

TOP 10 Corporate Law Tips

When preparing to launch a company, there are ten important corporate law tips that founders should consider to help minimize risk, maximize profits and comply with the law.

1) Determine the Best Legal Entity

It is essential for startups to form a legal entity to conduct their business and so founders and other owners can shield themselves from personal and tax liability. The law provides a number of options. The most common include a corporation, limited liability company (LLC), and limited partnership. Founders should consult with their attorneys and accountants to determine which type of entity fits their business best based on taxes, flexibility and other considerations. Some examples of available legal entities and taxable election options are listed below:

- A **C-Corporation** is treated as a separate legal entity for tax purposes, and is taxed at the corporate level and then at the individual level following any dividends. Essentially, it creates double taxation.
- An **S-Corporation** is not taxed at the corporate level. Shareholders pay tax on their pro rata share of the entity's income regardless of whether or not it was distributed. There are certain restrictions in an S-Corporation including the number of shareholders, no foreign shareholders, etc.
- A **limited liability company (LLC)** has the tax advantages of an S-Corporation without many of the restrictions. The LLC will not be taxed at the corporate level and the owners will only be taxed based on their share of profits. An LLC also has the option to elect to be taxed like a corporation. LLCs can also later be converted to corporations if the owners wish to do so.

2) Select the State of Incorporation

Once a type of business entity is selected for the startup, the founder must determine the preferable state of incorporation (e.g. Florida, Delaware, etc.). There are several factors to consider in making this decision, including:

- The State where the company will have its principal place of business
- Favorable corporate, tax and other types of laws (e.g. Delaware vs. Florida)
- The sophistication and preference of investors
- Taxes and filing fees (e.g. Delaware franchise tax and Florida's annual reporting obligations)

If an entity is incorporated in a state other than where it conducts business, it must nevertheless register to do business in each of the states where it conducts business.

3) Establish Sound Corporate Governance

Formation Document: The Articles of Incorporation for a corporation or Articles of Organization for an LLC are the constituting document of the entity and must be filed with the appropriate state agency for the business to be legally recognized. The requirements vary from state to state, but generally require the following:

- Name of Corporation or LLC and its business address
- Name and address of Registered Agent and Office
- Intended Purpose of Entity and the duration of the anticipated duration of the entity (e.g. perpetual or expressly limited)
- Number of Authorized Shares or membership units
- Name and Signature of Incorporator(s) or agent filing the charter document

Bylaws: The bylaws are a set of rules and procedures that govern the formalities of a corporation and are binding on the shareholders and the board of directors. Bylaws include information on shareholder meetings, voting requirements, voting procedures, election and duties of directors and corporate officers, etc. An Operating Agreement (discussed below) serves a similar function for a limited liability company but refers to members and managers rather than shareholders and directors.

Minutes and Consents: Significant or material decisions or actions taken by the Board of Directors or Shareholders of a corporation or the members or managers of an LLC should be documented in meeting minutes or signed written consents to memorialize authorized actions and to establish a comprehensive corporate governance record.

Stock Certificates or Membership Certificates: Although not necessary, it is advisable to prepare and issue stock certificates or membership certificates that reflect the ownership interest of shareholders or members in a company. The certificates provide evidence of ownership and are later used to evidence the transfer of ownership from one shareholder or member to another.

4) Prepare a Shareholders or Operating Agreement

In any entity with more than one owner, it is essential to have a Shareholders or Operating Agreement to outline the rights and obligations shareholders or members. These agreements establish owner's rights and responsibilities, and typically include restrictions on transfer of ownership, voting rights, voting requirements for certain major decisions, noncompetition and confidentiality agreements, etc. By ensuring that each of the potential ownership issues is agreed upon at the time the company is established, founders and owners will avoid spending significant time, money and disruption to the business in the future.

5) Determine the Right Ownership Structure

If a founder is bringing in other investors, he/she must document the amount of shares/ownership each investor will own. This will help to prevent potential disputes, especially once the business is operating and successful. Establishing an appropriate valuation for the company, the amount of investment required by an owner or investor, and determining the appropriate ownership structure is critical. A founder must also determine the type of stock or equity and the value per share or membership unit to be issued (e.g. Common Stock, Preferred Stock, etc.). Examples include:

- Common Stock: The holder has all voting rights and no preference to creditors or other stockholders
- Preferred Stock: The holder has limited voting rights, fixed dividends, and preference over common stockholders upon sale or liquidation

6) Comply with Securities Laws

Any offering of stock or other equity interest in a company must comply with federal and state securities laws. Generally, in order to offer and sell stocks or other securities, the company must register the offering with the Securities Exchange Commission (SEC) or rely on a private offering exemption. To satisfy an exemption, the offering must meet certain criteria, which may include an offering that:

- Is Limited to a Small Number of Investors
- Is Made Only to Accredited Investors
- Imposes Resale Restrictions on Securities
- Is Conducted with a Prospectus, and/or
- Complies with Certain Filing Requirements

Failure to comply with applicable securities laws in an offering may enable investors to exercise rescission rights, unwind the investment transaction and demand a full return of their investment. Moreover, officers and directors may be held criminally liable and subject to significant fines and penalties, including imprisonment.

7) Prepare Clear and Concise Contracts

The owner(s) of a company must direct management to prepare contracts that clearly establish the obligations and responsibilities of the parties they do business with, including its customers, vendors/suppliers, contractors, etc. Drafting clear and concise contracts and agreements is crucial to protect the company's rights when conducting business transactions. These contracts may cover a wide range of transactions or relationships, including sales, distribution, supply, executive or other employment, consulting, etc. Online businesses should also ensure that they have appropriate Terms of Use and Privacy Policies on their websites, which are essentially agreements with the website user. Without a valid contract, companies may be unable to legally enforce their rights in a particular transaction or may find themselves engaged in costly litigation that otherwise might have been avoided.

8) Protect Intellectual Property

Depending on your business, intellectual property may be one of the most valuable assets the company owns. Failure to protect it early and correctly can result in a significant loss of value and goodwill. It may also cost a considerable amount of time and money to establish and protect it in the future. Whether it's an idea, a symbol, word, logo, or software, etc., it's important that founders take the necessary legal and practical steps to ensure this valuable asset is legally protected. As such, founders or management should work with an experienced attorney to conduct an audit of the company's intellectual property rights, including patents, trademarks, and copyrights. Once the audit is conducted, the company must make the necessary filings to ensure the initial and continued protection of its intellectual property rights.

9) Comply with Labor and Employment Laws

Violations of labor and employment laws can pose serious risks to startup businesses, including significant fines and penalties. Prior to hiring employees and/or consultants, consult with an attorney to ensure the company complies with applicable labor and employment laws, including the Fair Labor Standards Act (FLSA), Employment Retirement Income Security Act (ERISA), Consolidated Omnibus Budget Reconciliation Act (COBRA), Americans with Disabilities Act (ADA), Family and Medical Leave Act (FMLA), Occupational Safety and Health Act (OSHA). It is also important to create a comprehensive employee manual that includes important company policies and to provide adequate training for your employees to help ensure compliance with these laws.

10) Avoid Piercing the Corporate Veil

While the corporate legal entity is designed to shield shareholders from personal liability, courts have pierced the “corporate veil” and found personal liability where shareholders failed to observe sound corporate governance and related processes. The following is a list of actions to take to protect the shareholders from such consequences:

- Observe legal formalities, including conducting and documenting board and shareholder meetings.
- Maintain adequate corporate records.
- Avoid commingling corporate and personal funds.
- Segregate corporate and personal assets.
- Reserve adequate capital for the corporation.
- Maintain an arms-length relationship with affiliates

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