

A LEGAL PERSPECTIVE

Jeffrey J. Greenberger Attorney at Law
Katz, Greenberger & Norton LLP
105 E. Fourth Street, Ste. 400
Cincinnati, Ohio 45202-4056
(513) 721-5151

CHOOSING THE FORM OF YOUR BUSINESS ENTITY

“To LLC or not to LLC that is the question.” If the great Bard were alive today the issue of the form of the entity which owned the Globe Theater would be far more important to Shakespeare than the metaphysical questions posed in Hamlet.

All analogies aside, in this day and age with our society as litigious as it is, it is extremely important that the owners of Self Storage facilities not overlook whether they have done everything that they can to insulate themselves from liability in the event of an unexpected disaster or business failure. This column is slightly more difficult to write than most because the laws of each state vary somewhat on the forms of business permitted and the specific rules and regulations that apply to those forms. This article is, more than most, intended to give you a general overview of the issue of selecting a business entity. Please discuss any plans to form a specific entity with your attorney.

There are several forms of business entities that exist somewhat universally.

1. A Proprietorship - A Proprietorship is any business
- 2.

owned by one or more people that has not formally filed for recognition with the appropriate authority of the state in which the business is located. This includes multiple owner businesses not otherwise formally registered as a partnership.

3. General Partnerships - A formal ownership arrangement between two or more individual entities which provides no additional protection or insulation from liability to the individual owners.

4. Limited Partnership - Limited Partnerships allow certain owners/investors to limit their exposure or risk for liability to the sum total of their investment. However, every limited partnership must have a general partner. The general partner is exposed to all liability from the investment which includes exposure to the general partner's individual assets. The general partner can be an individual or another form of business entity. The most common mistake I see as a attorney who represents a lot of Self Storage owners, is that owners say I am in a limited partnership therefore I am protected. When we review the facts the person who has come to see me is the general partner of a limited partnership and I always end up breaking the bad news to them that they have left themselves fully exposed to all liability, come what may.

5. The Corporate Forms - We are all familiar with a basic corporation format such as with the large Fortune 500 Companies. They provide the benefit of insulating, to a certain extent, the personal assets of the shareholders from liability in the event the business fails. The IRS permits certain corporations to make what is called an S-Election which allows qualified corporations to be taxed like a partnership, and avoid the double tax on corporate earnings which applies to businesses which cannot or do not make an "S" election. The "S-Corp" provides the same type of protection from certain individual liability as non-electing corporations and provides the benefits of avoiding double taxation on earnings.

Until about ten years ago the S-Corp was the best corporate form for a small Self Storage operator to have held its facility or facilities. S-Corps have other limitations, as an example the number of shareholders is limited to approximately thirty five and regular minute books and resolutions have to be kept just as in a C-Corp.

About ten years ago we began to see the emergence of Limited Liability Companies or “LLCs” in the various states, and most states now permit an LLC in some form. An LLC allows the same type of insulation from certain types of personal liability for actions of the business, allows for single taxation of earnings, and also has much less rigid requirements for formation and the type of record keeping typically associated with corporation law such as minutes and resolutions.

Before you drop this issue of ISS to call your attorney, LLC’s and S-Corps are not the solution to every problem in your business.

1. Several of the things that you can do with an LLC or an S-Corp can also be accomplished by buying good business insurance with a large business liability umbrella policy and a large personal umbrella policy.
2. The assets of the business in the LLC or S-Corp are always at risk.
3. There are certain types of actions which give rise to liability which cannot be insured against nor can you form an entity to avoid personal liability. Examples of these types of conduct are:

- a. Failure to pay certain payroll trust taxes;
- b. In some states certain wrongful discharge, sexual harassment charges;
- c. Violation of certain consumer protection laws;
- d. Willful or malicious and criminal types of acts.

- e. Contract obligations, ie. Trade debt.

In order to clarify some examples would be helpful.

- i. If you are accused of improperly discharging
 - 1.

an employee of your Self Storage facility with the allegation of some type of sexual harassment, your insurance may not cover this type of action; the assets of your business would as always be at risk; and in many states the law imputes personal responsibility to the person who actually conducted or permitted the alleged act so that, to the extent that a judgment is rendered it would be against the business and yourself, and the fact that your business is in the form of an S-Corp or an LLC would grant no additional protection to you. Most if not all insurance policies exclude payment for these type of damages. Thus, no matter the business entity you have set up your personal and other business assets cannot be protected.

- ii. On the other hand, if an employee, in the course of their work, is driving the company vehicle and crosses the center line and hits a bus killing 25 people and your insurance is not adequate to cover the amount of damages awarded, having the business in the form of an LLC or an S-Corp will allow you to limit that which is subject to attachment to the assets of the business in the S-Corp or LLC. You will be able to insulate from judgment your personal assets and other business ventures. Thus, you may lose the facility but you may be able to protect your personal assets such as your home, bank accounts, automobiles, etc.

The best reason to consider setting up an LLC or an S-Corp is in the unfortunate event that the business fails. Obviously, there is no insurance against a business failing and, if the business fails there will most likely be a

large number of unpaid creditors from the business. If you have not personally signed or guaranteed debts and you were properly set up in the form and operated as an S-Corp or LLC, creditors can only collect the debts from the business assets. Conversely, if you were doing business as a sole proprietorship or a partnership your creditors would be able to look beyond the assets of the business to your own personal assets and to assets of other businesses (even to other LLCs) which you own, for collection of the amounts due.

This leads to the second best reason to form an LLC and/or an S-Corp. If you are an owner, part owner or have interest in multiple facilities or other businesses, setting up of LLC or an S-Corp can help insulate the liabilities between each business. For instance, if you own a successful manufacturing business and two Self Storage facilities and all three are separate entities such as C-Corps, S-Corps or LLCs and they are not cross collateralized, if one of the facilities fails you would, be able to insulate the other facility and your manufacturing business from the creditors of the failed Self Storage facility.

The formation of a business entity like an LLC or an S-Corp is not a panacea. There are certain actions and liabilities from which you cannot insulate your personal liability. Additionally, the setting up of an LLC or S-Corp will not insulate your interest in the LLC or S-Corp from personal judgments. For example, if while driving home one night you cross the double yellow line and hits the same bus, you would have personal liability to pay for the injuries or deaths that occurred on the bus. This is why you carry personal liability insurance through your automobile policy. However, if in the event your policy does not have enough dollar coverage to cover all the potential claims of all of the victims, a judgment could be rendered against you personally, your insurance company would only have to pay the limits of their policy and the balance would be left to be collected from your personal assets such as your home, your cars, and bank accounts, etc. If these personal assets prove insufficient, one of the other assets that creditors can attach is your interest in any business. In this example, it does not matter

if you are a partnership, S-Corp or LLC, creditors would simply attach your share of the partnership and try to force the business to be liquidated. Thus, we are full circle, an LLC or an S-Corp is not a good substitute for proper insurance, but a properly formed business entity complements a good business plan and personal insurance to help avoid or insulate your other assets and your other businesses from liability in the event that something happens within your Self-Storage facility business operations. It also insulates the facility in the event something happens in another one of your businesses.

There are multiple other requirements to properly operate your business in the form of an S-Corp or LLC. Your attorney can help you with these requirements. As an example, it is important under the law for the world to know that you are operating in a specific business form. That is why businesses have the word "Inc." or "Co." or "LLC" after their name. If you are operating in the form of an LLC or an S-Corp and are not identifying yourself to the world via your signage, your invoices, your checks and the way you sign documents that you are operating in this form, you may be waiving the protections granted under the LLC or S-Corp laws in your state. For instance, if you are an S-Corp you should be signing all documents on behalf of the corporation in your official capacity in the corporation. Further, if you are a Corp and have not kept your minutes up to date you could be running a risk of someone claiming that your corporation is no longer valid. The same requirements exist for an LLC. The world must know that you are operating as an LLC. The letters "LLC" or the words "Limited Liability Company" must appear in your title of your business, on your letterhead, and on your checks. Checks received should be made payable to the business as an LLC not to you personally. Correspondence and checks should be signed by you in your capacity as a "Member" of the LLC and not individually. There are multiple examples of ways to make certain that the world knows that you are operating as an LLC or a corporation. The examples given above are the simple ones that I often see businesses not following and running the risk of losing their protection after they have gone to the trouble of forming a business entity.

We recommend, for the most part, the LLC form for our Self-Storage Facility owners. The true beauty of an LLC, if it is available in your state, is that they are not particularly expensive to form and they are not particularly labor intensive or attorney fee intensive to maintain once they are properly formed. There is certainly a learning curve to get up to speed in acting as an LLC, there are printing and signage costs that are unattractive to the small business owner. However, these costs are minute compared to the costs of losing your home, other business interests, or other assets because of one bad day at the office that you have worked so hard to build in your career. Finally, it is worth a phone call to your attorney to make sure that if you are already in a corporate form that you are up to date with your documents and your filings to the appropriate authorities in your state.

If you are operating as a Sole Proprietorship, Partnership or Limited Partnership, give serious thought to whether or not an LLC or S-Corp may not be a better business form for you.

Jeffrey Greenberger practices with the law firm of Katz Greenberger & Norton LLP in Cincinnati, Ohio and is licensed to practice in the states of Ohio and Kentucky. This column is for the purpose of providing general legal insight into the Self Storage field and should not be substituted for the advice of your own attorney.

Mr. Greenberger's practice focuses primarily on representing the owners and operators of commercial real estate including self storage owners and operators.

Mr. Greenberger is the legal counsel for the Ohio Self Storage Owners Society, Inc., and the Kentucky Self Storage Association, Inc., as well as a regular presenter at Inside Self Storage Trade Shows. You can send your questions, comments, or suggestions for future topics to Jeffrey Greenberger at JJG@kqnlaw.com or mail them to Jeffrey Greenberger c/o Katz Greenberger & Norton LLP, 105 E. Fourth Street, Suite 400, Cincinnati, Ohio 45202 or you can reach Mr. Greenberger at (513) 7215151.

76940.1