



OFFICE IN A FLASH

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CHAPTER 1: BUSINESS PLAN

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Before you open your firm, you must first develop a written business plan. The business plan will provide the blueprint for your firm, highlighting your ideas, strategy, and team. The plan will be used by you and others, such as banks and potential partners. At a minimum, your law firm business plan should include an executive summary, mission statement, and thorough analysis of your proposed entity structure (i.e., solo or partnership), management, potential targeted clients, market, and financials. Other topics that may be covered in your plan include formation and start-up costs, professional liability insurance, capital (financial, intellectual, and human), suppliers, equipment, space, technology, advertising, banking relationships, insurance, taxes, governance and compliance, growth, alternative strategies and opportunities, and an exit strategy.

The process of preparing a business plan is arguably more important than the business plan itself. It not only brings to light previous unknowns but it forces you to consider a multitude of critical issues. It also compels you to articulate challenges and anticipate potential solutions. This deep and thorough analysis is vital to the success of your business, both at its inception and throughout its existence. While you should try to stick to the goals and objectives you have set forth in your firm business plan, understand that the legal market itself is dynamic. Your business plan may change in order to meet market demands. For more information about how to write and implement a law office business plan, visit <http://www.texasbarcle.com/CLE/site/LawOfficeMgmtBrochures/BusinessPlan.pdf>. You can also visit the "Forms" section of this flash drive for a general example business plan.

STRUCTURE OF THE FIRM

One of the first decisions you will make and incorporate into your business plan is what type of business entity under which you will operate. Key factors that may play a part in your decision will be:

- How do you protect your personal assets if the firm is unsuccessful and creditors come knocking?
- Will you have a partner in your firm?
- What are the different tax benefits/obligations if you choose one firm structure over another?
- Will you have any employees?



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The Texas Business Organizations Code (the “Code”) contains the controlling statutes for all Texas entities, and you should thoroughly review the Code before deciding how you will structure your firm. Below are the most common organizational structures for law firms.

1. Sole Proprietorship

A sole proprietorship is when a person decides to do business under her own name (e.g., the “Law Offices of Larry Lawyer”). There are no formal organizational requirements to form a sole proprietorship. You simply hang out your own shingle. From a tax perspective, a sole proprietorship has no entity taxation at either the federal or state level. Earnings are taxed directly to the owner.

With a sole proprietorship, there is no limit to liability. All of your personal assets are at risk. Additionally, you can only transfer the interests in your business by selling the assets themselves which could increase your tax liability. If you die or stop working for any reason, the firm will cease to exist. Finally, but not less important, access to capital can be limited. Banks might have an adversity to lending to individuals as opposed to a business entity.

2. General Partnership

A Texas general partnership exists when two or more individuals carry on a business for profit as owners. *See* TEX. BUS. ORGS. CODE ANN. § 152.051. The partnership is itself an entity, distinct from its partners, but does not have to file any documents (e.g., certificate of formation) with the Texas Secretary of State. *See* <http://www.sos.state.tx.us/corp/businessstructure.shtml> (visited on August 24, 2010); TEX. BUS. ORGS. CODE ANN. § 152.056. A general partnership has what is commonly referred to as full flow through taxation. In other words, the taxes are paid at the individual partners’ level and not at the entity level. General partners may also be subject to self-employment taxes.

All partners have an equal right to participate in the management and control of the partnership and each partner is liable jointly and severally for any debt or obligation of the partnership. *See* TEX. BUS. ORGS. CODE ANN. § 152.304. A partner owes a duty of loyalty and care to the partnership and to the other partners. *See* TEX. BUS. ORGS. CODE ANN. § 152.204. Moreover, each partner is an agent of the partnership, and therefore, any partner can bind or obligate the partnership, even without the other partners’ knowledge. *See* TEX. BUS. ORGS. CODE ANN. §§ 152.302, 152.303. Thus, it is imperative that you know who your partners are and that you trust them.



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It is very important that you have a partnership agreement that clearly defines the legal relationship of the partners, and between the partners and the partnership. Issues to address when drafting your partnership agreement include:

- right to receive a share of profits in the business;
- participation or right to participate in control of the business;
- sharing in the losses of the business and liability for claims by third parties against the business;
- contributions of money or property to the business;
- events requiring a winding up of the partnership;
- effect of death or divorce on partnership interest;
- withdrawal of a partner; and
- termination.

See TEX. BUS. ORGS. CODE ANN. § 152.001 et seq.

3. Limited Partnership

A Texas limited partnership is a partnership formed by two or more persons, with at least one general partner and at least one limited partner. A limited partnership must file a certificate of formation and other reports, as requested, with the Texas Secretary of State. *See* TEX. BUS. ORGS. CODE ANN. § 153.301; <http://www.sos.state.tx.us/corp/businessstructure.shtml> (visited on August 24, 2010). The partnership must also maintain records in its principal office that include information such as the names and addresses of each partner, separately identifying the general and limited partners in alphabetical order, the percentage or other interest in the partnership owned by each partner, the partnership agreement and copy of its tax returns, certificate of formation, and more. *See* TEX. BUS. ORGS. CODE ANN. § 153.551. For tax purposes, a limited partnership normally has pass-through taxation, but must meet certain criteria in order to avoid being taxed as a corporation.

The essence of a limited partnership is that the general partners have unlimited liability for the partnership's obligations, while the limited partners have limited liability for the partnership obligations. *See* TEX. BUS. ORGS. CODE ANN. §§ 153.102, 153.152. Subject to the

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terms of the limited partnership agreement, a general partner has the same rights, powers, restrictions, and liabilities that the general partner would have in a general partnership, without limited partners. *See* TEX. BUS. ORGS. CODE ANN. § 153.152. Accordingly a general partner may participate in the control of the business, whereas, a limited liability partner should not, in order to maintain limited liability status. *See* TEX. BUS. ORGS. CODE ANN. § 153.102. Similar to a general partnership, it is important to have a partnership agreement that clearly defines the relationships among the general partners, the limited liability partners and the limited liability partnership. In addition to addressing all of the same issues that may arise under a general partnership agreement, the limited partnership agreement should also address assignment of partnership interests which, unless restricted by the agreement, are assignable under the Code. *See* TEX. BUS. ORGS. CODE ANN. § 153.001 et seq.

4. Limited Liability Partnership

A Texas limited liability partnership is a partnership formed by two or more persons, whereby the partners seek to limit the liability of all partners. *See* TEX. BUS. ORGS. CODE ANN. §§ 152.801. A limited liability partnership must file an application and register the partnership with the Texas Secretary of State. *See* TEX. BUS. ORGS. CODE ANN. § 152.802; <http://www.sos.state.tx.us/corp/businessstructure.shtml> (visited on August 24, 2010). Information that must be provided in the application include the name of the partnership, the federal tax identification number, the address of the partnership's principal office, the number of the partners at the date of the application, and a brief statement of the partnership's business. *See* TEX. BUS. ORGS. CODE ANN. § 152.802. For tax purposes, a limited liability partnership is treated as an association of co-owners, and each co-owner is taxed on his or her proportional share of the LLP profits.

Subject to the terms of the limited liability partnership agreement, a partner in a limited liability partnership is not personally liable to any person for any debt or obligation of the partnership, including those debts or obligations arising from an error, omission, negligence, incompetence, or malfeasance committed by another partner or representative of the partnership committed during the course of the partnership business unless the first partner was:

1. supervising or directing the other partner or representative when the error, omission, negligence, incompetence, or malfeasance occurred;

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2. involved directly in the specific activity in which the error, omission, negligence, incompetence, or malfeasance was committed by the other partner or representative; or
3. had notice or knowledge of the error, omission, negligence, incompetence, or malfeasance by the other partner or representative at the time it occurred and then failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence, or malfeasance.

See TEX. BUS. ORGS. CODE ANN. § 152.801. The limited liability partnership must carry at least \$100,000 of liability insurance designed to cover the kind of error, omission, negligence, incompetence, or malfeasance for which there is limited liability protection. *See* TEX. BUS. ORGS. CODE ANN. § 152.804.

5. Professional Entities

A professional corporation or professional limited liability corporations (collectively, “professional entities”) may be formed by lawyers for the purpose of providing legal advice. Only lawyers may be owners, officers, or a governing person of a law firm professional entity. *See* TEX. BUS. ORGS. CODE ANN. §§ 301.004, 301.007. All of the normal corporate formalities must be adhered to by professional entities, but they are exempt from securities laws. *See* TEX. BUS. ORGS. CODE ANN. §§ 21.001 et seq., 101.001 et seq., 301.001 et seq. In general, professional entities are taxed similar to that of a regular business corporation or limited liability company. In some instances, a professional corporation may pay flat federal income tax. For tax matters, it is always best to seek the advice of an accountant.

A professional entity is jointly and severally liable for an error, omission, negligent, or incompetent act, or malfeasance committed by an owner, managerial official, or employee, while providing a professional service for the entity during the course of the person’s employment. *See* TEX. BUS. ORGS. CODE ANN. § 301.010. The owners, managers, employees and agents are not subject to the same liability as that of the professional entity. *See* TEX. BUS. ORGS. CODE ANN. § 301.010. Thus, the real advantage of structuring your firm through a professional entity is that you limit your liability if you did not commit the error.
