



BUYNAK LAW FIRM

Those of us who become entrepreneurs, who “go into business for ourselves” should be applauded. We’ve been driven to better the lives of others, to take on many risks. We are contributing to our economy, to its rebuilding. You are a person who wants to be of service. A business should not be undertaken for pure profit, as eventually, it will sputter when your interest wanes and it will fail. Having your eye on the finances of your business is really important, but it, not the end-all, be-all of your operations. Great interest and service lie at the heart of what you are accomplishing. At Buynak Law, we enjoy working with enterprising individuals and groups, from start-ups to seasoned businesses. We have experience with most endeavors, whether for-profit or non-profit, and especially in the challenges that will arise – from your investors to your employees, your contracts, your operations, intellectual property (trade secrets & trademarks usually), and on & on! We usually are engaged as outside general counsel for the company to structure its formation and then, to assist with its operations.

Two principles are important for your business from a legal perspective ---

- You are risking your financial future with a business; the laws allow you to limit your risk, your personal exposure; and,
- You need to control your ownership, to manage your business so that you can implement your plans, your dreams and not have them lost, sidelined, or modified by others; you have your vision and that should be honored.

Risk - to limit your risk, your financial exposure, the law provides two basic legal vehicles – limited liability companies (LLCs) and corporations, within California or other US states. There are no nationally registered entities. LLCs and corporations are formed under a state’s law, although federal law may govern some interstate activities like stocks (securities), intellectual property (trademarks, patents), taxes, etc.

Normally, an individual or group of enterprising people starts with a sole proprietorship, venture, or partnership, and then moves into an LLC or corporation. A sole proprietorship offers no risk or protection, so moving into a legal entity quickly is important. Partnerships are a legal structure



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where two or more people combine together. There is no risk protection; all partners are individually liable for all actions and liabilities of the business.

The choice between an LLC and a corporation is usually based on taxes and the future plans of the company. This is an important choice and where an attorney is essential. Setting everything up initially is key to a successful business. For example, two individuals should not form a corporation where one contributes cash and the other “sweat equity”, and then have the taxing authorities treating the sweat equity as compensation subject to employment, income, and other taxes. It’s an eye-opener to receive such an IRS letter for an audit. There’s an easy way an attorney can structure this type of transaction without taxes.

In California, an S-Corporation is usually the corporation of choice for startups and smaller operations, under \$2,000,000 in profits. With a regular C-Corporation, profits are taxed twice, at the corporate level, and then at the individual level. S-Corporations are pass-through entities and there’s only one tax at the individual level with a minor 1.5% franchise tax at the corporate level. Eventually, if the corporation grows larger with outside investors, then a C-Corporation is usual, sometimes in Delaware. An S-Corporation can be easily converted into a C-Corporation in the appropriate state at the appropriate time.

Why aren’t LLCs preferred? It is because their California taxation is based on the gross revenue of the operation before any expenses. You can understand that that is a very different taxing structure. A business, like a restaurant, can have \$1,000,000 in gross receipts and \$10,000 in profit. Since California LLC tax is on the LLC gross receipts, this would amount to \$11,790 of taxes – more than the profit of the business. The difference is a lot & the taxes could cause the business to fail. Proper planning is essential. Sometimes, with high profit, it is best to be an LLC as S-Corporation taxes are continuing to grow with greater profits.

In summary, your choices are –



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- Limited Liability Companies – California or some other state
- S-Corporation – pass-through entity
- C-Corporation – double taxation, but the regular corporation for large operations and large investors.

Control – The control of an LLC or corporation is based on its Board and the rights that their shareholders, stakeholders or members have. These rights are spelled out in Bylaws, Shareholder Agreements, Operating Agreements, etc. The rights and restrictions are many – like does the individual have the right to vote; if so, what can they vote on; do they have a right to one or more Directors on the Board of Directors; are their distributions or dividends preferred; who owns the intellectual property; etc. Thus, please be sure that the interests of everyone are accurately reflected in these organizational documents. Planning and documentation are essential. For example, owners of a third or more of the ownership of a corporation can cause its dissolution, which could disrupt all that you've accomplished unless you give in to the demands of the minority of shareholders. Work with us and these pitfalls can be avoided.

Summary. We enjoy this area of our law practice. We look forward to being of service to you so that your venture thrives initially and throughout its operation. There will be many challenges; there are legal ways to avoid and minimize these challenges. Being your general corporate counsel would be an honor for us. It makes us proud of the productive work that we accomplish for many LLCs and corporations along the Central Coast of California.

Best!

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