

How To Avoid Double The Trouble

By Wayne M. Davies

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AUTHOR'S NOTE: This is the second in a series of articles on Choice of Entity. The first article, "It Could Happen To You: Why Any Sole Proprietorship Is A Risky Business", is at <http://www.YouSaveOnTaxes.com/happen-to-you.txt>

Let me introduce you to another client of mine, let's call him Tony.

Tony is a computer programmer who always wanted to be "on his own." One of his co-workers, Kevin, felt the same way. On their lunch breaks they often talked of the day when they'd be calling the shots and making all the money.

Before long, they got the guts to tell their employer they were quitting to start their own business. They didn't know much about paperwork, but Tony's brother-in-law, Kyle, who worked for an insurance company, always seemed to know a lot about "how things worked" in the business world.

Kyle told Tony that the business didn't need to do anything fancy to operate as a business. They could just run things as an informal partnership -- they each contributed 50% of the start-up funds and they agreed to share equally in the profits.

When it came to bookkeeping, Kevin's wife Jennifer agreed to take care of things. She was a bookkeeper at her regular day job and so that was fine with Tony.

The business took off and within a couple years Tony and Kevin were making more money than they ever made as employees. In fact, the partnership had to hire several employees to handle all the work.

Tony thought things were going fine until Kevin showed up at a job one day drunk as a skunk. A few weeks later,

Kevin literally disappeared, never to be heard from again.

Turns out that Kevin, with his wife's help, had been robbing the business blind. Kevin had a drinking problem that he was able to hide from Tony. He was also able to hide that fact that the money he was stealing should have been used for payroll taxes. The partnership was now \$18,000 behind in payroll tax payments.

Kevin and Jennifer were nowhere to be found.

And Tony was stuck with the bill from the IRS for \$18,000 in unpaid payroll taxes.

How could this be? Because in a General Partnership, both partners are liable for the debts of the partnership, regardless of who might be originally responsible for binding the Partnership.

Each partner is personally liable for the debts of the Partnership, and each partner can be held responsible for the business-related actions of all other partners.

It doesn't matter that Kevin was handling the books and the payroll tax payments. It doesn't matter that Kevin was stealing from the Partnership.

Kevin was gone. And Tony was left holding the bag.

The IRS went after Tony even though he had nothing to do with Kevin's wrongdoing. Because he was a partner, he was liable for the debts of the Partnership and had to pay the payroll taxes out of his own pocket.

Tony had to cash in his retirement plan to pay off the IRS.

So, from a liability standpoint, the General Partnership is identical to the Sole Proprietorship: the owners have unlimited liability, and all their personal assets are at risk.

From a liability standpoint, in a 2-person Partnership, you could say that a General Partnership is at least two times more dangerous than a Sole Proprietorship. In a 3-person General Partnership, your liability exposure is three times greater than a Sole Proprietorship.

If you are a partner in a Partnership, do you realize how much risk you are assuming?

Bottom Line:

If your business is a General Partnership, you need to

incorporate because all your personal assets are at risk, and your personal assets are at risk not only for your own actions, but also for the actions of all your co-partners, whether you like it or not.

Make the move from the world of Unlimited Liability to Limited Liability.

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Wayne M. Davies is author of the new eBook,
"Incorporation Tax Secrets Revealed:
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