STRATEGIES. SOLUTIONS. SUCCESS.

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CIESLA & CIESLA, P.C.

ATTORNEYS AT LAW

For Your Business

Choosing the Best Ownership Structure

The right structure — corporation, LLC, partnership or sole proprietorship — has a lot to do with who will own your business and what its activities will be.

When you start a business, you must choose an ownership structure for it — for example, whether it will be a sole proprietorship, partnership, corporation or limited liability company (LLC).

There is no one choice that fits every business; your job is to pick the form that best meets your needs. This article introduces several of the most important factors involved in picking the right legal structure for your business, including:

- The potential risks and liabilities of your business
- The formalities and expenses involved in establishing and maintaining the various business structures
- Your income tax situation, and your investment needs

Risks and Liabilities

In large part, the best ownership structure for your business depends on the type of services or products it will provide. If your business will engage in risky activities — for example, trading stocks or repairing roofs — you will almost surely want to obtain liability insurance and form a business entity that provides personal liability protection, which shields your personal assets from business debts and claims. This means setting up a corporation or a limited liability company (LLC).

Formalities and Expenses

Sole proprietorships and partnerships are easy to set up. You do not have to file any special forms or pay any fees to start your business. Plus, they don't require you to follow any special operating rules.

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Consider This

Are your company's corporate books in compliance with applicable law? At CIESLA & CIESLA, P.C., we can help your company review and update corporate books and records.

Contact one of our attorneys today.

Lending and Secured Transactions

Consumers and businesses routinely call on banks to lend them funds with which to purchase real estate, automobiles, equipment, and other assets.

Banks are typically happy to lend the funds so long as they believe they are adequately protected in the event of default. This protection is achieved through the borrower's execution of a promissory note in favor of the bank, and the borrower's granting the bank a security interest in collateral.

Where a borrower grants a bank a security interest in real estate, the security interest is referred to as a mortgage.

Where a borrower grants a bank a security interest in personal property, the security interest is referred to as collateral. For example, when a consumer purchases an automobile with purchase money loaned to the consumer by a bank, the bank will normally insist that the automobile be put up as collateral.

Pursuant to its resulting security interest in the automobile, the bank can take possession of the automobile in the event the borrower defaults on the loan.

The bank can then sell the automobile to offset all or part of its loss, and pursue the borrower for any deficiency.

Another common type of secured transaction in the small business context involves working capital. A small business owner will normally meet with his or her bank to discuss the current and anticipated financial needs of the business and to request a working capital loan.

The better prepared the borrower is to respond to the lender's questions concerning business conditions and the anticipated use of the loan proceeds, the more

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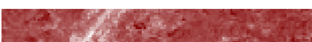

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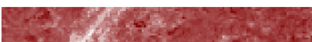

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Dissolution of Your Business

Businesses faced with persistent disagreement, negative business results, or simple disinterest may dissolve according to state law. Most states provide a variety of dissolution forms for different types of business interests. The proper procedure depends on the time and reason for the dissolution. In some instances, laws may prevent dissolution, and businesses must seek other solutions.

Dissolution before commencement of business involves a simple procedure that dissolves a new business before it opens its doors. The incorporators or the original board of directors can file a notice of dissolution to end the business before it even begins.

Dissolution by shareholder consent occurs when all shareholders agree to wrap up a business. Many states allow this type of procedure as long as a plan is made to protect creditor interests.

Voluntary dissolution means that the board of directors approves the dissolution and a specified portion of the shareholders votes for the action. The applicable law may require a simple majority of the shareholders, or a larger percentage.

Involuntary dissolution may occur when dissension and deadlock persist and no buy-out agreement can be reached. Shareholders can bring a dissolution petition to court for a judicial decree dissolving the company. The petitioner must show that legal grounds exist to dissolve the business, such as illegal, oppressive, or fraudulent action by the board; threatened or actual irreparable harm to the business; detriment to the shareholders; or misapplication or waste of corporate resources. Involuntary dissolution also may occur without judicial action by order of the secretary of state or other state official if the corporation fails to pay taxes, or file reports, or follow other statutory requirements.

States may not allow dissolution if the action is unfair to minority shareholders. If majority shareholders freeze out the minority interests from the dissolution decision, courts may strike down the action. Legal standards on this issue vary widely from state to state.

After the dissolution decision is made, state law may require a filing of notice of intent to dissolve, and may mandate a period for settlement of corporate affairs. Creditors must receive notice of the impending action so that they may press their outstanding claims prior to the close of business. After any wind-up period and satisfaction of creditor and tax obligations, the company files final articles of dissolution with the state. Some states allow for an expedited procedure requiring only the final articles.

Legally, the corporation

may continue for a specified period to deal with pre-dissolution claims. Creditors with unsatisfied debts, customers injured by defective products, or employees with residual disputes may bring actions against the legal shell of the corporation during this time. All claims must be made before statutory time limits run out, so parties with disputes against dissolved businesses should seek legal assistance immediately.

For more information regarding the dissolution of a business contact one of our attorneys.

Lending and Secured Transactions *(Continued)*

likely the borrower is to obtain the loan on favorable terms. If the bank's lending requirements are met, the bank will lend funds to the business contingent on the business granting the bank a security interest in either specified assets or all of the assets of the business (a "blanket security interest"). The security interest entitles the bank to take possession of the encumbered assets in the event of the borrower's default under the terms of the loan.

The Uniform Commercial Code governs secured transactions. The code requires that the parties execute a financing statement, which explicitly grants the lender a security interest in the collateral. The lender must then "perfect" the security interest by filing the financing statement with a state government office. This filing constitutes public notice of the lender's right to the collateral in the event of the borrower's default. By virtue of this filing, the lender has priority over other creditors who do not have a security interest in the collateral or who subsequently file financing statements. A potential problem can arise when a borrower sells a financed asset without using the sales proceeds to pay off the bank loan. The question arises whether the lender has a security interest in the sales proceeds. The code resolves this question in favor of lenders by taking the position that no reference to proceeds is necessary in the security agreement. Unless otherwise agreed, a security agreement gives the secured party the right to the proceeds. Similarly, a security agreement can provide that "after-acquired property" purchased with the proceeds of a sale is subject to the security interest.

“A potential problem can arise when a borrower sells a financed asset without using the sales proceeds to pay off the bank loan.”

Choosing the Best Ownership Structure *(Continued)*

LLCs and corporations, on the other hand, are almost always more expensive to create and more difficult to maintain.

To form an LLC or corporation, you must file a document with the state and pay a fee, which ranges from about $200 to $800, depending on the state where you form your business. In addition, owners of corporations and LLCs must elect officers (usually, a president, vice president and secretary) to run the company, and they must keep records of important business decisions and follow other formalities.

Business owners who are starting out on a shoestring budget often care most about spending as little money as possible on the legal structure of their business. For them, it can make the most sense to form the simplest type of business — a sole proprietorship (for one-owner businesses) or a partnership (for businesses with more than one owner). Unless yours will be a particularly risky business, the limited personal liability provided by an LLC or a corporation may not be worth the cost and paperwork involved with creating and running one.

Income Taxes

When it comes to taxes, sole proprietorships, partnerships and LLCs come out about even. These three business types are "pass-through" tax entities, which means that all of the profits and losses pass through the business to the owners, who report their share of the profits (or deduct their share of the losses) on their personal income tax returns. Therefore, sole proprietors, partners and LLC owners can count on about the same amount of tax complexity, paperwork and costs.

One thing to bear in mind is that owners of these unincorporated businesses pay income taxes on *all* net profits of the business, regardless of how much they actually take out of the business each year. Even if all of the profits are kept in the business checking account to meet upcoming business expenses, the owners must report their share of these profits as income on their tax returns.

Unlike other business owners, the owners of a corporation do not report their shares of corporate profits on their personal tax returns. The owners pay taxes only on profits paid out to them in the form of salaries, bonuses and dividends.

The corporation itself pays taxes, at special corporate tax rates, on any profits that aren't deductible — that is, profits that are left in the company from year to year (called "retained earnings") and dividends (portions of profits that corporations sometimes pay out to shareholders in return for their investments).

This separate level of taxation adds a layer of complexity to filing and paying taxes, but it can be a benefit to some businesses.

Not only do owners of a corporation avoid paying personal income taxes on profits they do not receive, but because federal corporate income tax rates on the first $75,000 of corporate income are lower than the federal individual income tax rates on that same amount of personal income, a corporation and its owners may actually pay fewer overall taxes than owners of unincorporated businesses.

Investment Needs

Corporations — unlike other types of business structures — provide a built-in stock structure that makes it easier to attract investment capital, including the possibility of raising public capital by making a public offering of shares. In addition, this stock structure allows businesses in the Internet and other hot technology industries to attract and retain key employees by issuing employee stock options.

But for businesses that do not need to issue stock options and will never "go public," forming a corporation probably is not worth the added expense. If it is limited liability that you want, an LLC provides the same protection as does a corporation, but the simplicity and flexibility offered by LLCs offer a clear advantage over corporations.

Changing Your Mind

Keep in mind that your initial choice of a business structure is not necessarily permanent. You can start out as a sole proprietorship or partnership and later, if your business grows or the risk of personal liability increases, you can convert your business to an LLC or a corporation.

For further information on how best to structure ownership for your company, contact one of our attorneys or visit us at www.cieslaciesla.com.

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PRACTICE AREAS

- Business & Corporate Governance
- Business Contracts
- Business Formation
- Business Succession Planning
- Business Transactions
- Commercial Real Estate
- Corporate Mergers & Acquisitions
- Education Law
- Employment Practices
- Estate Planning
- Executive Asset Protection
- Hospice & Health Care Compliance
- Liquor Licensing
- Real Estate Closings
- Securities

Speaking Engagements

The attorneys at CIESLA & CIESLA, P.C. also take part in speaking engagements. If you need a speaker for a meeting or conference regarding the above areas of law call one of our attorneys at 847-412-1988 or email us at mciesla@cclegal.net.

This newsletter and the articles herein should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only. Contact our attorneys for advice on any legal matter.

Wage & Hour Laws

“The mere fact that an employee is paid a salary… does not mean that the FLSA does not apply.”

The Fair Labor Standards Act of 1938 (FLSA) governs the method and rate of pay to be given to virtually all employees in the workforce, including those who are members of unions. An employer is required to comply with the FLSA if it is covered by the act on either an enterprise or individual basis.

Under the FLSA, a covered employer is required to pay a minimum wage regardless of whether the employee is paid hourly, by the job, by piece, by incentive or by any other basis. The mere fact that an employee is paid a salary, or is crowned with an impressive title, does not mean that the FLSA does not apply.

If state law requires a higher minimum wage than the FLSA wage, the state law minimum wage must be paid. The FLSA also requires that all covered employees, unless they are categorized as exempt, receive overtime pay for hours worked in excess of forty hours per workweek at a rate not to fall below one-and-a-half times their regular rate of pay. The regular rate of pay for an employee under the FLSA is defined as all remuneration, including production bonuses, shift differentials, and attendance bonuses, divided by the total hours of work in the workweek. The following employees are considered exempt from the overtime pay requirement, so long as their salaries meet the statutory minimum:

- Professionals with specialized training for their job
- Employees whose work directly relates to the business/management operations of the employer
- Employees who work with computers (if their hourly rate meets the statutory minimum amount)
- Employees who work in outside sales
- Employees who are engaged in creative or artistic endeavors

The Wage and Hour Division of the Department of Labor enforces the FLSA. Investigators, as authorized representatives of that division, have the authority to conduct investigations and gather data on wages and other employment conditions or practices, in order to monitor compliance with the FLSA.

For more information regarding the FLSA and wage and hour laws call one of our attorneys or log onto www.cieslaciesla.com.

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