



# Partnership or Incorporation?

by Quenda Behler Story

For a brief period, my husband was involved in a partnership that fell apart when his partner became ill. Because of that illness, we were not able to complete all of the partnership's contracts. When I look back, I don't understand why we made it a partnership in the first place. It's not as if I didn't know better. I suppose we used the partnership form because both men had known each for many years, had worked together on other projects before, had approximately the same skill levels, and brought roughly the same assets and number of contacts to the business. In other words, they seemed equals, so why not be equal partners?

However, we should have incorporated the business and made them equal shareholders. It's as simple as this: A partnership offers no advantages that aren't available in a corporation, but a partnership lacks several advantages a corporation provides.

## Death Is Just the Beginning

The most obvious disadvantage of a partnership is what happens if one of the principals dies. If my husband's partner had died from his illness, his death would have instantly ended the business as a legal entity. You cannot have a partnership, logically or legally, with a dead partner. We would have had to start all over again with a new business, and we would have had a terrible mess in the meantime trying to settle the business of the defunct partnership.

A corporation, on the other hand, has a life of its own. Even if every single owner (or shareholder) dies, or if the business goes belly up for some other reason, the corporation continues to exist until it is legally terminated. Closing up or continuing the business is much more orderly.

Partnerships are hampered by other problems as well. For instance, in the absence of complicated arrangements to the contrary (arrangements which may not be effective), each partner bears

total liability for the partnership's debts. This means that if the partnership can't pay its debts, creditors might be able to force either or both partners to use personal assets to pay those debts, even if they are debts that one of the partners objected to.

There are even situations in which the assets of a partnership can be seized to pay a partner's personal debts. If one of the partners gets sued and loses, for instance, the assets of the partnership might be seized to pay the judgment. The corporate form, on the other hand, restricts business debts to the business, and does not expose business assets to possible seizure for a shareholder's personal debts.

## Worth the Trouble

It costs more to set up a private, closely held corporation for a typical construction company than it does to

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set up a partnership. But not a lot more, because the terms "private" and "closely held" simplify things. "Private" means you're not selling the stock to the public; "closely held" means only a few people own the stock. A bright law school student can set up a private, closely held corporation; a competent lawyer can do it with one hand tied behind his back. (Do-it-yourself kits are also available, but I strongly recommend consulting an attorney.)

Once established, a corporation requires only slightly more trouble to maintain than does a partnership. In most states, keeping the corporation going requires the timely filing of certain papers with the appropriate state agency, but you can do this with standard, preprinted, fill-in-the-blank forms.

With a corporation, you'll spend a little more to have an accountant file your annual corporate returns. These "extra" expenses are a small premium to pay for protecting your personal assets.

## Subchapter S or C?

A private, closely held corporation can elect to be taxed in pretty much the same way an individual or a partnership is. The corporation does this by electing to be a subchapter-S corporation. (The IRS has prepared Publication 589: Tax Information on S-Corporations, a surprisingly intelligible instruction booklet describing what kind of corporation qualifies for that treatment.) S corporations file corporate tax reports, but unlike subchapter-C corporations, they pay no taxes themselves. Instead, the corporation's owners treat the income as if they had earned it as individuals. This makes accounting easier for most small-to medium-sized contractors.

One advantage to a C corporation, however, is that you can elect not to distribute earnings to the business's owners every year. Instead the corporation can retain the money and use it to expand or buy equipment, or simply hold the money to distribute it (by declaring dividends or gains) in a year in which shareholders might have less taxable income. Either way, the shareholders' taxes stay lower.

## The Local Factor

Some of the possible complications to becoming a corporation vary according to state. Here in Michigan, for instance, a builder cannot simply assign his or her contractor's license to the corporation; the corporation must obtain (through a corporate officer) its own license. Similar problems exist with a partnership, however, for each partner must be individually licensed. A good lawyer can identify and help you satisfy such state-specific requirements.

Such wrinkles should not discourage most jointly owned businesses from incorporating. While it takes a little more time and money, and requires a little extra paperwork and observing a few bookkeeping and accounting rules, more often than not, it's worth it. ■

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