

CLE PRESENTATION

Business Entity Selection in Texas

A Practical Guide for Texas Practitioners

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Today's Agenda

What we'll cover in this session

I

Statutory Framework

The Texas Business Organizations Code

II

Principal Entity Types

Corps, LLCs, Partnerships & more

III

Comparative Analysis

Liability, tax, governance, capital

IV

Foreign Entities

Registration requirements in Texas

V

Practical Checklist


A decision framework for advising clients



SECTION I

Statutory Framework

The Texas Business Organizations Code (TBOC)
Riveting reading indeed, but worthwhile to know.



Statutory Framework

Texas Business Organizations Code — Title 1 et seq.

The TBOC consolidates what were once separate statutes for corporations, partnerships, and LLCs into a single unified code.

Title 2

Corporations

Ch. 21 (for-profit); Ch. 22 (nonprofit)

Title 3

LLCs

Chapter 101

Title 4

Partnerships

Chs. 152–153 (GP & LP)

Title 6–7

Cooperatives & Associations

Professional & nonprofit assoc.

Also Key:

Texas Franchise (Margin) Tax

Tex. Tax Code § 171.001

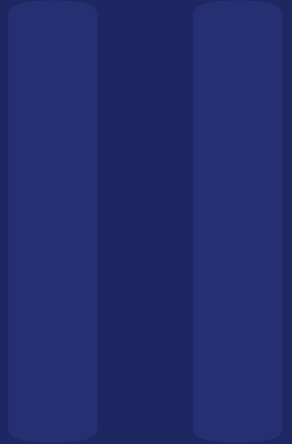
Applies to most taxable entities — corporations, LLCs, and partnerships alike. Exemptions exist for:

- Passive entities
- REITs
- No-tax-due threshold entities, but that no tax due threshold paperwork better darned well be filed or the entity will forfeit its existence with the State of Texas.
- **A note: Texas Franchise Tax No Tax Due Threshold for 2026-27 is \$2,650,000.**



SECTION II

Principal Entity Types



Sole Proprietorship:

No Filing With SOS Required, however filing a DBA/Assumed Name Cert should be done.

Unlimited Personal Liability for Business Debts & Liabilities

This is the simplest business structure, which is an unincorporated business owned by an individual.

Pros

- You don't get simpler than a sole proprietorship.
- A single individual simply engages in a business activity with no formal organization.
- If the business is conducted under an assumed name, then a DBA should be filed with the office of the County Clerk in the county in which a business premise is maintained.
- Taxes: Owner reports business income and expenses on their personal tax return.
- Direct receipt of profits, so no worries over distributing earnings among shareholders or partners.

Cons

- You literally cannot get more liability than this. Owner's personal assets are exposed to business debts (which, many require personal guarantees on everything, so this is less important today) and legal judgments (this is legitimately a big deal).
- This type of organization, while extremely simple to maintain, offers very little room for expansion.
- If you involve others, a de facto partnership could be created.
- Greater difficulty in raising capital
- Limited lifespan of the business since it's tied directly to the owner.

Entity Types at a Glance

Key characteristics comparison

Entity	Filing Required?	Liability Shield	Default Tax	Management
Corporation	Yes — SOS	Shareholders	C-Corp / S-Corp	Board → Officers
LLC	Yes — SOS	All members	Pass-through	Flexible
General Partnership	No	None	Pass-through	All partners
Limited Partnership	Yes — SOS	Limited partners only	Pass-through	General partner
LLP / LLLP	Yes — SOS	All partners	Pass-through	Partners

Corporations

Tex. Bus. Orgs. Code Title 2, Chapter 21

Key Structural Features

- Shareholders own via stock; no direct management role
- Board of Directors elected by shareholders — sets policy
- Officers appointed by board — day-to-day management
- Perpetual existence independent of shareholder changes (§ 21.223)
- Shares are personal property — freely transferable

Case Note

Corporations and LLCs are legally distinct forms — the terms are NOT interchangeable.

Alta Mesa Holdings v. Ives, 488 S.W.3d 438 (Tex. App. 2016)

Tax Treatment

C-Corp: Double taxation (entity + shareholder)

S-Corp: Pass-through; eligibility restrictions apply

Franchise Tax

Subject to Tex. Tax Code § 171.001 unless exempt. Margin tax applies broadly to taxable entities in Texas.

Limited Liability Companies (LLCs)

Tex. Bus. Orgs. Code Title 3, Chapter 101

Liability Protection & Other Info

Members are NOT personally liable for LLC debts or obligations. Tex. Bus. Orgs. Code § 101.114.

Veil-piercing possible only for actual fraud for personal benefit.

In Cole's view, these are probably the simplest and most effective business structure for many clients, simply due to the flexibility they offer.

Tax Flexibility

Single-member: disregarded entity (sole prop).

Multi-member: partnership by default.
Either can elect corporate taxation.

Series LLCs

Texas permits distinct series within one LLC, each with separate assets & liabilities. § 101.601.

Ideal for real estate & investment.
Federal / bankruptcy treatment unsettled.

General Partnerships

Tex. Bus. Orgs. Code § 152.051 — No Filing Required

⚠ Partnerships can arise INADVERTENTLY — no intent or written agreement required.

Courts look to: profit-sharing, intent to be partners, and participation in control. Big Easy Cajun Corp. v. Dallas Galleria Ltd., 293 S.W.3d 345 (2009)

How It's Formed

- Two or more persons carry on a business for profit as owners
- No filing with Secretary of State required or available
- Failure to file does NOT alter partnership status
- Garrett v. Koepke, 569 S.W.2d 568 (1978)
- The question over a partnership existing has resulted in many different litigation matters. One side says a p'ship exists so they may invoke the fiduciary duty responsibilities of another partner.

Key Drawback

- Each general partner bears joint and several UNLIMITED personal liability
- Suitable only where liability risk is managed by other means (e.g., insurance, entity-level partners)
- Counsel should always assess whether a GP already exists and recommend formalization

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Partnership Criteria – Five Factors (lonestarlandlaw.com)

- Receipt or right to receive a share of profits of the business;
- Expression of an intent to have partnership in the business;
- Participation or right to participate in control of the business;
- Agreement to share or sharing losses or liability for claims by third parties against the business; and
- Agreement to contribute money or contributing money or property to the business.

Factors Discussion

- Most important of the factors are sharing profits and participating in control of the business, under *Big Easy Cajun Corp. v. Dallas Galleria Ltd.* listed above.
- Simply collaborating is not enough, especially when the parties do not share profits, losses, or liabilities and lack the intention to be partners.
- BOC does specifically require an intention to share profits or losses, but that is an important factor.
- Partnerships, along with Joint Ventures, are considered to be legal entities that may be sued and held liable for damages.

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Difference between GPs & Joint Ventures

- A joint venture is governed by the same rules as a partnership.
- JVs are often considered to be a specific subgroup of partnerships, usually seen as a general partnership for a particular limited purpose.
- David Willis (Lonestarlandlaw.com – an excellent resource for the public and lawyers alike) noted that he often sees JVs for particular purposes such as buying, rehabbing, and flipping a property.

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Limited Partnerships, LLPs & LLLPs

Tex. Bus. Orgs. Code Titles 4 — Filing Required

Limited Partnership (LP)

- 1+ general partner (unlimited liability) + 1+ limited partners
- Limited partners: liability capped at investment
- Limited partners who participate in control lose their shield (§ 153.102)
- Common in private equity, real estate, FLPs

Filing Fee w/SOS: \$750

Limited Liability Partnership (LLP)

- General partnership that elects limited liability registration
- Partners shielded from personal liability for certain obligations
- Must register with Texas Secretary of State

Filing Fee w/SOS: \$200 per General Partner

Limited Liability Limited Partnership (LLLLP)

- Hybrid: LP structure with liability shield extended to general partners
- Partnership governed as a limited liability partnership and a limited partnership.
- All partners — general and limited — receive personal liability protection
- Recognized under Tex. Bus. Orgs. Code § 1.002
- Less common; niche use cases

SECTION III

Comparative Analysis

Choosing the right entity for your client



Liability Protection Compared

Who is protected — and under what conditions?

Entity	Protection Level	Conditions / Caveats
Corporation	Shareholders fully protected	Veil-piercing for fraud; formalities required
LLC	All members fully protected	Veil-piercing for actual fraud (personal benefit)
General Partnership	NO PROTECTION	All partners: unlimited joint & several liability
Limited Partnership	Limited partners protected	Must remain passive — active control = loss of shield
LLP / LLLP	All partners protected	Must register; LLLP protects general partners too

Tax Treatment Compared

Entity selection and federal/state tax implications

C Corporation

Double taxation: entity-level federal income tax + shareholder-level on distributions. Reduced corporate rate (post-2017) makes this form more competitive for profit-retaining businesses.

S Corporation

Pass-through taxation. Subject to eligibility limits: ≤100 shareholders, U.S. citizens/residents only, one class of stock permitted.

LLC

Single-member: disregarded entity. Multi-member: partnership. Either may elect corporate tax treatment. Flexible allocation of income/loss among members.

Partnerships (GP/LP)

Pass-through treatment by default. Less flexibility in tax classification elections than LLCs..

LLC vs. Corporation: When Each Wins

Choose based on client goals, not just simplicity

Prefer the LLC when...

- Owners want active management without losing liability shield
- Pass-through taxation is the priority
- Flexibility in governance and economic arrangements is needed
- Fewer administrative formalities are desired
- Real estate or investment holding structures (esp. Series LLC)
- Family business or single-owner operation

Prefer the Corporation when...

- Venture capital or institutional investment is anticipated
- Multiple classes of equity (common/preferred) are required — §§ 21.154, 21.168
- An IPO or public offering is a long-term goal
- Clear board/officer hierarchy is preferred by stakeholders
- Industry custom or regulation requires corporate form

Capital Formation & Continuity

Critical factors for growth-stage clients

Raising Capital

- Corporations can issue common stock, preferred stock, options, warrants, convertibles
- Preferred stock is the standard VC instrument — LLCs cannot replicate this without significant customization
- Investors frequently require conversion to a corporation (often Delaware) before a major financing round
- Advise startup clients early about the conversion pathway

Continuity & Transfer

Perpetua

Corporate existence — In re ReadyOne Indus., 294 S.W.3d 764 (2009)

Freely

Corporate shares transferable as personal property — no consent required

Consent

LLC membership interests often require member consent to transfer governance rights

Practice Note: Company agreements should address ALL transfer scenarios in detail — death, divorce, bankruptcy, and voluntary sale.

SECTION IV

Foreign Entities

Transacting business in Texas

IV

Foreign Entities in Texas

Tex. Bus. Orgs. Code § 9.001 — Registration Required

When Must a Foreign Entity Register?

- Entity would be required to file a certificate of formation if formed in Texas
- Entity provides limited liability to its owners under its home jurisdiction
- Registration is filed with the Texas Secretary of State
- Assumed name certificate required if legal name is unavailable in Texas

Consequences of Non-Registration

- Significant penalties may apply
- May lose ability to maintain a lawsuit in Texas courts

PRACTICE TIP

Multi-State Compliance Audit

Clients operating across multiple states need a regular audit of registration requirements in each jurisdiction.

Check for:

- Active transacting of business
- Nexus for tax purposes
- Name availability in each state
- Local filing deadlines and annual reports

Inadvertent noncompliance is common and avoidable.

SECTION V

Practical Checklist

A decision framework for advising clients on entity selection



Entity Selection Checklist

Ten questions to ask every client

1 Number of owners and nature of the ownership relationship

2 Desired level of personal liability protection for each owner

3 Federal and state income tax objectives (pass-through, allocations, losses)

4 Texas franchise tax implications and available exemptions

5 Anticipated need for outside investment or institutional financing

6 Governance preferences (formal board vs. flexible member management)

7 Transfer restrictions and succession/estate planning objectives

8 Regulatory or professional licensing requirements

9 Whether foreign entity registration is required in Texas or other states

10 Long-term exit strategy: sale, IPO, dissolution, or succession

Key Takeaways

1

The LLC is the most flexible and commonly preferred entity for closely-held businesses — but it is not always the right choice (though Cole does believe that it is often an excellent choice for many clients starting a business).

2

Corporations remain superior when institutional investment, multiple equity classes, or an eventual IPO is in the client's future.

3

General partnerships can arise inadvertently — always conduct a threshold analysis when clients are co-venturing informally.

4

Entity selection is a living advisory function — revisit it as the client's business, ownership, and goals evolve.

5

Always collaborate with the client's tax counsel unless you're well-trained in tax — we don't have to be enemies (though sometimes the CPAs deserve it).

Problems Often Seen From the Bank's Side

If they need the money, then their docs need to be correct.

Common Errors Seen Upon Loan Application/Approval

- for LLCs, poorly drafted company agreements or failure to have company agreements at all.
- The most common error – Discrepancies between members/managers with SOS & LLC docs.
- Failure to get signed resignations from previous members.
- Failure to use correct names throughout.
- Registered agent information not kept updated.
- Forfeited existence due to failure to file info.

Corporations

Very old Corporate Docs not kept updated with correct ownership info.

Failure to regularly update minutes of shareholders.

Partnerships

Lack of a partnership agreement

Failure to keep partnership info updated.

Same issues as all the others, really.

Sole Proprietorships

No docs because no entity.

All lending will be done in the borrower's personal name.

Potential estate issues

Potential family/Divorce issues



Questions?

