

# ***Business Fundamentals BootCamp*** ***Strategies for Growing Your Business***

## ***Top 20 Legal Mistakes Made by a Growing Business***

Northern Illinois University, Naperville, IL  
Supporting Strategies

May 19, 2017

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# **Who Owns the Intellectual Property**

- **Who Owns Intellectual Property to Run the Business?** Ideas co-developed with another party, are not yours to use, without permission or purchase.
- IP includes Name, Tag Lines, Trade Secrets, Lists of Customers, Employees, Investors, Vendors; Website
- **IP Developed Where?** While you were employed elsewhere? If so, employer may own it.
- **Co-developed with another** party? If so, they may partially own it. Are their legal rights assigned to you? If not, you don't own it.
- If Co-developed with current partner? Document Capital Contribution of all partners, including IP
- Protect IP going forward with NDA, NCA.

# *Noncompetes Apply?*

- Noncompete Agreement can impede business expansion, sell business, or raise capital.
  - With Former Employer, Partners in another venture, or
  - With customer or vendor. supplier, especially with a larger company client, noncompete in consulting or supplier agreement
  - Buyer of your former business.
- To what degree prohibited? Is business idea encompassed by NCA?
- Geographic scope limit? Industry Limit? Time limit? Customers?
  - 2016 IL case possibly holds: If employment <2 years, not enforceable
- Prohibits only contact of customers & employees?
- Does any other agreement, **impede expanding, your business?**
  - Distribution Agreement or Limits on one?
  - Licensing Agreement Limits
  - Lender/Bank Limitations or Restrictions?
  - Franchise Agreement
  - Regulatory Licensing
- Negotiable? Strategy to disclose & negotiate or not?

# **Convesely: Protect Your Intellectual Property**

- **Protection of IP Possible?**
  - Patentable? Business Process Patent (BPP for Software are dead)? Triggers and Filing Deadlines
  - Copyright? (Software, writing, art, video, music)
  - Nondisclosure Agreement?
- Trademark of Company Name, Tag Line, Product Name?
- Don't blow IP protection by putting ideas in public domain, before protecting ! Tradeshow, website.
- If you don't own the IP, then you don't own business idea
- Impose NDA's & Noncompetes on your Employees & Contractors: Reasonable in scope and duration
- Protect Trade Secrets Internally
- Defense of Trade Secrets Act, Prevents EEs taking ER Trade Secrets



# ***Name Selection & Search (1)***

## ***(For Biz Names, Tag Lines, Product Names, Logos)***

- Name check before business unit operated; Before use of d/b/a, product name, logo, tag line or domain name. [www.uspto.gov /trademarks/TESS](http://www.uspto.gov/trademarks/TESS).
- Common Law rule: 1st to use name in industry wins, even if not trademarked, or no entity formed.
- Use of internet and websites: We are all doing business everywhere, not just in home state. Therefore, competing for names on a national, or global, level.
- Can't use same, *or similar*, name in the *same industry*. Even homonyms, same root words, or phrases prohibited if "likelihood of name confusion" may result.
- A federal judge ordered **Houston College of Law** to change its name 10/2016, after HCL sued by **University of Houston Law Center** in trademark fight with the recently-renamed HCL.

# **Name Selection & Search <sup>(2)</sup>**

## **(For Biz Names, Tag Lines, Product Names, Logos)**

- Extensive name searches required at many levels: Google, federal trademark, state trademark, state corporate, common law unincorporated, state tax roll, county DBAs, biz directories, domains.
- Do you love your name and don't care if someone else is using it? Beware of web surveillance by trademarked 1st users, looking for "infringers"! Electronic search systems used for a fee.
- Your marketing person thinks of a name & domain name is available, does not mean name is available to you. (Trademark law controls).
- Full Formal searches may be required at some cost.
- Allow copious amounts of time and mental energy to find a good meaningful name, that is available under trademark law, for which domain name is available. Takes days or weeks; dozens of names
- [www.uspto.gov/trademarks/](http://www.uspto.gov/trademarks/). [Hand-out: "Name Search..." tools]
- Name change later is costly, embarrassing, loses brand momentum.  
Change bank account (new account?), credit cards, loans, contracts with clients, domain name, email addresses & website.

## **Business Filings & Licenses Required In Each State Doing Business**

- State Tax IDs and Qualifications in each state “Doing Business”
- State Dept. of Revenue; REG-1: IL Payroll, Sales Tax, Use Tax, Income Tax (Illinois IBT)
- Local Business License (City, Village) - 1/2 page form, \$50
- County License: Health, food, or touch people/animals
- Specialty Licenses: Building Contractor, Oil & Gas, Cooking, home health, day care, massage, dog kennel, many others
- Professional License – Illinois Dept. of Professional Regulation: Investment Adviser, Mortgage Broker, Real Estate Broker, Business Broker, CPA, Law, Architect, Medical, Nurse, Landscape Architect, Surveyor, 100s of others.
- Assumed Name DBA Filing with State
- Trademark Filings for Name and Logo, Federal and State
- State Qualifications in Other States if EE's There
- Certifications for Gov't Contracts or Corp Contracts (Optional)

# ***Owners, Shareholders, Members, Managers, Managing Members, Directors***

| <b>People</b>           | <b>Title in a Corporation</b>                           | <b>Title in an LLC</b>  | <b>Role in Either</b>   |
|-------------------------|---|---|---|
| <b>Owners</b>           | Shareholders, or Stockholders, or "Partners", or Owners | Members, or LLC Members, or LLC Interest Holders, or "Partners" or Owners   | <p>Owners Elect Board of Directors, or Managing Members, each year. The Owners can also remove Board of Directors or Managing Members.</p> <p>Owners/Shareholders/LLC Members can have meetings and vote on issues related to the ownership of the company: Add or remove owners, sell the company, merge it or dissolve it.</p>  |
| <b>Management Board</b> | Directors, or Board of Directors                        | Managing Members, or Managers, or Managing Partners, or Board of Managers, or Board of Managing Members                     | <p>Strategic Vision; Big Picture View for Company, Relationships, Strategic Alliances.</p> <p>They Elect Officers each year, and can also remove them. They can remove other Managing Members. Managing</p> <p>Decisions on issues related to the strategic vision, as well as the nuts and bolts operation, of the company: Expand or contract business, buy property, large equipment purchases, hire key employees, compensation issues, implement benefit plans, impose limits on Officers, grant signature authority, and other issues.</p> <p>They vote on the same issues on which Owners vote: Add or remove owners, sell the company, merge it or dissolve it.</p> |
| <b>Officers</b>         | <b>Officers:</b><br>President, VP, Treasurer, Secretary | Officers (if Company chooses to have them). We highly recommend using officers, at least Treasurer, and possibly secretary. | Run the Day to Day operations of the Company: Hire Employees, Purchase Goods and Services, Spend Money, Run the Business, Business Development, Sales, Marketing, Executing contracts ... all under the direction and control of the Board.   |

# **Corporate Formalities**

- Proper Entity Formation
- Ownership – Stock Ledger or LLC Ledger
- Corporate Resolutions or Operating Docs
- Keep Corporate Records Straight, Ownership and Contracts
- Operate Like a business, not a hobby
  - Implement professional documentation, processes, operations, actions
  - Act like the bigger company you want to be, not the smaller are now
  - It's Business, Not Friendship !
- Tax ID, IL Tax ID, and Business License Records Handy
- Diligent accounting records; Use QuickBooks & Take Class;
  - Separate finances business & personal; no vacation condo or college tuition to business
- Corporate Maintenance, legal, tax, make all filings.
  - File Annual Corporate Report. (Bankers, Lenders, Investors, Vendors, Business Buyers check this often! Simple step makes you look professional vs irresponsible.
  - Payroll tax, Sales & Use Tax, Income Tax Reporting
- Maintain Insurance



## **Corporate Clean Up (1)**

- Name problems: Using a “taken” name that is not available at federal level, or under common law or outside of IL
- Authorized shares too low. All authorized shares were issued. Par value too low. Thin capitalization, Share changes not reported to State.
- No Shares Issued, Wrong # of issued shares.
- No ownership % decided, no capital contributions, No Share Ledger Documents Ownership
- Wrong State of Formation; Wrong Entity Type

## **Corporate Clean Up (2)**

- No Organizing Resolutions Adopted (Company not legally operating until adopted, Agreements cannot be signed.)
- No board of Directors or board of Managers elected
- No Legal Operating Agreement or Bylaws
- No Corporate Formalities Documented, no banking or contracting authority stated.
- Contracts not in writing
- State Qualifications in Other States if EE's in state
- Document Business Processes Internally
- If your company is built on all on free work from other people, what is company worth? \$0

## **Corporate Clean Up (3)**

- Corporate Records Straight
- Tax Returns Filed (Income, Payroll, Sales, Use)
- License Handy
- Diligent Accounting Records
- Corporate Maintenance – Annual Report – Used in Due Dil.
- Maintain Insurance
- Pay People for Services - If your company is built on all on free work from other people, what is company worth? \$0

# **Avoid "Piercing the Corporate Veil"**

In litigation, suing party tries to "pierce the corporate veil", to get at your personal assets. Avoid by:

- Follow Corporate Formalities.
- Don't Mix finances between business & personal
  - Don't pay personal expenses from business checking
  - Do paycheck, loan payment or shareholder dividend
- Don't Mix finances between two businesses
  - No Check writing from one business account to pay for an expense of another.
- Sign documents & contracts in business name, with you as officer or manager.
- Two businesses? Use two business entities !
- Maintain separate actions, identity, contracts, tax returns

# **Worker Classification: Employee vs Independent Contractor (1)**

- Most 1099 Consultants should be W-2 Employees.
- Even Part Time Workers = Employees (if Sole Employer)
- IRS and IL presume Employee (even if part-time)
- Hot issue with IRS, IL Dept. Rev, and IDES.
- IRS retroactively reclassifying “independent contractors” as employees;
  - Retroactively imposing payroll tax, interest and penalties on all prior wages paid. No time limit! Severe \$ penalties
- Illinois Worker who works >10 hours per week = Employee
  - Illinois stricter than federal classifying contractors as employees, for unemployment tax, and unemployment claims
- Budget for Your Payroll Tax



## **Worker Classification (2)**

- IRS's 8 factor-test, including:
- Who has control over worker
  - Location of work, whose equipment or vehicle, dictated schedule or dress
- Who else do they work for? Other clients or just you?
- Insurance differs for EE's vs Contractors
- IP Ownership differs
  - Employee > Employer Owns the Work
  - Contractor > Contractor Owns Work Unless Stated Otherwise
- Benefits May Be Required for EEs

# **Illinois Employer Reporting** **Short Deadlines**

- Legal issues arise from hiring employees, such as Unemployment Liability
- Terminate bad employee before 30 working days if they don't work out, to avoid UE claim
  - Even Part-Timers.
- Illinois "New Hire Reporting": Employers must report all new employees, and their SS#, within 20 days of their 1st day of work. Even Part-Timers. Chasing Child Support deadbeats.

# **Employment Laws - Federal & State (1)**

- Overtime Pay Required to Administrative, Professional, executive workers < \$47K
  - Texas court halted the new Federal DOL Rule
  - Illinois New Rules for EEs<\$47K
- Minimum Wage (federal, state some cities including Chicago)
- Sexual Harassment & Discrimination are Illegal – Applies to all employers, of any size, any # of Employees
- Other laws apply only to business with >10 or >20 Employees
- Safety OSHA – Dangerous Work

## **Employment Laws - Federal & State (2)**

- Unemployment Claims - Employer can appeal Claims made by employees
- Employee Manual for Procedures
- Write-up & Document Problem Employees
- Figure into your customer pricing:
  - Payroll taxes
  - Minimum Wage
  - Overtime Pay
- Federal and State employer laws – Two layers

# **Issuing Shares – Dos and Don'ts**

- Don't Issue More Shares Than Authorized in Articles (Corp)
- Don't use tiny par value (use \$1 per share or interest. If raising \$ from investors, maybe use .10 share)
- Stock Ledger or LLC Ledger – Document Shares Issued,
  - Ledger is the “Corporate Share Check Book”
  - Especially if Not Issuing Certificates
- Share Certificates: Paperless is Now Fine.
  - “uncertificated Shares” go paperless and no issues with lost certs
  - Collect Certificates when redeeming shares
- Report Share Changes to Secretary of State
- Corporate Resolutions: Authorize Shares, Signers, Officers, Transactions, Spending, Voting, Property Purchase
  - Corporate Formalities
  - Sign Resolutions or Shares not Validly issued.



# **Shareholder/Partner or Not ?**

## **Equity Dos & Don'ts (1)**

- Don't Make Just Anyone a Partner or Shareholder:
- You can fire an Officer, Manager or Employee. You can Remove a Director. But you cannot fire or remove a partner without buying them out at current value.
- Equity only to your closest partners inside the business, only if trust intimately.
- Don't give away equity as monopoly money when you don't have real money (consultants, employees, partners)
- Don't give or sell equity to consultants, employees, partners, investors, without understanding long-term consequences, and securities law compliance items.
- Don't confuse Business Partner vs Alliance Partner;
  - Alliance Partners share profit/losses on a transaction.
  - Business Partners Share P & L in the entire business

# **Shareholder / Partner or Not ?**

## **(Equity Do's & Don'ts) (2)**

- Partnership or Share ownership is a Marriage. Splitting Up Requires Divorce (+“alimony” or “estate division”).
- Jointly in business with person if no entity formed = Partnership by default. Partnership law applies, not corporate or LLC law. General Partner = Personal liability
- Should person be a partner? Or a paid employee instead? Split work and skills, ideas, delegation
- Shareholder agreement between you and business partners: Discuss Arrangement Among Partners
  - Email partner discussion points & agreement among partners
  - Provide dissolution mechanism and Vote
- Don't make spouse partner.
  - Unless works significantly in the business. More than admin.
  - Use a Will for Estate Planning, not shares.
  - Fraud to add spouse to gain “Women-Owned Biz” Status

# **LLC Agreement or Shareholder Agreement Among Owners**

Business Pre-Nup between owners:

- Who invested What? How much?
- What % percentage of ownership each?
- What Percentage Vote to pass an Issue? SH&DR
- Profit & Loss Allocation vs. Ownership Allocation
- Title, Role, Responsibilities
- Dissolution Provisions – Who gets what marbles?
- Indemnification of Management
- Buy Sell Provisions – Death or Disability
- Departure of a Shareholder? Noncompete?

# *Changes in Ownership*

- Adding or Removing Partners Requires:
  - Legal Docs (signed by owners & managers)
  - Corporate and Tax Filings, with State and IRS
- Corporate Split-Up requires a transaction (usually w/ \$.)
- Before Changes, keep ducks in order: Ownership, Corporate Records, Legal, Loans Accounting, Tax, Processes Documented, Good Management, Limit Debt.
- May need valuation by valuation expert
- Realistic expectations on price for redemption or sale & timing
- Selling the Business: Plan years in advance

# **Fiduciary Duty & Conflicts of Interest (1)**

- **Who** is Bound by Fiduciary Duty: Officer, Director, Managing Member (In some cases, "Control Person")
- **Duty To Whom**: Shareholders, partners, the business
- **What** is Fiduciary Duty? "Highest legal and ethical duty of one party to another". In Corporate Sense:
  - Duty of care, good faith, loyalty; honesty, ethics; Reasonable care of assets; act in shareholders' best interest (never to director's benefit); Act as trustee for shareholders
- **Duties**: No conflicts of interest between director and shareholders or company (or fully disclose them).
- Do not work in competing business, or own one.
- Earn no profit/advantage/leverage from fiduciary position.
- Minority Shareholder freeze out: Fiduciary must deal in good faith.
- Board views all possible options & chooses best for company & its owners, in current and future business.



# **Fiduciary Duty & Conflicts** <sup>(2)</sup>

- **Multiple Businesses:** Fiduciary Duty to all companies of which you are officer, director, manager. Balance conflict among other entities you own. Partner's Conflicts Can Become Your Conflicts
- **Disclose Conflicts** to those who would be affected by them, would scrutinize them, or would later object to them when disclosed. Some conflicts addressed by disclosure and agreement; some not.
- **Conflicts in other Business** Relationships – Referral Fees and profit sharing, must be disclosed: Client relationships; referrals of business; Finders Fees,
- **Liability:** Legally liable for breach of fiduciary duty, pay back profits +
- **Business Judgement Rule** – Defense to breach of duty

# **Due Diligence**

## **Failures Can Risk Your Company -**

### **Conduct It on Others**

- Conduct Due Diligence on Clients, Co-Owners, Alliance Partners, Suppliers, Lenders, Investors.
- You Are Judged by the Company You keep
- Bad actors prey on small or new businesses, or woman-owned or minority-owned businesses. Crooks, scammers, deadbeats, toxic clients. If THEY found YOU, instead of YOU finding THEM, be careful, they hunt you. If too good to be true it is.
- Avoid the Toxic Client/Customer —
  - No money /doesn't pay, in a rush for services, high maintenance, unprepared, energy-sucking, makes their lack of planning or error into your problem; trust your gut, walk away

# ***Due Diligence Others Conduct on You***

- Your Clean Background is Key:
  - Principals: Shareholders/Owners, Directors, Officers
  - The entity itself, and
  - Prior business (Can run, but can't hide, by forming new entity)
- Due Diligence will be conducted by: Lenders, Vendors, Industry Alliance Partners, Investors, Business Partners
  - Background checks, criminal, regulatory, tax liens, bankruptcy, licensure, Facebook, LinkedIn, Google.
  - Credit check (Sometimes)
  - Legal history (litigation, regulatory Issues, licenses)
- Business Reputation like Virginty, once gone, its gone.

# **Business Contracts (1)**

- Agreements must be **in writing** to be enforceable
  - **Email is a writing** (Can be contract if both parties state they agree and contract elements all present.)
  - Digital Signatures are 100% legal
- **Sign the Contract!** All Parties ! No signature = No Contract
- Elements of Contract: Capacity, Offer, Acceptance, Consideration Exchanged, Legal Purpose, Meeting of Minds, Mutual Assent.
- Expensive & Risky to retroactively paper oral agreements, so paper them when they are agreed to.
- Smoke out bad deals: Documenting can kill deal, but best to know before you perform under the contract: Oral discussion of terms can bring up deal-killing discussion points. Know disconnect **before** you start acting under the contract.
- Read, and understand, every word. The section or word you skip will come back to bite you. No such things as “boiler plate”, unless you want someone else’s deal without your terms. \*

# ***Business Contracts (2)***

- “Reps & Warranties”. Make sure:
  - You can now perform provisions stated (on signing date, and later).
  - The facts you are “repping” are true (i.e. insurance requirement)
- Understand Breach of K and Reps; Indemnification, and consequences of failure to perform, or of untrue reps.
- Get Insurance to cover the Indemnification Clause.
- Contract Items are many Business Points, fewer are Legal points
- **Business person – Write your business points or deal terms for lawyer to draft into structure agreement.**
  - Business person need not write full provisions
- What could go wrong from business standpoint? Think through what keeps you up at night.
- When to involve counsel
- Realistic Expectations as to Cost and Timing
- Plain English Writing
- Contract Assignable if business may be sold? Services? [Handout]



# **Website Legal Notices, Activity Limits**

- **Don't collect credit card info on your site, unless you have a significant cyber-security, ecommerce, system in place. Use payment services like PayPal, Stripe, or others.**
- States terms & conditions of use of site, including disclaimers for:
  - Warranties for website information,
  - Responsibility for information on other linked websites,
  - Endorsement of the products/info offered on other websites,
  - Liability for damages resulting from use of website or info contained on the site, or any other site to which it links.
- Privacy Policy may be required on your website
- Know rules for allowing kids under 13: COPPA  
<http://www.ftc.gov/privacy/coppafaqs.shtm>.
- Prohibited activities (offensive or illegal content).
- Monitoring and data collection - Limitations.



# **Websites, Social Media, CrossLinks**

## **Website Developers Don't Always Know These:**

- Must own the intellectual property on your site, or permission to use it.
- Credit the writer or source.
- Statements about your company on your own site or own social media must be true! If not = fraud.
- Consider privacy rights of others before using FB, LinkedIn, Twitter posts about your work.
- If your website links to another site: Don't imply or state relationship, unless there is one.
- Don't post a trademark on your site, even as a link, without permission. No "confusingly similar" marks.
- Responsible to readers for accuracy of info on site to which you link (maybe).

# ***Email & Internet Advertising Rules***

The CAN-SPAM Act establishes requirements for e-mailed commercial messages. Penalties for violations. Summary of the rules:

- ***Illegal to spam people*** who don't want your emails, even your newsletters ! Ask permission of recipient before sending.
- ***Unsubscribe Link or Method is Required.*** Message must include a clear explanation of opt out procedure, or provide working "unsubscribe" link. ***Honor opt-out requests promptly.***
- ***Don't use false or misleading header information.*** Your "From," "To," "Reply-To," and routing information - including the originating domain name and email address - must be accurate. Must identify the message sender or initiator.
- ***Don't use deceptive subject lines.*** The subject line must accurately reflect the content of the message.
- ***Tell recipients where you're located.*** Your message should include your street address or a post office box.

# **Use of Technology is Key to Business**

- Use Technology to Operate, Manage & Promote Business
  - Budget For it: Expensive, but Costs Decreasing
  - Apps that do Everything
- Efficiency of tech makes better management, processes, documentation.
- Document Business Processes Internally, to systemize the business, and pull “out of the heads” of the founders to build business value.
- If website is “under construction”, at least have an “info page”, with “Name, Address, Location, Phone, Email, and “What we do”
- May need a website firm, IT firm, SEO Firm
- Use Email-able brochures so colleagues can easily refer you to others.
- Don't use AOL, Hotmail, Yahoo email address for business – It says “I'm too cheap to use a real email provider” or shows lack of email experience. Gmail is more sophisticated, includes connections to other business tools, and fine.
- Looks even better to have your own domain name. Can set up on Office 365 without your own email server now.
- Due Diligence on partners, via technology.

## ***Selling Your Business: Long-Term Plan (1)***

- Plan 5 years out to sell: Keep ducks in order, Corporate Records, Ownership, Contracts, Licensing, Accounting, Assets lists, Regulatory Compliance
- Enhance net income
- Change C Corp to S Corp 5 years before closing.
- Document company processes
- Train successor, Maintain Good Team of Management and Employees
- Maintain Employee list with titles and roles.
- Maintain property in good shape, limit debt
- Legal liability, limit it, document it; avoid lawsuits

## ***Selling Your Business: Long-Term Plan (2)***

- Protect Intellectual Property and technology
- Cyber security in place
- Obtain Valuation, or at least an “eyeball” valuation.
- Transaction, Be Familiar With: Noncompete on Seller, Seller Financing Note, Price Deductions; Seller Consulting for a Period; Reps and Warranties; Disclosure Schedules, Consider Tax & Estate Planning Aspects.
- Use a lawyer and an accountant before signing the deal
- Timing: Buyers take months to complete Due Diligence on Sellers; Buyers & Sellers should have realistic expectations as to selling price, timing, fees.
- Plusses & Minuses of using business brokers [Checklist]

# **Venture Capital or Private Equity**

- Owner gives up big % of Ownership in exchange for big money.
- Give up Board Seat to VC and PE
- Terms can be severe (for VC, against owner)
- VC Provides needed capital and sophisticated advisors to the small Business



# ***Securities Laws Apply if You Solicit or Bring In Investors***

- Issuing *any* equity interest, ownership, or profits interest, in your company, in exchange for investor providing cash, property, or services, or a supplier contract, is a securities issuance.
- Even selling stock to your mother, your employees, board members, advisors, is a securities sale.
- Exemptions from registration apply, but have conditions.
  - Close Relationships, Small \$, Accredited Investors
  - Notice Filing Still Required with SEC and States + Conditions
  - Private vs. Public Distinction
- **Disclosure Document or Method Required** - No disclosure exemptions.
- Complex laws apply. NFH can email further detailed handouts
- **Beware of Money Finders:** Many are unregistered, illegal & not good; some expelled or sanctioned stock brokers, criminals, ethics are variable; disclosure now of finders on SEC Form D causes issue for issuer. Your legal fees will increase by using finders.

# **Borrowing Debt vs. Raising Investor Equity – Pros & Cons**

- Lenders easier to find
- Debt faster to negotiate and close.
- Debt less costly than equity in a few ways.
  - Equity (Investor money) more expensive than debt due to securities compliance costs. Deal must be larger to make it worth cost
  - Equity: Issuer gives up a piece of the company
- Investors share fully in profits & losses and only get paid if there are profits; while lenders get paid regardless of profits & losses.
- Lenders often prefer debt because of lender priority in liquidation or dissolution.

# **Borrowing Debt vs. Raising Investor Equity** **When Loans Are /Are Not Securities**

## **Security (Investor):**

- Investor shares equity ownership in the property or investment
- Investor owns a percentage or \$ value of the LLC or LP or corp.
- Investor shares in profits & losses (lenders received fixed paymts)
- Note or Loan Convertible into stock or equity ownership.
- Participating Note, or Loan, where borrower's payments only due, or lender makes more \$, if investment makes profits. No fixed P&I.
- Expensive & Time-consuming to raise investor capital, more transaction cost than bank loan

## **Not a Security (Lender):**

- Debt, Loans, Notes (generally), Borrowing a loan from lenders
- Fixed payments, payment dates & obligation amount
- Payment Not Based on Profits or Loss: Borrower's payments due even if business becomes financially unsuccessful
- Lender has priority rights over investors in liquidation
- Bank Debt is faster and cheaper than equity

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Extra Slides If Time

# **Business Points**

## **Business Ducks in a Row:**

- Due Diligence, Conflicts, Fiduciary Duty,
- Know Competition, Assess Risks, Be Prepared
- Entity Formation, Ownership, Document Arrangements
- Document Business Processes Internally, to systemize the business.

## **Research Industry Before Starting**

- Will this be a viable Business?
- How will you get paid?
- Revenue Model?
- What are real costs? Don't count on free stuff, it is not sustainable.
- If you built a company all on free work, what is your company worth?



# ***Corporation vs. LLC (1)***

Corp vs LLC, S corp or C Corp. is mainly a tax decision (see a CPA); but consider these legal Corporate Law Factors and business decisions, in general.

- Form as a corporation, if you plan to:
  - **Raise money from outside investors** (outside of founders or family), such as angels, VCs, employees, friends;
  - **Have any non-US owners, or investors, or employees who will receive shares.**
    - If any owner is not a US Citizen or Resident Alien, then business must be either C Corp or LLC, but not S Corp. Some countries require C Corp
  - **Issue equity to employees** as compensation, or adopt employee stock option plan, or
  - **Offer a 401(k)** or other retirement plan to owners and employees (see tax advisor, many factors)(possibly can be LLC taxed as Corp), or
  - **Build a company to IPO** with a game-changing, disruptive idea for a product, invention, or service that might take the company public on NASDAQ Global Select, or on NYSE. Form as a Delaware C Corp, or temporarily as an IL corp, to later “merge” into Delaware C Corp.
  - Operate a Retailer or Manufacturer selling goods, with store or production employees, (Can be LLC if accountant advises).
  - Some accountants prefer service company formed as S corps - PR,401K

## **Corporation vs. LLC** <sup>(2)</sup>

- Form as LLC if you plan to:
  - Offer only services. (Service companies generally formed as LLCs)
    - Some accountants prefer that service companies be S corporations (See tax adviser.)
  - LLC if the owners will never take W-2 Payroll Checks and will always receive only periodic partner distributions. (Or if owner doesn't mind setting up the LLC up to pay W-2 payroll tax.)
  - LLC if the business may have two classes of partners, such as "Profits Interest" vs "Ownership Interest" or such as "Income Partner" vs. "Capital Partner". (In S Corp only one class is allowed)
  - LLC if any owner is not a US Citizen or resident alien (S Corps must be all US shareholders)
  - LLC can be taxed as partnership, sole prop, S corp or C corp.
  - Not LLC if offering a 401(k) plan, unless chose LLC taxed as a corp.
- See tax adviser for entity type decision. This is important.

# **Sole Proprietorship vs. Entity**

- Personal Liability in sole proprietorship
- Separation of financial & tax matters, tax returns easier if you are a corporation or LLC.
- Insurance easier to obtain for entity than for sole prop.
- Larger companies require entities around business owners.
- Perception of customers.
- Entity required to obtain a Loan if you look like a "real business".
- Entity required to apply for certification status, like WBE, SB, VOB.
- Due Diligence goes more professionally and easily if people can conduct Due diligence on you on Sec of State site.
- If you will ever raise capital by issuing stock to investors or reward employees with stock, it cannot be done with a sole prop.
- Must file DBA with IL SOS, and County and a REG-1, therefore much of the time consuming cost of forming a corporation must also be done for a sole prop, therefore there isn't a huge difference in cost

# **State of Formation**

- Form in the state in which you are located.
- “Qualify” in other states as you add employees or customers there.
- Don’t form in Delaware, NV or WY or other “foreign” state:
  - Formed in Foreign State, must also qualify in home state = \$.
  - Must hire a registered agent in the foreign state = \$
  - Adds formation cost & annual cost, to no benefit, unless going public.
  - If you will go public, or have venture capital investors, form in DE
- Filing in NV or WY to save money on filing fees, makes you look cheap
- Filing in WY or other states that don’t disclose the business owners, implies hiding something / not transparent, to anyone doing due diligence on you, which may draw suspicion.
- Form in Delaware if you are certain (realistically) that you will go public. Highly unlikely for 98% of companies. Can change to Delaware later, by doing a “migratory merger” with a new Delaware C Corp.

# **Business Filings & Licenses Required**

- State Tax IDs and Qualifications in each state “Doing Business”
- State Dept. of Revenue; REG-1: IL Payroll, Sales Tax, Use Tax, Income Tax (Illinois IBT)
- Local Business License (City, Village) - 1/2 page form, \$50
- County License: Health, food, or touch people/animals
- Specialty Licenses: Building Contractor, Oil & Gas, Cooking, home health, day care, massage, dog kennel, many others
- Professional License – Illinois Dept. of Professional Regulation: Investment Adviser, Mortgage Broker, Real Estate Broker, Business Broker, CPA, Law, Architect, Medical, Nurse, Landscape Architect, Surveyor, 100s of others.
- Assumed Name Filing with State
- Trademark Filings for Name and Logo, Federal and State
- State Qualifications in Other States if EE's There
- Certifications for Gov't Contracts or Corp Contracts (Optional)