Congratulations. You are about to undertake a powerful and enlightening journey. By reading this book you will learn quickly and easily the legal secrets and strategies that the rich have used to run their businesses, hold their real estate and protect their assets. In short order you will clearly understand exactly how certain entities—corporations, limited liability companies, and limited partnerships—can not only save you thousands and thousands of dollars in taxes but can also save your house and savings and family assets from the attacks of creditors. And because real estate is an important component of your wealth strategy we have included information on using good entities to protect your real estate holdings from attack.

These are the same lessons that Robert Kiyosaki’s rich dad taught him. Own nothing and control everything. Use the techniques of the rich to improve your financial standing and protect your family. And above all, work smarter instead of harder.

This is the third edition of this book, and we have changed the title from “Own Your Own Corporation” to “Start Your Own Corporation.” In discussions with readers there is a great deal of interest in knowing what to do once your entity is formed. To that end, a companion book to this one will be available entitled “Run Your Own Corporation.” As well, we have updated “Start Your Own Corporation” to include new strategies for maximum results.

As such, by the time you finish this book you will have the legal savvy of an experienced entrepreneur and the knowledge necessary to immediately implement your own custom legal strategy.

Let’s begin...
Welcome to the world of asset protection and entity formation. As you gain knowledge of the strategies and advantages (and you will, in this book) you will come to appreciate your six main menu choices:

- C corporation
- S corporation
- Limited Liability Company (LLC)
- Limited Partnership (LP)
- General Partnership
- Sole Proprietorship

As legal business systems and traditions have developed over the last five hundred years, several structures for running a business have evolved. Each structure or entity, has its own benefits and drawbacks, which we will explore.

First off: What does the word ‘entity’ mean? It refers to an organization (be it a business or governmental unit) which has a legal identity separate from its members. It is derived from the Latin word ‘ens,’ meaning an existing or real thing. So an entity is a real thing, distinguishable and apart from its owners. (Two of the six choices aren’t really real things, which, as you will learn, is not a good thing.)

As a frame of reference for making your entity selection, it is important for you to clarify your strategy in this planning. The purpose of this chapter is for you to clearly understand and choose the best entity for your
unique and specific purpose. To that end, the following checklist should be considered:

1. Protection of family assets and investments
2. Management control
3. Avoiding family disputes
4. Flexibility of decision making
5. Succession of children and other family members to management
6. The nature of the business to be operated
7. The nature of the asset to be held
8. The number of owners involved
9. Estate planning and gifting of assets
10. Who may legally obligate the business
11. Effect upon an owner’s death or departure
12. The need for start-up funding and raising of capital
13. Taxation
14. Privacy of ownership
15. Consolidation of assets and investments

These and other issues will become apparent as we review your choices. And please note, your decision does not have to be made alone. It is recommended that these issues be discussed with your attorney, accountant, or other professional advisor. An individual well versed in these areas will provide excellent insight into which entity is right for you.

By reading this book you will be better able to work with your professional advisors. They won’t have to spend time explaining all of the tax issues and limitations of liability strategies to you. By reading this book you will have a leg up. When you meet with your advisors you won’t be stepping up to the plate for the first time. Instead, you’ll be at second base, ready to score. (Fear not, our first sports analogy is also our last one.)

It is important to know that in entity selection one size does not fit all. If your attorney or accountant suggests only one entity, a general partnership for example, for each and every business venture you have him
or her review, you will want to question why they believe one entity fits all situations. Or you may want to seek out a new professional advisor.

We will discuss which entities work well in various business and asset holding scenarios. But before doing so, we must point out which entities do not work well in any situation. For as important as knowing which entity to use for running your business, protecting your assets, and limiting your liability is knowing which entity NOT to use.

**Bad Entities**

- Sole proprietorships
- General partnerships

In my legal practice I represent various businesses, from small and basic to large and complicated. I enjoy helping entrepreneurs and business owners make money, provide for their families and employees, and secure a stable future.

I cannot do my job if a client insists on using a bad entity. Sole proprietorships and general partnerships provide no asset protection. Remember the Latin word ‘ensa’? It means an existing or real thing. These bad entities are not separate legal ‘things.’ You haven’t registered them with your state. Instead, they are just you, doing business without any protection. One lawsuit against your business, and your house, savings, and personal assets can all be lost. Our first case is illustrative.

**Case No. 1: Johnny**

Johnny was a plumber. He had been at it for five years and was starting to succeed. His customers were satisfied with his work and the word of mouth for Johnny’s Ace Plumbing was good.

While Johnny was a good plumber, he felt intimidated by legal matters. Lawyers and accountants were supposed to be smart, so the work they did must be difficult. When Johnny was a young boy his father had been unfairly treated by a lawyer. He remembered it to this day, and wanted nothing to do with them.
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So instead of consulting with a professional on how best to conduct his business, Johnny let his part-time bookkeeper select an entity off the menu. The results were disastrous.

Johnny’s part-time bookkeeper knew only that forming a corporation required filing special documents with the state but did not know how to file them. He knew that a corporation needed to file a separate tax return but was not sure of the ins and outs of preparing one. And so he suggested Johnny use a sole proprietorship because he knew how to handle one and always suggested one for his clients. One size fits all.

The problem was that a sole proprietorship provides absolutely no asset protection. By operating as a sole proprietorship Johnny has unlimited liability for the debts, claims, and obligations of the business. This unlimited liability meant that his house and savings and personal assets were exposed to the claims of others.

Of course, as in all horror stories, a demon entered Johnny’s business. He had hired Damien as an employee to assist with his growing workload. Damien seemed like a decent guy and appeared to know the plumbing business. Johnny did not bother to do a background check on Damien. Johnny was new to the business world and not aware of the need to do so.

After one week on the job, Damien assaulted one of Johnny’s customers while they were alone in her house. Without going into the sordid details, this woman was so severely traumatized by what Damien did to her in her own home that she and her family had to move away.

Within three weeks of the incident Johnny’s business was sued. Because Johnny was a sole proprietor, this meant that he, and not the business itself, as with a corporation, was sued and had to defend himself.

The lawyers suing for the woman did the background check of Damien that Johnny did not do. Damien was a recently released ex-convict with a history of sexual assaults. Johnny did not have the insurance to cover such a claim. The case went forward. The lawyers argued to a jury that Johnny’s business was irresponsible for failing to check up on Damien and was responsible for the consequences. They presented to the jury what was true—a business is vicariously liable, or responsible, for the acts of its
employees. The jury was horrified by the whole case and awarded damages of $10 million.

Johnny was wiped out. As a sole proprietor he was completely and personally responsible for every claim the business incurred. And he had attorneys with a one-third contingent interest in the collection of $10 million after him.

Johnny lost his house, his savings, and his family. The stress of it all resulted in his wife divorcing him, obtaining custody of the children, and moving away. Johnny declared bankruptcy. He ended up a broken man despising lawyers and our legal system all the more.

The irony, of course, is that by consulting with a lawyer and using the legal system to his advantage, Johnny could have prevented the disastrous consequences that resulted from relying on a part-time bookkeeper with a one-size-fits-all mentality for entity selection.

A competent lawyer would have told Johnny that there were risks—known and unknown—in running any business. To protect yourself from such risks you need to limit your liability by establishing a corporation or other good entity.

A good entity is one that shields and protects your personal assets from business risk. A bad entity is one that provides you no protection whatsoever. By using a good entity Johnny could have used the legal system—which has evolved to encourage business activity and limit the liability of risk takers—to his advantage.
Other Sole Proprietorship Disadvantages

As if personal liability was not bad enough, there are several other disadvantages to using a sole proprietorship:

- **Owners.** There can only be one owner of a sole proprietorship. If you later want to bring on owners you will have to switch to another business entity.
- **Sale.** It is hard to sell a sole proprietorship since its value is based on the owner and not the business.
- **Death.** When a sole proprietor dies, the sole proprietorship terminates. The sole proprietor’s successors can only sell assets, not the business as a going concern.
- **Audit Risk.** Because sole proprietors report their business profits and losses to the IRS on Schedule C, there is a much higher risk of IRS audit. Schedule C returns are audited at a five times greater rate than corporate tax returns.

A general partnership is also a bad entity. In fact it is twice as bad as a sole proprietorship because you have twice the personal exposure: personal liability for your acts and your partners’ acts. This will be illustrated in Case No. 2 ahead.

Whenever two or more persons agree to share profits and losses a partnership has been formed. Even if you never sign a partnership agreement, state law provides that under such circumstances you have formed a general partnership.

A written partnership agreement is not required by law. A handshake is acceptable for formation. In the event you do not sign a formal document, you will be subject to your state’s applicable partnership law. This may not be to your advantage, since such general rules rarely satisfy specific situations. As an example, most states provide that profits and losses are to be divided equally among the partners. If your oral understanding is that you are to receive 75 percent of the profits, state law and your handshake
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will not help you. Instead, against your wishes, state law may have you sharing 50-50. You are better advised to prepare a written agreement addressing your rights and rewards. But again, you are better off not using a general partnership in the first place.

Unlike a sole proprietorship, in which only one individual may participate, by definition, a general partnership must consist of two or more people. You cannot have a one-person partnership. On the other hand, you may have as many partners as you want in a general partnership. This may sound like a blessing but it is actually a curse.

The greatest drawback of a general partnership is that each partner is liable for the debts and obligations incurred by all the other general partners. While you may trust the one general partner you have not to improperly obligate the partnership, the more general partners you bring aboard the greater risk you run that someone will create serious problems.

And remember, just as with a sole proprietorship, your personal assets are at risk in a general partnership. Your house and your life savings can be lost through the actions of your partner. While you may have had nothing to do with the decision that was made and you may have been five thousand miles away when it was made and you may have voiced your opposition to it when you found out it was made, you are still personally responsible for it as a general partner.

As such, a general partnership is much riskier than a sole proprietorship. In a sole proprietorship, only the proprietor can bind the business. In a general partnership, any general partner—no matter how wise or, unfortunately, how ignorant—may obligate the business. By contrast, limited liability companies, limited partnerships, and corporations offer much greater protection. All of them offer owners limited personal liability for business debts and the acts of others.

It should be noted that because of these unlimited risks the last thing you want to do is become a general partner of an enterprise in which you do not have day-to-day management control. If you do not thoroughly know what is going on in the company you should not put your future on the line as a general partner.
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Case No. 2: Louise

Louise had worked for someone else all her life. For the last ten years she had worked in the gift section of a large department store. She did not like the floor manager insisting she do things a certain way when she knew her way would generate more sales for the company. It was all petty politics. She looked forward to the day when she could open her own business and make her own decisions.

Then one day, Maxine came to work at the department store. The two of them hit it off immediately. Maxine had a certain style and attitude that appealed to Louise. They had similar interests, the same feel for what the customers wanted, and the same desire to escape working for a faceless corporation filled with narrow-minded managers who stifled their every idea for improvement. Soon they were talking about opening their own gift boutique.

Louise had managed to save $10,000 to pursue her dream. Maxine did not have any money to contribute, but convinced Louise that she would contribute her first $5,000 in profits back into the business.

Louise was not aware that agreeing to form a partnership with Maxine without getting a written agreement as to distributions meant that they were automatically 50-50 partners. While Louise put up all the money and Maxine orally agreed to put her profits back later, the law treated them as each owning 50 percent of their new business, L&M Gifts.

In nine businesses out of ten there are problems when only one partner puts up all the money. L&M Gifts was no exception.

Maxine wanted the store to have the right atmosphere. She decided on leasing a storefront in a nice area and obligated the partnership to a three-year lease at an above-market rate. She decided on stylish tenant improvements to achieve the right look for her dream store. She then obligated the partnership to buy a large quantity of gifts in order to stock the store.

Before L&M Gifts opened its doors the partnership had obligated itself to spend $12,000 on improvements. They were also obligated to pay
$1,500 per month in rent for the next three years. Louise was not aware of these transactions. However, as general partner, Maxine could obligate the partnership without informing or getting the approval of her other partner.

Louise wanted to announce their grand opening by placing an ad in the newspaper. Because they were a new business, the paper wanted a check up front. When Louise went to write a check it hit her. They were out of money. Maxine had spent Louise’s entire $10,000, and then some, to open the store.

When Louise confronted Maxine with this Maxine was unconcerned. She asked Louise if she could put up any more cash. But Louise did not have any more money. Her life savings, her dream of her own business and control of her future, was the $10,000 that Maxine had already spent.

Maxine said she did not have a credit card but asked if Louise had or could get a credit card to help them get over this hump. Maxine said that if they could just get the doors open together they would be rolling in profits. It was with this comment that Louise realized that she was putting up all the money and taking all the risk so that Maxine could share in all the profits.

Louise was shaken by this realization but remained composed. She said she did not have a credit card nor did she have good enough credit to get one.

At this, Maxine flew off the handle. She said that she had invested all her ideas of style and atmosphere into the business. All Louise had to do was put up the money. She was furious that her creative vision for L&M Gifts was to be dimmed by Louise’s refusal to put in more money.

Louise was stunned by her partner’s reaction. She had put her life savings into the business. Maxine, without telling her, had squandered it. And now Maxine was angry that she could not put in more.

As one would expect, things soured very quickly between the two. As soon as Maxine learned that no more money was forthcoming, she reignited a relationship with an old boyfriend who lived two thousand miles away. She picked up and left town within forty-eight hours. No one heard from her again.
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Louise was left with all the bills. Because Maxine had obligated the partnership, even though Louise had no knowledge of such obligations, Louise as the remaining general partner was personally responsible.

The landlord, the contractor who did the tenant improvements, and the suppliers of the inventory all sued Louise. While Maxine was equally responsible (if not more so) for these debts, the creditors did not even bother to pursue her. She had no money and she was on the other side of the country. Why would someone spend the time and money to chase her? The sole burden of the partnership’s debts fell upon Louise.

Other General Partnership Disadvantages

As if all of the risk and double the exposure were not bad enough, there are other disadvantages to operating as a general partnership:

- **Termination.** A partnership terminates when one partner dies, leaves, or goes bankrupt. You may be surprised by some unexpected event.

- **Sale.** Most sophisticated buyers do not want the risk of being in a general partnership. This will hinder the ability to sell your interest in a general partnership.

- **Self-employment taxes.** We will be discussing those darn Social Security and Medicare taxes throughout this book. Please note here that all general partners (even those not considered employees of the partnership) must pay self-employment taxes on their share of partnership income. Several good entities ahead offer ways to reduce such taxes.

With her life savings gone and her vision of her own business dashed, Louise unhappily went back to work at the department store.

As Case No. 2 illustrates, with a general partnership you have double the exposure of a sole proprietorship. Not only you—but your partner—can put your personal assets at risk. All of the risk and double (or triple or
more depending on the number of general partners you have) the exposure is not a good way to do business.

As our first two cases point out, it is important to select the correct entity at the start. (And, please note, not all of our stories will be so dire. It is just that right now we are dealing with bad entities.)

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**Rich Dad Tips**

- The longer you operate as a sole proprietorship or general partnership the longer you are going to be personally responsible for every bad thing that can happen in your business.

- If you are currently operating as a sole proprietorship or general partnership, see a professional or visit www.corporatedirect.com about switching to a good entity.

- If you are considering getting into a business, do not start out on the wrong foot by using a bad entity.