

Entity Basics

1. Is it possible to limit one's liability through the use of a corporation or LLC?

Yes, but it's not as easy as merely hiring one of the \$300 on-line services to file articles of incorporation (or articles of organization) for you, because filing articles is only one part of the process.

In order to qualify for limited liability, one must also:

- capitalize the business adequately
- have all documents properly prepared (bylaws, board minutes, securities notices, stock certificates, and others, if a corporation, and an operating agreement, if an LLC)
- operate as an entity (don't commingle personal and business assets, do know how to sign documents, do keep minutebook up to date, etc.)

A good corporate attorney can help with these requirements.

2. Does using an entity properly allow a person to avoid all types of liabilities?

No. Certain types of liabilities, notably for employment taxes and one's own professional errors and omissions, cannot be avoided in this way.

(It may however, be possible to avoid responsibility for one's co-owners' errors and omissions.)

3. If an entity is used properly, does it take the place of insurance?

No. One element of capitalizing the business adequately is making sure the business has enough assets – including insurance – to cover its foreseeable risks.

4. Are entities advisable?

Yes, as long as one is willing to meet the requirements, they can provide many advantages, including limited liability and making it easier to bring in co-owners, reward employees with options, and transfer ownership. They can also help avoid reclassification of a consultant as its customer's employee because the customer contracts with the corporation, not the individual, to render services.

5. Aren't most owners required to personally guaranty the corporation's obligations anyway, resulting in personal liability for the owner?

Often (but not always) an owner is asked to guaranty an obligation such as a lease or a bank loan. Even when this occurs, it may be possible to negotiate some limits on the guaranty--for example if there has been no default during the first three years of the lease, the guaranty will be released. Also, guaranties generally apply only to written contracts, not to other obligations, such as agreements with employees or tort liabilities, which can involve much greater amounts and are much less predictable.

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