

THE RIGHT START

LEGAL TIPS

FOR YOUR BUSINESS

By Judy Gedge Esq.



JUDY GEDGE *The Small Business Lawyer*

Judy Gedge is an experienced small business lawyer who helps people build successful businesses. Judy provides traditional legal services in such areas as forming LLC's and other business entities, buying and selling businesses, business loans and preparing business contracts. In addition, Judy applies her strong analytical skills, business experience and communication skills to help her clients achieve their underlying objectives. Whether it's helping structure a long-term lease in a way that benefits both landlord and tenant, or helping a business owner understand how to launch a new business, Judy works closely with her clients to help them achieve their goals. Judy has the ability to explain legal issues in a way that business owners can easily understand. This allows her clients to see their options clearly so they can make well-informed business decisions.

Judy is also an author and frequent lecturer on business law topics. She is the author of *A Legal Road Map for Consultants* and her articles with legal tips for business owners are published in numerous newspapers and trade journals including the Hartford Business Journal, Connecticut CPA Magazine and The Consultant. Judy has presented legal workshops for many organizations including SBA, the Entrepreneurial Center, and the Connecticut Business Expo. In addition, Judy teaches business law at the Lender School of Business, Quinnipiac University.

Judy received a B.A. degree from Emory University and a J.D. degree from the University of Connecticut School of Law.

Whether you're just starting your business or have been in operation for years, you'll want to be sure that your business entity is the right one for you. While it may seem the simplest approach to just open your doors for business without forming a legal business entity, this may not be the best approach for you. Because if you don't operate your business as a corporation or limited liability company (LLC), you'll be exposing your personal assets to the risks of your business.

Under Connecticut law, if you operate your business as a sole proprietorship or as a general partnership, your business entity provides *no legal protection* for your personal assets. But, if you operate your business as a corporation or an LLC, in general, your personal assets are protected from the liabilities of your business.

Every business has its own legal risks. If you're unclear about the risks arising out of your particular business, it's best to consult with an attorney. In general, the best way to protect yourself and your business from legal risks is to: (a) form and properly maintain a limited liability entity; and (b) maintain appropriate insurance.

Let's examine your options keeping in mind that choosing the right entity can provide you protection from personal liability.

- Sole Proprietorship
- General Partnership
- Corporation
- Limited Liability Company

This summary is intended to provide an overview to help you select the business entity that's right for you. However, this is a complex area of the law, so it's important for you to consult with a business attorney and a business accountant for assistance tailored to your particular needs.



If you are in business on your own and you have not formed any other business entity, then you are operating as a sole proprietor. As a sole proprietor, there is no legal distinction between you and your business. This means that your personal assets are at risk if your business is sued.

As a sole proprietor you can operate under your own name or under a tradename. If you are operating under a tradename, this is referred to as a d/b/a which stands for 'doing business as'. As an example, let's assume that John Smith runs a lawn care business under the name 'Lovely Lawns.' John Smith is the owner of the business. He is a sole proprietor doing business as 'Lovely Lawns.' The legal name of his business is therefore 'John Smith d/b/a Lovely Lawns'.

There are no legal documents required to form a sole proprietorship. However, you are required to file a tradename (or fictitious name) certificate if you are operating your business under a tradename which does not include your surname. This certificate is filed with the town clerk where you maintain your principal place of business. Note that the filing of this tradename certificate does not provide you any exclusive or proprietary rights to the use of that tradename.

A sole proprietorship does not survive the death of the owner. Instead, the assets of the business become part of the sole proprietor's estate and are distributed to the beneficiaries under his or her will. If there is no will, the assets are distributed in accordance with applicable state law.

Remember that you will be required to obtain a Connecticut state tax identification number and other tax identification numbers for your sole proprietorship. You'll want to check with your accountant to find out what taxes your business may be required to pay. As a sole proprietor you will be reporting the income and expenses for your business on *Schedule C* of your personal tax return.

SOLE PROPRIETORSHIP

- *Only One Owner*
- *No Protection From Personal Liability*
- *No Continuity of Business on Death of Owner*
- *Not Subject to Entity Income Tax*



GENERAL PARTNERSHIP

A general partnership is a business entity in which two or more people join together to share in the profits of an enterprise. If you are operating as a general partnership then your entity provides you *no protection* from personal liability. Further, as a general partner, you are personally, jointly and severally, liable for all obligations of the business.

Let's look at an example. Let's assume your partnership consists of five partners. One of your partners arranges for the delivery of \$10,000 worth of business inventory on credit. In general, any act taken by a partner in the ordinary course of business is binding on the partnership. This means that you can be held personally liable for this business obligation. You can be held personally liable for the entire \$10,000 obligation because each partner can be held liable by a creditor of the partnership for the *entire* obligation, not just his pro-rata share of it.

While there are no legal documents required to form a general partnership, it is important that the partners adopt a written partnership agreement. In addition to financial and management issues, the partnership agreement should address 'buy-sell' issues. These include a mechanism to buy out a partner's interest in the business on death, retirement, termination or disability. The death of a partner can create difficulties for the business and the remaining partners unless adequately provided for in the partnership agreement. (See discussion below on A Business with Multiple Owners.)

Just as with a sole proprietorship, if the partnership is operating under a tradename, it must file a tradename certificate with the town clerk in the town where it maintains its principal place of business.

Remember that you will be required to obtain a Connecticut state tax identification number and other tax identification numbers for your general partnership. You'll want to check with your accountant to find out what taxes your business may be required to pay.

As a general partnership, your partnership is required to file an informational tax return with the IRS (*IRS Form 1065*) and with the CT Department of Revenue Services (*Form CT-1065*). The partnership as an entity is not required to pay income tax.

The taxable income (or loss) of the partnership is 'passed through' to the partners who then report such taxable income or loss on their personal tax returns. This is why a partnership is referred to as a 'pass through' tax entity.

GENERAL PARTNERSHIP

- *Two or More Owners*
- *No Protection From Personal Liability*
- *Partnership Agreement Recommended*
- *Not Subject to Entity Income Tax*



A corporation is a legal entity which is formed under the laws of a particular state. If your principal business location is in Connecticut and you plan to form a corporation, most likely you will choose to form a Connecticut corporation. A corporation provides protection from personal liability to the owners of the business. In general, it is the assets of the corporation, and not the owners' personal assets, that are exposed to satisfy the obligations of the business.

To form a Connecticut corporation, certain documents must be filed with the Office of the Secretary of State including the corporation's Articles of Incorporation and its Organizational Report. A filing fee and franchise tax are payable to the Secretary of State to form a corporation. Also, the corporation is required to file an annual report with the Secretary of State and pay an annual filing fee. In addition to filing documents with the Secretary of State, the organizers of the corporation will adopt the corporation's *Bylaws* and other organizational documents which become part of the corporate *Minute Book*.

A corporation is comprised of its *Shareholders*, *Directors* and *Officers*. It is possible for one person to fulfill all three roles but it is still important to understand the different legal roles that each one plays in the corporation. The *Shareholders* are the owners of the corporation. They receive shares of corporate stock in exchange for their initial contributions to the corporation. The shareholders are entitled to receive such dividends as the Board of Directors authorizes. In addition, the shareholders are required to meet at least once a year to elect the *Directors* of the corporation.

The *Directors* of the corporation (also referred to as the *Board of Directors*) make the policy decisions for the corporation. This is done at Board of

Directors' Meetings and the actions taken at those meetings are reflected in corporate *Minutes* or *Resolutions*. The corporation needs to maintain records of its organizational documents and Minutes of its Meetings of Shareholders and Directors in its *Minute Book*. (See discussion below on Piercing the Veil – Personal Liability.)

In addition, the Board of Directors appoints the *Officers* of the corporation. It is the *Officers* of the corporation who implement the policy decisions of the Board and who are responsible for the day-to-day operations of the business.

Since a corporation is a separate legal entity, the legal existence of the corporation continues even after a shareholder dies. A corporation is also a separate taxable entity. This means that a corporation must pay federal and state corporate income tax on its taxable income each year.

A corporation with up to 100 shareholders that meets certain other IRS criteria, can elect to be treated as a pass-through tax entity by filing a simple form with the IRS (*IRS Form 2553*). This corporation is then referred to as an 'S' corporation. A corporation that is not an 'S' corporation is referred to as a 'C' corporation.

Because of the complexity of the tax treatment of corporations, it is particularly important to obtain the advice of a business accountant to help you decide whether the corporation is the right entity for you.

Remember that you will be required to obtain a Connecticut state tax identification number and other tax identification numbers for your corporation. You'll want to check with your accountant to find out what taxes your business may be required to pay.

CORPORATION

- *One or More Owners*
- *Provides Protection From Personal Liability*
- *Minute Book Must Be Maintained*
- *Continued Existence on Death of Shareholder*
- *May be Subject to Entity Income Tax*



LIMITED LIABILITY COMPANY

The LLC is a business entity that combines the liability protection of the corporation with the pass-through tax treatment of a partnership. This makes it an excellent choice for many small businesses. Adopted in Connecticut in 1993, the LLC is now available in all 50 states.

An LLC is formed under the laws of a particular state. If your principal business location is in Connecticut and you plan to form an LLC, most likely you will choose to form a Connecticut LLC. An LLC provides protection from personal liability to the owners of the business. In general, it is the assets of the LLC, and not the owners' personal assets, that are exposed to satisfy the obligations of the business.

Articles of Organization are filed with the Office of the Secretary of State to form a Connecticut LLC. A filing fee is payable to form an LLC and the LLC is required to file an annual report with the Secretary of State. In addition to filing the Articles of Organization, the organizers of the LLC will adopt an LLC *Operating Agreement* which is similar to a partnership agreement. The Operating Agreement and other organizational documents become part of the LLC *Minute Book*.

The owners of an LLC are called its *Members*. The LLC can be operated by its members or by a *Manager* who is appointed by the members. The Operating Agreement contains detailed provisions governing the operation of the LLC including the rights and responsibilities of the members. (See discussion below on A Business with Multiple Owners.)

Since a limited liability company is a separate legal entity, the legal existence of the LLC continues even after a member dies.

Remember that you will be required to obtain a Connecticut state tax identification number and other tax identification numbers for your LLC. You'll want to check with your accountant to find out what taxes your business may be required to pay.

An LLC is a 'pass-through' tax entity. It is normally treated for income tax purposes just like a partnership. In the case of a single member LLC, the entity is treated for tax purposes like a sole proprietorship with income and expenses reported on a *Schedule C* of your personal tax return. (However, an LLC can elect to be treated as a corporation for tax purposes.)

LIMITED LIABILITY COMPANY

- *One or More Owners*
- *Provides Protection From Personal Liability*
- *Minute Book Must Be Maintained*
- *Continued Existence on Death of Member*
- *Not Subject to Entity Income Tax*



If you are in business for yourself, a single-member LLC may be right for you. When first adopted in Connecticut, the statutes required a minimum of two members to properly form an LLC. But changes in the law now permit the creation of single-member LLC's. If you're considering this, remember that it's important to fully document the organization of your LLC *even if you are the sole member*. This means adopting an Operating Agreement and other organizational documents for your LLC. If you simply file the Articles of Organization with the Secretary of State without completing the organization of your LLC, you may be putting your personal assets at risk. Remember that under the doctrine of 'Piercing the Veil', failure to maintain complete and up-to-date legal records for your LLC can expose you to *personal liability*. (See discussion below on Piercing the Veil – Personal Liability.)



**LLCexpress.com can help you
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- Low-cost package for single-member LLCs
- Service provided by Attorney Judy Gedge
- Package includes customized LLC Documents
- We also get your federal and state tax IDs

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If you're planning to go into business with other people as co-owners in the business, you'll need to address management issues. For instance, what happens if one of the owners wants to lease himself a company car. Can he do this without the approval of *all* the owners? It's also important to address what are referred to as 'buy-sell' issues. What happens if one of the owners wants to sell out his/her interest in the company to a person you dislike or distrust? Can you be forced to share your company with that person? What happens if one of the owners dies? Will his/her spouse step into that owner's shoes and tell you how to run your company? What if one of the owners becomes inactive through disability or 'change of lifestyle?' Will that owner continue to receive the same share of the profits?

None of us has a crystal ball. We don't know which, if any, of these scenarios will arise in your business. However, by proper up-front planning, you can put in place established rules for dealing with situations like these. You can address these issues as part of the organization of your business in a fair and even-handed manner. After all, none of the owners knows if he'll end up on the 'buy' side or the 'sell' side of these scenarios. By documenting your agreement on these issues, you can deal with them in a way that allows your business to grow and prosper despite these challenges.



Filing the organizational documents with the Secretary of State is not enough to provide you protection from personal liability. You'll need to comply with all the legal requirements including maintaining thorough records for your entity. Failure to do this can expose the owners of a corporation or LLC to personal liability under the doctrine of *'piercing the veil'*. In deciding whether to impose personal liability, Courts look closely at the way the business has been operated. Here are some practical pointers which not only make good business sense, they will also help to protect you from personal liability under the doctrine of *'piercing the veil'*.

- Maintain a complete minute book for your entity including Bylaws for a corporation and an Operating Agreement for an LLC
- Use a separate bank account for your corporation or LLC and keep thorough financial records
- Make sure the business is adequately capitalized
- Maintain appropriate liability insurance for your business
- Sign all contracts and legal documents on behalf of the entity and not in your individual capacity
- Always hold yourself out to the public as a corporation or LLC on your letterhead, invoices, checks, advertising, etc.

You'll want to rely on a solid team of professional advisors to help you build a successful business. A business attorney can help you identify the legal risks arising out of your particular business and can help you decide which business entity is right for you. By structuring your business as an LLC or a corporation, you can achieve significant legal protections and you may also be able to achieve tax benefits. In addition to helping you decide on the best structure for your business, a business attorney will be able to prepare all the documentation required to form and properly maintain your entity. Your attorney can answer your questions about other start-up matters such as tax identification numbers, insurance needs and opening your business bank account. If you're going into business with co-owners, your attorney can help you work through the 'buy-sell' issues and prepare the governing agreement amongst the owners.

A business attorney is an important member of your professional team. Your team should also include an accountant, insurance agent, and banker

PROFESSIONAL TEAM

- *Business Attorney*
- *Accountant*
- *Insurance Agent*
- *Banker*



U.S. SMALL BUSINESS ADMINISTRATION

In addition to providing workshops and counseling through SCORE, the SBA provides guarantees for qualifying small business loans. The SBA is at 330 Main Street, Hartford, CT (860) 240-4700. www.sba.gov

SERVICE CORPS OF RETIRED EXECUTIVES (SCORE)

SCORE Chapters throughout the State provide business counseling and workshops. The Hartford chapter provides a full-day Business Basics Workshop once a month. Contact the SBA for information about your local chapter at (860) 240-4700. www.score56.org

THE ENTREPRENEURIAL CENTER

The Entrepreneurial Center, located at the Hartford College for Women, provides a variety of programs and resources to small business owners and budding entrepreneurs. Twice a year, the Center runs a 16 week Comprehensive Small Business Training Course. The Center is located at 50 Elizabeth Street, Hartford, CT (860) 768-5681. www.entrepreneurialctr.org

CONNECTICUT ECONOMIC RESOURCE CENTER

CERC provides information for starting a business as well as economic development and marketing strategies. CERC can be reached at (860) 571-7136 or at www.cerc.com
See also www.youbelonginCT.com

STATE OF CONNECTICUT LICENSING INFORMATION CENTER (CT-CLIC)

CT-CLIC is operated by CERC. It helps to streamline the business licensing/registration process and provides personalized customer service. CT-CLIC is comprised of an online self-service approach through a website www.CT-CLIC.com and through a customer assistance full-service approach through the Smart Start business registry program. Smart Start can be reached at **1-800-392-2122** or SmartStart@cerc.com

PUBLIC LIBRARIES

Many public libraries provide resources for small businesses including access to computers, business reference materials and magazines as well as business workshops. In particular, the Simsbury Public Library has an extensive business resource center (www.simsburylibrary.info). Call your local library for information.

CT SMALL BUSINESS DEVELOPMENT CENTER

CSBDC provides business counseling and workshops to small businesses and start-ups. CSBDC has recently re-located to Central Connecticut State University. www.ccsu.edu



Judy Gedge

The Small Business Lawyer

977 Farmington Avenue, Suite 200

West Hartford, Connecticut 06107

telephone: (860) 231-7711

fax: (860) 523-9235

judy.gedge@gedgelaw.com

www.gedgelaw.com

www.LLCexpress.com

THE RIGHT START FOR YOUR BUSINESS

	SOLE PROPRIETORSHIP	GENERAL PARTNERSHIP	'S' CORPORATION	'C' CORPORATION	LIMITED LIABILITY COMPANY
Personal Liability	YES	YES	NO	NO	NO
Entity Taxation of Profits	NO	NO	NO	YES	NO
CT Business Entity Tax	NO	NO	YES	NO (minimum tax due)	YES
One Owner Permitted	YES	NO	YES	YES	YES
Filings Required with Secretary of State	NO	NO	YES	YES	YES
Initial Filing Fees to Secretary of State	\$0	\$0	\$275	\$275	\$60
Annual Filing Fees to Secretary of State	\$0	\$0	\$75	\$75	\$10
Tradename Certificate Required	YES, if not using surname	YES, if not using surname	NO	NO	NO
Continuity of Life	NO	LIMITED	YES	YES	YES