

Managing Business Entities and Owner Liability

Knowing who controls a business—and who's on the hook when things go wrong—matters enormously for CPAs working with business clients. This course covers management and control structures across entity types, examines how owner liability differs between partnerships, LLCs, and corporations, and introduces civil liability concepts including respondeat superior and damages. Real-world case examples help illustrate how these rules play out in practice, making this course both practical and highly applicable to client advisory work.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify rules governing the management and control of business entities.
- Identify personal liability characteristics of various business forms.
- Recall characteristics of the American tort system.
- Recognize when employers are liable for the acts of their employees.
- Recognize the types of damages awarded in civil cases.

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Chapter 1: MANAGEMENT AND CONTROL OF BUSINESS ENTITIES

Chapter Objective

After completing this chapter, you should be able to:

- Identify rules governing the management and control of business entities.

I. SINGLE-OWNER ENTITIES

One of the key factors in choosing an appropriate business form when there are two or more owners is the level of desire each owner has for participating in the management of the enterprise.

Single-owner entities do have some flexibility in selecting a business structure: the traditional sole proprietorship, a corporation or a limited liability company. In each of these options, the owner retains ultimate responsibility for managing the enterprise whether or not they elect to engage employees or other agents in the running of their business. The only real differences for the single owner – other than tax issues – is whether he or she is, in most cases, subject to personal liability and the amount of formalities involved in the management of the enterprise.

TABLE 4.1 OPTIONS FOR THE SINGLE-OWNER

Issue	Sole Proprietor	Corporation	LLC
Taxation	Income and losses flow through to the individual; there is no separate legal entity for the business	Income is taxed at the entity level and then again if distributions, other than wages or other benefits, are made to shareholders	Single-member LLC has option of being taxed as a corporation or having income and losses passed through to member
Formalities	There are no legal formalities for either formation or operation of the business	Significant state law formalities for both formation and operation	State law formalities for formation, significantly less than corporation
Liability	The owner is personally liable for all the debts and obligations of the business	Shareholder not personally liable for the debts and obligations of the business*	Members not personally liable for debts and obligations of the business*

* This rule can be broken by legal doctrine called “piercing the corporate veil,” discussed in detail in Chapter 2.

For multi-owner businesses, the issue becomes more complex. The issue is not only whether or not a particular owner wants to be involved in the active management of the business, but also the degree of personal liability the owner is comfortable subjecting himself to. Table 4.2, next, compares the potential personal liability of each owner with the level of participation each wants to have in management of the business.

TABLE 4.2 LEVEL OF PARTICIPATION IN MANAGEMENT AND PERSONAL LIABILITY

OF VARIOUS MULTI-OWNER BUSINESS ENTITIES		
Business Entity	Management Rules	Liability of Owners
General Partnership	Each general partner has an equal right to manage the enterprise	Each general partner is jointly and severally liable for the debts and obligations of the partnership
Limited Partnership	Each general partner has equal right to manage the enterprise; limited partners risk losing limited liability status by participating in management and are usually "passive" investors	Each general partner is jointly and severally liable for the debts and obligations of the partnership; limited partners are not personally liable so long as they remain "passive" investors
Limited Liability Partnership	All general partners have equal right to participate in management of the enterprise	All general partners are jointly and severally liable for the debts and obligations of the partnership; limited partners not personally liable so long as they are not actively involved
Limited Liability Company	Right to manage is vested in all of its members unless provided otherwise in articles of organization	Every member retains limited liability regardless of whether they actively participate in management of the company
Corporation	Management and control normally vested in the board of directors, elected by the shareholders of the corporation	Shareholders retain limited liability in the absence of special facts; directors can be personally liable for certain breaches of duty

II. PARTNERSHIPS

A. GENERAL PARTNERSHIPS

The general rule of law is that, absent a contrary provision in a written partnership agreement, all partners in a general partnership have an equal right to manage the enterprise. Texas law, for example, Art. 6132b-4.01(d), provides: *“Each partner has equal rights in the management and conduct of the business of a partnership. A partner’s right to participate in the management and conduct of the business is not community property.”*

Absent a contrary agreement, each partner has a continuing right to participate in the management of the partnership and to be informed about the partnership business, even if his assent to partnership business decisions is not required.

1. Resolving Disputes

Every state has a default rule that governs partners in the event of a dispute when resolution is not governed by a written partnership agreement. Most states provide when there are differences between partners in the ordinary course of business, the matter is to be decided by a majority of the partners. If the dispute concerns a matter that is beyond the scope of the partnership’s normal business affairs, e.g., whether to dissolve, most courts have held that the matter must receive the consent of all of the partners. In general, each partner has a single vote regardless of the contribution provided at the time of formation.

2. Voting Classes

Under most circumstances, partners are free to establish classes of partners which can, for example, give preferential voting rights to certain partners.

Texas law, for example, Art. 6132b-4.01(l), provides:

(l) Classes or Groups of Partners. A written partnership agreement may establish classes or groups of one or more partners having certain expressed relative rights, powers, and duties, including voting rights, and may provide for the future creation of additional classes or groups of partners having certain relative rights, powers, and duties, including voting rights, expressed in the partnership agreement or at the time of creation of the class or group. The rights, powers, or duties of a class or group may be senior to those of one or more existing classes or groups of partners.

(m) Voting Rights. A written partnership agreement that grants or provides for granting to a partner a right to vote may contain provisions relating to:

(1) Giving notice of the time, place, or purposes of a meeting at which a matter is to be voted on by the partners;

- (2) Waiver of notice;
- (3) Action by consent without a meeting;
- (4) The establishment of a record date;
- (5) Quorum requirements;
- (6) Voting in person or by proxy; or
- (7) Any other matter relating to the exercise of the right to vote.

B. LIMITED PARTNERSHIPS

The general rule of law is that limited partners do not have a right to actively participate in the management of the partnership.

Limited partners are, by their nature, passive investors. As a practical matter, a limited partner does not generally want to participate in the management of the company, because to do so normally results in the loss of their limited liability status. Although not generally entitled to manage, state laws generally have provisions that protect the interests of limited partners, including the right to access the books and other records of the partnership.

According to the Revised Uniform Limited Partnership Act, a general partner of a limited partnership has the same rights and powers as a partner in a general partnership, absent an express provision to the contrary in a partnership agreement. This means the general partners of a limited partnership likewise have equal rights in the management of the enterprise.

Other than the limits on limited partnership participation, the partnership as a whole is fairly flexible with respect to the allocation of management authority. State law generally gives general partners freedom in selecting a management structure and, as noted above, in even creating classes of partnership interests. The draw-back, of course, is that general partners remain personally liable for the obligations of the partnership.

III. LIMITED LIABILITY COMPANIES

A. DESIGNATING MANAGEMENT OF A LIMITED LIABILITY COMPANY

One of the many advantages of a limited liability company over other business forms is the flexibility in deciding who will manage the enterprise. For example, in a limited liability partnership, limited partners are precluded from participating in the active management of the business if they want to maintain their limited liability status. A limited liability company, on the other hand, can be managed by some, all or none of the members of the company, yet in all of those scenarios ALL members maintain their limited liability status. See Table 4.3, next.