# Business Corporations & LLCs

## Skilled Massachusetts Business Law Attorney

As an entrepreneur looking to start a business, you are moving one step closer to realizing a dream. It is important to have all of your i's dotted and t's crossed before becoming fully operational. At the law firm of Mark J. Guay, P.C., we can help you make certain you are on the path to success by creating strategic legal systems throughout your business formation and beyond. Contact our business law attorney to discuss your goals.

## How can a Business Attorney help you?

Have you have ever tried to hire a Business Attorney and found out they weren’t really a “business” attorney? Have you shopped around looking for the right fit and just didn’t seem to click with the Attorneys you are talked to? What is a capitalization plan & why do I need one for my business?

Here are some important questions to ask to help you decide if there is a good fit:

- What kind of connections will I need to succeed in business? If I become a client will you help me get connected to these people?
- What are you looking for in a client relationship? What will I need to bring to the table in order to have a successful relationship with your firm? How do we know that your firm is a good fit?
- Can you tell me what kind of "exposure areas" you see in my business or industry? How does your firm help with "Risk Management"?
- Can you tell me the difference between "organizing" an entity and "operating" it? How can we do both correctly?
- How soon should I worry about Intellectual Property? Can you help us manage our Intellectual Property?
- How do taxes apply to my business from both an accounting perspective and from a legal perspective?
- How do I know if my business model is sustainable and transferable? Are there areas we should watch out for, or any concerns we should have? What kind of consulting do you offer in this area?
- How do we build a corporate culture? Do you offer consulting, advice and execution to help us improve our current culture?
- How do we address organizational functionality?

You need to build a relationship with a firm that is concerned about the success of your business. How? By helping you make regular progress and improvements on your business. We want to make sure you are asking the hard questions. You need a firm that has the expertise in business law, and also one that will help you implement your ideas and solutions.

## Business Formation

A company can operate under many different entities depending upon its needs, tax incentives and personal liability to owners. These operational forms can include such risk management entities as corporations, or Limited Liability Companies (LLC). Choosing an entity that best suits your goals and establishing a strong start-up system can be complex. Our goal is to help you navigate the process as smoothly as possible.

## Phase I - Risk Management

First, we will evaluate your operational entity options and review various risk management and tax issues involved in a small business start-up. We will also discuss key contract law concepts and their relationship to your risk management strategies. Your biggest risk is that you don't know what you don't know, so we spend time educating you on various key strategies.

## Phase II - Organization

Next, you will be given a questionnaire to complete which provides us with information about your proposed business. We will then supply you with an organizational outline and a cost-estimation for your business formation process. If a corporation, the outline will include the information concerning development of a Board of Directors, shareholder meetings, bylaws and other necessary documents. It may also contain data pertaining to the following:

- Tax consequences of stock types
- Corporate taxes
- Organizational expenses
- Debt/equity characterization
- Buy-sell agreements

If you choose a limited liability company, we will prepare and review with you the Operating Agreement which is the governing document crucial to managing your entity properly. We will also work with you on your charter documents and related tax issues with your accountant.

## Phase III – Corporate Operation And Governance

Many small companies have what is referred to as their OPERATIONAL PLANS. As the definition states, this is how they “operate” their daily business working IN their company as a W-2 employee. Congratulations, that is a good start but it is not a good finish unless you just wanted to create a job for yourself and others? If not then you need to work ON your company. In fact, working ON your business is just as important because you want more than income, you also want profit and equity (“ROE”) which are the results of ownership work - not just employee work.

The biggest mistake you will make this year is equating working IN your company with working ON your company, according to the well-known book author Michael Gerber entitled, “The E-Myth Revisited.” He states that P&Ls and tax data are static because they look backwards - not forward. Ownership work gets beyond Income only and into Profit and Equity (ROE) strategy. And isn't that why you went into business in the first place - to go beyond income? You simply can't be effective long term until you integrate what you do IN with what you do ON your company. So stepping back and doing some critical decision-making is the key. But that raises the question of who does it and how to do it? So let's answer the first question of who is responsible for governance? In a corporation the Board of Directors sole job is to “govern” the company. So HOW does a Board “govern”? The answer lies first in defining the difference between management and governance. Most people have a good idea of what management is so I will restrict my remarks to governance issues. Some top 10 good governance director practices are the following:

- Strategic Planning addressing sustainability, competitive advantage, etc.
- Corporate performance and valuation planning
- Risk and Crisis Oversight [e.g., data security]
- Oversight of company core principles, ethics and culture
- Oversight of human resources [e.g., management] and recruitment of directors
- Financial Oversight [e.g., review of P&L, Balance Sheet and Budgets]
- Oversight of sustainability matters and stakeholder relations
- Create/approve company-wide policies and procedures
- Manage Board of Directors education, meeting processes, committees, etc., and
- Oversight of corporate ESG.

I recommend that these key governance issues be addressed by your Directors. Managers manage the company. Directors govern (direct) managers. They are both important but very different. The Massachusetts Business Corporation Act ("MBCA"), Section 8.30(a) defines the standard a director must comply with. It states, in pertinent part, that a director must, generally speaking, act (i) in good faith, (ii) with the care that a person in a like position would reasonably believe appropriate under similar circumstances; and (iii) in a manner the director reasonably believes to be in the best interest of the corporation. So how does a director comply with this legal standard? The comment section to Section 8.3 provides advice by stating: "The process by which a director informs himself will vary but the duty of care requires every director to take steps to become informed about the background facts and circumstances before taking action on the matter at hand. [However], a director may rely on information, opinions, reports, and statements prepared or presented by others as set forth in Section 8.30(b)."

So who are these "others" referred to? Section 8.30(b) lists the individuals and groups (the "others") that a Director may rely on. Generally speaking, they are as follows:

- Corporate officers or employees whom the Director reasonably believes to be reliable and competent with respect to the information, opinions, reports or statements presented,

- professional advisors as to matters within their professional competence, and

- a committee of the Board, where the Director is not a member, if the Director reasonably believes the committee merits confidence.

But there are two major caveats. The first is that "a Director so relying must be without knowledge concerning the matter in question that would cause his reliance to be unwarranted." The second is that "…in order to rely on a report, statement, opinion, or other matter, the Director must have read the report or statement in question, or have taken other steps to become familiar with its contents."

In summation, Directors must become actively engaged in the governance of the company or else they should resign. Ask yourself "is your Board living up to the legal standards of the laws in your state"? If not, your company is at an increased risk. Haven't started yet to address the governance systems of your company? I suggest you do so at your next annual board or directors meeting if not sooner before a third party discovers you are running a high risk business - and that high risk is the result of your decision-making.

# An Overview of Limited Liability Companies

How to overcome some of the most common problems business owners run into when forming a Limited Liability Company (LLC).

## Business Risks Overview

Did you know that over 50% of new businesses fail within the first five years? Most business owners do not have the vast knowledge needed to run a business alone. Many times crucial mistakes are made which can cause the business to fail.

So what are the key things successful business owners are doing to succeed? The most important thing they are doing is creating relationships that help them in the areas where they are not an expert. Relationships are critical in order to build a solid foundation in areas such as accounting, bookkeeping, sales, marketing, IT services or legal and risk management services.

Your greatest risk is that you don't know what you don't know. This is why building a business team can be the difference in growing or closing your doors. And, doing it right the first time can save you two, three, or more times the original cost of hiring a professional.

Setting up your business properly when incorporating or forming an LLC takes experience and knowledge to ensure it is done right. Hiring a professional business attorney to walk you through the process can help save time, money and give you peace of mind.

## Top 5 questions to think about or ask your advisor.

1. What is an LLC, and what are it's pro & cons?
2. How do LLCs manage risk?
3. How are LLCs organized?
4. How are LLCs managed?
5. How does capitalization affect an LLC?

- ## What is an LLC?

1. A limited liability company ["LLC"] is a business structure that provides limited liability for participants and permits pass through treatment for tax purposes per M.G.L 156C. LLC's can have one or more owners, can be manager or member managed and can, in many cases, elect to be taxed as a disregarded entity [single member only], partnership or a corporation both at the federal and state level.

2. LLC's can elect to be taxed as a disregarded entity [single member only], partnership or a corporation depending on it's structure. By comparison, S Corporations can have only 100 shareholders, no corporations or partnerships [but some trusts] as a shareholder, no nonresident aliens as a shareholder, no multiple class of stock, no REITS, etc.

3. LLC's statutes have Mandatory Provisions and Default Provisions.

   Default Provision apply if the Certificate of Organization or
   Operating Agreement do not address a given legal issue.
   So it is important to insert these LLC optional provisions.

4. LLC's statutes are state specific so you need to refer to your state laws for detailed information on what applies to you. The references herein are general only for discussion with your attorney and specific to the laws of the Commonwealth of Massachusetts.

5. Some pros and cons of an LLC are as follows:

| Pros | Cons |
|---|---|
| • Limited Liability | • Tax Limitations |
| • Flexible Management Structure | • Statute of Frauds applies to oral OAs |
| • Can Exist Indefinitely | • Some states have entity tax on LLC |
| • Multiple Tax Classifications | • Some states limit certain activities |
| • Can have multiple members | • Single Member LLCs have more risk |

## • Risk

1. INSIDE-OUT

Inside liability is a legal claim that arose inside the business. Liability is determined by the LLC statute and the Operating Agreement and veil-piercing case law. It is similar to corporate shareholder liability and limited to your investment.

2. OUTSIDE-IN

Outside Liability is a legal claim outside the LLC between a non LLC creditor and an LLC member individually. It is enforced by a Charging Order.

3. EXCEPTIONS

No entity protection for operational liability such as lack of authority, torts, improper distribution, crime, false documents, fraud, etc.

## • Management

1. THE LLC ACT: It allows flexibility regarding authority and management [§24]. Management is vested in all members unless stated otherwise in Operating Agreement ["OA"]. Some exceptions are as follows:

   (i) VOTING: Majority Rule unless in OA. Meetings can be formal or informal depending on procedures.

   (ii) MANAGEMENT: By committee, board, or various managers. Titles such as President, Chairman, Director, and General Manager can be used.

   (iii) DUTY OF CARE OF MANAGERS AND DEADLOCKS: Rule: No standard of care in LLC Act itself (unlike MBCA 8.30 and 8.42) (a) Withdrawal with no penalty, (b) dissolve, (c) Buy-Out, or (d) Mediation/Arbitration.

   (iv) INDEMNIFICATION: LLC Act is flexible provided that Member/ Manager acted in good faith and reasonably believes it is in best interest of the LLC. No mandatory provisions in LLC Act so insert same.

2. SOME OPERATING AGREEMENT KEY ISSUES: Member Authority; Withdrawal of Members; Compensation; Contributions; Capital Accounts; Allocation of Profits and Losses; Distributions; Management; Meetings & Voting; Rights, Duties & Obligations of Members; Dissolution; Taxation; Dispute Resolution; Record Keeping; Transfers & Assignments.

- **Capitalization**

Some of the common types of capital contributions are as follows:

(i) Initial

(ii) Additional

(iii) Interest on Contribution

(iv) Default on Contribution

(v) Return of Contribution

(vi) Maintenance of Capital Account

(vii) Loans to LLC

[7/21]