



Issues Relating To Organizational Forms And Taxation

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1. **Identify the forms of organization available in your jurisdiction and discuss the advantages and disadvantages of each (eg., corporation, limited liability company, partnership, limited partnership, co-operative, etc.), describing which type of legal entity is mostly used or is of special interest, namely by foreign investors.**

Business Corporation

Advantages: perpetuity; limited liability; transferable shares; separation of ownership and management; and well-established law governing its operation.

Disadvantage: potentially subject to double taxation.

Note: this category may also include professional service corporations, which operate largely as business corporations, but owners and managers must be licensed members of a specified list of regulated professions, such as architecture, medicine, or law.

Limited Liability Company ("LLC")

Advantages: flexibility that allows them to combine nearly all the advantages of corporations and partnerships, without the disadvantages.

Disadvantages: flexibility entails greater time and cost in formation; form is relatively new, so there is uncertainty about how it will be treated by courts.

General Partnership

Advantages: income is passed through to partners and taxed at partner level; easily formed without any state filing.

Disadvantages: all partners are liable personally for partnership liabilities; without a well-drafted partnership agreement, partnerships may be susceptible to internal disputes, and a single partner may cause dissolution.

Limited Partnership

Advantages: income is passed through to partners and taxed at partner level; limited partner(s) have complete limited liability, but often do not participate in decision-making and management.

Disadvantages: the general partner(s), who generally manages the entity, is personally liable for partnership obligations.

Note on Partnerships: By filing a certificate with the Secretary of State, either a general or limited partnership may elect “limited liability” status, whereby partners are free from liability for acts and obligations of the partnership.

Nonprofit Corporation

Advantage: exempt from most income taxation.

Disadvantages: limited to statutorily-defined purposes such as charitable, educational or religious activities; do not issue capital stock and private individuals cannot benefit financially from their activities, with the exception of reasonable salary for employees.

Cooperative Marketing Association

Advantages: functions as a hybrid of a nonprofit and business corporation and are generally exempt from income taxation. Profits of the cooperative are generally returned to the members.

Disadvantages: ownership/membership is limited to those who consume the organization’s goods or services, i.e. agricultural producers; must follow statutory governance structure.

Business corporations and LLCs are by far the most commonly used forms. Partnerships may also be of interest to foreign investors in particular circumstances. Because cooperative marketing associations and nonprofit corporations are likely of little use to foreign investors, they will mostly be ignored in the remaining answers. For more information on Idaho nonprofit corporations, see Idaho Code § 30-3-1 et seq.; for cooperative marketing associations, see Idaho Code §§ 22-2601 et seq., 63-3025B(2).

2. Are there attributes of the form that you consider unique to your jurisdiction?

For the most part, there are no notable attributes of these forms unique to Idaho. The statutes creating and/or regulating these forms are based almost entirely on uniform legislation which has been adopted in many states. Business corporations are based on the Revised Model



Business Corporation Act, LLCs on the Revised Uniform Limited Liability Company Act, and partnerships on the Revised Uniform Partnership Act and the Uniform Limited Partnership Act.

3. Describe the management and governance structure for each organizational form.

Business Corporation

The corporation's shareholders elect a board of directors. All corporate powers are exercised by or under the authority of the board, which manages and directs the business and affairs of the corporation. Idaho Code § 30-1-801. The articles of incorporation and the bylaws govern internal management of the corporation, and the bylaws may provide for the election or appointment of officers to which the board may delegate certain responsibilities. Idaho Code § 30-1-840.

The board of directors must be elected by the shareholders, who may by agreement eliminate the board or restrict its powers. Idaho Code § 30-1-732. The articles of incorporation must set forth the number and classes of shares, and the voting rights of those shares. Idaho Code § 30-1-601. Once the corporation is formed, the articles of incorporation may generally only be amended with shareholder approval. Idaho Code § 30-1-1003.

LLC

In general, an LLC is governed by an operating agreement, which the members have great flexibility in drafting, subject to some mandatory statutory provisions and limitations. In the absence of an operating agreement, statutory provisions will apply. An LLC is "member-managed" unless the operating agreement provides that it will be "manager-managed". Idaho Code § 30-6-110(1).

If member-managed, each member has equal rights in the management of the LLC. Idaho Code § 30-6-110(2). Unless the operating agreement states otherwise, matters in the ordinary course of business may be decided by a majority of members, but acts outside the ordinary course, such as amendments to the operating agreement, require the consent of all members. Idaho Code § 30-6-110(2).

In a manager-managed LLC, "any matter relating to the activities of the company is decided exclusively by the managers." Idaho Code § 30-6-110(3). Unless the operating agreement states otherwise, a manager is chosen by a majority of the members, and need not be a member. Matters in the ordinary course of business may be decided by a majority of the managers. Idaho Code § 30-6-110(3). Matters outside the ordinary course must be approved by all members. Idaho Code § 30-6-110(3).

General Partnership

Management of a partnership may be governed by a partnership agreement, but is otherwise subject to the Idaho Uniform Partnership Act. Idaho Code § 53-3-101 et. seq. Matters in the ordinary course may be decided by a majority of partners, and all partners must consent to actions outside the ordinary course. Idaho Code § 53-3-401.

Limited Partnership

A limited partner cannot act for or bind the limited partnership. Idaho Code § 53-2-302. Any matter concerning the partnership's activities may be decided exclusively by the general partner, or by a majority of the general partners if there is more than one. Idaho Code § 53-2-

406. However, all partners must consent to certain acts outside the ordinary course of business, such as amendments to the partnership agreement. Idaho Code § 53-2-406.

4. Is there a residency requirement for management or owners? In particular, are there restrictions or prohibitions on foreign investors to perform, or have interests in, specific activities?

Business Corporation

No. “The articles of incorporation or bylaws may prescribe qualifications for directors. A director need not be a resident of this state or a shareholder of the corporation unless the articles of incorporation or bylaws so prescribe.” Idaho Code § 30-1-802.

However, in a professional service corporation, generally only a person licensed by the state to perform the particular profession may be a shareholder, director, or officer. Idaho Code § 30-1315.

LLC

No.

Partnership

No.

Note: In Cooperative Marketing Associations, only agricultural producers whose products will be handled by the association may be owners/members. Idaho Code § 22-2607.

5. Describe the extent to which management and owners are exposed to liability.

Business Corporation

Shareholders are “not personally liable for the acts or debts of the corporation”. Idaho Code § 30-1-622.

The articles of incorporation may limit or eliminate liability of directors for money damages, except for improper receipt of financial benefit, intentional infliction of harm or violation of criminal law, and authorizing unlawful distributions. Idaho Code § 30-1-202. The articles may also permit or mandate indemnification of directors and officers for actions taken as a director or officer, with the same exceptions as listed above. Idaho Code § 30-1-202.

LLC

LLCs provide complete limited liability. The LLC may indemnify members and managers for any debt, obligation, or liability incurred in the course of activities on behalf of the company, as long as the member or manager has not violated their fiduciary duties, or made a distribution leaving the company insolvent. Idaho Code § 30-6-408(1).

Transactions in which a member or manager has a conflict of interest do not violate the duty of loyalty if the transaction is fair to the company, or if all members or managers approve or ratify the transaction after full disclosure. Idaho Code § 30-6-409.

To fulfill the duty of care, the members and managers merely need to act in good faith and be reasonably informed. Idaho Code § 30-6-409.

As long as it is not “manifestly unreasonable”, the operating agreement may substantially narrow the fiduciary duties of managers or members set forth in the statute, including limiting violations of the duty of care to intentional misconduct or knowing violations of law. Idaho Code § 30-6-110.

General Partnership

Generally, “all partners are liable jointly and severally for all obligations of the partnership”. Idaho Code § 53-3-306.

Partners are not liable for partnership obligations if the partnership has filed for limited liability status. Idaho Code § 53-3-306. However, limited liability does “not affect the liability of a partner in a limited liability partnership for his own omissions, negligence, wrongful acts, misconduct or malpractice or that of any person under his direct supervision and control.” Idaho Code § 53-3-306. Partners also owe fiduciary duties to one another, which duties can be limited in the partnership agreement. Idaho Code § 53-3-103.

Limited Partnership

A limited partner is not liable for partnership obligations even if the limited partner participates in management and control. Idaho Code § 53-2-303. A limited partner does not have any fiduciary duty to the partnership or any partner solely by reason of being a limited partner. Idaho Code § 53-2-305.

Generally, “general partners are liable jointly and severally for all obligations of the limited partnership”. Idaho Code § 53-2-404. However, if the limited partnership has filed for limited liability status, then any partnership obligation “is solely the obligation of the limited partnership. A general partner is not personally liable”. Idaho Code § 53-2-404.

6. Ownership interest: (i) how is it represented? (ii) is it transferable?; and (iii) is there a minimum number of owners?

Business Corporation

Ownership is represented by shares of stock. The articles of incorporation must set forth the classes of shares, e.g. common, preferred, convertible, etc., and series of shares within a class. Idaho Code § 30-1-601. At least one class or series must have unlimited voting rights, and at least one class, which may be the same class, must be entitled to receive the corporation’s net assets upon dissolution. Idaho Code § 30-1-601.

The basic rule is that shares are fully transferable, unless the articles, bylaws, or a shareholder agreement restrict transferability. Idaho Code § 30-1-627.

The minimum number of owners is one. Idaho Code § 30-1-201.

LLC

Ownership is represented by a membership interest in the LLC. The consent of all the members is required to admit a new member, although the operating agreement can alter this requirement. Idaho Code § 30-6-401.

The basic rule is that membership interest are not transferable, but a “transferable interest” may be transferred. A transferable interest gives the transferee the right to receive the distributions to which the transferor would otherwise be entitled, but does not permit the

transferee to participate in the management or conduct of the company's activities. Idaho Code § 30-6-502. Thus, the economic rights to receive distributions are separated from governance rights. However, the statute does not prohibit transferring governance rights from one existing member to another. See Official Comment to Idaho Code § 30-6-502. Further, the operating agreement may be drafted to allow for a member to transfer governance rights without the consent of the other members. Official Comment to Idaho Code § 30-6-502.

The minimum number of owners is one. Idaho Code § 30-6-104.

General Partnership

Ownership is represented by partnership interests. A new partner may be admitted only with the consent of all the partners. Idaho Code § 53-3-401. "The only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions." Idaho Code § 53-3-502.

A partnership must have a minimum of two partners. Idaho Code § 53-3-101.

Limited Partnership

A limited partnership is the same as a general partnership for purposes of ownership, transferability, and minimum number of owners. However, the partnership agreement may be drafted such that limited partners may transfer their full partnership interest and not merely the right to receive distributions and profits. Idaho Code § 53-2-110.

7. Is there a minimum capitalization?

Business Corporation

There is no minimum capitalization required to form a business corporation. However, once formed, the corporation may not make distributions to shareholders that would leave the corporation insolvent, meaning the corporation would be unable to pay its debts or that its assets would be less than its liabilities. Idaho Code § 30-1-640(3). Liabilities include liquidation preferences unless the articles of incorporation provide otherwise. Idaho Code § 30-1-640(3). In addition, the common law provides that if a business corporation does not have sufficient resources to pay reasonable liability claims, a court may ignore the corporate form and impose personal liabilities on the shareholders.

LLC

There is no minimum capitalization required to form an LLC. However, once formed, the LLC may not make distributions that would leave the company insolvent, meaning the LLC would be unable to pay its debts or that its assets would be less than its liabilities. Idaho Code § 30-6-405(1). Liabilities include liquidation preferences. Idaho Code § 30-6-405(1).

General Partnership

No.

Limited Partnership

There is no minimum capitalization required to form a limited partnership. However, once formed, the limited partnership may not make distributions that would leave it insolvent, meaning the limited partnership would be unable to pay its debts or that its assets would be less than its liabilities. Idaho Code § 53-2-508. Liabilities include preferential rights upon dissolution. Idaho Code § 53-2-508.

8. Is there a security that can be issued to the public?

Business Corporation

Yes. Subject to applicable state and federal securities laws, the board of directors may authorize the corporation to issue shares of stock to the public. Idaho Code § 30-1-621.

LLC

Yes. Subject to applicable state and federal securities laws, the LLC may issue interests to the public. The rights and nature of such interests will be determined by the operating agreement.

General Partnership

Yes. Although generally an interest in a general partnership is not considered a security, such an interest may be a security if the holder has little or no power to manage the partnership. The Idaho Uniform Partnership Act allows sufficient flexibility to draft the partnership agreement such that securities may be issued. Idaho Code § 53-3-103. However, it would be unwise to invest in a general partnership security as this could entail personal liability for the security holder.

Limited Partnership

Yes. Subject to applicable state and federal securities laws, the limited partnership may issue limited partnership interests to the public as securities.

9. Can the form incur debt, or grant security for debt?

Business Corporation

Yes. A business corporation has the power to “make contracts and guarantees, incur liabilities, borrow money, issue its notes, bonds, and other obligations, which may be convertible into or include the option to purchase other securities of the corporation, and secure any of its obligations by mortgage or pledge of any of its property, franchises or income”. Idaho Code § 30-1-302(7).

LLC

Yes. An LLC has broad authority “to do all things necessary or convenient to carry on its activities”. Idaho Code § 30-6-105.

General Partnership

Yes. As partners are personally liable for partnership liabilities, they may borrow and grant security just as an individual would.

Limited Partnership

Yes. “A limited partnership has the powers to do all things necessary or convenient to carry on its activities” Idaho Code § 53-2-105.

10. What is the duration of the form? Can it be renewed?

Business Corporation



“Unless its articles of incorporation provide otherwise, every corporation has perpetual duration and succession in its corporate name”. Idaho Code § 30-1-302.

LLC

“A limited liability company has perpetual duration.” Idaho Code § 30-6-104(3).

General Partnership

The duration of a general partnership is unlimited, although without a well-drafted partnership agreement the form can be unstable and subject to dissolution with the death or other exit of a partner.

Limited Partnership

“A limited partnership has a perpetual duration.” Idaho Code § 53-2-104(3).

11. Describe the process, customary time period and approximate cost of establishing the form.

Business Corporation

The incorporator files articles of incorporation with the secretary of state. Idaho Code § 30-1-201. There is a \$100 filing fee. The articles must set forth the corporation’s name, the number of shares it is authorized to issue, its registered agent, and the name(s) and address(es) of the incorporator(s). Idaho Code § 30-1-201.

After incorporation, the incorporator(s) must elect a board of directors, unless the initial board was named in the articles. Idaho Code § 30-1-205. The board then appoints officers and adopts bylaws. Idaho Code § 30-1-205.

The cost in 2010 of basic incorporation documents is approximately \$600, plus the \$100 filing fee.

LLC

The organizer files a certificate of organization with the secretary of state. Idaho Code § 30-6-201. There is a \$100 filing fee. The certificate must state the LLC’s name, designated office, registered agent, and the name and address of at least one member or manager. Idaho Code § 30-6-201.

An operating agreement should be drafted and signed, especially if there are multiple members. Given the flexibility of the LLC form, drafting the operating agreement may involve significant time and expense.

In addition to the \$100 filing fee, the approximate cost of forming an LLC in 2010 is \$2,000, due to the need to draft an operating agreement.

General Partnership

“[T]he association of two (2) or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership.” Idaho Code § 53-3-202. Formation is thus fast and easy, but it is advisable to draft a partnership agreement, which will involve varying amounts of time and expense.

The partnership may become a limited liability partnership if such action is approved by the number of partners necessary to amend the partnership agreement. Idaho Code § 53-3-1001. The partnership then files a statement of qualification with the secretary of state. Idaho Code § 53-3-1001. There is a \$100 filing fee. Idaho Code § 53-3-1001.

In addition to the \$100 filing fee, the approximate cost of forming a general partnership in 2010 is \$2,000, due to the need to draft an operating agreement.

Limited Partnership

A certificate of limited partnership must be filed with the secretary of state. Idaho Code § 53-2-201. There is a \$100 filing fee. The certificate must state the name of the limited partnership, its registered agent, the name and address of each general partner, and whether the limited partnership is a limited liability limited partnership. Idaho Code § 53-2-201. The certificate may also be amended subsequently to make the partnership a limited liability limited partnership. Idaho Code § 53-2-202. A partnership agreement should also be drafted and signed.

In addition to the \$100 filing fee, the approximate cost of forming a limited partnership in 2010 is \$2,000, due to the need to draft an operating agreement.

12. Are there requirements for the government (central or local) to be part of a project or investment vehicle or receive part of the profits arising therefrom (apart from taxes)?

Business Corporation

No.

LLC

No.

General Partnership

No.

Limited Partnership

No.

13. For what taxes is the form liable?

Preliminary Notes:

Besides income taxes outlined below, all entities in Idaho are subject to: (i) a 6% retail sales tax; and (ii) property tax at a rate varying from year to year and county to county.

Any entity with employees is also liable for federal and state payroll taxes.

Tax rates provided are for 2010.

Idaho matches its income tax code as closely as possible to the Internal Revenue Code of 1986 as amended ("IRC"), so that Idaho defines and measures income, capital gains and losses, and most other concepts in the same manner as the federal government. Idaho Code § 63-3002.

Gain or loss from sale of ownership interests in an entity will generally result in a capital gain or loss. 26 U.S.C. § 1221. If the interest is held for more than one year, the capital gain is considered “long-term” under the IRC, and is subject to a preferential tax rate for federal income taxes. 26 U.S.C. §§ 1222. However, in Idaho, the gain will be taxed as ordinary income. Idaho allows significant deductions for capital gains from sales of “qualifying property,” but ownership interests in an entity are not qualifying property. Idaho Code § 63-3022H.

Business Corporation

Entity

Federal corporate income tax: In 2010, taxable income is taxed at increasing marginal rates, from 15-35%.

Idaho corporate income tax: In 2010, taxable income is taxed at a 7.6% flat rate, but all corporations must pay a minimum of \$20. Idaho Code § 63-3025.

Individual Owners

Federal income tax: Dividends paid to shareholders are taxed as income, although the corporation has already paid corporate income tax on the profits distributed as dividends. In 2010, “qualified dividends” meeting IRS guidelines are taxed as capital gains (0-15%) and ordinary dividends as ordinary income (10-35%).

Idaho income tax: In 2010, dividends are taxed as ordinary income from 1.6-7.8%. Idaho Code §§ 63-3002, 63-3024.

Note: The above information applies to a “C Corporation.” In an “S Corporation,” all income passes through to the owners and is taxed as individual income, but the corporation is subject to certain IRS restrictions. The S Corporation/C Corporation distinction is a federal income tax concept and not unique to Idaho.

LLC

Entity

If an LLC elects to be taxed as a partnership, then no income is taxed to the LLC.

Individual Owners

If an LLC elects to be taxed as a partnership, all LLC income thus passes through and is taxed to members at their individual income tax rates, which in 2010 are state (1.6-7.8%) and federal (10-35%).

General Partnership

Entity

No income taxed to partnership.

Individual Owners

All partnership income passes through and is taxed to the partners at their individual income tax rates, which in 2010 are state (1.6-7.8%) and federal (10-35%).

Limited Partnership

Entity

No income taxed to partnership.

Individual Owners

All partnership income passes through and is taxed to the members at their individual income tax rates, which in 2010 are state (1.6-7.8%) and federal (10-35%).

14. What is the tax treatment of payments to foreign owners?

Federal tax treatment of payments to foreign owners is governed by federal law, and is not unique to Idaho.

Foreign owners are liable for income “derived from or related to sources within Idaho.” Idaho Code § 63-3026A. This includes income “attributable to or resulting from... [a]ny business, trade, profession or occupation conducted or carried on in this state, including the distributive share of partnership income and deductions, and the pro rata share of S corporation income and deductions”. Idaho Code § 63-3026A. As noted, an LLC may, and usually does, elect to be treated as a partnership for taxation purposes. Idaho Code § 63-3006A.

15. Is there a tax treatment which would impact foreign owners differently than owners resident in the jurisdiction?

See answer to question 14. Foreign owners are only taxed in Idaho on income “derived from or related to sources within Idaho.” Idaho Code § 63-3026A.

However, “[t]his is to be computed without the deductions for either the standard deduction or itemized deductions or personal exemptions except as provided in subsection (4) of this section.” Idaho Code § 63-3026A.

Subsection (4) provides that a portion of the standard deduction and personal exemptions may be deducted, based on the proportion of the foreign owner’s income which is Idaho income. Idaho Code § 63-3026A(4).