

## **Small Business Owners: Protect Your Assets!**

Many small business owners never incorporate. This is risky because the owners of the business can be held personally liable for financial obligations.

Consider this hypothetical: You own a small bakery in Naperville that is operated as a sole proprietorship. Your part-time high school assistant is delivering a cake to one of your customers in Aurora. As he is passing the Naperville train station and thinking about getting a better job in Chicago, he accidentally runs over a pedestrian (who is married to a personal injury lawyer) that is badly injured. Bad news: the pedestrian may be able to obtain a judgment against you (the business owner) personally. Worse news: the pedestrian may be able to collect money to satisfy a judgment by taking your personal assets such as your savings, your business, and even your furniture.

To protect your personal assets, it is advisable to operate as an Illinois statutorily-recognized business entity. Here are a few examples of business entities that may afford their owners with protection from personal liability:

- (1) **Corporation:** Owners of a corporation (its shareholders) are usually not personally liable for the corporation's obligations because the company has its own separate existence apart from its owners. Corporations must be formed in accordance with the Illinois Business Corporations Act. A "C Corporation" is taxed separately from its owners. Accordingly, shareholders do not pay income tax on the corporation's profits until profits are distributed. On the other hand, an "S Corporation" results in profits and losses flowing directly to its owners for taxation purposes.
- (2) **Limited Liability Company:** A limited liability company "LLC" offers its owners limited liability and can provide favorable tax advantages. LLC's are governed by an "Operating Agreement", which is a contract that details the rights and responsibilities of its owners. LLC's are governed by the Illinois Limited Liability Company Act.
- (3) **Limited Partnerships:** A limited partnership "LP" offers limited liability for some of its investors. A LP has a general partner who remains liable for partnership debts and who is responsible for managing the partnership. A certificate of limited partnership must be filed with the Illinois Secretary of State.

The type of entity appropriate for a business depends on a number of factors such as the type of business (i.e., professional services vs. non-professional services), the plans of the owners (i.e., whether they want to obtain financing in the future, transfer ownership, etc.), and the financial expectations of the company--which may have significant tax consequences.

Be careful, however. Forming a business entity does not guarantee limited liability. If the owners of a business entity act irresponsibly (i.e. by commingling personal and corporate assets, not following corporate formalities, under-capitalizing the

company, etc), then the owners may still be held personally liable. This is called “piercing the corporate veil”. Moreover, not all persons may insulate themselves against liability. Thus, it is important to consult with an attorney about the appropriate business entity that is right for your company and the need for other necessary safeguards such as insurance.