

Relationships. Resources. Results.

*Legal Needs for Emerging Growth
Companies*

Presented to UF Small Business Mentoring
Program

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About Me

- Former Navy submariner (nuclear electronics technician)
– served from May 1994 – May 2000
- Attended University of Florida for Bachelors of Science in Nuclear Engineering, Juris Doctor (law degree), and Masters of Biomedical Engineering
- Practice includes IP, Corporate and Private Securities
Adjunct Professor UF Law (Entrepreneur Practicum)



U.S. SUBMARINE SERVICE





Learning Objectives

- Choosing Corporate Form
 - Corporation vs. LLC
 - Florida vs. Delaware
 - Discuss tax implications of each corporate form
- Importance of Intellectual Property



What is a corporation?

A legal entity that is separate and distinct from its owners. Corporations enjoy most of the rights and responsibilities that an individual possesses; that is, a corporation has the right to enter into contracts, loan and borrow money, sue and be sued, hire employees, own assets and pay taxes.

Why Incorporate?

- Unlimited life
- Entity to hold assets owned by several people (IP)
- Transferability of shares
 - rights and privileges are represented by the shares of stock they hold
- Ability to raise investment capital.
- Shareholder is not legally liable for the actions of the corporation
 - Only risk is the assets of the company and the value of the stock in the company
 - Owners are protected from personal liability from company debts and obligations (sometimes)
- Certain tax incentives (particularly for LLC or Subchapter S)



Downside?

- Is there additional record keeping as compared to sole proprietor?
 - annual reports, annual franchise taxes
 - separate tax returns (sometimes)
 - separate corporate tax (sometimes)
- Require annual meetings and require owners and directors to observe certain formalities
- more expensive to set up than partnerships and sole proprietorships

Corporation Types

- Limited Liability Company (LLC)
- Corporations
 - For Profit Corporation
 - Not for Profit Corporation
 - Benefit Corporations



NOTE: “S” and “C” Corporations are an IRS election, and available to EACH entity type.

BUSINESS ENTITY COMPARISON	sole proprietorship	general partnership	limited partnership	limited liability partnership	c corporation	s corporation	limited liability company
formation	No state filing required.	Agreement between two or more parties. No state filing required.	State filing required.	State filing required. In California the use of LLP is limited to accountants & lawyers.	State filing required.	State filing required.	State filing required.
duration of existence	Dissolved if entity ceases doing business or upon death of the sole proprietor.	Dissolves upon death or withdrawal of a partner, unless safeguards are specified in a partnership agreement.	Perpetual	Dependent on the requirements imposed by the state of formation.	Perpetual	Perpetual	Dependent on the requirements imposed by the state of formation.
liability	Sole proprietor has unlimited liability.	Partners have unlimited liability.	At least one general partner has unlimited liability.	Partners are not typically responsible for the debts of the LLP.	Shareholders are typically not responsible for the debts of the corporation.	Shareholders are typically not responsible for the debts of the corporation.	Members are not typically responsible for the debts of the LLC.
operational requirements	Relatively few legal requirements.	Relatively few legal requirements.	Some formal requirements, but less formal than corporations.	Delaware, Georgia, Pennsylvania, Texas, and Virginia require an LLP to carry insurance or an escrow account to cover liabilities.	Board of directors, annual meetings, and annual reporting.	Board of directors, annual meetings, and annual reporting.	Some formal requirements, but less formal than corporations.
management	Sole proprietor has full control of management and operations.	Typically each partner has an equal voice, unless otherwise arranged.	Limited partners are excluded from management unless they serve on the board of directors.	All partners have the right to manage the business directly.	Managed by directors who are elected by shareholders.	Managed by directors who are elected by s shareholders.	Members have an operating agreement that outlines management.
taxation	Not a taxable entity. Sole proprietor pays all taxes.	Not a taxable entity. Each partner pays tax on his/her share of income and can deduct losses against other sources of income.	Files taxes as a separate entity, must meet certain criteria to avoid being taxed as a corporation.	Files taxes as a separate entity, must meet certain criteria to avoid being taxed as a corporation.	Taxed at the entity level. If dividends are distributed to shareholders, dividends are also taxed at the individual level.	No tax at the entity level. Income/loss is passed through to shareholders.	If properly structured there is no tax at the entity level. Income/loss is passed through to members.
pass-through income/loss	Yes	Yes	Yes, if requirements are fulfilled	Yes, if requirements are fulfilled	No	Yes	Yes
double taxation	No	No	No	No	Yes, if income distributed to shareholders as dividends.	No	No
cost of creation	None	None	State filing fee required.	State filing fee required.	State filing fee required.	State filing fee required.	State filing fee required.
raising capital	Often difficult unless individual contributes funds.	Contributions can be made from partners, and more partners can be added.	Contributions can be made from partners, and more partners can be added.	Contributions can be made from partners, and more partners can be added.	Shares of stock are sold to raise capital.	Shares of stock are sold to raise capital.	Possible to sell interests, though subject to operating agreement restrictions.
transferability of interest	No	No	Yes, pending approval of other limited partners and the general partners.	Possible, dependent on operating agreement restrictions.	Shares of stock are easily transferred.	Yes, observing IRS regulations on who can own stock.	Possible, dependent on operating agreement restrictions.

Limited Liability Corporation (LLC)

- No limitations on who may participate (citizenship)
- Cannot be a non-profit organization
- Profits and losses pass-through personal income
 - All profits subject to self-employment tax (FICA & Medicare)
 - 15.3% until \$118,500 then only 2.9% (Medicare only)
- May be taxed as a single member, partnership, subchapter “S” corporation, subchapter “C” corporation.
 - Single Member LLC is a “disregarded entity”
 - not separate from its owner for tax purposes
 - Advantageous if the business is to buy or sell property’
 - Multi-member LLC automatically treated as “partnership”

Corporation (Profit, Non-Profit, Benefit)

- Certain limitations on who may participate (S corp)
- Corporate formalities (Board resolutions, minutes)
- May be taxed as a subchapter “S” corporation or subchapter “C” corporation
 - Automatically treated as “C” Corporation
 - Must file form 2553 to be treated as a “S” Corporation
 - Tax treatment depends on “C” or “S” election.

Corporation (Profit, Non-Profit, Benefit)

- “For profit” = maximize the value of the company’s stock
- “Not for Profit” = maximize expenditures
 - NPO may receive tax exempt status (form 1023 federal) and
 - sales tax exempt (DR-5 state)
 - Need 501(c)(3) dissolution language in Article of Incorporation
- NPO and Benefit are formed for a public good
- Benefit is still a “for profit” corporation, but decisions of the Board may be to achieve a public good rather than to enhance the value of the stock

Subchapter “S” Corporation

- Be a domestic corporation
- Have only allowable shareholders
 - May be individuals, certain trusts, and estates and
 - May not be partnerships, corporations or non-resident alien shareholders
- Have no more than 100 shareholders
- Have only one class of stock
- Not be an ineligible corporation (i.e. certain financial institutions, insurance companies, and domestic international sales corporations).
- Election must be made within 75 days of formation or within 75 days beginning of tax year (file form 2553)

Why “S” Corporation

- S Corporation
 - FICA, Medicare, Income Tax paid on Wages
 - Income Tax only on “distributions” to shareholders
 - Wages must be “reasonable”
 - Services of shareholder (wages)
 - Services of non-shareholder employees (distributions)
 - Capital and equipment (distributions)
 - May rely on other factors to determine reasonable
 - What comparable businesses pay for similar services
 - The use of a formula to determine compensation
 - General guidance from IRS
 - Should be a delicate balance between wages and distributions
 - 50/50 preferred (talk to your CPA)

Why “S” Corporation

- Recall all income from LLC passes through personal return (partnership or single member
 - FICA and Medicare on all income
 - Income tax on all income
- C Corporation
 - Corporation pays FICA and Medicare (withholds half from employee wages)
 - **Corporate Tax on remaining income**
 - Payments (dividends) to shareholders subject to self-employment tax (corporate tax + tax on dividends = double taxation)

	C-Corp	LLC (sole)	LLC(partner)	S Corp
Income	\$100k	\$100k	\$100k	\$100k
Salary	\$50k	N/A	N/A	\$50k
Corporate (\$7500 + 25%)	\$7,500	\$0	\$0	\$0
Distribution	\$42,500	\$100k	\$100k	\$50k
FICA (12.4%)	\$6,200	\$12,400	\$12,400	\$6,200
Medicare (2.9%)	\$1,450	\$2,900	\$2,900	\$1,450
Income	\$907+\$4,174+\$11,988	\$907+\$4,174+\$11,950	\$907+\$4,174+\$11,950	\$907+\$4,174+\$13,113+\$840
Payout	\$67,781	\$67,669	\$67,669	\$73,316
Notes	1040 Income	Schedule C,E	Form 1065, K-1	Form 2253, k-1

BOCA RATON | FORT LAUDERDALE | GAINESVILLE | JACKSONVILLE | KEY WEST
LAKELAND | MELBOURNE | MIAMI | NAPLES | ORLANDO | TALLAHASSEE | TAMPA

Which is right for You



LLC

- Do not want to be a non-profit
- Single person company without revenue (or will not have revenue within taxable year); or
- Single person company with revenue derived from property; or
- Multiple person company without revenue (or will not have revenue within taxable year); or
- Multiple person company with or without revenue and ownership percentages, capital contributions, and services are something different from equal (so will want to have variable distribution of profits and losses); or
- Any company who does not meet “S” corp requirements and would like to minimize tax consequences;

AND

- Plan to distribute all income

“S” Corporation

- Single person company with revenue (or will have revenue within taxable year) that is not derived from property; or
- Multiple person company with revenue (or will have revenue within taxable year) where ownership percentages (capital contribution and sweat) is undisputed
 - (50/50 holders, 50/50 capital contribution, 50/50 share of the work)

AND

- Each shareholder is a US Resident (and less than 100 shareholders)
- Not likely to sell preferred shares of stock (institutional investors) within taxable year.
- Plan to distribute all income

“C” Corporation

- If goal is to raise capital, reinvest capital, grow fast, grant equity incentives, and ultimately be acquired or go public
- Usually once you have institutional investors
 - Usually want preferred shares of stock/equity
 - Prefer formalities required for corporations
 - Some VC’s are tax-exempt and cannot have active income (all income from LLC is active income)
 - Qualified Small Business Stock – 1202 (expired December 31, 2013) & 1045
 - Shareholders do not need to worry about being taxed on company income that was not distributed
 - LLC and Scorp - If company doesn’t distribute all income, then shareholders are liable for the tax without receiving the income

Delaware VS. Florida

- Advantages of Delaware
 - The Delaware Court of Chancery focuses solely on business law and uses judges instead of juries.
 - Delaware has long established corporate law and case history
- Similar Advantages
 - No personal income tax for non-residents
 - No state corporate tax if not doing business in the state
 - Annual Franchise Tax
- Disadvantages of Delaware
 - Must be registered in both states
 - 2 annual franchise taxes (\$400 DE, \$150 FL)
 - Must Pay Registered Agent (at least \$100 annually)
 - DE Franchise tax can get out of control based on assets

When in Delaware

- Investors demand it
- Potentially if moving company into more than one state
- Desire to go public

OR

- If goal is to raise capital, reinvest capital, grow fast, grant equity incentives, and ultimately be acquired or go public

AND

- Have a high level of attention to detail or an awesome attorney

Patents

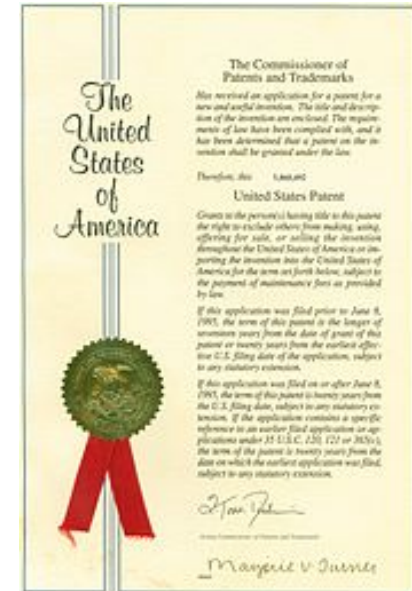
- Involves rights granted to Inventor(s) for an idea conceived and reduced to practice.
 - Protected by national laws in which it is granted for the inventor to secure a monopoly for a limited period of time.

▶ Protection derived from US Constitution

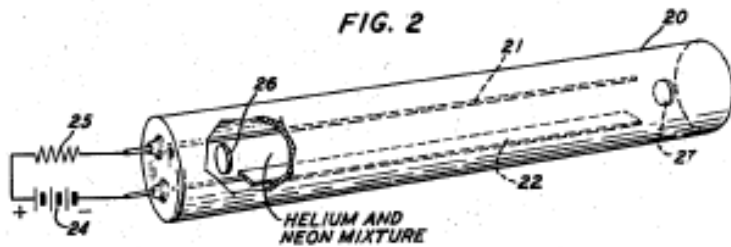
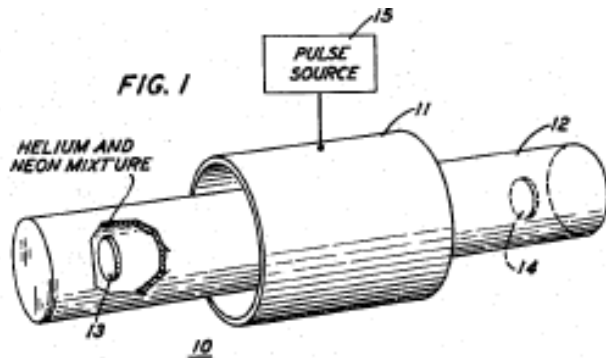
- Article 1 Section 8

▶ Protection principals similar to real property.

- Trespass and Infringement are synonymous



New and Useful



Subject Matter

PROCESS

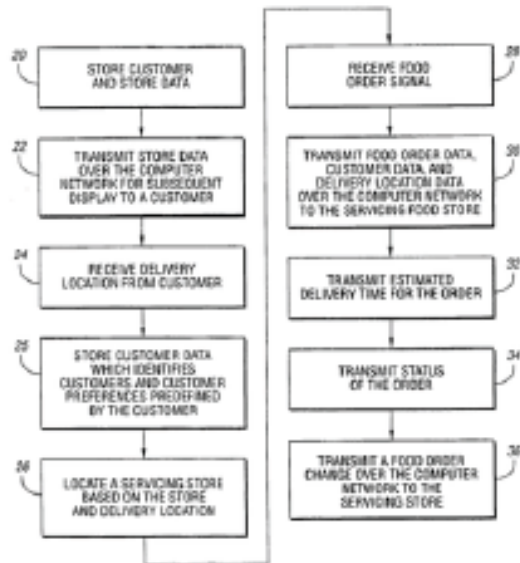
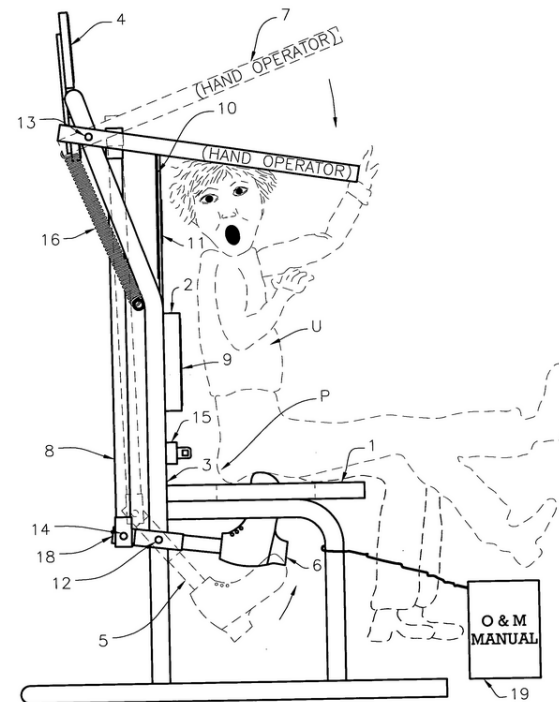


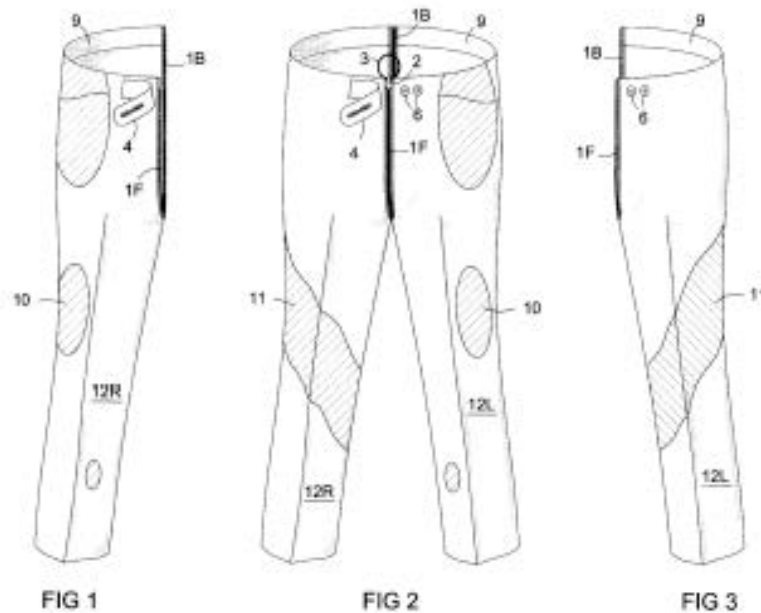
Fig. 2

MACHINE



Subject Matter

MANUFACTURE



COMPOSITION OF MATTER

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2  aatctgaacataaaaaacaacaattacgaaccaaacctatttaaaactccaTaaaggas
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Trademarks/Service Marks/Cert. Marks

Trademarks

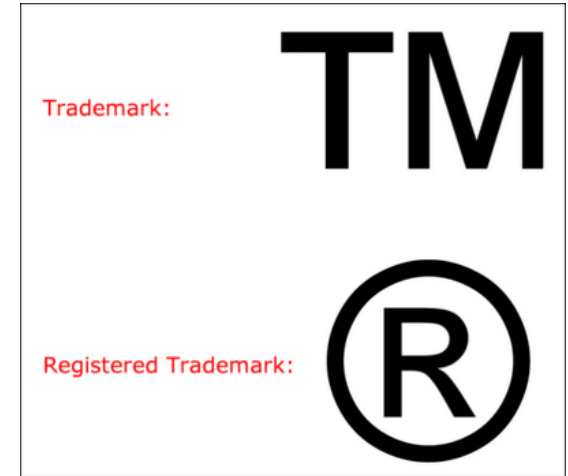


Certification Marks

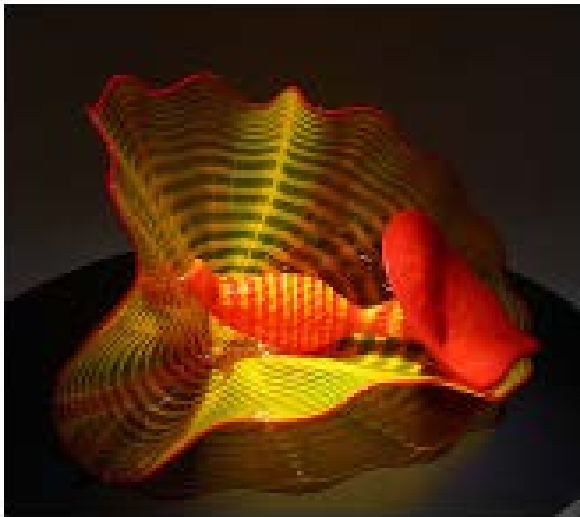


Trademarks

- A trademark includes any word, name, symbol, device, or any combination, used or intended to be used to identify and distinguish the goods/services of one seller or provider from those of others, and to indicate the source of the goods/services
 - ▶ Focuses on “likelihood of confusion” and “unfair competition”
 - ▶ Coke, Pepsi, Apple, Microsoft are all well-known trademarks
 - ▶ Use of internet does not provide common law protection outside of geographic location



Copyright



Copyrights

- Gives a creator of an original work (books, musical score, lyrics) exclusive rights to it, for a limited time (generally life of creator plus 70 years).
- Prevents others from copying the material, giving the holder the monopoly to control copying and distributing their works.
- Registration provides for attorney fees and statutory damages
- Non-Registration attorney fees at discretion of court and must prove damages



Trade Secrets

- a formula, practice, process, design, instrument, pattern, or compilation of information
- not generally known or reasonably ascertainable
- which a business can obtain an economic advantage over competitors or customers



Why is IP important to my Business?

- Ownership Rights?
 - Employees keep ownership of anything developed unless agreement otherwise
 - Consultants and other service providers own
 - Who made your website? Advertisement? Took pictures or video of your business?
- Copyright
 - if registered then may receive statutory damages and attorney fees
- Trade Secrets
 - Must make efforts to keep as a secret

Why is IP important to my Business?

- Patents
 - Others may prevent you from practicing their invention
 - May be entitled to damages
- Trademark
 - Others may prevent you from creating consumer confusion
 - May be entitled to damages
 - Opposition/Cancellation of marks

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