

Organizing a Small Business Part 2

Narrator: Hello my name is Chris Placitella. I'm a Partner here at Wilentz, Goldman & Spitzer and we'd like to welcome you to this week's broadcast of Your Legal Rights. This week we will continue our discussion with Douglas Lubic, a Partner in this firm, concerning organizing a small business. The response from the last program was so overwhelming that we decided to do at least a continuation today and probably one other if we can't get to all the topics we want. As always, the information that will be provided on this program is not legal advice. It is general information to help you better understand what the legal issues are that may be facing you. There is no substitution for an in-person consultation with your attorney. Also, most of the information you'll hear today concerns New Jersey corporate law, although many of the principles that Doug will discuss with us may be generally applicable elsewhere and once again I caution you for instance if you are watching this in Nevada, Oklahoma, Texas, that you have an in-person discussion with your attorney in those states. With that being said, I'd like to welcome once again Doug Lubic. Hi Doug how are you?

DL: Good morning. Very good thanks.

CP: Thank you for agreeing to come back on this show. I know we had a lot of great response the last time and last time we discussed kind of a general financial and legal concerns when you are deciding to go into business. And today what I would like to do is get a little bit more specific and talk about actually forming the business entity so to speak. So if somebody decides that they want to open up a bagel store, Dunkin Donuts, bowling alley, service, whatever they want to do, what kind of entity should they think about establishing and why. And I guess my first is what is an entity in terms of the law?

DL: An entity in terms of the law is really a legal person. It has many of the rights that individuals have. It can have contracts, it can sue people in court, it can own assets, it can be sued as well. And actually being sued is the reason we get to this point in setting up a small business. Many people start small businesses as sole proprietorships. They just do it themselves and the problem with that is that if there is any lawsuit against the business, let's say somebody slips and falls and the insurance was cancelled or you know a creditor sues because he wasn't paid in a timely fashion on one of his bills. All those liabilities go right through to the person who runs the business in the sole proprietorship. And that's kind of a problem because you're putting your personal assets on the line as well as your business assets. So most businesses will form an entity by which we mean in New Jersey usually a corporation or a limited liability company. And they have different rules, different sets of law govern them. Generally we recommend the limited liability company unless there is some pretty good reason to do it by means of a corporation or even a limited partnership sometimes but that usually doesn't come into play.

CP: I want to ask you about that specifically but I want ask you one questions upfront so I don't forget it. If someone wants to organize their business through an entity, whether it be a corporation or a limited liability company, what kind of costs are they generally talking about when they go to do that? Are these some hurdles to getting your protection or are they reasonable?

DL: They're reasonable expenses, by which I mean you know between \$500-\$1,000, the actually filing fees to prepare the document and submit it to the State for filing is not great it's \$150, I think. Of course recently we had an uptake in all of these charges. Typically you want to have a lawyer or an advisor work with you on it and there are some documents that you usually purchase. You need a corporate seal so you figure between \$500-\$1,000 tops would be what the cost is. And that's not a lot because when you think of setting up any kind of business you're talking about tens of thousands of dollars.

CP: No it seems very reasonable. Let's talk about – we always used to think about corporations and then in recent years this issue of limited liability companies came up. What is the difference being a corporation and a limited liability company?

DL: Well as I said before the limited liability company has a different statutory basis. Both entities are created by the legislature by passing an appropriate law. So there is a different governing law for them. Really what a limited liability company does is it enables you to not have to pay tax at the entity level for the income that you make. All the income will flow right through to the owners and will be disclosed on their personal tax returns. With a corporation you can do the same thing with an S election, but it gets a little more complicated. Some states recognize S elections and some states don't, you have to be careful how much you have, are you paying reasonable compensation so an LLC generally is simpler to set up, well simpler to run really, the setting it up is the same.

CP: The LLC – is that recognized in all 50 states?

DL: I don't believe that all 50 states have there own LLC acts to allow the creation of LLCs. New Jersey was one of the last states to do it and we've had it for 8 or 10 years. But all states will recognize that entity. If you're doing business in another state and you're properly qualified by doing your tax filings and so on, the limitation on liability would be recognized. So there really isn't much of a difference between them the corporation.

CP: So the real advantage of a LLC then is basically you operate your business but the income passes through to you. Do the expenses stay at the corporate level?

DL: Oh yes, the expenses stay at the corporate level. And of course you can't take income from the entity until it's satisfied its creditors. So if your idea is to set up an entity, run up big bills, take all the money home and then collapse the thing

and hang up a gone out of business sign, there are legal doctrines that will prevent you from doing that, that will enable creditors to get the money back.

CP: Well can you pay yourself a salary?

DL: Absolutely, absolutely.

CP: Even when you owe people money?

DL: Absolutely.

CP: OK.

DL: On a going concern basis, paying yourself a reasonable salary, you're not going to pay yourself \$500,000 a year for running a delicatessen. If you had \$500,000 from running a delicatessen that would be great, but all the normal ordinary expenses you can go ahead and pay including yourself or if you have family who are working there, same thing you can pay those in the ordinary course of business.

CP: And then let's say you go through a year and you pay yourself a salary and at the end of the year when you're doing your final accounting at the end of the year it's clear that you have money in your returned earning or profit. Can you then take a distribution of the profit at that point in time?

DL: Yes, yes. And usually if you're going to have an entity you're probably want to have an accountant to work with you. Some types of entities you might want to make a quarterly distribution of profit, if you're really making money hand over fist. But yes at the end of a year with a LLC you would just get a distribution in addition to your salary. If you're operating in a corporate form, you may want to take that money as salary, as additional salary or bonus, rather than a dividend because dividends are taxed differently, they're paid with after-tax dollars from the corporation, so you end up paying more tax.

CP: Okay. I am Chris Placitella and I want to open a restaurant in Highland Park, New Jersey and I want to know I'm doing things right so I call you, Doug Lubic, up and I say I want to meet with you. What happens next?

DL: I'll set up a meeting and I'll sit down with you. I usually do my initial consultations without charge. And basically you'd have kind of a discussion we're having now which is I'd ask what the business is about. I'd inquire whether you've located a site and we could talk about leases for business sites. I'd ask if you're going to have any partners or any additional people involved in ownership or operation of the business. I'd ask if you have an accountant and depending on the answers for all these things before you leave you would have asked me to set up an entity for you to run your business, either a corporation or a LLC. Again with a restaurant you'd then have to question him are you going to serve liquor and in New Jersey at least liquor licenses are a whole different

- CP: Well I'm a bring-your-own kind of guy.
- DL: Then you'll be fine.
- CP: Okay. So we have a meeting and I say I want to set up a LLC. What physically happens next, do you draw up papers, do I sign them, do you file them. What happens? When do I know I'm protected and I can open my doors and sell the good food.
- DL: Well as soon as the entity is formed then you're able to open for business in the name of the entity. The creation of the entity is filling out a Certificate of Formation and filing it with the appropriate office of the State. It's not a hard thing to do and if you're in a rush we can even do it within a day depending on the time of day of course they'll turn it around at State and get in filed pretty quickly. So there is not a lot of delay in getting the entity formed. Once the entity is formed it exists in the eyes of the State, there are some registrations that you have to do but they don't impair the functioning of the business. So you would have to do a filing for a sales tax identification number if you're going to collect sales tax. You have to do a filing with the State just to get set up and get your own identification, you need a federal taxpayer identification number. All of these things are things that need to be done, but don't have to be done immediately.
- CP: Who does that for me? Do I ask you to do that or I have my accountant do that? Just assume all I want to do is make pizza. I don't want to have to worry about that stuff. I want somebody to set it up for me. So, who does that for me?
- DL: Your accountant would do that in terms of the filings. We typically don't do the tax filings for clients just because they are either going to do it themselves or they already have an accountant who's going to do it. It's not hard to do. It just needs to be done and most people figure out a way to do it themselves or have an accountant do it.
- CP: Okay so I meet with you, I fill out the papers, you file them, I open the doors. Am I now protected? Is that done or are there things I have to do during the course of the year to make sure I comply with the law?
- DL: Well you're done as far as all the things that you can do in a formal sense but the most important part of getting protection from liability is how you operate the business. There's a whole series of case law, series of cases, dealing with what's called "Piercing the Corporate Bail". The metaphor is that you have a person who's running a business and if they have a corporation or an LLC because the same thought applies. It's almost like there's a veil in front of their face and you can't get to that person behind the veil unless there's specific things that they have done wrong so there are many things that you do need to do from an operational basis. Most of them have to do with identifying the corporation or the LLC to the people you do business with. So, for instance, you never sign your own name to

things. You always sign on behalf of the entity. When you put up a sign or if you have letterhead, you're printing up letterhead, you make sure that that clearly indicates that there is a corporate entity or a limited liability company involved. You make sure when you sign up leases or sign, you know, a copy or lease or when you make standing orders for goods, that it's always in the name of the corporation. The danger is that by creating confusion between yourself personally and the entity, a creditor is going to be able to come and reach your personal assets because he's going to say, well I didn't know I was dealing with an entity. I thought I was dealing with Chris Placitella so the biggest danger is the confusion between the individual and the entity itself.

CP: Are there any dangers inherent in the fact that you may deal with some creditors or vendors who want a personal guarantee from you even though they are dealing with your company. Does that create problems or is that okay?

DL: Well, it's very commonly done. The nightmare scenario for a creditor that you lend money or you enter into an agreement with an entity and then for whatever reason the business fails and the entity disappears and now there's nothing there so you would sue the entity but the entity has nothing. So, a creditor who savvy will require the principle, the owner of the entity, be personally obligated on the debt as well so if you're borrowing money from a bank, the bank's going to want your guaranty personally. If you're signing a lease, the landlord's going to want you to sign personally because they don't want to hear about your business failing. They want to know that there is a person with assets that they can reach.

CP: Right. So you're not protected in that sense if it's somebody savvy enough to say to you, I want your guaranty.

DL: But a lot of people aren't, a lot of people aren't. You know, if they are dealing with a landlord of a small building, he may not think to ask. A lot of creditors, they don't care. They'll do business with anybody as long as there's a promise that there's going to be payment. So, it's one of those things that you give up when you have to give it up but you operate the business in such a way so that you don't have that liability attaching to you just from the way you're acting.

CP: Okay so I've set up my restaurant now and I'm doing well. I'm not doing peaches anymore, I'm actually serving dinners, everything's going great and should I be thinking about getting insurance or am I pretty much protected because I have a LLC cloak around me that stops people from getting to me personally.

DL: Well you do have an LLC cloak or veil around you that stops people from getting to you personally but the people can still get to the restaurant so you may have a case involving somebody slips and falls and they come and sue the entity, and well they can't reach you personally but, by god, they're going to take the coolers and all the food and the, you know, if there's a liquor license they'll take that. I mean creditors can reach all sorts of assets and really destroy the business so the

answer to your question is yes, you absolutely should have insurance. It's expensive but by not having insurance, that's one of those penny wise, pound foolish things. You may never need it but if you do and you don't have it's going to be a disaster.

CP: Okay, so now I'm really busy. You know, I'm very successfully, everybody knows about my restaurant, I quit the law business, and I'm going great guns. Is there any thing I have to be filing during the course of the year to make sure I get that continued protection that you provided me.

DL: Annually you'll get a letter in the mail from the State which will require you to file an annual report which is a company bio. It's like a \$50 fee. You fill out some of the information on the form, write the check, and send it back and that's all you have to do. If you don't do that two years, you forget or you decide you don't want to pay the money or whatever it may be, after two years the State will revoke your charter. That's what it's called. Essentially they say this entity no longer exists and in the case of your restaurant, you might not even know that you've been revoked because you did get the notices in the mail but, if you're revoked, now you're running the business as a sole proprietorship and you have no protection from liability at all so it is important to do those annual filings and file corporate tax returns that have to be filed.

CP: Okay. When I create the business, can I, what kind of name do I give it, the corporation or the LLC? Is there any restrictions on what I can name it.

DL: There are some restrictions dealing with charitable organizations and you obviously can't use obscene words but for the most part, we, as a matter of fact in twenty years I don't think I've run up on a problem with somebody having a name that wasn't permitted. The reason the name would not be permitted is because it's confusingly similar with another existing name of a different entity. So, typically, at that meeting when you sit down with me, you'll say I want to form an entity and I'll say, fine, give me three names in your order of preference. If the first one's not available, we'll use the second one. If that one's not available, we'll use the third so that will be the name of the entity. Now, that may be different from the name you want to hang on the sign over the door.

CP: Well that was my next question.

DL: Oh okay.

CP: Okay. Do I have to call the name of the business the exact same thing as the company I formed?

DL: You do on your tax returns but you can have a doing business as, a trade name, it's called a number of things but with an entity, what you file is an alternate name certificate so if your restaurant, let's say, is called CMP LLC for your initials and you want to call it Chris' Bistro, well you then

- CP: I like that.
- DL: make an alternate. Maybe I'm in the wrong career. I should be doing advertising consulting. Take your name, Chris' Bistro, put it on the alternate name certificate and off it goes to the State to be filed. Then, you can use that name at that location.
- CP: Well I've got a question about that. Okay now the restaurant's going great and I want to open up a donut shop where they serve really strong coffee and it's right near a bar so the people that come out of the bar always need coffee and I want to call it Drunkin Donuts. Am I allowed to do that?
- DL: Well I don't think the Secretary of State or the Department of Treasury is going to stop you from doing that but you get into a whole other legal question involving unfair competition and the right to use the names. Now, given that Dunkin Donuts is a national chain, I would be sure if you did that and used a similar color scheme, you'd be getting nasty letters from their lawyers pretty quickly. The State will let you file an alternate name for anything and it's your problem if there's, if it unfairly competes or it's too similar to somebody else's name.
- CP: Well the reason I'm being obviously facetious but I'm trying to make a point and the point is that if I'm going to invest my sweat and my hard work and my money into building the business and a goodwill in the business, how do I, you know, protect myself from someone coming later on and saying that name is too much like my name and therefore we wouldn't want you to use that name anymore? Are there procedures or things you can check to minimize those kinds of possibilities?
- DL: Well there are two ways to go with this and the simple way, of course, is just to do a search. With the internet it's very easy. You can just google the name you want to use. See if anything pops up. When you go, again, to file your papers to form the entity, if that entity name is taken by somebody else then the State will let you know so those ways you'll know if there's anybody nearby with that name. The more involved way would be if your business is really going well and now maybe you want to start opening branches in different parts of the state or different parts of the country and there's a trademark registration laws in New Jersey and federal laws which you can do but most businesses don't really need to do that.
- CP: And one of the reasons I asked the question is, let me just switch the scenario. A lot of what goes on in organizing small businesses from the people I know in my town and our community are people who get into technology and internet based businesses. They have an idea that they're going to sell something on the internet or their going to provide some service over the internet. They come up with a catchy name and, you know, because of the, this is the day where people buy domain names and all that stuff way in advance and put them on a shelf, I wouldn't want to go out there, spend all this money and have somebody with a

name similar to mine and then have a problem later on because that's the kind of thing where, you know, if Drunkin Donuts was an internet based company

DL: Right.

CP: somebody who worked for Dunkin Donuts would likely see that and take issue with it, so that's the issue I just want to crystallize now, getting the name and making sure it's okay.

DL: Well getting the name is not hard to do as we've said. Finding out if anybody's using it is really a question of investigation and the situation, the example that you gave where you want to use a specific URL or a, you know, the tag line www or whatever it may be .com, you look up that name. You just go search for the name and see what happens and it may come up with one of those companies that has names and can sell you the name or you may find somebody who actually is using that name. Typically, in small businesses, people sort of know the neighborhood or know the area and they know who's around. For instance, when you open Chris' Bistro, you're going to know whether there's Chris' Bar up the street or Chris' Cavern in New Brunswick or whatever it may be so people typically know where there are similar names or you find out by looking in the phone book and pretty simple means. The major concern that you have is getting the name and using the name in an area where it doesn't compete with the other people who are using the name. Then, there's really nothing they can do. They can go to court but the court's going to say there's no competition here because they're in New Brunswick and you're in Highland Park and they serve regular food and you serve kosher and there's no competition between the two so

CP: Right. So just to put this one issue to bed before I move in. If in the abundance of caution I have a concern, I can still have a trademark search or something like that?

DL: Absolutely.

CP: but most cases it's not necessary.

DL: That's correct. It's, the only time we do trademark searches is if somebody really is thinking they want to go national with a product. They have an idea that they want to market nationally or they have a business which has done so well now they want to maybe set up franchises in other states or in other parts of the state but typically that's on the order of thousands of dollars to have the search done.

CP: Now, one of the questions we got in was can you operate Drunkin Donuts and Chris' Bistro under the same LLC?

DL: Certainly. There's no reason you can't do that. You can have more than one alternate name. There's no problem with that.

CP: Can you have more than one business under the same company?

