

Legal Considerations for Business Owners

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CHOICE OF ENTITY

Choice of entity for a business includes the following:

- C corporation
- S corporation
- General or limited partnership
- Limited liability company
- Massachusetts business trust

TAXATION

<u>C Corporation</u>	<u>S Corporation</u>	<u>General or Limited Partnership</u>	<u>Limited Liability Company</u>
<p>Income is taxed to corporation at corporate rates. Compensation paid to owners is taxed to owners and is deductible to the corporation.</p> <p>Double taxation.</p> <p>See Exit Strategies slide.</p>	<p>Income is taxed to owners at their personal income tax rates, regardless of whether it is distributed to them or retained by the corporation.</p> <p>Single level of taxation.</p> <p>Similar to C Corporation taxation in some events</p> <p>See Exit Strategies slide.</p>	<p>Income is taxed to owners at their personal income tax rates, regardless of whether it is distributed to them or retained by partnership.</p> <p>Local taxation of personal property may be higher.</p> <p>Special allocations of profits and losses are possible.</p>	<p>Income is taxed to owners at their personal income tax rates, regardless of whether it is distributed to them or retained by company. Local taxation of personal property may be higher.</p> <p>Special allocations of profits and losses are possible.</p> <p>LLCs with one member are generally disregarded entities for income tax purposes. LLCs with more than one owner are generally taxed as partnerships.</p>

CAPITAL STRUCTURE

<u>C Corporation</u>	<u>S Corporation</u>	<u>General or Limited Partnership</u>	<u>Limited Liability Company</u>
<p>Requires only one shareholder and may have an unlimited number of shareholders.</p> <p>Capital may be comprised of any form of equity, including common stock, preferred stock, and convertible debt.</p> <p>Stock Options.</p>	<p>Requires only one shareholder but cannot have more than 100 shareholders.</p> <p>Corporations, partnerships, LLCs, nonresident aliens, and certain trusts cannot be shareholders.</p> <p>May have only one class of stock except for voting rights.</p> <p>Stock Options.</p>	<p>Must have at least two partners and may have an unlimited number of partners.</p> <p>There are no capital or debt restrictions.</p> <p>Can grant Profits Interests.</p>	<p>Requires only one member and may have an unlimited number of members.</p> <p>There are no capital or debt restrictions.</p> <p>Can grant Profits Interests.</p>



LIMITED LIABILITY

<u>C</u> <u>Corporation</u>	<u>S</u> <u>Corporation</u>	<u>General</u> <u>or Limited</u> <u>Partnership</u>	<u>Limited</u> <u>Liability Company</u>
Shareholder-owners are not liable for corporation obligations.	Shareholder-owners are not liable for corporation obligations.	<p>General partners have joint and several liability for partnership obligations.</p> <p>Limited partners are not liable for partnership obligations, provided they do not actively participate in management of partnership.</p>	Members are not liable for company obligations.

Personal Liability Risks

- Piercing the Corporate Veil
- Annual maintenance
- Annual Meeting
- Best Practices

FORMATION

<u>C Corporation</u>	<u>S Corporation</u>	<u>General or Limited Partnership</u>	<u>Limited Liability Company</u>
Requires filing of articles of organization with secretary of state, adoption of bylaws, and issuance of stock certificates.	Requires filing of articles of organization with secretary of state, adoption of bylaws, and issuance of stock certificates.	Limited partnerships must file a certificate of limited partnership with secretary of state. There is no filing requirement for general partnerships.	LLCs must file a certificate of organization with secretary of state.

EXIT STRATEGIES

<u>C Corporation</u>	<u>S Corporation</u>	<u>General or Limited Partnership</u>	<u>Limited Liability Company</u>
<p>Capital gain recognized on sale of stock.</p> <p>Double Taxation on sale of assets by a C corporation; the corporation incurs tax on the sale; shareholders incur additional tax on liquidating distribution.</p> <p>Eligible to issue Qualified Small Business Stock</p>	<p>Capital gain recognized on sale of stock.</p> <p>On sale of assets by an S corporation, the corporation incurs no federal tax; shareholder incurs tax on sale of assets (not on liquidating distributions in most cases).</p> <p>Election is available in certain circumstances to have a stock sale taxed as an asset sale.</p>	<p>Capital gain recognized on sale of partnership interest except for certain types of assets.</p> <p>On sale of partnership assets, partners incur tax on the sale (not on liquidating distributions in most cases).</p>	<p>Capital gain recognized on sale of LLC interest except for certain types of assets.</p> <p>On sale of LLC's assets, members incur tax on the sale (not on liquidating distributions in most cases).</p>

QUALIFIED SMALL BUSINESS STOCK

- Provides an exclusion (in whole or in part) of gain in certain sales of C-corporation stock for taxpayers other than corporations.
- Becomes more relevant now that the TCJA lowered corporate tax rates.
- 100% exclusion on gain of QSBS stock issued after September 27, 2010

LLC OPERATING AGREEMENTS

- Setting expectations
 - single or multiple equity classes
 - wages & bonuses or distributions
 - right to employment
- Voting and management
 - protective provisions
- Buy-sell considerations
 - “good” or “bad” departure
 - purchase option or mandatory?
 - funding

LLC OPERATING AGREEMENTS

- Non-Compete
 - business opportunity doctrine
 - fiduciary duty
 - state law considerations
- Allocations of Profits & Losses, Cash Distributions
- Carried Interest / Profits Interests

INTELLECTUAL PROPERTY CONSIDERATIONS

- What is it
 - Patents - ® vs patent pending
 - Trademarks/servicemarks (branding) - ™ vs trademark “company”
 - Trade secrets (e.g, secret sauce, vendor/customer lists, pricing methods) – only if kept secret
 - Copyrights - ©

INTELLECTUAL PROPERTY CONSIDERATIONS

- Who Owns it
 - Employer/employee
 - Contractor
 - Prior Employer?

INTELLECTUAL PROPERTY CONSIDERATIONS

- How do you protect it?
 - Nondisclosure Agreements
 - Employees bound by duty of confidentiality and loyalty
 - Due diligence –prior restrictions
 - Internal policies and procedures (e.g., restricted areas, visitor logs, network security)
 - Licenses

FINANCING CONSIDERATIONS

- Equity or debt issuance
 - friends and family or “professional” sources
 - valuation
 - securities laws; finder fees; rescission risk
 - hiring and retaining talent
- Commercial loans
 - covenants
- Personal Guarantees
 - contribution
 - change of control

CONTRACTS

- Leases
 - office & equipment
- Customer & Vendor agreements
- Licenses
- Key Terms
 - commercial leverage
 - standard agreements vs. battle of the forms
 - payment terms
 - executory contracts



CONTRACTS

- Key Terms continued...
 - performance requirements
 - assignability/ change of control flexibility
 - exclusivity?
 - confidentiality (is the agreement itself confidential?)
 - IP protection
 - insurance, indemnity, limitation of liability and claim deadline
 - dispute resolution, choice of law and jurisdiction

CONTRACTS

- Employee and consulting agreements
 - all or just key employees
 - work-for-hire; pre-existing or created in contract performance
 - open source software
 - insurance and indemnity
 - non-compete and non-solicitation

BUSINESS LITIGATION AND RISK MANAGEMENT

- Reducing likelihood of litigation
 - credit and background checks
 - contract provisions
- Insurance
 - require of all contractors
 - commercial general liability and provide additional named insured
 - professional liability aka errors and omissions



BUSINESS LITIGATION AND RISK MANAGEMENT

- Insurance continued...
 - vehicle (owned, non-owned and hired)
 - worker's compensation and employer's liability
 - employee dishonesty
 - cyber liability
- Negotiating departures of employees with equity and shareholder/partner