Reinhart

Opening a Brewery: Choosing from the Entity Structure Menu

Article #3 of Hopping on the Brewery Bandwagon Series

Before you get to the fun part of brewing beer, it is important to take the appropriate legal steps to establish your business. The first step in this regard is choosing the right entity structure for operating the business. Choice of entity involves a number of considerations, including liability protection, taxes, capital structure and governance. This article provides an overview of entity structures and related issues to consider.

Sole Proprietorship

A sole proprietorship is the default form of ownership when a single owner starts operating a business. Operating a sole proprietorship is easy and generally does not require filing with a state authority. All income and loss of the business is reported directly by its owner. However, new brewers should think twice before relying on this simple form of ownership. A sole proprietorship does not enjoy liability protection. Rather, sole proprietors are personally liable for all debts and claims against the business. As such, if a sole proprietorship encounters an unexpected claim, the owner's personal assets may be at risk.

Partnership

A partnership is the default form of ownership when more than one owner starts operating a business. A general partnership can exist without any formal filing by two parties simply acting in concert. In a general partnership, all partners have authority to act on behalf of the partnership and share liability for partnership debts and claims. Alternatively, parties can form a limited partnership by filing a certificate of limited partnership with the applicable state authority. In a limited partnership, the general partner has authority to act on behalf of the partnership and is liable for debts of the partnership. A limited partner is generally a passive investor without management rights and enjoys limited liability. In either case, a partnership files an information tax return and partners report their allocable share of partnership income and loss.

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Limited Liability Company

A limited liability company ("LLC") is probably the most common structure for operating a brewery. This is the case because an LLC offers significant flexibility in terms of corporate governance and capital structure. An LLC provides limited liability to each of its members and the income and loss of the LLC is reported by its members. An LLC is formed by filing articles of organization with the applicable state authority. Generally, the members will desire to establish an operating agreement to establish the management and economics of the entity.

Corporation

A corporation is a legal entity formed under state law by filing articles of incorporation with the applicable state authority. A corporation issues stock to its shareholders, which then enjoy limited liability protection. A corporation might be a preferred form of entity for a brewery that anticipates obtaining significant limited investors (as some investors desire to invest only in a corporation). Generally, the significant drawback to operating as a corporation is that a corporation is subject to "double tax," which means the corporation pays tax and its shareholders pay a second level of tax on distributions from the corporation. A corporation can avoid this double tax, however, if it makes an "S" election. In that case, the income and loss of the corporation is reported directly by its shareholders. An "S" election requires certain filing with the IRS and is subject to significant limitations with respect to its capital structure.

Additional Thoughts

Brewers may choose to either lease or purchase property. If a brewer owns its own real property, it should consider forming an entity separate from the operating business to hold the real property. This structure provides an additional level of liability protection (although tax consequences should be considered based on the individual facts and circumstances). The real property entity (likely an LLC) can lease the property to the operating business.

After you choose your entity structure, the filing and corporate governance requirements do not stop there. Entities generally must obtain a federal taxpayer identification number and will have required tax filings. If an entity hires employees, it must also consider employment taxes and compensation structures for its employees. Corporate governance formalities should also be followed, which may include a partnership agreement, operating agreement or shareholder agreement (depending on the choice of entity), annual minutes and authorizing resolutions.

Like any Cicerone, we are here to help you with your menu options. If you have any questions about choice of entity and corporate governance matters, contact your Reinhart attorney or any member of the Food and Beverage team.

Stay tuned for the series' next article on trademarks.