Creative Vision Legal℠

Two Legal Strategies for Small Business Success

By Michael J. Thomas, Attorney & Founder

Introduction

So you've taken your business from a seed of an idea to opening day. It can seem like a long road to start your own business, and no doubt a lot of equity, both sweat and monetary, went into it. Unfortunately, a lot of small business owners overlook two key legal strategies for success because they assume they are not worth the money or they promise themselves they will take care of them once they are "up and running." To the contrary, these strategies, namely (1) forming your own LLC or incorporating and (2) trademarking a company name, should be handled up front to ensure your business is built on a solid foundation. As an added bonus, you can write these items off as start-up expenses!

Although forming an LLC or creating a corporation and clearing and registering a trademark are not free, no new business can afford to overlook these two crucial legal strategies. That's why Creative Vision Legal offers the "Small Business Legal Bundle," which includes the firm's LLC business formation package and a trademark registration package for $500 plus search report and government filing fees. For more details go to http://www.creativevisionlegal.com/getting-started.

1. PROTECT YOUR PERSONAL ASSETS: FORM AN LLC OR INCORPORATE YOUR BUSINESS

Forming your own LLC or incorporating a company are the best ways to protect your personal assets from the debts and liabilities of your business. Businesses run as sole proprietorships or partnerships expose their owners to the possibility that their personal bank accounts or real property could be used to pay a judgment if the business loses a lawsuit or incurs a debt that it can't pay. The key is to organize your new business formation as an entity distinct from yourself and <u>to run it that way</u>.

Incorporating or Forming an LLC: Which is Best? Much has been written about the pros and cons of LLCs and corporations as business formations, and most business owners wonder which is "the best." Unfortunately, the answer is "it depends," because every business is different just as every business owner is different. What may be right for one business may not be a good fit for another. However, certain overarching principles emerge when comparing the two types of business formations which can point the way to which is best for your business:

- ***Flexibility vs. Formality***
- ***Income Taxation Considerations***
- ***Limited Liability***

Flexibility vs. Formality: LLCs offer flexibility in day-to-day management as opposed to corporations, which can demand as a matter of law a high degree of formality. A limited liability company is governed by its operating agreement, a document which for the most part can be shaped to fit the managing styles of the LLC's members. In contrast, corporations by design require designated directors and officers, regular meetings and the keeping of minutes, and strict adherence to state laws governing the conduct of meetings and the implementation of corporate action.

While choosing an LLC may seem like a no-brainer to a mom-and-pop family store wishing to minimize formalities and conform management to their style of operation, a corporation might be strategically advantageous to a small tech start-up looking to go public because the necessary organizational machinery would be in place long before the anticipated IPO.

Income Taxation Considerations: LLCs allow owners the option of being taxed as a partnership or to be taxed as a corporation. Choosing taxation as a partnership results in "pass-through" tax liability in which the income, gains, losses, deductions, and credits of the LLC pass through to its members for reporting on their personal income tax returns. Business owners with more complex management structures may elect to have their LLCs taxed as corporations; under this approach some may even be able to pay themselves a salary and deduct it as an expense!

The main "knock" against choosing a corporation for business formation has always been the specter of "double taxation," which results from taxation on corporate earnings <u>and</u> taxation on profits realized by shareholders/business owners from corporate activities. However, those seeking to incorporate a business need not despair: setting up an S-corporation allows the owners to choose "pass-through" taxation like a partnership. For some, this type of business formation may be the way to go, but note that there are some restrictions for forming an S-corporation which need to be discussed with your legal and tax advisors.

Limited Liability: “Limited liability” refers to shielding a business owner’s personal assets from the debts and liabilities of the business. Both LLCs and corporations offer this protection to business owners, with some strings attached. To maintain the limited liability status of the LLC or corporation, the ownership must:

Operate the business as an entity separate from themselves: When operating an LLC or a corporation, the number one rule to maintain the entity’s limited liability status is to run the business as an entity separate from yourself. The best way to do this is to avoid commingling funds between the business and its owner(s)’ personal bank accounts.

If funds are commingled, the limited liability status of the LLC or corporation can be attacked by creditors or plaintiffs in lawsuits on the grounds that the entity is merely the “alter ego” of its owner(s). Under the “alter ego” theory, the ownership’s personal assets may be reached to satisfy debts or judgments against the entity.

File all necessary business formation documentation with the state(s) in which the business will operate: Business owners are required to file basic paperwork with the state of California’s Secretary of State (“SOS”) in order to complete a business formation as either a corporation or an LLC. The forms are similar but go by different names (“Articles of Incorporation” and “Articles of Organization” respectively). Besides the articles, a “name reservation” and a “statement of information” are two other filings necessary in a California SOS business formation. LLCs and corporations are also required to file with the California Franchise Tax Board and pay the yearly minimum franchise tax ($800/yr).

Observe all legally required formalities associated with running the LLC or corporation: Likewise, failure to observe all legally required formalities when running an LLC or corporation can result in an application of the alter ego theory. With an LLC, the legally required formalities are minimal and in most cases, the members need only observe the rules they agreed to abide by in their operating agreement. Corporations, however, have many statutorily mandated rules governing things such as director and shareholder meetings, notice requirements, and the compositions of their corporate structures.

Running your own business can be stressful enough without worrying about the possibility of your house or car being taken away to pay a business-related debt or judgment, so shielding yourself from personal liability by forming an LLC or incorporating will give you piece of mind.

2. PROTECT YOUR BUSINESS NAME: FILE A TRADEMARK

Protecting your business name is something many small businesses overlook, either because they assume the cost to trademark a company name is too expensive or that it is unnecessary. However, in the internet age, you cannot afford the lost goodwill that can occur when another business begins using the same name or one that is confusingly similar to yours.

Choosing Your Business Name: Great care should be taken when actually choosing a company name. When deciding how to name your company you should avoid names that are generic or merely descriptive (such as “Call Forwarding” for a telephone call forwarding service or “Pizza & Suds” for a restaurant offering pizza and beer).

Making Sure Your Business Name is Available: Determining the trademark availability of a business name begins with a federal business name search of USPTO records for registered trademarks the same as or similar to your name, followed by a common law trademark search reviewed by an attorney to see if another business is using your company name but has not registered it.

Filing for a Federal Trademark: After your business name has been cleared, obtaining a business name registration with the USPTO takes 6 months to a year, but once you are done filing for a trademark, you have priority over anyone who starts using the same or a similar name as yours after the filing. While relatively straightforward, there are potential pitfalls in filling out the federal trademark application that can be avoided by hiring an attorney. For example, the classes of goods or services that you intend to use your business name trademark for need to be chosen carefully and sometimes strategically depending on your short-term and long-term business plans.

For more information about business formations and the trademark registration process, go to http://www.creativevisionlegal.com/legal-services/business-formations/ or http://www.creativevisionlegal.com/legal-services/trademark-registrations/.