

“Joe the Electrician”

Joe knows how to be a good electrician. But he is not so sure how to protect his business, especially during these uncertain economic times.

Joe, a successful electrician, operates his business as a sole proprietorship. Joe’s daughter graduated the regional technical high school and is now a licensed electrician working beside Dad. His son helps out in the office during his college breaks. Joe recently decided to hire an employee and purchase a second work van. Someday Joe hopes to retire and have his children take over the business. But today Joe is concerned he may not be doing enough to protect himself and preserve the business for his family.

Most small businesses, like Joe’s, are operated as sole proprietorships, whereby the owner simply files a “d/b/a” certificate with the town clerk in the town or city where the business is located. The benefits of operating a business as a sole proprietorship are the centralization of management and control and lack of complication and expense in operating and maintaining an “organization”. A corporation, for example, must file annual reports with the state of its incorporation, maintain a corporate record book relative to all actions taken by the officers and, depending on the type of corporation, file its own income tax return. However, for Joe, the risks of continuing to operate his business as a sole proprietorship are likely greater than the benefits.

Since a sole proprietor is merely an individual operating a business, there is no separate legal status between Joe and his business. This exposes Joe, as the sole proprietor, to unlimited personal liability in connection with the operation of his business. This includes being held personally liable for the acts of employees occurring in the course of their employment. Joe may now be especially concerned taking on the added risk of liability with the non-family employee he plan to hire.

Upon Joe’s death, use of a sole proprietorship also puts the continuity of existence and operation of the business at risk. This is of particular concern to the extent Joe’s objective is to “pass” the business down to his daughter and son. Since Joe’s business has operated with him at the helm, a succession plan needs to be established so both his daughter and son will know and understand their role in the future operation of the business.

The source of working capital for the operation and growth of Joe’s business, such as access to funds to purchase the second van, may also be limited by the lack of separate legal status. Further, upon Joe’s death access to business credit would in all likelihood be terminated putting any intended continuation of the business in jeopardy.

Although there are costs which Joe’s business would incur in creating and maintaining a separate legal entity for its operation, such as a corporation or limited liability company, the benefits clearly outweigh these costs. By creating a separate legal entity for the operation of his business, Joe has the ability to limit his personal liability and protect any assets, such as his home, which may be subject to liability. Further, the use of a separate legal entity can facilitate Joe’s objective to “pass” the business on to his daughter and son. Corporate shares and membership interests in limited liability companies can be transferred in such a manner as to create family

members' interests in the operation of a business, while Joe maintains management control during his life time. The use of a separate legal entity for the operation of a business can assist in not only establishing a framework for continuity in day to day management in the event of death, but also in keeping sources of working capital and credit open.

For Joe, the risks associated with the continued operation of his successful electrician business as a sole proprietorship are greater than the benefits. Any sole proprietor concerned with protecting his or her personal assets and the continuity of their business should consult with an attorney and a tax professional to determine what is the best legal entity to protect the success of their business today and tomorrow.

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