



Home-Based Business

Your Business Organization

Any business, including those based at home, must be conducted through some form of business organization. There are basically three forms of business organization: sole proprietorships, partnerships and corporations. The form you choose will depend upon a number of factors. In order to make an intelligent choice, you must be familiar with some of the principles of the various business forms and how they will apply to you in the context of a home-based business. Although you may want to seek legal help at some point, the ultimate decision will rest with you.

Sole Proprietorships

Sole proprietorship is self-defining. It means there is only one owner. As a legal matter, this means the sole proprietor is an individual who personally owns assets which are being used in the conduct of a business. There is no such thing as a business separate from the individual who is

carrying on business activities. This is the simplest form of business organization. To be a sole proprietor, all you have to do is start selling something.

Of course, since your business activities are nothing more than your personal activities, you're personally liable for anything that happens. This is what is meant when it is said a sole proprietor has unlimited personal liability for the business. Personal liability means your personal assets as well as your business assets may be exposed to the risks of the business.

Partnerships

A partnership is defined legally as two or more persons who are co-owners of a business of which they split the profits. A partnership may be viewed as two or more sole proprietors who are engaged in a common business activity. The critical difference between partnerships and sole proprietorships is relationships.

In a sole proprietorship,

there is only one relationship—that of the sole proprietor with the rest of the world. The rules that govern that relationship are simple. The sole proprietor personally is responsible for whatever happens.

With a partnership, relationships become more complicated. There are now two sets of relationships—that of the partners to the outside world and that of each partner to the other within the partnership. Because we have two different relationships, we need special rules to define how they are to be governed. These rules are found in statutes known as the Uniform Partnership Law, which has been adopted in all states. Although parts of the Uniform Partnership Law are complicated, the important thing to remember is that a partnership is nothing more than a collection of sole proprietors. That being the case, the Uniform Partnership Law essentially says all the

partners are going to be treated as sole proprietors with respect to the rest of the world. This means each partner has full, unlimited personal liability for anything done by himself or herself *or any of the other partners* with respect to the partnership's business activities. This is called "joint and several liability." It means all partners or any one partner can be held fully accountable for all of the partnership's liabilities. If any partner does a thing in the apparent conduct of the partnership's business, then all partners are considered to have done it and are liable for it. There are few ways to avoid joint and several liability. In fact, the Uniform Partnership Law specifically says that the rules concerning partners' relationship to the outside world cannot be modified by any partnership agreement unless the outside person agrees to the modification. However, partners are not liable for something done by another partner that is unrelated to the partnership business. For example, if a partner has an automobile accident while on a personal errand, there will be no partnership liability.

The relationship of the partners to each other within the partnership is a different matter. The Uniform Partnership Law sets out rules to govern that relationship, but allows the partners to change them in a written partnership agreement. If you do not have a written partnership agreement, your state has written one for you in the form of the Uniform Partnership Law. Therefore, you should familiarize yourself with the

terms of the Uniform Partnership Law by asking a lawyer, attending a seminar or reading it. If there are any provisions that do not fit your situation, you must have a written agreement to change them. It's important for all partners to understand the terms of your agreement. Otherwise, if something goes wrong or there is disagreement, you may wind up resolving your differences in court. You may want to have a lawyer draft your partnership agreement. If things go well, you may never look at it again. If things go wrong and you don't have one, it will be too late.

Corporations

The final form of business organization is the corporation. It's the most complicated way to do business because a corporation is defined by law as a real person. This means the corporation owns its own property, pays its own taxes and runs its own business. This also means there are legal procedures which *must* be followed in order to create a corporation.

In any business, there are three roles to be played: owner, manager and employee. In a sole proprietorship or partnership, the sole proprietor or partners perform all three roles, with no distinction as to who does what. With a corporation, however, those three roles are divided among three different groups. The shareholders are owners of the corporation; the board of directors sets policies the corporation will follow and

makes major business decisions; and the officers are the major employees of the corporation and are responsible for day-to-day activities and for implementing decisions of the board of directors.

In a small corporation, of course, all three groups will usually be the same person, you. The legal formalities required to form and maintain a corporation and the role playing involved, make a corporation a complicated and expensive way to conduct a business, especially a home-based business.

So why incorporate? The most common reason is limited liability. Because the corporation is a separate legal person that owns the business assets and conducts the business, *it* is responsible for all business liabilities. The shareholders are considered passive owners of a portion of the net liquidation value of the corporation and so have no personal involvement in the corporation or its business activities. Therefore, they are immune from suit. That's why, for example, the shareholders of General Motors could not be sued if General Motors did something wrong. The problem is that a corporation really is not capable of doing anything wrong because it has no physical existence. It must act through its agents, who are generally the officers or the employees. When a corporation does something wrong, it is really one of these individual agents who has done the wrong. Although the corporation, as employer and owner of the business, bears ultimate responsibility, it is not the only one who will be sued.

The individual who committed the wrong will be sued also. The fact you have limited liability as a shareholder will mean nothing if you commit some wrong in your capacity as an officer or employee. In addition, most lenders will not loan money to a small corporation unless all shareholders personally guarantee the loan. This means that if the corporation is unable to repay its loan, you will be personally liable for it and will be required to pay.

It should be clear that no form of business organization provides unlimited protection from personal liability. However, a good liability insurance policy can do a lot to protect you. Furthermore, in some states such as Missouri, a form of property ownership between spouses known as "tenancy by the entirety" can protect family assets from the business liabilities of one spouse. This may be an important reason for not making a spouse a partner in a

home-based business.

Conclusion

Regardless of the form of business organization you select for your home-based business, you must understand enough about that form of business to help keep yourself out of trouble. This means learning enough about the different rules, whether through a lawyer or some other means, so that you can play the game to your benefit.

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