



Newsletter

JULY 2003

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Our office will be closed for the following holidays:

July 4th – Independence Day

August 29th – Sept 1st – Labor Day

Our next newsletter will be mailed out the beginning of October 2003.

Remember if you have an article that you would like to contribute to our newsletter just fax it to us for our review. We must receive the article no later than June 15th for our September newsletter.

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PREPARATION OF ANNUAL MINUTES

Professional Legal Assistors now prepares your annual comprehensive minutes and resolutions. The cost is \$300 per corporation, per year. Are your annual minutes up to date? If not, you may lose your corporate status. Your best line of defense against the loss of your corporate status is to keep written minutes and resolutions that record every important corporate decision and the votes taken to approve them. You may ask why bother to prepare minutes of meetings or written consents for key corporate decisions?



Here are a few excellent reasons:

- Annual corporate meetings normally are required under state law. If you fail to pay at least minimal attention to these ongoing legal formalities, you may lose the limited liability protection of your corporate status.
 - Your legal paperwork provides a record of important corporate transactions. This "paper trail" can be important if disputes arise. You can use this paper trail to show your directors, shareholders, creditors, suppliers, the IRS, and the courts that you acted appropriately and in compliance with applicable laws, regulations, or other legal requirements.
 - Keeping your corporate records up to date goes a long way toward avoiding problems down the road and may also protect you in the event of an audit.
 - Formally documenting key corporate actions is a fail-safe way of keeping shareholders informed of major corporate decisions.
- your loan correctly.

- Directors of small corporations commonly approve business transactions in which they have a material financial interest. Your minutes or consent forms can help prevent legal problems by proving that these self-interested decisions were arrived at fairly, after full disclosure to the board and shareholders.

- Banks, trusts, escrow and title companies, property management companies, and other institutions often ask corporations to submit a copy of a board or shareholder resolution approving the transaction that is being undertaken, such as a loan, purchase, or rental of property.

by Christopher Gonzalez, Esq.

How to Gain Corporate Protection When You're Unincorporated

Business owners frequently start their venture unincorporated sole proprietorships and become concerned about the possible loss of personal assets only as their business heads for bankruptcy. If you're that business owner, here's what you can do now to escape personal liability for business obligations. Quickly incorporate your business and transfer the assets from the proprietorship into the new corporation. The corporation should then pay the oldest business obligations first. Since these would be obligations of the proprietorship for which you are personally liable, their discharge will free you of personal exposure. As your corporation pays the older debts it will incur new debts-usually with the same suppliers. However, these debts are now those of the corporation since they were incurred after the business was incorporated. Eventually all proprietorship debts will be fully paid and your corporation can be safely liquidated as the creditors will have no further personal recourse against you.

This strategy works well, but it demands careful coordination. For instance, you must keep your business operating as long as necessary to complete the transition and fully pay your pre-incorporation debts. You must also advise your creditors that your business is now incorporated. Finally, you must be certain your creditors apply your payments to the oldest balance-the proprietorship debts you want discharged. This is best accomplished by noting on each check how it is to be applied.

Do you now own an unincorporated business? Convert to a corporation before you're in serious financial trouble. Best advice: Incorporate before you start your business.

The Friendliest State for Incorporation

In which state should you incorporate? Most people say Delaware, but they're wrong. Nevada is now the state that offers the most advantages to incorporators. Here's why:

- ?? Delaware imposes an income tax on corporate profits. Nevada is tax-free. By comparison, Delaware could prove costly if you anticipate significant corporate earnings.
- ?? Nevada doesn't share information with the IRS. All other states do, including Delaware. With a Nevada corporation, you are thus less likely to face an IRS audit since there is no state tax information to trigger discrepancies.
- ?? Delaware has a franchise tax. Nevada doesn't. The Delaware tax is modest, but it unfortunately requires voluminous annual disclosures- such as dates of stockholder meetings, places of business outside of Delaware, and disclosure of the number and value of the shares of stock issued. This is not the privacy you need in your asset protection program. Nevada requires none of this information. Nevada only requires a current list of officers and directors. The stockholders are not a matter of public record in Nevada, nor does the state ask you who they are.
- ?? Nevada not only beats Delaware in privacy, but Nevada also offers corporate officers and directors far broader protection than does Delaware. Example: Articles of incorporation in Nevada may eliminate or limit the personal liability of officers and directors for claims resulting from breach of their fiduciary duty. This is true in all cases, other than those involving the improper payment of dividends. In contrast to Nevada, Delaware has a longer statute of limitations to sue when improper dividends are paid. It also provides fewer creative options for director indemnification. Finally, in Delaware the right of director indemnification is at the discretion of the court, while it is an absolute right in Nevada.

?? Nevada also allows creative financial arrangements to indemnify. Indemnification can be extended to any person serving the corporation who may incur liability. The corporation can make these arrangements regardless of its authority to indemnify. These financial arrangements include insurance in the form of trust funds, self-insurance, or granting directors a security interest or lien on corporate assets to guarantee indemnification. From an asset protection viewpoint, the absolute authority of corporate officers and directors to place liens against their own corporation for the purposes of indemnification, provides them near-complete control over corporate assets. Unlike Delaware, and most other states, where such self-serving financial and legal arrangements are usually invalid, Nevada fully supports such protective arrangements. In fact, in Nevada, absent fraud, the decision of the board of directors concerning any financial arrangement is conclusive and is neither void or voidable. This is not true in Delaware, nor in most other states.

More good news! It's remarkably easy to incorporate in Nevada. Just call us!

A final point: The one best state for incorporating is probably the state where you will operate your business. If you incorporate in another state, including Delaware or Nevada, you must still file as a foreign corporation in your own state. Your corporation is then subject to the laws of your state, nullifying the advantage of incorporating elsewhere. You'll also be subject to multiple state taxes and filing requirements.

When does it make sense to incorporate elsewhere – such as in Nevada? When your corporation will not regularly do business elsewhere. This means that your corporation must remain relatively passive. A passive corporation can, however, still be an ideal shelter for certain assets you want protected, and in that instance, a Nevada corporation is preferable to incorporating in your own state, as your own state will undoubtedly be more creditor friendly.

How to Finance Your Corporation for Maximum Protection

Funds loaned to your own corporation are easily lost. But you can greatly reduce your risk if you structure

Let's start with the wrong way to finance your corporation:

You put your funds into the business either for shares of stock or as a loan. If your business fails, you're at best an unsecured creditor and will probably reclaim none, or only a small portion of your loan. A bankruptcy court may even subordinate your claim of other unsecured creditors. Then, you would certainly recover nothing.

Be a shrewd owner. Put yourself in a position where your loan is fully secured by the business assets, and your claim superior to general creditor claims. Be careful. Your loan must be completely protected so your security interest against the assets of your business will not be voided by a bankruptcy court.

The strategy: Have a bank, rather than yourself, loan the funds to your business. Your business, in turn, would pledge its assets to the bank as collateral. Your bank is certain to make the loan because you would pledge as additional collateral a passbook or other personal collateral with a value equal to the loan. Since the loan would be 100 percent secured, the bank has absolutely no risk. Should your business fail, your bank as the secured party would be repaid first from the business assets. Once paid, your bank would then release to you your personal assets pledged as additional security. In this indirect way, you safeguarded your investment. Using the bank as a helpful intermediary, you're insured your investment would have priority from liquidation proceeds of the business.

Travel one step further with this idea. Recent bankruptcy cases say that where a lender is secured by the business owner's personal guarantee, repayments to the lender from the business within one year of its bankruptcy is recoverable by other creditors as an insider preference. The theory is that the burden for repaying the lender should fall upon the business owner rather than upon its general creditors. The solution: Have a friend or relative act as intermediary and guarantee the bank loan. You would give your cash collateral to your intermediary who, in turn, would pledge it to the bank. Since you are not the direct guarantor of the bank loan, bankruptcy would not prevent the bank from asserting first claim upon the business assets. With the bank repaid, it would surrender the cash collateral back to your intermediary, who, in turn, would return the money to you as its original source.

Before you invest or make loans to your cooperation, review this strategy with your attorney. It is not nearly as complicated as it appears, and your attorney and bank can easily put together the necessary paperwork. Its two tactical advantages are obvious: First, a major portion of the money you invest in your business would be far better protected than if you simply invested the cash for shares of stock, or as an unsecured debt. Secondly, since you indirectly control the mortgage on

your business, you can better protect your business from its creditors by asserting your rights as a lien holder of its assets.

When The Professional Corporation Can Be a Liability Shield

Are you a physician, dentist, accountant, lawyer, architect, or other professional who operates through a professional corporation? Professional corporations owe their popularity to the fact that their principals can invest more into corporate pension plans than if they were unincorporated.

Since the professional corporation gained its popularity as a tax-saver, few professionals rely on it for liability protection. Professionals are generally unconcerned about ordinary business debts since they only provide services and incur few liabilities. As professionals operating their practice they correctly reason they can still be sued personally for malpractice, and therefore the corporation is of no consequence in protecting them. Malpractice insurance further reduces liability concerns.

The professional corporation can have significant value as an asset protector. A sole practitioner can be the target of a malpractice suit where he himself is negligent, but what about instances where a subordinate or another associate causes injury without negligence on the part of the professional? Here the corporation, not the professional-stockholder, would be the target of the lawsuit since the corporation is the principal who employed the negligent individual.

Large law, accounting, and physician groups

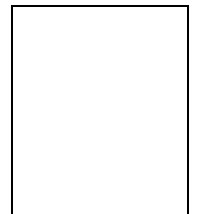
that operate as partnerships, or "loose-knit" associations, can equally benefit from corporations. A corporation would insulate each "partner" from the unlimited liability they are exposed to as individuals. Rather than the individuals becoming partners, a safer arrangement would be for each professional to set up a professional corporation. Their respective corporations, in turn, would form the partnership, with each corporation becoming a partner. Should the partnership incur liability, creditors could only reach the assets of the respective partner corporations, rather than the assets of their principals.

Despite this advantage, the professional corporation is not always the corporation of choice. A regular business corporation offers a major advantage over the professional corporation – the professional need not be the stockholder as is required with the professional corporation. For effective asset protection, the shares in the regular corporation can instead be owned by the professional's spouse or another entity, such as a trust, or a limited partnership. This greater protection is possible only when you incorporate as a regular business corporation without restrictions on who its stockholders may be.

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Competition whose motive is merely to compete, to drive some other fellow out, never carries very far. The competitor to be feared is one who never bothers about you at all, but goes on making his own business better all the time. Businesses that grow by development and improvement do not die. But when a business ceases to be creative, when it believes it has reached perfection and needs to do nothing but produce – no improvement, no development – it is done.

Henry Ford



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