



Newsletter

JANUARY 2002

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Our office will be closed for the following holidays:

January 21st – Martin Luther King Day

February 18th – Presidents' Day

Our next newsletter will be mailed out the beginning of April 2002.

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 March 15th for our April newsletter. ♦

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CALIFORNIA CORPORATE FILING FEE FOR 2002

To the best of our knowledge the California Filing fee for new corporations or qualifying corporations will be \$115. Corporations filed or qualified in the year 2002 will be exempt from PREPAYING the required California Franchise Tax fee. We have heard that a lot of people have misunderstood the exempt status and think they are exempt from paying California Franchise tax all together. This is incorrect. You are exempt from PREPAYING the California Franchise Tax. You will pay it, just not up front with the filing fee. ♦



RESIDENT AGENT FEES

Once that we resign as the Resident Agent on a corporation we WILL NOT put ourselves back on. You must contact another Resident Agent company if you wish to have a Resident Agent reinstated for a corporation that we have officially resigned on. ♦



Intellect and industry are never incompatible. There is more wisdom, and will be more benefit, in combining them than scholars like to believe, or than the common world imagine; life has time enough for both, and its happiness will be increased by the union.

S. Turner

EIGHT SUREFIRE WAYS TO LOSE YOUR CORPORATE PROTECTION

If your corporation is to be an effective liability insulator, it must function as a corporation, be treated as a corporation, and be recognized by its creditors as a distinct entity. You can lose your corporate protection when you relax these rules.

Beware the eight most common mistakes that can allow creditors to successfully “pierce the corporate veil” and impose personal liability for business debts on you as its owner.

***You commingle funds:** Operate your corporation as a distinct entity separate from yourself in every respect. Keep the corporation’s funds separate from your own. Funds transferred between yourself and your corporation must be properly documented. Example: Deposits of your funds to the corporation may be either a loan or a contribution to capital. Funds flowing from the corporation to yourself may be a loan, dividends, salary or expense reimbursement. Whatever the nature of the transaction, is it properly recorded on your personal records as well as the corporation’s? The same advice applies to financial transactions between related corporations.

***You commingle assets:** Prohibitions against commingling cash also apply to other assets, such as inventory. You can transfer inventory between corporations, provided accurate records are maintained. Creditors of one corporation frequently throw affiliated corporations into bankruptcy when they see undocumented transactions between the bankrupt corporation and those affiliated corporations not in bankruptcy.

***You fail to sign documents in the corporate name:** Avoid sloppiness when signing documents. Since you operate as a corporation, the documents to which it is a party should say so. Clearly state the corporate name. Designate your title aside or beneath your signature. This advice applies equally to checks. There are many cases where an individual is personally sued on a corporate obligation because she signed it in her name rather than the corporate name. Be disciplined. Always include the corporate name on all its documents and state your corporate title when signing on its behalf.

***You don’t operate your corporation autonomously:** If you operate more than one corporation it is important to operate each autonomously. This means, for instance, separate rather than duplicate or inter-locking boards of directors. Individuals who serve as officers of two related corporations should hold different offices in each. Corporate meetings should be held separately, and of course, separate corporate books must be maintained.

***You don’t keep adequate corporate records:** Creditors can challenge a corporate existence by showing no records, or inadequate records were maintained to document authority for corporate actions. Keep good records of all director and stockholder meetings. It is not difficult to keep accurate corporate records.

***You don’t identify your business as a corporation:** Let creditors know they are dealing with a corporation. This will discourage personal lawsuits from creditors and others who may believe they are dealing with a proprietorship or partnership. Place your corporate name on all signs, letterheads, billheads, checks and everywhere else a business name usually appears. If you use a fictitious name instead of the corporate name, then properly register the fictitious name according to your state laws.

***You haven’t kept your corporation in good standing:** A corporation dissolved by the state leaves you with no corporation, and in some states, no corporate protection. Pay all necessary taxes and corporate franchise fees to keep your corporation in good standing so it serves as an effective personal shield from business claims. Never voluntarily dissolve a corporation with debts, as these debts are then automatically assumed by you the stockholder.

***You undercapitalized the corporation:** Do you have too little invested in your corporation? Compare the amount you paid for your shares of stock versus funds you loaned to your corporation. A safe ratio? There’s no absolute rule in most states, but most lawyers and accountants advise at least \$1 invested as equity (for the shares) for every \$4 in loans. Some states set minimum capitalization requirements, and you’re safe if you follow them.

Set up your corporation so that it legitimately operates as a corporation. Apply these five test:

- 1). Does your corporation have an actual business address, as well as cancelled checks, to show the corporation paid for its overhead and own expenses?
- 2). Does your corporation have a telephone number listed in its name?
- 3). Has a business license been issued to the corporation if applicable?
- 4). Does your corporation have a bank or checking account?
- 5). Does your corporation transact some business with unaffiliated parties?

Compliance with these few simple points can help prove that your corporation is actually engaged in business and is a legitimate entity separate and apart from you.

Creditors may try to “pierce the corporate veil” and claim the corporation is nothing more than a sham or alter-ego of its principals, but a creditor who asserts this argument has the burden of proof. Courts

are reluctant to dismiss the important protection afforded by a corporation, but they have been known to do so when its owners flagrantly ignore the most basic requirements of respecting the corporation as a distinct entity. More commonly, a creditor's lawsuit against its owner-rather than the corporation-is simply a bad faith effort to force the owner to personally defend against the suit, and thus hopefully encourage a settlement. If this happens to you, threaten a countersuit against the creditor and his attorney for a frivolous bad faith litigation. Even with the most careful attention to corporate protection you may find yourself personally defending against "bad faith" creditor claims.◆

HOW TO MAKE YOURSELF AN INVISIBLE SHAREHOLDER

Shares of stock in a corporation are an asset that your creditors can reach. A good asset protection program will therefore conceal your identity as a shareholder. How can this be accomplished? To start, understand the several giveaways creditors always use to discover who the corporate shareholders are:

- Examination of corporate books- A creditor may subpoena corporate books to determine who the shares of stock have been issued to.
- Bank and credit records-frequently contain the names of the stockholders of a corporate borrower. Major suppliers may also list the true principals on credit applications. Utility companies also request stockholder information as part of their credit inquiries.
- Licensing applications-are another giveaway. For example, pharmacies must be licensed by boards of pharmacy. Nursing homes, liquor stores, barber and beauty salons are other examples of licensed businesses where ownership disclosure is mandatory.
- Building permits, zoning variances and other municipal applications-frequently require corporate shareholders to be disclosed.
- Corporate tax returns-specifically ask for the names of each stockholder and the percentage of shares each owns. This, of course, is a dead giveaway.
- Personal tax returns-shows dividend income from the corporation. However, a small business corporation seldom issues dividends to its stockholders. More commonly, as evidence of ownership, sophisticated creditors will investigate personal tax returns hoping to find a "passing-through" profit or loss from an "S" corporation.

It is impossible to conceal your stock ownership in a publicly-owned corporation because accurate records are kept by the transfer agent. Here corporate shares are

Best owned by a "straw," or by a trust, limited partnership or another corporation. In the case of a privately-owned corporation where various records clearly show ownership, the stockholder's best defense is to claim the shares are pledged to a third-party, or that the shares have been recently transferred. Since either action may invite challenge as a fraudulent conveyance, the best course is to properly plan stock ownership before it is issued. A limited partnership or irrevocable trust are two good options. Where the husband and wife jointly-owned property is exempt from attachment by state law, co-ownership as tenants-by-the-entirety is a good third option.

To avoid creditor hassles, do more than conceal or protect your stock ownership. When trouble looms, resign as an officer or director of the corporation. Courts are more likely to believe you are not a stockholder if you are not a principal officer or director of the corporation. When creditors discover you are an officer or director of a small closely-held corporation, you will also invite investigation into whether you also own stock in the corporation.◆

SIX WAYS TO MAKE YOUR CORPORATE SHARES WORTHLESS TO CREDITORS

With creditors in hot pursuit, quickly sell your stock or bonds in any publicly-owned corporation. A judgment creditor can seize the shares of stock or bonds that you do own. The options open to you as a stockholder of a privately-owned corporation are more numerous"

- Impose transfer restrictions on the shares: Restrictions on transfer generally do not prevent a creditor from seizing your shares, but they may discourage less-knowledgeable or less-aggressive creditors.
- Assess your shares: If you can establish that your shares are not fully paid, or are subject to assessment, the creditor can only claim the shares subject to such obligations. A sufficiently high assessment will wipe out any value the shares may have to creditors.
- Issue non-revocable proxies: The fact that the creditor will be unable to vote the shares will certainly diminish the creditor's enthusiasm, lessen the value of the shares, and give the creditor less control

- Encumber the business: Your shares of stock have no value of the business itself. Why offer the creditor a financially healthy company that can be profitably sold or liquidated by the creditor? Offer instead a heavily indebted business that would yield the creditor nothing. This is the “poison pill” strategy that works wonders. Place a “friendly mortgage” against your business assets and you have your “poison pill.” Pledge the shares: Perhaps you borrowed using your shares as collateral. If the amount borrowed approaches the value of the shares, the creditor would again be chasing worthless shares.
- Transfer the shares to a limited partnership: Set up a limited partnership and exchange your shares in the corporation for a limited partnership interest. Now the creditor would have to go after the limited partnership interest which is a difficult process. A victory here would give the creditor only a limited partnership interest in a partnership that is a shareholder in a corporation. The creditor gains nothing of value for this effort.

Tip: For maximum protection combine strategies. Best strategy: Keep the shares out of your name to begin with. Your most practical strategy if you now own shares in a public corporation and have creditor problems? Sell the shares. Cash is the easiest asset to protect because there are so many ways it can be spent.♦

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ADDRESS CORRECTION REQUESTED

Corporations are treated as a separate taxpayer under IRS Income Tax laws. But if one corporation owns at least 80% of the outstanding shares of another corporation, the income and losses of the two corporations can be combined for tax purposes as if they were a single corporation.



Who can be entertained? The IRS does not have a specific list of people describing who can and cannot be entertained. The regulations seem to indicate that it depends on the circumstances of a particular situation. Typically, any customer, supplier, client, employee, agent, partner, or professional advisor can be entertained, whether they are established or prospective.



What is the difference between a taxidermist and a tax collector?

The taxidermist takes only your skin.

Mark Twain

