BUSINESS LAW BASICS FOR NON-BUSINESS LAW ATTORNEYS

Course Name: **Business Law Basics for Non-Business Law Attorneys**

Course Syllabus: This course will provide attorneys who do not regularly practice business law matters with a basic understanding of the common business law issues

Course Benefits: Will help non-business law attorneys to recognize basic issues and pitfalls when representing business owners in non-business matters such as divorce or litigation

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COURSE OUTLINE

1. **STATE CORPORATION COMMISSION WEBSITE (https://cis.scc.virginia.gov)** [5 Minutes]

   A. **Available Entity Information**

      (1) Corporation – Search by name of entity, registered agent, or a principle

      (2) Limited Liability Company – Can only search for name of entity & registered agent

   B. Uniform Commercial Code Financing Statement/Tax Liens

   C. **Online Options**

      (1) **Establishing Entity**

      (2) **Change Registered Agent**

      (3) **File Fictitious Name** – No local filing now required for fictitious name certificate

      (4) **Certificate of Fact/Good Standing** – Can get a Certificate of Good Standing for a corporation that confirms the entity has paid required fees and filed all required Annual Reports to date. For an LLC, can only obtain a Certificate of Fact that only confirms existence and that all required fees have been paid.

2. CHOICE OF ENTITY & TAXATION [20 Minutes]

   A. Why an Entity of Any Kind?

      (1) Liability Protection – Corporations, limited liability companies, limited liability partnerships, and limited partnerships all offer some level of liability protection. Most recent vehicle is the limited liability company.

(2) **Capital raising** – Preferred entity for venture capital is corporation due to standardized statutes nationally.

B. <u>Options:</u>

(1) **Corporation** [https://law.lis.virginia.gov/vacode/title13.1/chapter9/]

(a) Advantages

(i) Capital solicitation

(ii) Limited personal liability

(iii) Near universal body of law

(b) Disadvantages

(i) Annual formalities for shareholder & Director meetings

(ii) Need separate Redemption/Shareholder Agreement vs an LLC

(iii) Officer/Director information is public

(2) **Limited Liability Company** [https://law.lis.virginia.gov/vacode/title13.1/chapter12/]

(a) Advantages

(i) Can create and forget without annual meeting requirements

(ii) Limited personal liability

(iii) Operating Agreement covers both Bylaws/Redemption issues

(iv) Membership is private and not tracked by state organizations

(v) Can elect to be taxed as a Corporation despite being an LLC

(b) Disadvantages

(i) Relatively new in legal history so not as preferred for high liability risk industries

(ii) Cumbersome if have lots of owners

(3) **Partnerships** [https://law.lis.virginia.gov/vacode/title50/chapter2.2/]

(a) Advantages

(i) Easy to start

(b) Disadvantages

(i) No liability protection

(ii) Often do not have written Partnership Agreements

C. <u>Taxation of Entities:</u>

(1) **Obtaining a new Tax/Employer Identification Form**

(a) Complete & File IRS Form S-4

(b) Online Link: https://www.irs.gov/businesses/small-businesses-self-employed/apply-for-an-employer-identification-number-ein-online

(2) **Partnership Taxation (IRS Form 1065)**

(a) Each owner receives a Form K-1

(b) Self-Employment tax must be paid if actively work the business as an owner

(3) **Subchapter S Election for Small Businesses (IRS Form 1120-S)**

(a) File IRS Form 8832 & IRS Form 2553

(b) Each owner receives a Form K-1

(c) If a small business has employees receiving payroll checks regularly, most CPAs prefer Sub-S election due to the benefits for owner to not have to pay employment taxes on all of income

(4) **Subchapter C Election for Larger Businesses (IRS Form 1120-S)**

D. **Common Pitfalls:**

(1) **Not having base shareholder/operating agreements** – Individuals will set up on State website, but not create other organizational documents, which could void the limited liability protections

(2) **Using "form" shareholder/operating agreements** – Each business with multiple owners have different expectations many issues, and rarely will a "form" Shareholder or Redemption Agreement fit any business without some customization. Need to address what happens in event of disability, death, desire to leave, termination of employment, etc., as well as governance issues such as Director/Officer roles for each owner.

3. **BUSINESS TAXATION BASICS** [10 Minutes]

A. **What is "Basis"?**

(1) *What you pay for an asset* – Purchase price and closing costs incurred to buy an asset and make it useful to the business

(2) *What you "add" to an asset* – Capital additions such as roof, new flooring, etc. are treated as additions to cost where ordinary maintenance of property do not add to basis; however, expenses for ordinary maintenance can be deducted from the business income to lower income tax consequences.

B. **Long-Term Capital Gains vs Ordinary Income Rates**

(1) *15% Federal, Plus Virginia state of 6%* (Link: https://www.irs.gov/taxtopics/tc409)

(2) *Ordinary Income Rates* (Exhibit 1)

C. **Depreciation & Accelerated Depreciation** (Link: https://www.irs.gov/publications/p946)

(1) *Residential rental real estate 27.5 Years*

(2) *Non-Residential real estate 39 Years*

(3) *Recapture* – When property is sold, the depreciation that has been claimed is "recaptured" by paying the taxes on that part

D. **Goodwill**

(1) *What is it?* The established reputation of a business regarded as a quantifiable asset and it arises from having the name in use, and a history of service to a community.

(2) *Deducted over 15 years* – (Link: https://www.irs.gov/pub/irs-drop/rr-04-49.pdf)

4. **BUY/SALE OF BUSINESS** [20 Minutes]

A. **Valuing a Business:**

(1) *Using Valuation companies*

(a) National Association of Certified Valuation Analysts (https://www.nacva.com)

(b) AICPA Certification (https://www.aicpa-cima.com/membership/landing/credentials?tab-1=1)

(c) Certified Public Accountants

(2) *Stream of Income vs Hard Assets* – Manufacturing business will have both, whereas many service-based businesses have little hard assets. Valuation is always a combination of those value of the hard assets plus a factor for the stream of income that business is able to generate from what it does

B. **Equity Purchase:**

(1) *Advantages*

(a) Easy compared to asset purchase as all of the "old" company governance documents still apply unless updated/changed with new equity owners

(b) Favorable tax treatment for seller as most all of "gain" is taxable as Capital Gain rates rather that ordinary income

(c) Allows for seamless assumption of valuable supply or sale contracts that the prior ownership may have negotiated

(d) If no internal prohibition on transfers among owners, allows for easy transfer of minority interests

(2) *Disadvantages*

(a) Assumption of all past liabilities & tax reportings, or failures to even file required reports

(b) No ability to re-start depreciation of business equipment

(c) Due diligence needs to be intensive to find hidden problems in tax filings and in contracts already in place

(d) Usually means that all equity holders must agree unless governing documents have “drag-along” or “tag-along” language

(i) Majority owners can legally “drag” non-majority owners along with them and force the minority owners to accept the sale terms, or,

(ii) Minority owners can force the majority to take them along through the sale even if the majority would prefer not to have the others sell

C. **<u>Asset Purchase:</u>**

(1) *Advantages*

(a) Favorable tax treatment for buyer in that equipment depreciation is restarted

(b) Liabilities are known by buyer as they likely just set up a new entity for the venture

(c) Can sometimes be done without 100% of equity holders agreeing as most governing documents only require between 50% and 75% of equity holder’s approval rather than 100%

(2) *Disadvantages*

(a) More expensive when one ignores the due diligence costs required by an equity purchase

(b) More unfavorable tax consequences for seller if not carefully structured. Seller wants assets classified in ways to allow capital gains treatment (15% Fed rate) versus classified in categories that require the higher, ordinary income rates (up to 37% Fed)

5. **QUESTIONS/ANSWERS** [5 Minutes]