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Business Law Essentials

Biz Fair

September 29, 2018

U.S. Small Business Administration

Disclaimer

This information is intended to provide a general overview of legal issues facing small businesses. It is not intended to constitute legal advice.

Business Law Essentials: Overview

- Legal Structure 101
- Selection Tips
- Contracts
- Selecting an Attorney

Business Law Essentials: Overview

- Maintenance of Business Entity
- Entry/Exit of Business Owners
- Succession Planning

Business Law Essentials: Overview

- Purchase/Sale of Business
- Intellectual Property
- Commercial Leases

Legal Structure 101

- Sole Proprietorship
- General Partnership
- Limited Liability Partnership (LLP)
- Limited Partnership (LP)

Legal Structure 101

- Corporation
- Social Purpose Corporation (SPC)
- Limited Liability Company (LLC)
- Professional Entities (PS, PLLC)

Sole Proprietorship

- Common, simple type of business ownership for one-person business
- No protection from individual liability

Sole Proprietorship

- Tax: Income flows through to individual
- Individual income tax return – Schedule C
- Appropriate entity for many businesses

General Partnership

- Similar to a sole proprietorship, but two or more people own the business
- Need a partnership agreement prepared by attorney (A handshake is not enough!)

General Partnership

- No protection from individual liability
- Tax: Income flows through to individuals
- IRS Form 1065, Schedule K-1; RCW 25.05 (Revised Uniform Partnership Act)

General Partnership

- General Partnership generally not recommended entity
- No liability protections
- Incur legal expenses for proper set up

Limited Liability Partnership

- Formed by filing Limited Liability Partnership registration with Secretary of State
- Similar to general partnership, but one partner is not responsible for another's negligence

Limited Partnership

- Formed by filing Certificate of Limited Partnership with Secretary of State.
- RCW 25.10 (Uniform Limited Partnership Act)

Limited Partnership

- General partners manage the business & share in profits/losses. Unlimited liability.
- Limited partners are passive. Share in profits. Losses limited to investment amount.

Limited Partnership

- Additional option: Limited Liability Limited Partnership (LLLP).
- Formed by filing Certificate of Limited Partnership with Secretary of State & checking LLLP box.

Corporation

- Formed by filing Articles of Incorporation with Secretary of State
- RCW 23B (Washington Business Corporation Act)

Corporation

- One or more individuals can create
- Offers protection from individual liability if properly formed & maintained

Corporation

Tax:

C Corporation: Two levels of federal income tax. Business income is taxed, then shareholder dividends are taxed.

Corporation

Tax:

S Corporation: Not a separate tax paying entity. Income and losses pass through to shareholders per their ownership percentages.

Corporation

Tax:

- S Corporation: Pay yourself a “reasonable salary.”
- Reasonable salary is subject to self-employment tax of 15.3% up to \$128,400

Corporation

Tax:

- 12.4% = Social Security
- 2.9% = Medicare

Corporation

Tax:

- Excess of \$128,400 subject to 2.9% Medicare tax only.
- Profits beyond salary taken as a shareholder distribution, not subject to self-employment tax.

Corporation

Tax:

- Tax Cuts and Jobs Act of 2017
- Reduced C corporation tax rate from 35% to 21%

Corporation

Tax:

- Pass through businesses can generally deduct 20% of qualified business income (QBI).
- Phases out at \$157,500 (single taxpayers) & \$315,000 (married couples)
- Consult CPA for detailed tax advice

Corporation

Criteria for S-corporation:

- Be a domestic corporation
- Have only allowable shareholders

Corporation

Criteria for S-corporation:

- Shareholders may be individuals, certain trusts & estates
- Shareholders may not be partnerships, corporations or non-resident aliens

Corporation

Criteria for S-corporation:

- No more than 100 shareholders
- Only one class of stock (investors like preferred stock)

Corporation

Criteria for S-corporation:

- No ineligible corporations (i.e. certain financial institutions, insurance companies, and domestic international sales corporations)

Corporation

- Election of Board of Directors
- Selection of corporate officers
- Stock Issuance

Corporation

- Bylaws
- Shareholders Agreement

Social Purpose Corporation

- Formed by filing Articles of Incorporation with the Secretary of State
- RCW 18.100

Social Purpose Corporation

- Allows shareholders & directors to take a social purpose (other than maximizing profits) into account
- Allows flexibility to generate lower profits by making socially responsible choices

Limited Liability Company

- Formed by filing Certificate of Formation with Secretary of State
- One or more individuals may be members

Limited Liability Company

- Offers protection from individual liability if properly formed & maintained
- Relatively new entity as opposed to corporation

Limited Liability Company

- Tax: LLC not recognized for federal tax purposes. Can select how to be taxed. Default is taxation as a disregarded entity.
- Most popular form of business entity

Limited Liability Company

- RCW 25.15
- Allows tremendous flexibility
- Operating Agreement

Limited Liability Company

- New LLC Act came into play in 2016
- Oral LLC agreements allowed

Limited Liability Company

- Fiduciary duties outlined
- Don't have to say on Cert. of Formation whether you are member-managed or manager-managed

Limited Liability Company

- Default voting – one member/one vote (not equity based)
- More record keeping obligations

Limited Liability Company

- Classes of members with no voting rights okay
- LLCs can now be managed by a board

Professional Entities

- Designed for licensed professionals including physicians and attorneys
- Choices are Professional Service Corporation (PS) and Professional Limited Liability Company (PLLC)

Professional Entities

- RCW 18.100
- Additional requirements exist regarding membership and type of services conducted

Selection Tips

1. Evaluate your risk
2. Seek accounting advice
3. Seek legal advice
4. Evaluate your business relationships

Selection Tips

Step 1: Evaluate Your Risk

- Analyze your own business for potential risks.
- Seek advice from a commercial insurance broker and business attorney.

Selection Tips

- The riskier the business, and/or the more difficult it is to obtain insurance coverage, the more likely a corporation or LLC is needed.
- Commercial Insurance + Business Entity = Dual Layers of Protection

Selection Tips

Step 2: Seek Accounting Advice

- See a CPA
- Determine whether a corporation or LLC results in tax savings for your unique business

Selection Tips

Step 3: Seek Legal Advice

- An attorney should create any business entity except for sole proprietorship. Why?

Selection Tips

- Properly established and maintained business provides protection against lawsuits
- Legal documents needed to define relationships between business owners

Selection Tips

Step 4: Evaluate Your Business Relationships

Breaking up is hard to do! You need to trust your fellow partner, LLC member or corporate shareholder.

Contracts

- Use written agreements for key business relationships!
- You will likely use “template” contracts for your business.
- Don't forget employment contracts and independent contractor agreements.

Contracts

- Draft agreements to the best of your ability (form books, internet, etc.).
- Make sure your attorney reviews and finalizes all contracts prior to use.

Contracts

The Basics:

- Parties
- Relationship
- Subject Matter
- Definitions

Contracts

- Term
- Termination
- Compensation
- Confidentiality

Contracts

- Intellectual Property
- Breach
- Right to Cure
- Indemnification

Contracts

- Alternate Dispute Resolution
- Attorneys' Fees
- Jurisdiction & Venue
- Execution Requirements

Contracts

- Effective Date
- Other Issues Dependent on Nature of Agreement

Contracts

- What Needs to be in your Contract?

Selecting an Attorney

- Ask Questions!
- Will work be billed hourly or by flat fee?
- What extra costs will be involved? (ex. Secretary of State's filing fees, minute book, copying, postage, etc.)

Selecting an Attorney

- How often does attorney bill? Monthly? At end of project?
- What is the attorney's level of experience?

Selecting an Attorney

Bottom Line: Can you work with this attorney on a long term basis? Do you want this attorney on your team?

Maintenance of Business Entity

- Most business entities require on-going maintenance
- Need to comply with corporate Bylaws or LLC Operating Agreement

Maintenance of Business Entity

- Corporations must have annual meetings (RCW 23B.07.010)
- LLCs should have documented meetings on a periodic basis

Maintenance of Business Entity

- Meetings needed even if entity consists of one business owner
- Major decisions should be documented by meeting minutes

Entry/Exit of Business Owners

- Over time, ownership of business may change
- Develop entry/exit “rules” via a corporate Shareholders Agreement or LLC Operating Agreement

Entry/Exit of Business Owners

- Often involves a CPA to perform business valuation
- Often involves one or more attorneys to prepare, review and negotiate necessary legal documents

Succession Planning

- Death of business owners is a certainty
- How will the business survive the death of a key owner?

Succession Planning

- How will heirs of deceased business owner receive their inherited interest?
- How will the business be able to afford the payment to deceased owner's estate?

Succession Planning

- Succession planning needs to be discussed in advance with CPA and attorney
- Life insurance can play a key role in financing payment owed by business

Purchase/Sale of Business

- Involve attorney & CPA at the beginning of the process
- Start with a letter of intent
- “Formal” due diligence process needed

Purchase/Sale of Business

- Need purchase and sale agreement prepared by counsel
- Asset sale v. entity sale

Purchase/Sale of Business

- Consider how purchase price will be paid & how a payment default will be handled.
- Other potential issues: Employees?
Inventory? Existing business contracts?
Will prior owner(s) work in new business?
Non-compete? Non-solicitation?

Intellectual Property

- Types: Patent; Trade secrets; Copyright protection; Trademark
- Non-disclosure agreement?
- Non-compete agreement?

Intellectual Property

- License agreement?
- Many businesses engage in ongoing process of identifying and protecting IP

Trade Name

- Defined: “The name under which a business firm operates.” May differ from name of business entity.
- Trade names are registered by completing Master Business Application.

Trade Name

- Just because you've registered it doesn't mean it's yours!
- If your trade name is important, retain "IP" (intellectual property) counsel to complete proper registrations.

Commercial Leases

One of the most critical documents signed
by any business

Step 1: Shop for the perfect space!

Commercial Leases

Step 2: Negotiate the basic lease terms:

- Is the base rent acceptable?
- Additional amounts owed (percentage rent, operating expenses, etc.)?

Commercial Leases

- Term of lease?
- Option to renew?

Commercial Leases

Step 3: Obtain copy of written lease. Read every word.

Step 4: Make sure attorney reviews lease prior to your signature.

Commercial Leases

- Leases generally written by landlord's attorney. Favor landlords.
- Lease review and negotiation takes time! Reserve attorney in advance. Budget at least 3-4 hours in billable time.

The background is a solid teal color. It features several white geometric elements: a vertical line on the left side with a dot at the top; a horizontal line near the bottom with a dot at the right end; a horizontal line near the top with eight dots; a large, light-colored rectangle in the center; and a large, faint circle in the bottom right corner.

Questions?



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