

## **A Checklist for Creating Your New Business**

### 1) **Choosing a Legal Structure for Your New Business: The Entity Form**

When establishing a new business, you need to select the legal form of the entity for your new business. The most common selections in the United States are the following:

#### a. **Limited Liability Company (LLC)**

LLCs are the most popular form of new businesses in the United States. They offer significant tax advantages and protection from personal liability for the right situations—when properly formed and maintained. Consult with your legal and financial advisors to determine if an LLC is the right type of entity for your new business.

#### b. **Corporations**

Corporations have been around for hundreds of years in the United States. That history provides a track record that demonstrates reliability in certain positive attributes of corporations. Notably, corporations can provide a great deal of protection for personal liability. There are plenty of requirements for and qualifications to this protection, which you should discuss with your advisors. However, if you are forming a start-up business in a particularly risky area, such as a company that is likely to be sued, using a corporation for your new business can be the right choice.

On the other hand, corporations can provide disadvantages in the area of taxation. Simply put, corporations are taxed on their income and then dividends issues to the shareholders are taxed again—producing double taxation. Many entrepreneurs try to avoid this double taxation by electing to be taxed as a Subchapter S corporation. This election also presents its own set of requirements and limitations. Instead of rushing this decision, learn about the significant requirements and limits you will need to satisfy if you have elected to be taxed as a Subchapter S corporation.

#### c. **Partnerships**

Decades ago, before LLCs were created and became popular, many businesspeople chose to form Limited Partnership. In particular, the owner and developers of real estate projects frequently selected Limited Partnership because of the tax advantages over corporations. But, the owners of Limited Partnerships had to navigate tricky legal areas associated with liability issues. For this reason, when LLCs became available, many of these same types of entrepreneurs shifted to using

LLCs. There may still be situations where Limited Partnerships are the right choice for you. Again, consult your professional advisors.

In addition, some businesspeople—usually long ago—selected general partnerships. These general partnerships did not provide much in the way of advantages, except simplicity. That is, general partnership agreements often were short and simple. Some general partnerships did not even have written agreements (certainly not something we would recommend!). These general partnerships do have some tax advantages, but they expose each owner—that is, each general partner—to considerable liability. Consider use of a general partnership with an abundance of caution and thorough professional guidance.

d. **Sole Proprietorships**

A sole proprietorship is what you have—in the way of a form of entity—when you have nothing and you are all on your own. That is, you have no co-owners (the “sole” in sole proprietorship). Further, you have not formed an entity for your business. Rather, sole proprietorship is a description of a person conducting business without a legal entity. If you sign a contract and breach it, you are personally liable because, even though you are in business, you are conducting business in your own name and you are directly responsible for your business. Essentially, there is no legal form—no structure—protecting you from the obligations of your business. There are some tax advantages to conducting business as a sole proprietorship. But those advantages are so far outweighed by the liability issues and other problems that a sole proprietorship is only appropriate in very limited situations and, even then, only for short time periods—such as a brief time period while you are making arrangements to establish the entity for your new business. Even then, great caution should be exercised. Act only with the appropriate professional advice.

Once you have selected the appropriate entity for your new company, you need to tackle a variety of issues. This process starts with identifying the most important concerns, especially for your own unique situation.

So, consider the following important issues:

2) **Ownership**

Ownership is all about: “Who owns what?” For example, if you and your best friend are starting a new business, you need to establish how much of the company each of you will own.

- a. **Owners:** You need to identify the owners of the new company. Some people involved in the business may be owners right from the beginning. Others may happily assume the role of employees. And still others may start out as employees, with the aspiration of becoming an owner in the future.
- b. **Percentage interest:** You will need to determine what percentage of the company each person will own. Obviously, the owner of 90% is going to have a lot more say in (and responsibility for) the actions of the business than an owner of 10% of the company. However, this general rule can be modified by agreements between the owners.
- c. **Vesting requirements:** As noted above, some of the participants may not start out with any ownership. Also, ownership can increase over time. It is not unusual for the original owners of a company to allow certain employees to obtain an ownership interest over time. This process is often described as “vesting.” Vesting involves some tricky concepts and issues, including payment of taxes on the ownership interest as it “vests” and valuing the company to determine the proper amount of taxes due. Do not make promises about allowing employees (or others) to earn ownership interests over time without understanding the complexity and costs. This is a topic that particularly requires expert advice.

### 3) **Capital Contributions**

To start your new business, the owners will need to invest money in the company for a variety of needs, such as salaries, computers and software, marketing, rent, etc. This investment by the owners is called “capital contributions.” You should develop a budget and determine both your short term cash requirements and your intermediate requirements (that is, the money that you will need for approximately the first year or two in business). It is often too hard to predict how much you will need in the long term. Based on your immediate and intermediate needs, you can establish the requirements for initial and additional contributions. That is, each owner will be required to provide a certain amount of money to satisfy her or his initial cash contribution. This money is provided right at the beginning, to fund your initial, start-up and early costs. Then, the agreement among the owners—typically, the shareholder agreement (for a corporation) or the operating agreement (for an LLC) will establish when and under what circumstances that the owners must provide additional contributions.

There are a variety of other matters you should consider in establishing your new company. These include the following:

- 4) **Voting on important matters, such as:**
  - a. Appointment of directors/managing member

- b. Capital contributions
  - c. Addition/removal of other shareholders/members
  - d. Incurrence of obligations exceeding agreed thresholds
  - e. Sale of all or substantially all of assets
  - f. The wind-up, termination or dissolution of your company
- 5) **Management of your new business, including:**
- a. Responsibility for day-to-day management
  - b. Managing member (if LLC) and officers for corporation
  - c. Time and effort covenants
  - d. Non-solicitation
  - e. Non-disclosure
  - f. Non-compete
- 6) **Other economic matters, such as:**
- a. Draws
  - b. Distributions
  - c. Profit/loss allocation
  - d. Loans/repayment
- 7) **Restrictions on transfer of stock or membership interests**
- 8) **Obligation of company to repurchase shareholder/member interest**
- 9) **Rights of company to repurchase shareholder/member interest in the following events:**
- a. Involuntary transfer
  - b. Termination of employment (by employee; by employer)

- c. Death
  - d. Disability
  - e. Other
- 10) **Terms of company repurchase**
- a. First right of refusal
  - b. Notice
  - c. Price
    - (i) Basis for determination of price (e.g., appraisal, etc.)
    - (ii) Price before vesting
    - (iii) Price after vesting
  - d. Payment terms
  - e. Closing
- 11) **Liquidation/Dissolution**
- 12) **Additional Information**
- a. Principal Office
  - b. Resident Agent

After you consider these issues, you will want to document your solutions—how you, and your co-owners, if you are not the sole owner—want to address the solution to each of these issues. In a corporation, these solutions are usually documented in the Shareholder Agreement and, to a lesser extent, the By-Laws of the corporation. With an LLC, these solutions are described in the Operating Agreement.

All of these and so many other topics can be critical to the launching and ultimate success of your new venture. Garson Law LLC will be happy to explore these topics and related issues with you.