

Examining legal issues crucial for new business

Budding entrepreneurs face questions about tax, incorporation, financing

Entrepreneurs or consultants in business, advising on business or thinking of going into new business face many difficult tax and legal questions.

These questions revolving around incorporation and costs, other choices besides corporations, tax effects, infringement protection and financing.

The following tax, legal and business issues must be considered.

Business Choices and Incorporation

A new business can operate as a sole proprietorship or general partnership, without filing, or as a limited partnership, corporation (profit or non-profit), or limited liability company (LLC) or limited liability partnership (LLP), where state filing is required.

The big benefits of a corporation or LLC are: (1) insulate all owners from personal liability, (2) give management continuity, (3) define rights of owners and those who deal with the business and (4) allow transfer of business interests. This can add credibility to your business in the marketplace.

However, corporate or LLC benefits cost substantial money. First, there is incorporation red tape — articles of incorporation, bylaws, minutes, banking resolutions, shares and operation agreements for LLCs, with resulting lawyer's costs and State fees. Second, there is upkeep.

Creating a corporation or LLC is creating a new legal person. To get legal benefits, you have to treat her (him) right. That means transferring assets over to the new entity, so it owns something and then keeping separate records, using corporate letterhead, checks, etc., so you act through this paper person.

Taxation /S Corporations or LLCs

Paperwork and dollar costs are reasons why startups often put off incorporation. Another putoff is taxes. As a new person, a new corporation or LLC files for its own taxpayer ID. It must file its own tax returns and pay annual franchise taxes (\$456 per year in Mass. for a corporation, \$500 per year for an LLC).

Normally, corporations are also taxed on their income, but if a corporation files to be an "S Corporation", it avoids income taxes. Owners can also take losses on their personal tax returns, while the "S" is still a regular corporation in other respects.

LLCs offer these same "S Corporation advantages," without some of the technical "S Corporation" restrictions. LLCs also offer additional flexibility normally found in partnerships to split income, losses and capital disproportionately among members.

There are also disadvantages to "S Corporations" and LLCs — direct owner tax on all income, and loss of a chance for tax-free rollover or the 14% tax on sales of shares held 5 years or more. Additionally, the very flexibility of the LLC, so helpful in real estate and estate planning areas may be a drawback in a technology-based business where rights need to be clear.

Trademarks, Patents, Proprietary Protection

Care should be given in choosing a business name and logo as well. Filing a state or a Federal trademark or service mark gives protection against those who would try to sell products or services under your registered name.

If a federal trademark is filed and

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approved by the Patent and Trademark Office, this can give you priority in all 50 states. The mark can also be filed even before used in commerce.

Even more care should go to protect inventions, new products, trade secrets and infor-

mation proprietary to the business. This starts even before going into business—think about any documents signed with present or past employers; assure your rights in "intellectual property" and to transfer it "free and clear" to your new business.

Where feasible, filed patents should protect new inventions or improvements, or copyrights, expressions of ideas, and confidentially agreements, proprietary information and secrets.

Contracts for People, Products, Financing

Other issues for a new business, just as important, include:

- Supply contracts, equipment purchases,

leases, terms

- Product development, Sales/Licensing, marketing/distribution

- Employees/contractors, compensation, benefits, stock options
- Venture capitalists and angel investors, debt/equity deal terms, Securities law issues

International work can also involve other issues as well, including immigration issues for key employees.

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