machinery and tooling for factories.

CLASS OF STOCK

Corporations may divide their stock into multiple classes. The standard types of classes of stock are "common stock" and "preferred stock", though a corporation may have multiple classes of each, i.e. "Series A Preferred Stock," "Series B Preferred Stock" etc. Stockholders of any one class of stock must have all identical rights. Corporations are allowed to give different rights and preferences to holders of different classes- and shares of a corporation's classes of stock may be worth different amounts based on the varying rights and preferences attached to each class.

DIVIDEND

Payments made by a corporation to its shareholder members. It is the portion of corporate profits paid out to stockholders. When a corporation earns a profit or surplus, that money can be put to two uses: it can either be re-invested in the business (called retained earnings), or it can be distributed to shareholders. There are two ways to distribute cash to shareholders: share repurchases or dividends. Many corporations retain a portion of their earnings and pay the remainder as a dividend.

DOUBLE TAXATION

The term "double taxation" is used to refer to the fact that corporate profits are taxed and the shareholders of the corporation are (usually) subject to personal taxation when they receive dividends or distributions from these profits.

EQUITY FINANCING

A method of raising capital in which a corporation sells shares of stock.

GROSS RECEIPTS

The total revenue received in one year from all sources of income. This amount is not reduced by any costs or expenses.

LIQUIDATION

Where a business ceases to exist or terminates its existence either voluntarily or involuntarily and all the business's assets are sold and any proceeds from those sales are first used to pay the business's creditors and then, if any money is left, to the business's owners.

MANAGERS

The individuals who are responsible for the maintenance, administration and management of the affairs of a Limited Liability Company (LLC). In most states, the managers serve a particular term and report to and serve at the discretion of the members. Specific duties of the managers may be detailed in the articles of organization or the operating agreement of the LLC. In some states, the members of an LLC may also serve as the managers.

MEMBERS

The owner(s) of a Limited Liability Company (LLC). Unless the articles of organization or operating agreement provide otherwise, management of an LLC is vested in the members in proportion to their ownership interest in the company.



NOT-FOR-PROFIT CORPORATION:

A Not-For-Profit Corporation is generally organized for some socially beneficial purpose, rather than for the direct monetary benefit of the directors or members. Not all not-for-profit corporations are tax exempt and some make a profit. However, the profit is not distributed to the members or directors. This type of entity is also known as a non-profit corporation.

PARENT CORPORATION

A corporation that owns a controlling interest in another corporation.

PASS-THROUGH (FLOW-THROUGH) ENTITY

A Flow-Through Entity (FTE) is a legal entity where income "flows through" to investors or owners. That is, the income of the entity is treated as the income of the investors or owners. Flow-Through Entities are also known as pass-through entities. Depending on the local tax regulations, this structure can avoid dividend taxes and double taxation because only owners or investors are taxed on the revenue. Technically, for tax purposes, flow-through entities are considered "non-entities" because they are not taxed; rather, taxation "flows-through" to another tax return.

PERPETUAL EXISTENCE

In perpetuity is the concept that an entity may continue to exist forever without any specific end date.

REGISTERED AGENT

A person or entity designated to receive important tax and legal documents on behalf of the corporation. The Registered Agent must be located and available at a legal address within the specified jurisdiction at all times. Failure to maintain a Registered Agent in the jurisdiction in which the corporation is registered, may result in the forfeiture of the corporate status. This individual is also known as a Resident Agent.

SHAREHOLDER

An owner of a corporation, also called a stockholder, whose ownership is reflected in the shares of stock of the entity. Shareholder benefits include (possibly) receiving dividends for each share as determined by the board of directors, the right to vote (except for certain preferred shares) in the election of the board of directors and other matters, to bring a derivative action (lawsuit) if the corporation is poorly managed, and to participate in the division of value of assets upon dissolution and winding up of the corporation, if there is any value. A shareholder should have his/her name registered with the corporation, but may hold a stock certificate issued by the corporation.

SUBSIDIARY

A corporation that is either wholly owned or controlled through ownership of a majority of its voting shares- by another corporation or business entity.

LEGAL TERMINOLOGY



TEXAS STATE COMPTROLLER - PUBLIC INFORMATION REPORT (PIR)

Texas law requires corporations subject to franchise tax to file a Public Information Report (PIR) once a year. The Comptroller displays the officer and director information from the report on its website at window.state.tx.us/taxinfo/coasinr.html.

The officers and directors listed on the PIR are provided by the corporation itself. The Comptroller does not verify this information.

Changes to officer and director information occurring during the year, after the report is filed, should be reported to the Comptroller on the next annual Public Information Report. The Comptroller does not accept changes during the year.

An individual whose name was included on the report, but who was not an officer or director on the date the report was filed, may file a sworn statement to that effect with the Comptroller. A corporation which made an error on its annual report filing may file an amended Public Information Report with a cover letter explaining the error.

You can contact the Comptroller's office at (800) 252-1381 or via E-mail tax.help@cpa.state.tx.us.

GUIDES AND RESOURCES

START-UP GUIDES



TEXAS BUSINESS PORTAL: Offered as part of Texas.gov (formerly TexasOnline) and is the awardwinning official eGovernment web site for the State of Texas, providing citizens, local government, and state agencies with a single, secure structure to conduct business over the Internet.

SMALL BUSINESS ASSISTANCE: Information provided by the Small Business Advocacy of the Governor's Office; includes information on business structure, EINs, business taxes, and employer requirements.

TEXAS BUSINESS ADVISOR: Business start-up information offered by the Texas Comptroller of Public Accounts.

Business.USA.gov: Managed by the U.S. Small Business Administration, this official site of the U.S. Government provides access to Federal, state, and local information for small business owners.

SMALL BUSINESS PLANNER: A tool provided by the U.S. Small Business Administration containing resources for every stage of business.

TECHNICAL ASSISTANCE

S.C.O.R.E. HOUSTON
www.scorehouston.org
713-773-6565

UNIVERSITY OF HOUSTON SMALL BUSINESS DEVELOPMENT CENTER

www.sbdc.uh.edu
713-752-8400

HOUSTON LAWYERS REFERRAL SERVICE

www.hlrs.org/for-the-public
713-237-9429

HOUSTON CPA REFERRAL SERVICE

www.houstoncpa.org/Referral_Service/custom/forms/referral.aspx?Section=Referral_Service
713-622-7733

GUIDES AND RESOURCES



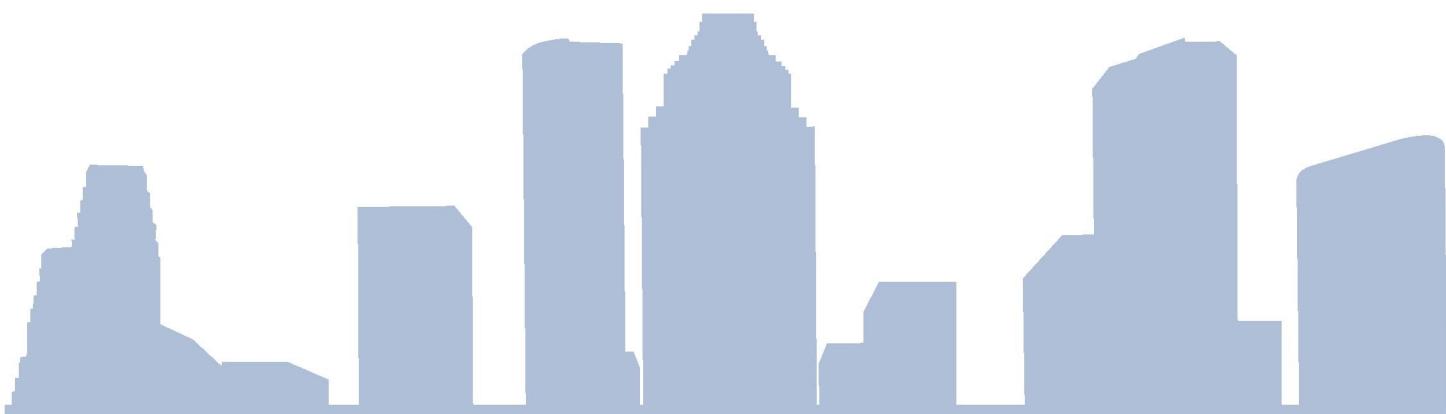
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