



Newsletter

APRIL 2003

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Our office will be closed for the following holidays:

May 26th – Memorial Day
July 4th – Independence Day

Our next newsletter will be mailed out the beginning of July 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 July newsletter.

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AGENT FOR SERVICE OF PROCESS

In the past it has been our policy not to put ourselves back on as the Agent for Service of Process once that we have resigned as the agent. The reason that we adopted this policy is that, in the last 10 years, we have seen a pattern. We resign, are put back on, resign again, request to be put back on. On and on and on... you get the picture.



Effective April 1, 2003 the cost to put ourselves on as the Agent for Service of Process is \$50. This is in addition to the \$99 per year agent fee. In addition to our fees you must pay the state fees that are necessary. For example, if your agent resigned on a Nevada corporation the usual Nevada fee is \$30. The state fee for designating a new agent on an existing Delaware corporation is \$99.

MINUTES & BYLAWS

It has been brought to our attention that some of you have difficulty completing your minutes and bylaws. Or, that you are too busy to complete your required annual minutes and bylaws. Please contact us if you run into these problems and we will see how we can assist you.

How to Protect Your Profit-Makers from Your Problem-Makers

Never put all your eggs in one basket. If one corporation makes sense, two make more sense. If you operate several businesses, incorporate each separately. Follow this advice and the failure of any one business will not endanger the others. It's the smart way to limit losses and defensively organize your growing conglomerate.

Many once-thriving companies disappeared only because all their eggs were in one corporate basket. Example: A restaurant owner starts with one successful restaurant and soon expands into three successful restaurants, all owned by the one original corporation. Its fourth restaurant is a disaster and quickly bankrupts with it the three healthy restaurants. It happens to the smartest restaurants. It happens to the smartest business people. Consider the law of probability. No matter how smart you may be, your growing company will inevitably make mistakes and become saddled with one or two losers. Accept that reality and you'll understand why it makes considerable sense to isolate your potential losers from your present winners. This, of course, can happen only when you operate with separate corporations. As you grow, you can safely shed your losers and continue to build on the strength of the winners.

Don't organize your business based on tax factors alone. Asset protection objectives are even more important while you are still small and vulnerable. Once you become larger you cannot walk away from your losers quite as easily as when you were small. Tax, financing, creditor relations, and operational factors then begin to override liability protection.

Once you effectively insulate liabilities through multi-corporations, you can set up a holding company to own each operating corporation as a subsidiary. You can then substitute parent company guarantees for your own and really begin to look and operate like a major corporation.

Do you now own a troubled-company that can be separated into distinct corporations? It may not be too late. Isolate as separate corporations, you can either liquidate or attempt rehabilitation of the sick business while leaving your healthy operations in tact. To accomplish this you must act early so your failing corporation is accepted by creditors as a separate entity and not entangle the healthy businesses in its financial difficulties.

You may face the opposite dilemma: Your company may now be properly organized as separate corporations, but you may lose this protection because you failed to operate each as a

separate corporation. Your companies, for instance, may operate one bank account or commingle cash, inventory or other assets. It may operate with one payroll, combine corporate meetings or generally operate as one large corporation rather than several separate corporations. Should one corporation file bankruptcy, its creditors can justifiably throw your other corporations into bankruptcy as well. This is the hefty price you pay when your businesses do not properly function independently.

It takes more effort to operate your business through separate corporations, however, it's well worth the effort. You'll enjoy a greater sense of security knowing the failure of any one venture cannot jeopardize those that are successful.

Consider your own business. How can you identify and isolate the more risk-prone aspects of your business under the protective umbrella of a separate corporation? How can you restructure your organization so that failure of any one part will not jeopardize your remaining organization? Take that drill. It's survival training!

How to Shield Your Business with a Friendly Mortgage

A "friendly" mortgage against the assets of your business is the next vital step in shielding your business.

A friendly mortgage is absolutely your very best friend when you need an ally to save your business from creditors. It's a simple strategy: Mortgage your business to the hilt to a friendly lender. If you run into creditor problems your lender can foreclose and give you back a debt-free business. Executed properly it's 100 percent legal!

Example: suppose you own a business with \$100,000 in assets. Also suppose that your brother held a valid \$100,000 mortgage against these same assets. Finally, assume your business owed \$200,000 to general unsecured creditors. Since your brother's mortgage must be satisfied first in bankruptcy or a liquidation, unsecured creditors would be totally wiped out should the business fail. That's precisely the leverage you need if your business runs into serious trouble and you must battle your creditors. Without this friendly mortgage your unsecured creditors have first claim. Although these creditors may not fully recover what they are owed, they nevertheless would control the future of your enterprise because they, not you, control your business assets.

With a friendly mortgage in place you never lose control over your business. No matter what the creditors do, your cooperative mortgagee can always foreclose and resell these same assets to a newly formed corporation. In a few days you're back in the very same business, but without those nagging debts.

It's not even necessary for funds to change hands. Your mortgagee can finance the purchase by substituting loans between your old and new corporation. Caution: Avoid a sham mortgage that won't stand up to close scrutiny. You need a legitimate mortgage with documented consideration. Since total honesty is essential, rely on one of several ways to establish that friendly mortgage:

- ?? Whatever you invest to buy or start your business, never invest directly into the business. Your investment would then be subordinate to creditor claims. Indirectly, through a cooperative friend or relative, loan the money to your own business as a secured loan.
- ?? An affiliated corporation you own can perform consulting or other services, and thus be owed substantial funds by this company. The affiliated corporation would then be entitled to a mortgage to secure payment of the amount owed.
- ?? Did you transfer personal assets, other than cash, to your corporation? Why not make the transaction your opportunity to create a friendly mortgage on your business for the value of those assets?
- ?? Do you have a key supplier you want protected should your business fail? Give your supplier a mortgage to secure what may be owed. In turn, demand his cooperation to help defend your business against less-favored creditors should later problems arise.

Remember, it's never safe for you as the owner to loan directly to your business and accept a mortgage as security. Bankruptcy courts void mortgages held by owners against their own business. The mortgage should always be between your business and a third-party, one who is both trusted and as remote as possible from you. Avoid transactions that appear collusive.

Many possible variations on the theme exist since there are many ways to set up a mortgage against your business. If your business is presently unencumbered, or is secured by unfriendly mortgage holders, then at least slip in a friendly mortgage to help protect your business from tax and unsecured claims that would then stand behind the mortgage in priority.

The friendly mortgage strategy particularly works well against the IRS. For maximum protection have your friendly mortgage plus any prior mortgages approximate the liquidation value of the business assets. The IRS and other creditors then have no equity to seize. IRS collection guidelines discourage seizure of assets if there is no equity to cover the IRS costs of seizure. Still, this doesn't guarantee the IRS won't seize a heavily-encumbered business. The IRS may inaccurately appraise the assets

and mistakenly believe that liquidation will yield a surplus. Even when the IRS is convinced there's no equity in the business, they often seize with hopes its owner will pay rather than lose the business.

Remember-with a friendly mortgage as a shield, you'll always stay in control. At worst, your friendly mortgagee can foreclose on the business and sell you back your assets free of other creditor claims. You can even by-pass a public auction. The mortgagee can legally conduct a private sale, provided it's for an amount above its appraised liquidation value. The IRS, if they hold a lien, must receive 25 days advance notice of the sale, but as a practical matter there is nothing they, or any other creditor can do to stop the sale unless they bid a higher price.

How to Control the Lease to Protect Your Business

Does your business have a favorable long-term lease for its premises? Is it the type business where a good location is important? If so, your lease may be its most important asset and the one in need of special protection.

The key strategy: Don't have your business the tenant under the lease. Should your business fail, the bankruptcy court can order the lease transferred to a high-bidder. This can even occur against the landlord's consent, and despite provisions in the lease that prevent assignment or sublet of the lease. Under these circumstances, you lose control of the location and with it your business.

Your lease can be your most valuable asset. With your lease in jeopardy you lose negotiating power against your creditors. Creditors, through the bankruptcy court, can sell your business as a going business concern since they control the lease as a business asset. That's why the lease must never be an asset of the business. How can this be accomplished?

- ?? *Best strategy:* Have the lease stand in the name of another corporation that you organize for that purpose. This corporation can then assign or sublet the lease to your operating company on a month-to-month tenancy. Since the operating company has no rights to a longer tenancy, you and not your creditors continue to control the location should your business fail. Because you hold the lease through a separate corporation, you can evict your failing business with only one month's notice and either sublet to a new tenant, or you can set up a new business at the same location under a new sublet agreement.

?? *Second best strategy:* Have the lease pledged as collateral security to a friendly mortgagee. At the first sign of business difficulty the loan can go into default and the mortgagee can take over the lease and re-lease to a new business you would organize. The landlord must agree to this arrangement and may as quickly agree to the first strategy.

?? *Third best strategy:* At the first sign of business trouble have your landlord cancel your current lease and rent to your business on a month-to-month tenancy. Simultaneously, the landlord can grant you an option to lease the premises through another corporation, should your existing corporation fail. This new lease would be on the same terms as your present lease. Your option to lease could be exercised upon any termination of its tenancy by your troubled corporation. You benefit because you, not your creditors still control the lease. Your landlord benefits because either you, a favored tenant, come back into tenancy, or if you fail to exercise your option, your landlord can seek a new tenant.

Safeguarding a favorable location is vital strategy for restaurants, gas stations, retail businesses and the many other businesses that demand good traffic. These businesses often fail for reasons other than location. Many of these failed businesses could have survived had their owners the foresight to control the location. If location is critical to your business consider these safeguards today!

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ADDRESS CORRECTION REQUESTED

IRS Tidbits

?? You have to be very careful about awarding a bonus simply because you had a good year. The IRS calls that "Disguised Dividends", which are subject to double taxation.

?? The IRS has the power to disallow some or all of the deductions associated with the best as "constructive dividends".

?? You can borrow up to \$10,000 from your corporation, tax-free, without paying interest or suffering tax consequences. This is called a **de minimis exception**, and should the loan ever go over the \$10,000 ceiling, you could lose the exception and be taxed accordingly.

?? A list of equipment that could be leased would include: Computers and peripherals, printers, typewriters, phone systems, office furniture, fax machines, photocopy machines, automobiles, airplanes, cargo ships, trucks and trailers, off-road equipment, bulldozers, forklifts, machine tools, and other specialized equipment.

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Postponement: the sincerest form of rejection.

Robert Half

