

# For The Life of Your Business:

From Business Plan to Exit Strategy

## **Is Your Company Properly Structured?**

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Santa Barbara County



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# About Your Presenter...

## *Attorney & SCORE Volunteer*



### Areas of Practice:

- **Business & Employment**
  - Risk Management
  - Entity Formation
  - Investment Structures
  - Leasing & Real Estate
  - Employment
  - Contracts
  - Business Succession Planning
  - Conflict Resolution
- **Estate Planning and Probate**
  - Wealth Transfer
  - Tax Strategies
  - Trust & Probate
  - Administration
  - Planning for Parents of Minors



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# BEFORE WE GET STARTED...



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# Agenda

## I. Entity Formation:

1. Who
2. Why
3. What
4. When
5. Where

## II. Protecting Your Intellectual Property



# Who?

You

Partners

Members/Shareholders

Outside Investors



# Why?

- Risk and Liability
- Organization
- Outside Investments
- Tax
- Exit Strategies



# Business Formations

## Typical Business Entities

- Sole Proprietorship
- Partnership / Joint Venture / Limited Partnership
- Limited Liability Partnership (LLP)
- Limited Liability Company (LLC)
- Corporation (“S” or “C” Corporation; Non-Profit)



# Sole Proprietorship

- Operate in your own name or as a DBA
- No corporate formalities/government filings except business license or DBA
- Individual tax liability – self-employment taxes (Social Security and Medicare)
- Individual risk liability
- Can have employees



# Partnerships

## General Partnership

- Business relationship of two or more individuals or entities
- Joint and full individual liability
- No entity taxes — individual tax liability
- Self-employment taxes
- Partnership agreement critical
- Terminates on withdrawal or death of a partner

# Partnerships



## Limited Partnerships

- General partner(s) and various classes of limited partners
- General partner(s) — full individual liability; have full management control
- Limited partners — no liability, except capital contribution
- Pass through taxation - self-employment taxes
- Minimum entity tax (\$800)
- Partnership agreement critical
- Terminates on withdrawal or death of a partner



# Limited Liability Companies

- No individual liability (like a corporation)
- Pass through taxation or can elect to be treated as a corp (S or C)
- Flexible financing arrangement (like a partnership)
- Multiple classes of ownership and profits
- Informal (no annual meetings, minutes, or corporate resolutions)
- SOS filing every other year
- No ownership restrictions



# Limited Liability Companies

## Disadvantages – California Taxes

- 15.3% self-employment tax on manager owner/employee's net income
  - (12.4% Social Security plus 2.9% Medicare)
- Entity franchise tax on gross revenues (\$800 to \$11,790 yearly)
- Termination when one member leaves
- Cannot involve a license

## Possible Uses

- Real estate
- Not expecting high revenues quickly

# Corporations



## S Corporation – Usual Small Business Entity

- No individual liability
- Pass-through tax (like partnership)
- Self-employment taxes on salary only
- Fringe benefits (medical) deductible to shareholders owning more than 2%
- Easy exit strategy: buy-out

# S Corps, cont.



## Disadvantages

- Inflexible financing arrangement
- Formalities (Annual meetings, minutes, corporate resolutions; SOS filing every year)
- One class of stock, 100 shareholders, citizen and residency
- \$800 minimum tax or 1.5% on profit in California



# Qualified Business Income

## Tax Cuts and Jobs Act of 2017

- Deduction equal to 20% of "qualified business income" earned from a business for pass through entities
- QBI = revenue the business was designed to generate, less applicable expenses

# Qualified Business Income, cont.



- Limited to the LESSER OF:
  - 20% of qualified business income, or
  - 50% of the total W-2 wages paid by the business (if between \$315k – \$415k married, \$157,500 – \$207,500 single)
- Does not apply to “Specified Service” businesses (including lawyers, accountants, doctors, consultants, and financial advisors)



# C Corporations

- No individual liability
- Multiple classes of stock
- Vehicle of choice for venture funds

## Disadvantages

- Formality in organization and operation
- Double Taxation
- Taxed at corporate level:
- California — 8.84%
- Federal — 21% (Tax Cuts and Jobs Act of 2017)
- Taxed at individual shareholder level
- Difficult exit strategy – tax implications

# Non-Profit Entities



- Nonprofit Association – labor unions, social clubs, lodges, political parties
  - Charitable Trusts – created for religious, charitable, scientific, literary, educational, or other purposes under IRC 170(c)(2)
  - Non-Profit Corporations (typically 501(c)(3)s)
    - Attorney General oversight
  - Social Purpose Corporation\*
  - Benefit Corporation\*
- \* Not tax exempt

# Fiduciary Duties



Partners

Manager

Directors

Majority shareholders

Duty of Loyalty (no self dealing, usurping corporate opportunities)

Duty of Care



# Where to Form an Entity

## Where to Incorporate

- California or Delaware?
- Other state

## Remember

- CA Corporation Code provisions still apply
- Taxed in California
- Dual state filing requirements
- Investors will determine the future
- Litigation strategy – diversity jurisdiction



# When to Form an Entity

## Considerations

- Organization
  - Who Are the Founders? Roles?
- Concept / Product / Service Developed
- Risks / Exposures
- Investment
- Taxes
- Intellectual Property
- Confidentiality
- Cost



# When to Form an Entity, cont.

## Formation Should Occur Early When

- Business Plan Developed
- Founders are Identified
- Before:
  - Any Outside Investment
  - Sales of Service or Product
  - Employees hired
- Properly Formed - Avoid Piercing the Corporate Veil
- Cost and Process Time
- Foundations are Important



# Getting Started

## How to Start

- Business Plan
  - Purpose / Goals Linked to Timeline
- Team
  - Attorney
    - Knowledgeable
    - Trusted advisor relationship
    - Cost
  - Accountants
    - Projections / Financial Strategy / Tax Returns



# Naming Your Entity

## Search name

- Secretary of State
- Google
- USPTO (trademark registry)

Reserve name with SOS (if not incorporating soon)

Obtain website domain name



# Protecting Your Intellectual Property

BUSINESS NAME	DOMAIN NAME
<ul style="list-style-type: none"><li>• Name of entity</li><li>• Registered with SOS or DBA filing</li><li>• First in Use</li></ul>	<ul style="list-style-type: none"><li>• Register it through a domain register</li><li>• Need more than a domain name to qualify for a trademark</li></ul>

# Protecting Your Intellectual Property



PATENTS	TRADEMARKS	COPYRIGHTS
<ul style="list-style-type: none"><li>• Patents protect new, useful, and non-obvious inventions (ideas)</li><li>• Right to exclude others from making, using, offering for sale, selling or importing the invention</li></ul>	<ul style="list-style-type: none"><li>• Brand identifier</li><li>• To prevent consumer confusion</li><li>• Words, designs, a logo, or a combination</li></ul>	<ul style="list-style-type: none"><li>• Protection for the original works of authorship</li><li>• Typically artistic and literary works, like songs and movies and books</li></ul>



# Patent Primer

## What is an invention?

A *new, useful, non-obvious* idea for a device, structure, process, machinery, business method, etc.

## What is a patent?

The right to exclude others from *making, using, importing, or selling* within the US for 20 years from application filing

## What are the different kinds of patent applications?

Utility, Design, and Plant Patents

Provisional v. Non-provisional



# Patent Primer

## What are “Claims”?

Defines specifically the protected subject matter

## When should you file a patent application?

No more than one year after you have publicly used or sold the invention. (“One Year Bar”)

First to Invent changed to First Inventor to File (March 2013)

## Where can you research patents?

USPTO.gov

# Trademark Primer



## TM versus ®:

™ indicates use in commerce of a good, <sup>SM</sup> of a service

® mark has registered before USPTO

## What is the function of trademarks?

- To identify and distinguish;
- To show that all goods/services with the mark originate from one source; and
- To provide quality assurance and consistency

# Trademark Primer



## Do you have to register your mark?

No. You just have to *use* your mark in commerce to establish rights.

## What are the *benefits* of Federal Trademark Registration?

- Constructive **notice** nationwide of the trademark owner's claim;
- Evidence of **ownership**;
- Federal court jurisdiction;
- Registration can be used as a basis for obtaining registration in foreign countries; and
- Registration may be filed with U.S. Customs Service to prevent importation of infringing foreign goods.

# Copyright Primer



## What is a Copyright?

- It is an original work of authorship fixed in a tangible medium
  - Poetry, novels, movies and songs
  - Also blueprints, technical drawings, product brochures, advertising, computer software, and architecture
- Your work is under copyright protection the moment it is created and fixed in a tangible form that is perceptible either directly or with the aid of a machine or device

## Who owns the copyright? Work for hire?

# Protecting Your IP & Trade Secrets



## The Nondisclosure Agreement (NDA)

- Acknowledge that Third Party Will receive trade secret/confidential information
- Identify this information “with particularity”
- Obligate Third Party to not possess, use or disclose the information in any unauthorized manner

## Who Should Sign?

- Investors
- Visitors
- Independent Contractors, Etc...

# Thank you for your time.



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