# BUSINESS PLANNING 101

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MINORITY BUSINESS OWNERSHIP

# MEET SABRINA CONYERS

- Sabrina Conyers is a partnership and corporate tax attorney with more than 16 years of experience providing domestic and international tax planning, general corporate, corporate governance, private equity, and real estate finance planning and advisory services to clients.
- Her clients include corporations, investment banks, private equity funds, and private companies (including partnerships, S Corporations and real estate developers).
- Ms. Conyers represents clients in structuring, negotiating, and documenting the tax consequences of their partnerships and joint ventures, mergers and acquisitions (M&A), real estate and REIT transactions, domestic and cross-border financings and other corporate combinations and reorganizations.
- Ms. Conyers advises clients on transactions involving limited partnerships, limited liability companies, joint ventures, and other strategic alliances.

# KEY ACTORS IN BUSINESS PLANNING

## ENTREPRENEUR

- Someone who creates value by offering a new product or service or by carving out a niche in the market that may not currently exist.

## TRANSACTIONAL PLANNER

- Lawyer who needs a breadth of knowledge for capital raising transaction concerning topics such as intellectual property, employee benefits, executive compensation, tax issues, mastery of agency, choice of entity (partnership, LLC,, corporation, etc.) general corporate and corporate governance, contracts, and federal securities laws.

# ENTREPRENEURIAL PROCESS

| Turn idea into viable concept | |
|---|---|
| Filling an unmet need in the market? | Better or cheaper than an existing competitor? |

| Determine the viability of product or service | |
|---|---|
| Complete feasibility or market study | Retain a consultant |

| Develop a business plan | |
|---|---|
| Organize a legal entity, identify potential market, raising capital/financing, hiring management/staff | Identify facility, determine business strategy, provide financial information, and detail executive summary |

# KEY COMPONENTS OF A BUSINESS PLAN

# DETERMINING BUSINESS OUTLOOK

## STATISTICS

- 20% of new businesses fail within first year.
- 50% of new businesses fail after the fifth year.
- Four out of five entrepreneurs are forced to step down as CEOs.
- Reasons: lack of commitment and perseverance of entrepreneur, employee problems, lack of funding, drain on time and energy, and managerial incompetence.

## PRODUCING POSITIVE OUTCOMES: INVESTOR'S EVALUATIONS

- Opportunity – can the entrepreneur develop, implement, and build a successful business based on their idea?
- Entrepreneur and managerial team – what are the qualifications and history of the entrepreneur and their management team?
- Resources needed – how much capital (debt or equity) is necessary for success and how likely will they have access to the resources they need?

# THINKING LIKE A DEAL LAWYER

- Determine the goals of the entrepreneur
  - Do they want to go public?
  - Future acquisition?
  - Future merger?
  - Future joint venture?
  - Run business privately?
- Adjust advice as necessary

# TEN COMMON MISTAKES OF TRANSACTIONAL LAWYERS

- Not properly licensing technology patented by others
- Hiring former employees of a competitor without doing diligence
- Not conducting a timely trademark search
- Improperly maintaining organizational records
- Selling securities to nonaccredited investors
- Creating a ”cheap stock” problem (offering employee stock options that are later valued at a significantly higher price following an IPO)
- Failing to make a timely Section 83(b) election (gives an employee, or startup founder, the option to pay taxes on the total fair market value of restricted stock at the time of granting)
- Not adopting an appropriate employee stock option plan
- Failing to institute a trade secret protection program
- Failing to obtain a good title to intellectual property

# ARE YOU THINKING LIKE A DEAL LAWYER?

## HYPO 1: SOFTWARE STARTUP

- What are the essential elements of their business plan?
- What should you do if the founders do not have access to personal or family and friend's capital?
- How can you avoid at least one of the common mistakes previously listed?

## HYPO 2: EXPANDING CORPORATION

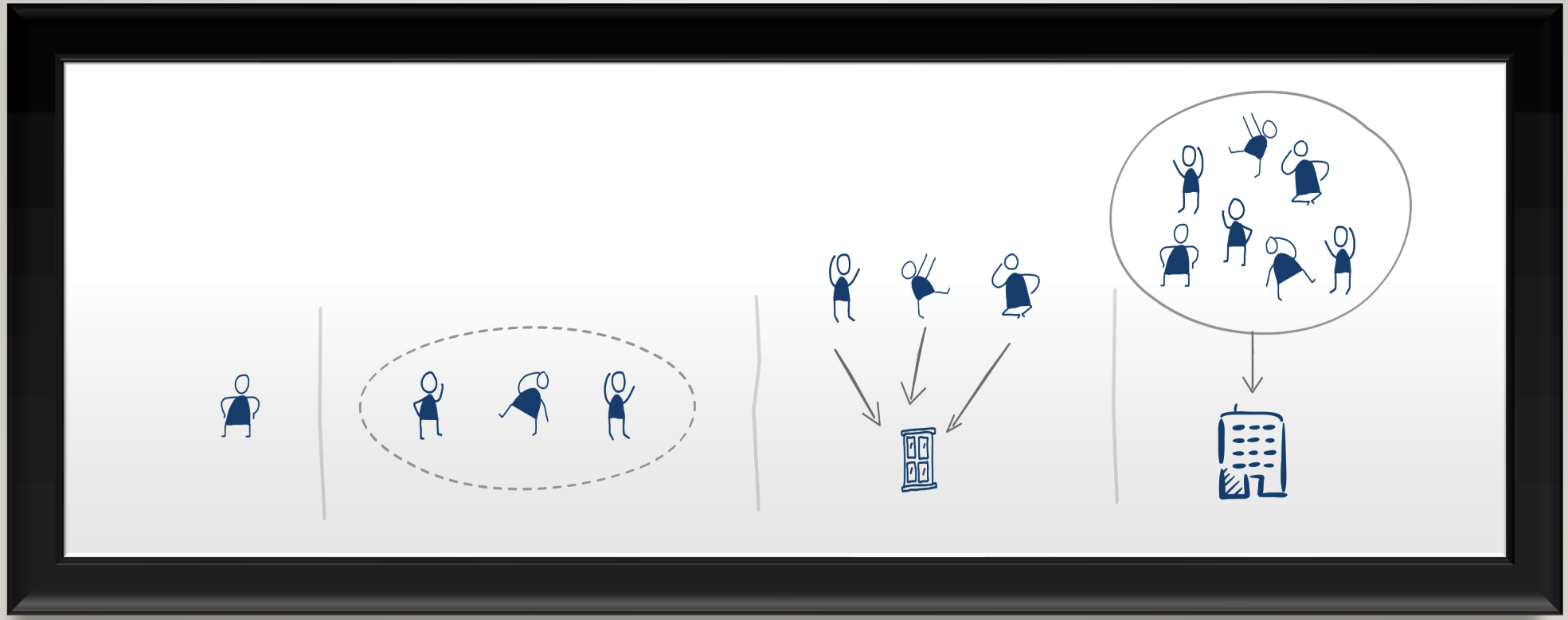
- What's one of the first questions you should ask the corporation's board?
- How can you help the corporation acquire more assets?
- How can you avoid at least one of the common mistakes?

# ETHICAL OBLIGATIONS OF THE LAWYER

- Competence – sufficient expertise to handle the legal work?
- Capacity – sufficient resources to meet client's needs?
- (Absence of) Conflicts – avoiding conflict or potential conflict.

# AVOIDING ETHICAL ISSUES

- Identify the client
  - Determine possible conflicts of interests
- Determine an appropriate compensation arrangement
  - Money
  - Equity –
    - Ensure terms are written, fair, and reasonable.
    - Encourage the client to hire a lawyer to review the terms.
- Weigh pros and cons of sitting on a company's board
  - Consider the impact on future clients and business development



# CHOOSING A BUSINESS ENTITY

KEEPING YOUR CLIENT'S GOALS IN MIND, CONSIDER THE VARIOUS ASPECTS OF EACH BUSINESS ENTITY.

# SOLE PROPRIETORSHIP

- Business owner manages the business and owns the assets of the business in their name.
  - Good for small businesses where the owner plans to manage the business full time.
  - No limitation on personal liability.
  - Tax consequences: business income is taxed as income, but the proprietor may qualify for a deduction of qualified business income.

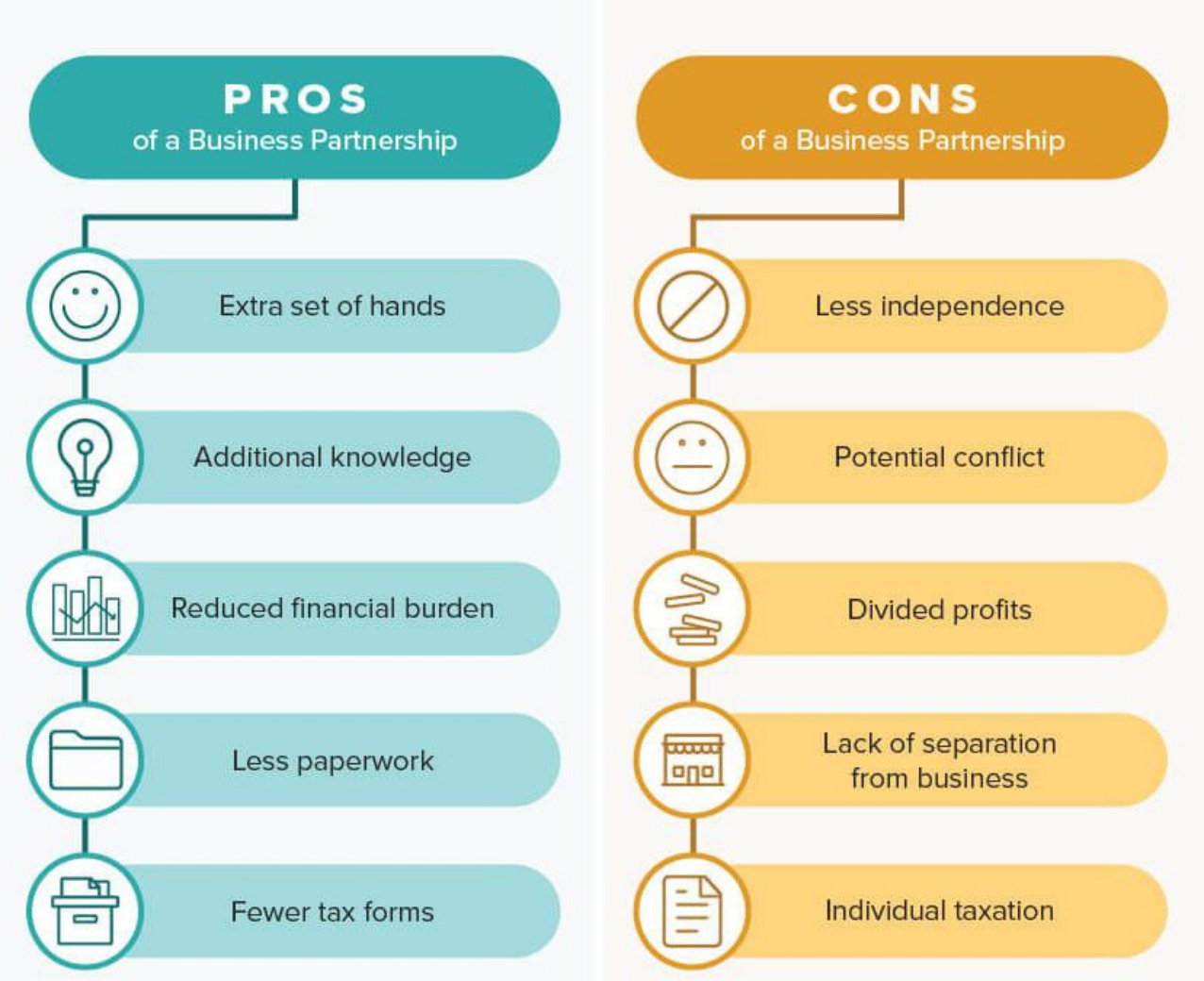
# Advantages and Limitations of Sole Proprietorship

- Easy to Start
- Easy to Wind-Up
- Quick Decision & Promt Action.
- Flexibility in Operations.
- Direct Maintenance of Business.

- Limited Capital.
- Unlimited Liability.
- Lack of Continuity.
- Limited Size.
- Lack of Managerial Expertise.

# GENERAL PARTNERSHIP

- Association of two or more persons to carry on as co-owners of a business for profit.
  - Most states have adopted either Revised Uniform Partnership Act (RUPA) or Uniform Partnership Act (UPA) to establish general statutes to govern these partnerships.
  - Individuals are held personally liable for the debts of the partnership.
    - However, RUPA states that a creditor must unsuccessfully attempt to retrieve assets of the partnership before coming after the personal assets of a partner.
  - Organized under state law, no other legal filing required.
  - Partners are encouraged to draft a partnership agreement to define the rights and duties of the partnership.
    - Otherwise default rules of RUPA or UPA will apply.
    - A comprehensive agreement should include provisions such as voting rights of partners, distributions to partners, and buy-sell agreements.
  - Unlimited liability


PROS
of a Business Partnership
Extra set of hands
Additional knowledge
Reduced financial burden
Less paperwork
Fewer tax forms
CONS
of a Business Partnership
Less independence
Potential conflict
Divided profits
Lack of separation from business
Individual taxation

# LIMITED PARTNERSHIP

- Consists of at least one general partner and one limited partner.
- Typically used for (1) sophisticated, manager-entrenched commercial deals who have a long-term commitment or (2) estate planning arrangements.
  - Assumes participants want strong centralized management and has passive investors with little control.
- Limited partners are only liable for contributions to partnership business.
- General partners, on the other hand, have unlimited personal liability of the business and bears all the responsibility for managing business affairs.
- Tax consequences: limited partners have restrictive limits placed on their ability to deduct tax losses generated by the business. General partners generally do not have the same restrictions and receive the same tax treatment as a general partnership.

LIMITED PARTNER
GENERAL PARTNER
• No company involvement
• No daily responsibilitives
• No liability
•OWN A PART OF THE COMPANY
•RECEIVE SHARE OF THE PROFIT
• Oversee company
• Responsible for daily operations
• Full Liability

# OTHER PARTNERSHIP FORMS

## LIMITED LIABILITY PARTNERSHIP (LLP)

- In some countries, LPs and LLPs differ because some allow all partners in a LLP to have some limited liability.
- Typical examples:
  - Group medical practices
  - Professional service providers
  - Law firms

## LIMITED LIABILITY LIMITED PARTNERSHIP (LLLP)

- General partners have limited liability as well.
- Mainly used in real estate industry.
- Not recognized in all states.

# CORPORATION

- An entity that provides a shield for the shareholders' personal assets.
  - The shareholders choose a board of directors to manage business affairs and then the board selects corporate officers to manage the daily operations.
- Two types:
  - C corp. (separate tax paying entity) and S corp., a pass-through entity (S corps and other partnerships are subject to subchapter K taxation).
- Governing law:
  - Every state has its own law governing corporations but some draw from the Revised Model Business Corporation Act (MBCA).
  - Internal affairs doctrine is a choice of law doctrine that appoints the law of the state of incorporation to govern matters involving the internal affairs of the corporation (including relations between shareholders, board, officers, and agents) even if business operations are conducted elsewhere.
- Limitations on limited liability:
  - Shareholders can be liable if a creditor requires them to personally guarantee the corporation's obligations or if their decisions are so intertwined with the management of the corporation that they cannot be distinguished (i.e. piercing the corporate veil).
  - Third parties might also require performance bonds or individual guarantees.
- Tax consequences: double taxation burden requires that entity and shareholders are taxed separately.

# LIMITED LIABILITY COMPANY

- An entity with limited liability for its shareholders, the ability for shareholders to participate in management, and favorable income tax treatment.
  - This flexible structure allows members to either manage it themselves (member managed LLC) or members can delegate management to managers who may or may not be a member of the LLC (manager managed LLC).
  - However, there is little common law concerning the extent of the limited liability, nature of fiduciary duties, scope of duties owed to creditors, and the status of investments as securities.
  - Treated as a partnership for federal income tax purposes if more than one member. If the LLC is owned by one person, it will be treated as a disregarded entity for tax purposes.

# NON -TAX CONSEQUENCES OF CHOOSING AN ENTITY

# COSTS OF FORMATION AND OPERATION

- General Partnership
  - Formation:
    - Inexpensive – no filing fees
    - Expensive – drafting a partnership agreement
  - Operation:
    - Low maintenance costs
- Limited Partnership
  - Formation:
    - Inexpensive – file certificate of limited partnership
    - Expensive – drafting a partnership agreement
  - Operation:
    - Low maintenance costs
- Corporation
  - Formation:
    - Expensive – draft articles of incorporation, draft and adopt by-laws, elect a board and appoint officers, and hold an organization meeting of the shareholders and directors.
  - Operation:
    - Expensive - Make regular public filings, document actions of the shareholders, and pay taxes for the entity such as franchise taxes.
- LLC
  - Formation:
    - Inexpensive - Minimal filing fee
    - Expensive – drafting an operating agreement
  - Operation:
    - Minimal maintenance fees and some states require franchise taxes.

# LIABILITY FOR BUSINESS DEBTS

- General Partnership
  - Unlimited personal liability
  - Creditor must recover assets of partnership first.
- Limited Partnership
  - General Partner - unlimited personal liability
  - Limited partner – limited liability
- Corporation
  - Limited liability
  - Exceptions:
    - Piercing the Corporate Veil
    - Third Party Guarantee
- LLC
  - Limited liability
  - Exceptions:
    - Similar Piercing the Corporate Veil Statutes
    - Third Party Guarantee

# MANAGEMENT AND CONTROL

- General Partnership
  - Partners are equal co owners.
  - Any general partner may, on behalf of the partnership, execute instruments, borrow money, transfer or purchase property, and hire or fire employees.
  - Doctrine of Mutual General Agency of Partner
    - Statement of Partnership Authority
- Limited Partnership
  - General partners typically handle management
    - Doctrine of Mutual General Agency of Partner
  - Limited partners are no longer prohibited from participating in management under RULPA
- Corporation
  - Shareholders elect board for management of business affairs and board elect corporate officers to handle day to day business affairs.
  - Agents (officers and employees) who are acting within their scope of employment bind the corporation.
  - Exception to board control: major, organic, fundamental changes such as a merger or amendment to articles.
- LLC
  - Member managed (decentralized) or manager managed (centralized) structure.

# CONTINUITY OF EXISTENCE

- General Partnership
  - Ends through dissolution whether stated in agreement or triggered by death, retirement, withdrawal, explosion, incapacity, or bankruptcy of any partner.
  - Wind up period granted after dissolution
  - RUPA's dissociation option
- Limited partnership
  - Limited partners will not dissolve the partnership by leaving.
  - General partners will be subject to the same triggers of dissolution (withdrawal, death, or incapacity) or dissociation.
- Corporation
  - Perpetual existence.
- LLC
  - State statute will typically assign a time limit for dissolution unless the members agree to carry on operations.

# ALLOCATION OF PROFITS, LOSSES, AND DISTRIBUTIONS

- General Partnership
  - Default rules provide equal contributions from each partner and partners receive equal profits, losses, and distributions, can be changed in partnership agreement.
  - Each partner has a capital account where they will deposit their contribution (capital investment in the form of cash, property, or services to join partnership) and receive their allocations and distributions.
  - Partners can agree on how much to distribute.
    - Profits - losses
    - Profits - losses + tax liability
    - Profits – losses + tax liability + bonus
- Limited Partnership
  - Equal contributions (unless otherwise provided in partnership agreement), profits, losses, and distributions are made in accordance with partnership agreement.
  - Capital account – required to be kept for every partner
- Corporation
  - Make contributions of cash, property or non-cash consideration such as future services or promissory notes in exchange for stock in the corporation.
    - However, California requires cash consideration, or a promissory note secured with collateral.
  - Articles must include a statement of authorized capital to specify the aggregate number of shares it plans to issue, the par value of the shares, and the class or classes in which these shares can be divided.
    - Prepare to issue blank check preferred stock for future investors.
- LLC
  - Flexible contribution, distribution and tax allocation arrangements
  - Capital account – required to be kept for every member, member and/or managers determine timing of contribution, distributions and allocations.

# FLEXIBILITY IN RAISING CAPITAL

- General Partnership
  - Difficulty raising capital because it can only offer few incentives for investors.
- Limited Partnership
  - Capital raised by limited partners and general partners contribute managerial expertise.
  - Limited partners tend to be passive investors.
- Corporation
  - Offers great incentives such as equity-based incentives and clear liquidity events.
    - Equity based incentives include stock options, stock purchase plans, and employee stock ownership plans.
    - Liquidity events include a public offering, asset sales, and the acquisition of the corporation.
- LLC
  - Difficulty raising capital because it also offers few incentives for investors.

# FIDUCIARY DUTIES

- General Partnership
  - Partners owe other partners the following duties:
    - Duty of loyalty – must account to partnership any benefit derived from partnership business, forbear from representing an adverse party during operations or wind up of the partnership business, and refrain from competing with the partnership before the partnership's dissolution.
    - Duty of care - abstain from engaging in grossly negligent or reckless conduct, willful or intentional misconduct, or a knowing violation of the law.
    - Duty to act in consistent with contractual obligation of good faith and fair dealing.
- Limited Partnership
  - General partners owe duty of loyalty, care, and good faith to limited partners.
  - Limited partners do not owe a duty to each other.
- Corporation
  - Board of directors and officers owe duties of loyalty and care to the corporation and its shareholders.
  - Shareholders do not owe duties to one another but controlling shareholders do owe duties to minority shareholders to act fairly towards the interests of the other shareholders.
- LLC
  - State law varies on the duties owed to managers and members.
  - Many states require managers to carry out their duties in good faith.

# TRANSFERABILITY OF OWNERSHIP INTERESTS

- General Partnership
  - Ownership interests are not freely transferable.
    - Transfer of management responsibilities requires consent of all partners.
  - However, a partner can assign their financial interests without consent.
- Limited Partnership
  - Ownership interests are not freely transferable.
  - Only transfer financial interests without consent.
- Corporation
  - Shares are freely transferable, but the board can place reasonable restrictions on transfers to third parties.
    - Closely-held corporations' shares are difficult to transfer.
    - Publicly traded corporations' shares are easily transferable but are limited by federal and state securities regulations and federal securities law.
- LLC
  - Must receive approval to transfer ownership interest.
  - Only transfer financial interests without consent.

# QUESTIONS?

Thanks for listening!