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**CHOOSING A BUSINESS ENTITY IN MONTANA
—
NON-TAX FACTORS**

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CHOOSING A BUSINESS ENTITY IN MONTANA — NON-TAX FACTORS

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CHOOSING A BUSINESS ENTITY IN MONTANA — NON-TAX FACTORS

by

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1. Introduction

Montana provides a variety of possible organizational forms for businesses. In the majority of cases, the choice narrows down quickly to one or two possibilities. Today's outline presented by Ray Petersen will focus on tax considerations, and this discussion will focus on the legal aspects of choice of entity, though necessarily some tax considerations will be included here. This outline is prepared for continuing education of lawyers and therefore will assume a basic understanding of terms and procedures related to the formation and operation of the types of organizations discussed here, and will instead focus on distinguishing features and what will be important to consider in choosing one form of organization over another.

This outline will also focus on the type of clients lawyers in Montana are likely to encounter. My typical situation is one or two individuals who are starting a business and have been told they need a corporation or LLC but are not certain of which or why. One of the first questions I will ask the client is whether it is anticipated the business will have any appreciating assets, such as real estate. If the answer is no, I will probably be headed towards recommending an S corporation, and if the answer is yes, a limited liability company to hold the appreciating assets and possibly an S corporation to hold the depreciating assets and to be the employer. If the business is looking for venture capital and possibly going through an IPO, a C corporation is more likely to be the better choice. This outline will go into the detail to demonstrate when such a recommendation might be appropriate, and when something else altogether should be considered.

2. Available Forms of Organization

[1] Statutory Forms of Organizations in Montana

Title 35 of Montana Code Annotated provides for the following organizations, of which this outline will deal with only the more common forms:

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- [a] Business Corporations [Title 35, Chapter 1]
- [b] Nonprofit Corporations [Title 35, Chapter 2]
- [c] Religious Corporations Sole [Title 35, Chapter 3]
- [d] Professional Corporations [Title 35, Chapter 4]
- [e] Limited Liability Companies [Title 35, Chapter 8]
- [f] Close Corporations [Title 35, Chapter 9]
- [g] Partnerships [Title 35, Chapter 10]
- [h] Limited Liability Partnerships [Title 35, Chapter 10, Part 7]
- [i] Limited Partnerships [Title 35, Chapter 12]
- [j] Mining Partnerships [Title 35, Chapter 13]
- [k] Cooperative Associations [Title 35, Chapter 15]
- [l] Agricultural Associations [Title 35, Chapter 16]
- [m] Cooperative Agricultural Marketing Associations [Title 35, Chapter 17]
- [n] Rural Cooperative Utility Corporations [Title 35, Chapter 18]
- [o] Electricity Buying Cooperatives [Title 35, Chapter 19]
- [p] Cemetery Associations [Title 35, Chapter 20]
- [q] Mausoleum-Columbarium Authorities [Title 35, Chapter 21]

[2] Sole Proprietorship

The simplest form of business is a sole proprietorship; the owner *is* the business. All income is reported directly on Schedule C of the owner's income tax return, and the owner is fully liable for all debts and obligations of the business. Nothing is required to be filed with the Secretary of State, other than perhaps an Application of Registration of Assumed Business Name.

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[3] Partnerships

[a] General Partnerships

[i] Formation

In general, the association of two or more persons to carry on as co-owners a business for profit creates a partnership, whether or not the persons intend to create a partnership. 35-10-202, M.C.A.

[ii] Agency authority

1) Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course of the partnership business or business of the kind carried on by the partnership binds the partnership unless the partner has no authority to act for the partnership in the particular matter and the person with whom the partner is dealing knows or has received a notification that the partner lacks authority. 35-10-301, M.C.A.

2) This agency authority may be restricted by filing a statement of partnership authority in accordance with 35-10-310, M.C.A., but such a statement is effective only for 5 years and in general does not bind third parties other than in real estate transactions.

3) An act of a partner that is not apparently for carrying on in the ordinary course of the partnership business or business of the kind carried on by the partnership binds the partnership only if the act was authorized by the other partners. 35-10-301, M.C.A.

[iii] Liability

All partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law. 35-10-307, M.C.A.

[iv] Taxation

General partnerships are flow-through entities for purposes of income tax. That is, the partnership reports the income, but the partners are responsible for any related income tax liability.

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[b] Limited Partnerships

[i] Formation

In order to form a limited partnership, a certificate of limited partnership must be executed, must be filed in the office of the secretary of state, and must set forth:

(a) the name of the limited partnership;

(b) the address of the office and the name and address of the agent for service of process required to be maintained by 35-12-507;

(c) the name and the business address of each general partner; and

(d) any other matters the general partners, in their sole discretion, determine to include.

35-12-601, M.C.A.

[ii] Liability

1) General Rule - No Liability for Limited Partners

Subject to certain exceptions, a limited partner is not liable for the obligations of a limited partnership unless, in addition to the exercise of the rights and powers as a limited partner, the limited partner participates in the control of the business. 35-12-703(1), M.C.A.

2) Permitted Participation - "Safe Harbor" Enumerated Rights and Powers

Not all participation by a limited partner is proscribed. The following rights and powers as a limited partner may be exercised without subjecting the limited partner to personal liability:

(a) being a contractor for or an agent or employee of the limited partnership or of a general partner or being an officer, director, or shareholder of a general partner that is a corporation;

(b) consulting with and advising a general partner with respect to the business of the limited partnership;

(c) acting as surety for the limited partnership or guaranteeing or assuming one or

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more specific obligations of the limited partnership;

(d) taking any action required or permitted by law to bring or pursue a derivative action in the right of the limited partnership;

(e) requesting or attending a meeting of partners;

(f) proposing, approving, or disapproving, by voting or otherwise, one or more of the following matters:

(i) the dissolution and winding up of the limited partnership;

(ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership;

(iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;

(iv) a change in the nature of the business;

(v) the admission or removal of a general partner;

(vi) the admission or removal of a limited partner;

(vii) a transaction involving an actual or potential conflict of interest between a general partner and the limited partnership or the limited partners;

(viii) an amendment to the partnership agreement or certificates of limited partnership; or

(ix) matters related to the business of the limited partnership not otherwise enumerated in 35-12-703(2)(f) that the partnership states in writing may be subject to the approval or disapproval of limited partners;

(g) winding up the limited partnership pursuant to 35-12-1203; or

(h) exercise any right or power permitted to limited partners under the Montana Uniform Limited Partnership Act and not specifically enumerated in 35-12-703(2).

35-12-703(2), M.C.A.

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3) Permitted Participation - Unenumerated Rights and Powers

The enumeration of permitted rights and powers in 35-12-703(2), M.C.A. does not mean that the possession or exercise of any other powers by a limited partner constitutes participation by the limited partner in the business of the limited partnership. 35-12-703(3), M.C.A.

4) Liability for Use of Limited Partner's Name in Partnership Name

a) In general, a limited partner who knowingly permits the limited partner's name to be used in the name of the limited partnership is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner. 35-12-703(4), M.C.A.

b) The only two exceptions are when the limited partner's name is also the name of a general partner, or the business of the limited partnership had been carried on under that name before the admission of that limited partner. 35-12-703(4), 35-12-505(1)(b)(i) and (1)(b)(ii), M.C.A.

5) Extent of Liability for Participating in Control of Business

If the limited partner participates in the control of the business beyond what is permitted, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based on the limited partner's conduct, that the limited partner is a general partner. 35-12-703(1), M.C.A.

6) Limited Liability Even When No De Jure Limited Partnership

a) Good Faith Mistake

A person who makes a contribution to a business enterprise and erroneously and in good faith believes that the person has become a limited partner in the enterprise is not a general partner in the enterprise and is not bound by its obligations by reason of making the contribution, receiving distributions from the enterprise, or exercising any rights of a limited partner if, on ascertaining the mistake, the person:

(a) causes an appropriate certificate of limited partnership or a certificate of amendment to be executed and filed; or

(b) withdraws from future equity participation in the enterprise by executing and filing in the office of the secretary of state a certificate declaring withdrawal under this section.

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35-12-704(1), M.C.A.

b) Exception: Third Party Reliance

Any third party who transacts business with the enterprise before the person withdraws and an appropriate certificate, if any, is filed to show that the person is not a general partner, may hold the person liable as a general partner. 35-12-704(2), M.C.A.

c) Exception to Exception: Lack of Good Faith Reliance

The third party has to have actually believed in good faith that the person was a general partner at the time of the transaction, or the third party cannot hold that person liable as a general partner. 35-12-704(2), M.C.A.

7) Control Through the Right to Vote

In general, the partnership agreement may grant to all or a specified group of the limited partners the right to vote (on a per capita or any other basis) upon any matter. 35-12-702, M.C.A. This, however, does not mean that the limited partners may extend by express voting rights their participation in the business of the partnership beyond what would otherwise be allowed. If voting powers are granted to limited partners beyond the "safe harbor" rights and powers enumerated in 35-12-703(2), M.C.A., a court may hold that, under the circumstances, the limited partners have participated in "control of the business" within the meaning of 35-12-703(1), M.C.A. *See* Commissioner's Comments in the Annotations to 35-12-703, M.C.A.

8) General Partner Liability

A general partner has joint and several liability for all obligations of the partnership unless otherwise agreed by the claimant or provided by law. 35-12-803, 35-10-307, M.C.A.

[iii] Taxation

Limited partnerships are flow-through entities for purposes of income taxation. If the partnership shows losses, or if the partnership agreement provides for special allocations, Treasury regulations may restrict the manner in which the income and losses are allocated, and the partners could have different results than they would in a general partnership.

[c] Limited Liability Partnerships

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[i] Formation

1) To become a limited liability partnership, a partnership files with the secretary of state an application for registration of an assumed business name, on a form furnished by the secretary of state, that indicates an intention to register as a limited liability partnership under this section. 35-10-701, M.C.A.

2) A partnership that has duly registered as a limited liability partnership is for all purposes of the laws of Montana the same entity that existed before the registration. 35-10-702, M.C.A.

[ii] Liability

1) General Rule

In general, a partner of a limited liability partnership is not liable, including by way of indemnification, contribution, assessment, or otherwise, for:

(a) any debts, obligations, or liabilities of or chargeable to the limited liability partnership or another partner of the limited liability partnership; or

(b) the acts or omissions of any other partner or agents, contractors, or employees of the limited liability partnership if the debts, obligations, or liabilities arise or are incurred while the limited liability partnership is duly registered. 35-10-307(1), M.C.A.

2) Exception: Partner's Own Acts

A partner may still be liable for the partner's own negligence, wrongful act, or misconduct, or that of any person under the partner's direct supervision and control. 35-10-307(3), M.C.A.

3) Exception: Guarantees

A partner may still act as a guarantor or surety for, provide collateral for, or otherwise agree to be primarily or contingently liable for the debts, obligations, or liabilities of a limited liability partnership. 35-10-307(4), M.C.A.

4) Partnership Liability

Status as a limited liability partnership does not affect the liability of the partnership for partnership debts, obligations, or liabilities to the extent of partnership assets. 35-10-307(5), M.C.A.

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5) Proper Parties to Lawsuits

Unless the partner is personally liable under 35-10-307, M.C.A., a partner in a limited liability partnership is not a proper party to a proceeding by or against a limited liability partnership to recover any debts, obligations, or liabilities of or chargeable to the limited liability partnership. 35-10-307(6), M.C.A.

[4] Corporations

[a] Business Corporations

[i] Formation

Business corporations are formed when one or more persons acting as the incorporator of a corporation deliver articles of incorporation to the secretary of state for filing. The articles of incorporation *must* set forth:

(a) a corporate name for the corporation that satisfies the requirements of 35-1-308;

(b) the number of shares the corporation is authorized to issue;

(c) (i) the street address of the corporation's initial registered office and, if different, the mailing address; and

(ii) the name of its initial registered agent at that office; and

(d) the name and address of each incorporator.

The articles of incorporation *may* set forth:

(a) the names and addresses of the individuals who are to serve as the initial directors;

(b) provisions consistent with law regarding:

(i) the purpose or purposes for which the corporation is organized;

(ii) managing the business and regulating the affairs of the corporation;

(iii) defining, limiting, and regulating the powers of the corporation, its board of

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directors, and shareholders;

(iv) a par value for authorized shares or classes of shares; and

(v) the imposition of personal liability on shareholders for the debts of the corporation to a specified extent and upon specified conditions;

(c) any provision that under this chapter is required or permitted to be set forth in the bylaws; and

(d) a provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any actions taken or any failure to take any action, as a director, except liability for:

(i) the amount of a financial benefit received by a director to which the director is not entitled;

(ii) an intentional infliction of harm on the corporation or the shareholders;

(iii) a violation of 35-1-713 (regarding liability of directors for unlawful corporate distributions); or

(iv) an intentional violation of criminal law.

35-1-216, M.C.A.

The Secretary of State provides a form for filing Articles of Incorporation, but this form need not be used as long as all the information is provided.

[ii] Liability

1) General Rule

Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation. 35-1-534(2), M.C.A.

2) Exception

a) Notwithstanding the general liability shield, a shareholder may become personally liable by reason of that shareholder's own acts or conduct. 35-1-534(2), M.C.A.

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b) This liability for one's own acts or conduct is an often overlooked gap in the liability shield. Preferably the lawyer would clearly explain to the client this caveat to the concept of limited liability. If the corporation has only one shareholder, that shareholder is almost always going to be the one whose acts or conduct give rise to a claim against the corporation.

[iii] Dissenter's Rights

1) A shareholder is entitled to dissent from and obtain payment of the fair value of the shareholder's shares, in the conditions specified by 35-1-827, M.C.A. in the event of consummation of a plan of merger, share exchange, or sale or exchange of all or substantially all of the property of the corporation other than in the usual and regular course of business, an amendment of the articles of incorporation that materially and adversely affects rights in respect of a dissenter's shares, or any corporate action taken pursuant to a shareholder vote to the extent the articles of incorporation, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and to obtain payment for their shares. 35-1-827(1), M.C.A.

2) A shareholder entitled to dissent and to obtain payment for shares under 35-1-826 through 35-1-839 may not challenge the corporate action creating the shareholder's entitlement unless the action is unlawful or fraudulent with respect to the shareholder or the corporation. 35-1-827(2), M.C.A.

[iv] Taxation: S Corporation or C Corporation?

The income taxation of the corporation and its shareholders depends on whether the corporation has elected to be taxed as an S corporation under the Internal Revenue Code, or has made no election and thereby will be taxed as a C corporation. A C corporation will file a Form 1120 with the IRS, pay tax on its income, and the shareholders will not have any income tax liability until the net income is distributed as a dividend or some other taxable event occurs. An S corporation will file a Form 1120S with the IRS, will *not* in general pay tax on its income, and instead the shareholders will report on their 1040's their shares of the corporation's income and expenses for the year.

[v] S Corporations vs. Close Corporations

Only small business corporations may elect S corporation status. IRC §1361. Montana law allows for statutory close corporations. Title 35, Chapter 9, M.C.A. The two should not be confused. Under Montana law, business corporations and statutory close corporations are two distinct forms of corporations, and either type may be treated as a C corporation or an S corporation for income tax purposes.

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Statutory close corporations are treated in more detail in the next section.

[b] Statutory Close Corporations

[i] Formation

A statutory close corporation is a corporation whose articles of incorporation contain a statement that the corporation is a statutory close corporation. A corporation having 25 or fewer shareholders may become a statutory close corporation by amending its articles of incorporation to include the such a statement. 35-9-103, M.C.A.

[ii] Applicability of Business Corporation Act

The Montana Business Corporation Act applies to statutory close corporations to the extent not inconsistent with the provisions of the Montana Close Corporation Act. 35-9-102(1), M.C.A.

[iii] Applicability to the Professional Corporation Act

The Montana Close Corporation Act applies to a professional corporation organized under the Montana Professional Corporation Act whose articles of incorporation contain the statement required by 35-9-103 (i.e., that the corporation is a statutory close corporation) except insofar as the Montana Professional Corporation Act contains inconsistent provisions. 35-9-102(2), M.C.A.

[iv] Share Transfer Prohibition

1) Right of First Refusal

An interest in shares of a statutory close corporation may not be voluntarily or involuntarily transferred, by operation of law or otherwise, except to the extent permitted by the articles of incorporation or after giving the corporation a right of first refusal. 35-9-202(1), M.C.A.

2) Purchaser Must be Eligible

The shareholder must first offer the shares to the corporation by obtaining an offer to purchase the shares for cash from a third person who is eligible to purchase the shares. 35-9-203(1), M.C.A. To be eligible to purchase the shares, the third person must be eligible to become a qualified shareholder under any federal or state tax statute the corporation has adopted and agree in writing not to terminate his or her

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qualification without the approval of the remaining shareholders; and the third party's purchase of the shares must not impose a personal holding company tax or similar federal or state penalty tax on the corporation. 35-9-203(2), M.C.A.

3) Transfers Not Restricted

Except to the extent the articles of incorporation provide otherwise, the statutory prohibition on transfer of shares does not apply to a transfer:

(a) to the corporation or to any other holder of the same class or series of shares;

(b) to members of the shareholder's immediate family or to a trust, all of whose beneficiaries are members of the shareholder's immediate family, which immediate family consists of his spouse, parents, lineal descendants including adopted children and stepchildren and the spouse of any lineal descendant, and brothers and sisters;

(c) that has been approved in writing by all of the holders of the corporation's shares having general voting rights;

(d) to an executor or administrator upon the death of a shareholder or to a trustee or receiver as the result of a bankruptcy, insolvency, dissolution, or similar proceeding brought by or against a shareholder;

(e) by merger or share exchange under Title 35, chapter 1, part 8, or an exchange of existing shares for other shares of a different class or series in the corporation;

(f) by a pledge as collateral for a loan that does not grant the pledgee any voting rights possessed by the pledgor; and

(g) made after termination of the corporation's status as a statutory close corporation.

35-9-202(2), M.C.A.

[v] Compulsory Purchase of Shares Upon Death of Shareholder

If the articles of incorporation provide that the provisions for compulsory purchase of shares upon death of a shareholder (35-9-205 through 35-9-208, M.C.A.) are to apply, then upon the death of a shareholder, the executor or administrator of the estate of a deceased shareholder may require the corporation to purchase or cause to be purchased all but not less than all of the decedent's shares or to be dissolved. The statutory buy/sell provisions can be modified only if the modification is set out in the

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articles of incorporation. 35-9-205, M.C.A.

[vi] Elimination of Board of Directors

A statutory close corporation may operate without a board of directors if its articles of incorporation contain a statement to that effect. 35-9-302, M.C.A.

While a corporation is operating without a board of directors:

(a) all corporate powers must be exercised by or under the authority of and the business and affairs of the corporation managed under the direction of the shareholders;

(b) unless the articles of incorporation provide otherwise:

(i) action requiring director approval or both director and shareholder approval is authorized if approved by the shareholders; and

(ii) action requiring a majority or greater percentage vote of the board of directors is authorized if approved by the majority or greater percentage of the votes of shareholders entitled to vote on the action;

(c) a shareholder is not liable for his act or omission, even though a director would be, unless the shareholder was entitled to vote on the action;

(d) a requirement by a state or the United States that a document delivered for filing contain a statement that specified action has been taken by the board of directors is satisfied by a statement that the corporation is a statutory close corporation without a board of directors and that the action was approved by the shareholders; and

(e) the shareholders may by resolution appoint one or more shareholders to sign documents as designated directors.

35-9-302, M.C.A.

[vii] Bylaws

A statutory close corporation need not adopt bylaws if provisions required by law to be contained in bylaws are contained in either the articles of incorporation or a shareholder agreement authorized by 35-9-301. 35-9-303, M.C.A.

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[viii] Liability

The failure of a statutory close corporation to observe the usual corporate formalities or requirements relating to the exercise of its corporate powers or management of its business and affairs is not a ground for imposing personal liability on the shareholders for liabilities of the corporation. 35-9-306, M.C.A.

[ix] Protection of Shareholders

1) In General

A shareholder of a statutory close corporation may petition the district court for any of the relief described in 35-9-502 through 35-9-504 (ordinary relief, share purchase, or dissolution, respectively) if:

(a) the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial to the petitioner, whether in his capacity as shareholder, director, or officer of the corporation;

(b) the directors or those in control of the corporation are deadlocked in the management of the corporation's affairs, the shareholders are unable to break the deadlock, and the corporation is suffering or will suffer irreparable injury or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally because of the deadlock; or

(c) there exists one or more grounds for judicial dissolution of the corporation under 35-1-938.

35-9-501, M.C.A.

2) Ordinary Relief - [35-9-502, M.C.A.]

Ordinary relief, as set forth in 35-9-502, M.C.A., includes one or more of the following types of relief:

(a) the performance, prohibition, alteration, or setting aside of any action of the corporation or of its shareholders, directors, or officers or any other party to the proceeding;

(b) the cancellation or alteration of any provision in the corporation's articles of incorporation or bylaws;

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- (c) the removal from office of any director or officer;
- (d) the appointment of any individual as a director or officer;
- (e) an accounting with respect to any matter in dispute;
- (f) the appointment of a custodian to manage the business and affairs of the corporation;
- (g) the appointment of a provisional director who has all the rights, powers, and duties of a duly elected director to serve for the term and under the conditions prescribed by the court;
- (h) the payment of dividends;
- (i) the award of damages to any aggrieved party.

3) Extraordinary Relief - Share Purchase [35-9-503, M.C.A.]

Statutory close corporations have available the extraordinary remedy of requiring that a shareholder's shares be purchased. 35-9-503, M.C.A. This form of relief is not available for regular business corporations, except in the specific instances giving rise to dissenter's rights. *See* 2[4][a][iii]. If the court finds that ordinary relief is or would be inadequate or inappropriate, it may order the corporation dissolved unless the corporation or one or more of its shareholders purchases all the shares of the shareholder for their fair value and on terms set forth in the statute.

If the court orders a share purchase, it shall:

- (a) determine the fair value of the shares, considering among other relevant evidence:
 - (i) the going concern value of the corporation;
 - (ii) any agreement among some or all of the shareholders fixing the price or specifying a formula for determining share value for any purpose;
 - (iii) the recommendations of appraisers, if any, appointed by the court; and
 - (iv) any legal constraints on the corporation's ability to purchase the shares;

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(b) specify the terms of the purchase, including if appropriate:

(i) terms for installment payments;

(ii) subordination of the purchase obligation to the rights of the corporation's other creditors;

(iii) security for a deferred purchase price; and

(iv) a covenant not to compete or other restriction on the seller;

(c) require the seller to deliver all his shares to the purchaser upon receipt of the purchase price or the first installment of the purchase price;

(d) provide that after the seller delivers his shares he has no further claim against the corporation, its directors, officers, or shareholders, other than a claim to any unpaid balance of the purchase price and a claim under any agreement with the corporation or the remaining shareholders that is not terminated by the court; and

(e) provide that if the purchase is not completed in accordance with the specified terms, the corporation is to be dissolved.

(3) After the purchase order is entered, any party may petition the court to modify the terms of the purchase and the court may do so if it finds that changes in the financial or legal ability of the corporation or other purchaser to complete the purchase justify a modification.

(4) If the corporation is dissolved because the share purchase was not completed in accordance with the court's order, the selling shareholder has the same rights and priorities in the corporation's assets as if the sale had not been ordered.

4) Extraordinary Relief - Dissolution [35-9-504, M.C.A.]

The court may dissolve the corporation if it finds:

(a) one or more grounds for judicial dissolution under 35-1-938; or

(b) all other relief ordered by the court under 35-9-502 or 35-9-503 has failed to resolve the matters in dispute.

35-9-504, M.C.A.

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5) Grounds for Dissolution [35-1-938, M.C.A.]

35-1-938, M.C.A. provides the following grounds for dissolution of a corporation:

35-1-938. Grounds for judicial dissolution. The district court may dissolve a corporation:

- (1) in a proceeding by the attorney general if it is established that:
 - (a) the corporation obtained its articles of incorporation through fraud; or
 - (b) the corporation has continued to exceed or abuse the authority conferred upon it by law;
- (2) in a proceeding by a shareholder if it is established that:
 - (a) the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally because of the deadlock;
 - (b) the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;
 - (c) the shareholders are deadlocked in voting power and have failed, for a period that includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired; or
 - (d) the corporate assets are being misapplied or wasted;
- (3) in a proceeding by a creditor if it is established that:
 - (a) the creditor's claim has been reduced to judgment, the execution on the judgment has been returned unsatisfied, and the corporation is insolvent; or
 - (b) the corporation has admitted in writing that the creditor's claim is due and owing and the corporation is insolvent; or
- (4) in a proceeding by the corporation to have its voluntary dissolution continued under court supervision.

[x] Shareholder Option to Dissolve Corporation

The articles of incorporation of a statutory close corporation may authorize one or more shareholders, or the holders of a specified number or percentage of shares of any class or series, to dissolve the corporation at will or upon the occurrence of a specified event or contingency. The shareholder or shareholders exercising this authority shall give written notice of the intent to dissolve to all the other shareholders. Thirty-one days after the effective date of the notice, the corporation shall begin to wind up and liquidate its business and affairs and file articles of dissolution. 35-9-404, M.C.A. This option is not available with regular business corporations.

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[c] Professional Corporations

[i] Applicability of the Montana Business Corporation Act

The Montana Business Corporation Act applies to professional corporations, domestic and foreign, except to the extent its provisions are inconsistent with the Montana Professional Corporation Act. 35-4-111, M.C.A.

[ii] Applicability of the Montana Statutory Close Corporation Act

The Montana Close Corporation Act applies to a professional corporation organized under the Montana Professional Corporation Act whose articles of incorporation contain the statement required by 35-9-103 except insofar as the Montana Professional Corporation Act contains inconsistent provisions. 35-9-102(2), M.C.A.

[iii] Formation

Professional corporations may be organized under the Montana Professional Corporation Act only for the purpose of rendering professional services and services ancillary thereto within a single profession, except that a professional corporation may be incorporated for the purpose of rendering professional services within two or more professions and for any purpose or purposes for which corporations may be organized under the Montana Business Corporation Act to the extent that such combination of professional purposes or professional and business purposes is permitted by the licensing laws and rules of Montana applicable to such professions. 35-4-205, M.C.A.

[iv] Directors and Officers

At least one-half of the combined directors and officers of a professional corporation, other than the secretary and the treasurer, must be qualified persons with respect to the corporation. 35-4-207, M.C.A.

[v] Permitted Shareholders

A professional corporation may issue shares, fractional shares, and rights or options to purchase shares only to:

(a) natural persons authorized by law of Montana or any other state, a territory of the United States, or the District of Columbia to render a professional service permitted by the articles of incorporation of the corporation;

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(b) general partnerships in which all the partners are authorized by law of Montana or any other state, a territory of the United States, or the District of Columbia to render a professional service permitted by the articles of incorporation and in which at least one partner is authorized by law in this state to render a professional service permitted by the articles of incorporation of the corporation; and

(c) professional corporations, domestic or foreign, authorized by law in Montana to render a professional service permitted by the articles of incorporation of the corporation.

35-4-301, M.C.A.

[vi] Liability

An individual who renders professional services as an employee of a domestic or foreign professional corporation is liable for any negligent or wrongful act or omission in which he personally participates to the same extent as if he had rendered such services as a sole practitioner. An employee of a professional corporation is not liable for the conduct of other employees unless he is at fault in appointing, supervising, or cooperating with them. 35-4-404(1), M.C.A.

In other respects, the personal liability of a shareholder of a domestic or foreign professional corporation is no greater in any respect than that of a shareholder of a corporation organized under the Montana Business Corporation Act. 35-4-404(3), M.C.A.

[d] Nonprofit Corporations

[i] This outline is directed to the choice of an appropriate *business* entity and consequently a detailed discussion of nonprofit corporations is beyond that scope. Nonetheless, there will be situations in which a business will have an interest in forming a nonprofit corporation, such as when a real estate developer wishes to form a homeowner's association. Montana law provides for three types of nonprofit corporations:

- (i) public benefit corporations;
- (ii) mutual benefit corporations; or
- (iii) religious corporations.

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35-2-126, M.C.A.

[ii] A nonprofit corporation is not necessarily a tax exempt corporation. In order to be tax exempt for federal income tax purposes, the corporation should file either Form 1023 or 1024, depending on the type of organization (501(c)(3) organizations file Form 1023). *See* Publication 557 for further information. A nonprofit corporation will have to file the Montana Corporate License Tax Return unless it furnishes the Department of Revenue with:

- 1) An affidavit showing the character of the organization, the purposes for which it was organized, its actual activities, the sources and disposition of its income, and whether or not any of its income may inure to the benefit of any private shareholder or individual;
- 2) A copy of the Articles of Incorporation;
- 3) A copy of the by-laws;
- 4) Copies of the latest financial statements showing the assets, liabilities, receipts, and disbursements; and
- 5) A copy of the IRS exemption certificate or letter if available.

ARM §42.23.103.

[iii] If the corporation is not going to have any income, or very little, it may be preferable to organize as some form of taxable entity, to avoid the possibility the corporation will not comply with the filing requirements of a tax-exempt entity. The penalty for failure to timely file a reporting form for a 501(c)(3) organization is \$20 for each day the failure continues (\$100 a day if it is a large organization), unless it can show that the failure was due to reasonable cause. The maximum penalty for each return will not exceed the smaller of \$10,000 (\$50,000 for a large organization) or 5% of the gross receipts of the organization for the year. A large organization is one that has gross receipts exceeding \$1,000,000 for the tax year.

[iv] Upon liquidation of a nonprofit corporation, absent a contrary provision in its articles of incorporation or bylaws, the corporate assets must be distributed as follows:

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| Type of Nonprofit Corporation | Default Distributees |
|---|---|
| 501(c)(3) Public Benefit or Religious Corporation | One or more 501(c)(3) organizations |
| Non-501(c)(3) Public Benefit or Religious Corporation | One or more public benefit corporations or religious corporations |
| Mutual Benefit Corporation | Its members or, if it does not have members, to those persons whom the corporation holds itself out as benefitting or serving |

35-2-725, M.C.A.

[v] Each incorporator and director named in the articles shall sign the articles, 35-2-213, M.C.A., which is not a requirement under the Montana Business Corporation Act.

[5] Business Trusts

[a] Definition

Montana recognizes common law business trusts, also known as Massachusetts trusts, which is defined as an unincorporated association or trust created by an instrument under which property is held and managed by trustees for the benefit and profit of such persons as are or may become the holders of transferable certificates evidencing beneficial interests in the trust estate. 35-5-101, M.C.A.

[b] Treatment as Corporations

Business trusts are subject to the law of corporations, including provisions of law as to the issuance of securities, filing of required statements and reports, service of process, general grants of power to act, withdrawal, right to sue and be sued, limitation of individual liability of shareholders, and rights to acquire, mortgage, sell, lease, operate, and otherwise deal in or with real property. 35-5-103, M.C.A.

[6] Limited Liability Companies

[a] Genesis of the Montana Limited Liability Company Act

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The Montana Limited Liability Company Act (MLLCA) was originally adopted by the Montana Legislature in 1993. It is based on the July 1992 Draft of the American Bar Association Prototype Limited Liability Company Act, with some revisions. In 1999, the legislature adopted amendments taken from the 1996 Uniform Limited Liability Company Act (ULLCA (1996)). Consequently, the MLLCA as it now exists is an amalgam of the ABA Prototype Act and the Uniform LLC Act.

[b] Formation

One or more persons may form a limited liability company consisting of one or more members by signing and filing articles of organization with the secretary of state. 35-8-201, M.C.A.

While partnerships are formed by two or more persons to carry on as co-owners a business for profit, LLC's can be formed by one person 35-8-201, M.C.A., and may be formed for *any* lawful purpose except for the purpose of banking or insurance. 35-8-106, M.C.A.

[i] Term Companies vs. At Will Companies

Among other things, the articles of organization must set forth whether the LLC is a term company or an at will company. If the articles of organization are silent, the LLC will be treated as an at-will company. 35-8-202(b), M.C.A.

1) Term Companies

A "term company" is a limited liability company designated as a term company in its articles of organization. 35-8-102(31), M.C.A.

2) At-Will Companies

An at-will company is a LLC other than a term company. 35-8-102(2), M.C.A.

3) Differences in Default Rules

The default rules applicable to a term company significantly differ from those applicable to an at-will company. An operating agreement may alter any of these rules. In general, a member of an at-will company may rightfully dissociate at any time whereas a dissociation from a term company prior to the expiration of the specified term is wrongful. Comment, ULLCA, §203. As a result, a dissociated member of an at-will company is entitled to have the company purchase that

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member's interest for its fair value determined as of the date of the member's dissociation. In contrast, the dissociated member of a term company usually must wait for the expiration of the agreed term to withdraw the fair value of the interest determined as of the date of the expiration of the agreed term. So, a dissociated member in an at-will company receives the fair value of the interest sooner than in a term company and also does not bear the risk of valuation changes for the remainder of the specified term. *Id.*

[ii] Member Managed vs. Manager Managed

The articles of organization must also state whether the LLC is to be member-managed or manager-managed. 35-8-202(d), M.C.A.

1) Confidentiality

If the LLC is to be member-managed, the articles of organization must include the names and addresses of the initial members, but if it is to be manager-managed, that information is not required and instead the names and addresses of the managers who are to serve as managers until the first meeting of members or until their successors are elected is required. 35-8-202(d), M.C.A.

2) Agency Authority

a) Member-Managed LLC

If the articles of organization do *not* provide that management of the limited liability company is vested in a manager or managers, then

- (1) a member is an agent of the limited liability company for the purpose of its business or affairs and
- (2) the act of a member, including but not limited to the execution of any instrument in the name of the limited liability company for apparently carrying on in the usual way the business or affairs of the limited liability company binds the limited liability company, unless
 - (a) the member so acting has, in fact, no authority to act for the limited liability company in the particular matter and
 - (b) the person with whom the member is dealing has knowledge of the fact that the member has no such authority. 35-8-301(1), M.C.A.

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b) Manager-Managed LLC

If the articles of organization provide that management of the limited liability company is vested in a manager or managers, then:

- (1) a member, acting solely in the capacity as a member, may not be an agent of the limited liability company;
- (2) a manager is an agent of the limited liability company for the purpose of its business or affairs and
- (3) the act of a manager, including but not limited to the execution of any instrument in the name of the limited liability company for apparently carrying on in the usual way the business or affairs of the limited liability company binds the limited liability company, unless
 - (a) the manager so acting has, in fact, no authority to act for the limited liability company in the particular matter and
 - (b) the person with whom the manager is dealing has knowledge of the fact that the manager has no such authority. 35-8-301(2), M.C.A.

c) Rules Applicable to Both Management Types

- (1) An act of a manager or a member that is not apparently for carrying on in the usual way the business of the limited liability company does not bind the limited liability company, unless authorized in accordance with the articles of organization or the operating agreement, at the time of the transaction or at any other time. 35-8-301(3), M.C.A.
- (2) An act of a manager or member in contravention of a restriction on authority may not bind the limited liability company to persons having knowledge of the restriction. 35-8-301(4), M.C.A.

[iii] Liability

A person who is a member or manager, or both, of a LLC is not liable, solely by reason of being a member or manager, or both, in any manner, for a debt, obligation, or liability of the LLC, or for the acts or omissions of any other member, manager, agent, or employee of the LLC. 35-8-304, M.C.A.

A member or manager *is* responsible for acts or omissions to the extent those acts

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or omissions would be actionable in contract or tort against the member or manager if that person were acting in an individual capacity. Official Comments to 35-8-304, M.C.A.

[iv] Taxation

1) Check the Box Regulations

The check-the-box regulations [Treas. Regs. §§301.7701-1, -2, -3, -4] allowed increased flexibility and certainty in the structuring of limited liability companies.

Montana allows formation of one-member LLC's. The check-the-box regulations make clear that such a LLC will be ignored for tax purposes. Treas. Reg. §301.7701-2(c) states that for federal tax purposes, "a business entity that has a single owner and is not a corporation under paragraph (b) of this section is disregarded as an entity separate from its owner." One-member LLC's, therefore, will be taxed as sole proprietorships.

Under the check-the-box regulations, therefore, LLC's can be taxed in one of three ways: (i) as partnerships; (ii) as corporations; or (iii) as sole proprietorships.

2) Sole Proprietorship

The default rule for a single member LLC is that it will be taxed as a sole proprietorship, with all income and expenses reported on Schedule C of the Form 1040 of the member.

3) Partnership

The default rule for a multiple member LLC is that it will be taxed as a partnership, which would require the annual filing of a Form 1065 by the LLC with Schedules K-1 provided to the members so they could report the individual items of income and expense on their Form 1040's.

4) Corporation

A multiple member LLC may elect to be taxed as a corporation and also may elect S Corporation treatment.

3. Some Factors to Consider

The choice of entity will necessarily include both tax and non-tax considerations.

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So at the risk of encroaching on today's presentation on the tax considerations, here are some of the factors that might be taken into account in making a choice.

[1] Number of Owners and Employees

Will there be one or maybe two owners of the business, or many? If there is just one, the simplicity of a sole proprietorship may be desirable. There is no separate income tax return to file: the business operations are reported on Schedule C of the owner's Form 1040. Besides, one of the few tax-advantaged methods of saving for a child's college education is available to sole proprietorships and not corporations or, in general, partnerships: A proprietor's child under age 18 is not subject to employment tax. The child is subject only to income tax, presumably at a lower rate than the proprietor and maybe none at all. (The same rule applies to partnerships if there are two partners, both of whom are the parents of the child employee.)

If there are two owners, even if husband and wife, beware that a partnership can be formed without the partners realizing it. All they have to do is intend to carry on a business for joint profit, and they will have satisfied the definition of a partnership. That opens them to joint and several liability for their actions and if they fail to file income tax returns as a partnership may open themselves to penalties and may miss the opportunity to make elections on their partnership tax returns that haven't been filed. Consider forming an LLC or filing as a limited liability partnership to provide limited liability protection.

The limited liability shield for both corporations and LLC's does not in general extend to one's own acts. If there is only one owner and no employees, the limited liability shield is probably more exception than rule. On the other hand, if there are going to be multiple employees who can expose the owners of the business to risk of liability, or if there are going to be multiple owners, especially professionals, who can risk expose each other to liability for their own actions, then the use of an organization with limited liability is much more attractive.

[2] Asset Protection

Creditors of members in LLC's or partners in limited partnerships can only get a charging order against the partnership interest; they cannot substitute themselves in as partners or reach the underlying assets of the business. Instead, they are only entitled to reach the distributions that are made to the debtor-members/partners. Creditors who have become assignees of the debtor-owner's interest may seek judicial dissolution of an LLC but such a remedy is not available in a limited

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partnership.

[3] Appreciating Property

If the business is going to own appreciating property, such as real estate, it usually should not be inside a corporation. Upon the death of the owner, property owned outright by the business owners gets a new basis, but if the property is inside a corporation, only the owner's stock gets a new basis, not the underlying property because that is owned by the corporation and the corporation has not died. Property inside a partnership (or an LLC taxed as a partnership) is eligible for a step up in basis. IRC §754. Consequently, if there is appreciating property, there is a tax advantage to having the property inside a partnership or LLC taxed as a partnership.

[4] Employment Taxes

All of the income from a partnership or LLC taxed as a partnership is subject to both income and employment taxes of the owners. Profit from an S corporation is subject to income tax of the owners but not employment tax. The combined employer and employee tax rate for social security is 12.4% on the first \$87,000 (in 2003) of wages (the combined 2.9% Medicare tax is not subject to a limit). Consequently, if the owner can take out profits in the form of a dividend instead of salary and can thereby keep the salary under \$87,000, there is a tax savings of \$1,240 on every \$10,000.

This strategy does not work well with a C corporation because the profits left in the corporation are subject to income tax at the corporate level and then subject to income tax a second time when the profits are distributed in the form of a dividend to the shareholders.

[5] Type of Owners

S corporations cannot have more than 75 stockholders or have as a shareholder a person who is not an individual (subject to specified narrow exceptions) or who is a nonresident alien. IRC §1361(b)(1). These restrictions do not apply to LLC's, partnerships or C corporations.

[6] Management

If there are multiple owners, the nature of the desired management may dictate the

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choice of entity. A partnership is decentralized, with each partner having an equal say in the operation of the business. A regular corporation has a hierarchy of officers running the day to day operations and a board of directors overseeing the officers. Consider which model better suits the owners.

LLC's have the statutory provision that members in member-managed LLC's have agency authority for the LLC while those in manager-managed LLC's do not. If only one of the members is truly going to be running the business, a manager-managed LLC might be the appropriate choice. This is a common situation on family ranches and farms that have been left to the second generation, with one child running the ranch and the others living elsewhere.

In limited partnerships, the limited partners cannot participate in the control of the business. The general partners are vested with that responsibility.

[7] Operating Without a Board of Directors

Corporations cannot operate without a board of directors unless they are formed as a statutory close corporation and the appropriate election is made in the articles of incorporation. The General Motors model of corporations, complete with boards of directors, is appropriate for large, widely-held corporations but is perhaps overkill for the Mom and Pop closely-held business. If a corporation is going to be used and it will be closely-held, consider the statutory close corporation.

[8] Statutory Buy/Sell Provisions for Close Corporations

If the articles of incorporation for a statutory close corporation make no specific mention, lifetime transfers of shares will be prohibited unless first offered to the corporation, and there will be no mandatory purchase of shares upon the death of a shareholder. The articles of incorporation can change either of those results. Obviously, these ought to be considered and decided upon at the time of filing the articles of incorporation.

[9] "Super" Limited Liability of Statutory Close Corporations

The failure of a statutory close corporation to observe the usual corporate formalities or requirements relating to the exercise of its corporate powers or management of its business and affairs is not a ground for imposing personal liability on the shareholders for liabilities of the corporation. 35-9-306, M.C.A.

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[10] Workers' Compensation

Unless the employer elects coverage, the Workers' Compensation Act does not apply to employment of sole proprietors, working members of a partnership, working members of a limited liability partnership, or working members of a member-managed limited liability company. 39-71-401(2)(d), M.C.A.

On the other hand, officers of corporations or managers of manager-managed limited liability companies *are* subject to the Workers' Compensation Act unless they fall within specific exemptions. The exemptions applies only if:

- 1) the officer or manager is not engaged in the ordinary duties of a worker for the corporation or the limited liability company and does not receive any pay from the corporation or the limited liability company for performance of the duties;
- 2) the officer or manager is engaged primarily in household employment for the corporation or the limited liability company;
- 3) the officer or manager either:
 - a) owns 20% or more of the number of shares of stock in the corporation or owns 20% or more of the limited liability company; or
 - b) owns less than 20% of the number of shares of stock in the corporation or limited liability company if the officer's or manager's shares when aggregated with specified family members total 20% or more of the number of shares in the corporation or limited liability company; or
- 4) the officer or manager is the spouse, child, adopted child, stepchild, mother, father, son-in-law, daughter-in-law, nephew, niece, brother, or sister of a corporate officer who meets the preceding two requirements.

39-71-401(2)(r), M.C.A.

[11] Profits and Losses

The profits and losses from an S corporation are divided among the shareholders in accordance with their share holdings. IRC §1366. In a partnership, the partner's share of profits and losses is determined in accordance with the partnership agreement, IRC §704(a), unless there is no partnership agreement or the partnership agreement does not have "substantial economic effect," in which event the

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partner's share is determined in accordance with the partner's interest in the partnership. IRC §704(b). Partnerships (and LLC's taxed as partnerships) are more flexible in allowing special allocations of profits and losses, which can be useful in situations such as when one individual has an idea and the other money to invest, and they desire to split profits differently before the investment has been recovered than after.

If it is anticipated that the business, at least in the first few years of operations, will have losses, the owners of the business may want to be able to deduct the losses against their personal income. In such situations, a C corporation would not be indicated; an S corporation, a partnership, or LLC taxed as a partnership would instead be advisable. Losses can be deducted only to the extent of a shareholder's basis in S corporation stock or a partner's basis in the partnership interest. Partners are allowed basis for their proportionate share of partnership debt, but shareholders in S corporations are not allowed basis for their proportionate share of corporate debt.

[12] Accounting

The accounting for a partnership is more complex than accounting for corporations or sole proprietorships. It is necessary to track not only the partnership's "inside basis" of its assets but the partners' "outside basis" in their partnership interests. Special allocations of profits and losses are available for partnerships (and LLC's taxed as partnerships), but only if the daunting regulations under §704(d) are complied with. Losses can be deducted, subject to three different limitations: basis in the partnership interest, passive activity loss limitations, and at-risk limitations. Partnerships are simple on their face, but the applicable Internal Revenue Code provisions are some of the most complex in the tax code.

[13] Consider a Combination of Organizations

A business that will have appreciating assets and the owners of which desire to take advantage of employment tax advantages of an S corporation may want to have two organizations: an LLC to hold the appreciating assets and an S corporation to conduct the business operations and hire the employees. A lease between the two entities for the appreciating assets (e.g., the building housing the business) would then be appropriate.

[14] Differing Standards of Duties Owed

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[a] Limited Liability Companies

[i] Member-Managed

1) The only fiduciary duties that a member owes to a member-managed LLC and the other members are a duty of loyalty and a duty of care. 35-8-310(1), M.C.A.

2) A member's duty of loyalty to a member-managed company and its other members is limited to the following:

(a) to account to the company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the company's business or derived from a use by the member of the company's property, including the appropriation of a company's opportunity;

(b) to refrain from dealing with the company in the conduct or winding up of the company's business on behalf of a party or as a person having an interest adverse to the company; and

(c) to refrain from competing with the company in the conduct of the company's business before the dissolution of the company.

35-8-310(2), M.C.A.

3) A member's duty of care to a member-managed company and the other members in the conduct of and winding up of the company's business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. 35-8-310(3), M.C.A.

4) A member is required to discharge the duties of loyalty and care and any additional duties provided under the operating agreement and exercise any rights consistently with the obligation of good faith and fair dealing. 35-8-310(4), M.C.A.

[ii] Manager-Managed

In a manager-managed company, a member who is not also a manager owes no duties to the company or to the other members solely by reason of being a member. A member who pursuant to the operating agreement exercises some or all of the rights of a manager in the management and conduct of the company's business is held to the standards of conduct prescribed for members in member-managed

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LLC's to the extent that the member exercises the managerial authority vested in a manager by this chapter.

[b] Partnerships

- 1) The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care. 35-10-405(1), M.C.A.
 - 2) A partner's duty of loyalty to the partnership and the other partners is limited to the following:
 - (a) to account to the partnership and hold as trustee for it any property, profit, or benefit derived:
 - (i) by the partner in the conduct and winding up of the partnership business;
 - (ii) from a use or appropriation by the partner of partnership property; or
 - (iii) from a use or appropriation of an opportunity without the consent of the other partners;
 - (b) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership without the consent of the other partners; and
 - (c) to refrain from competing with the partnership in the conduct of partnership business before the dissolution of the partnership without the consent of the other partners.
- 35-10-405(2), M.C.A.
- 3) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. 35-10-405(4), M.C.A.
 - 4) A partner is required to discharge the duties of loyalty and care and any other duties imposed under the partnership agreement and exercise any rights consistent with the obligation of good faith and fair dealing. 35-10-405(5), M.C.A.
 - 5) The duties of a partner are nearly identical to the duties of a member of a

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member-managed LLC, but a member of a manager-managed LLC has almost no duties owed to the other members.

[c] Corporations

[i] Directors

1) A director must act in good faith, with the care an ordinarily prudent person in a similar position would exercise under similar circumstances, and in a manner the director reasonably believes to be in the best interests of the corporation. 35-1-418, M.C.A.

[ii] Officers

An officer with discretionary authority must act in good faith, with the care an ordinarily prudent person in a similar position would exercise under similar circumstances and in a manner the officer reasonably believes to be in the best interests of the corporation. 35-1-443, M.C.A.

[iii] Shareholders

The Montana Business Corporation Act provides for no statutory duty owed by shareholders, but case law holds that the fiduciary duty between shareholders of a close corporation is one of utmost good faith and loyalty. Sletteland v. Roberts, 2000 MT 382, 304 M 21, 16 P3d 1062, 57 St. Rep. 1639 (2000); Daniels v. Thomas, Dean & Hoskins, Inc., 246 M 125, 804 P2d 359, 47 St. Rep. 2293 (1990). In Sletteland, the argument was raised that this standard only applies to a majority shareholder. The Montana Supreme Court, though, stated, “On the contrary, this duty of good faith cannot be limited where a minority shareholder has power to do damage to the corporation.”

[15] Estate Planning

Family limited partnerships are useful in leveraging gifts of assets from one generation to the next. The restrictions on limited partnership interests provide a basis for valuing those interests at less than the value of the underlying properties held by the partnership might otherwise indicate. Members of limited liability companies are not subject to as severe restrictions on participation in the business as limited partners are, and members of limited liability companies have somewhat greater rights in causing a dissolution of the business and thereby having access to the assets of the business, which can be a basis for appraisers to not

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discount interests in LLC's as much as they might in limited partnerships. The law in this area is constantly evolving and each particular situation is best evaluated after first consulting with a qualified business appraiser. In any event, if the purpose of forming the business entity is to obtain discounts for estate planning purposes, the different characteristics of each form of business should be evaluated in determining the appropriate choice.

[16] Will Venture Capital be Sought?

Venture capitalists prefer C corporations for two reasons, among others:

[a] Section 1202 of the Internal Revenue Code provides an exclusion from income of 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years. A "qualified small business" has to be a C corporation.

[b] Section 368 of the Internal Revenue Code provides non-recognition treatment for mergers and other reorganizations of corporations. Similar non-recognition provisions are not found in the Internal Revenue Code for partnerships or LLC's taxed as partnerships.