



Organizing a start-up business

An Introduction into starting your business

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For Desk Chair Workspace - Made in Loveland Series

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Do I need to form an entity?

This depends on present needs and foreseeable developments .

- + 1. Will I need a vehicle for partners or investors? Employees?
- + 2. Do I need to protect personal assets? Limited Liability.
- + 3. Perception of public or customers?

Structure vocabulary

- + 1. Corporation is owned by shareholders. These shareholders elect a board of directors. The directors hire officers such as a President, Secretary and Treasurer. They hire employees.
- + 2. A Limited Liability Company is owned by the members. They may run the company or elect or appoint managers to run the business. They may hire officers or employees.
- + 3. Partnerships are owned by the partners. They can have limited or general partners depending on authority vs investment.
- + 4. Fiduciary Duty. A fiduciary relation exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation. A duty to act with utmost loyalty on behalf of, and for the benefit of, the other party. *Accident & Inj. Med. Specialists, P.C. v. Mintz*, 2012 CO 50, ¶ 21, 279 P.3d 658, 663.

Limited Liability

- + An LLC is a legal entity separate from the members who own it. Thus, neither the members of an LLC nor its managers are personally liable for debts incurred by the LLC. § 7-80-705, C.R.S.
- + The corporate veil fiction "isolates 'the actions, profits, and debts of the corporation from the individuals who invest in and run the entity, and only extraordinary circumstances justify disregarding the corporate entity to impose personal liability." *Dill v. Rembrandt Grp., Inc.*, 2020 COA 69, ¶ 27, 474 P.3d 176, 183, reh'g denied (May 7, 2020), cert. denied.

Limited Liability - LLC same as Corporation

- + Piercing the corporate veil is an equitable, common-law doctrine that penetrates the corporate veil of limited liability to impose liability on individual shareholders for the corporation's obligations. Its application is appropriate when a corporation is merely a corporate shareholder's alter ego, and the shareholder uses the corporate structure to perpetrate a wrong.
- + "It would be an unwarranted stretch to say that these [limited liability company statutes] intend to extend the insulation of limited liability beyond that traditionally provided by the corporate form. That means that participants in closely held enterprises will continue to be liable for their acts taken in the entity's name that are wrongful or violate regulatory provisions either under agency law or by a court piercing the entity's veil.").
- + *Sheffield Servs. Co. v. Trowbridge*, 211 P.3d 714, 720 (Colo. App. 2009), overruled by *Weinstein v. Colborne Foodbotics, LLC*, 2013 CO 33, 302 P.3d 263.
- + New equitable ownership doctrine. *McCallum Family LLC v. Winger*, 221 P.3d 69 (Colo. App. 2009).

Piercing the Veil

- + To pierce the corporate veil in Colorado, a court must conduct a three-part inquiry. First, it must determine **whether the corporate entity is the alter ego** of the person or entity in issue. *Id.* An alter ego relationship exists when a corporation or LLC is merely an instrumentality for the transaction of the shareholders' or members' affairs and "there is such unity of interest in ownership that the separate personalities of the corporation [or LLC] and the owners no longer exist."
- + Second, upon finding that an entity is the alter ego of its owners, a court must determine whether the corporate fiction was **used to perpetrate a fraud or defeat a rightful claim.**
- + Third, a court must consider whether disregarding the corporate form would achieve an **equitable result.**
- + *Dill v. Rembrandt Grp., Inc.*, 2020 COA 69, ¶ 28, 474 P.3d 176, 183, reh'g denied (May 7, 2020), cert. denied, No. 20SC460, 2020 WL 6325871 (Colo. Oct. 26, 2020).

Unity of Interest

- + To determine whether unity of interest exists, a court considers several factors, including whether (1) the corporation or LLC operates as a **distinct business entity**; (2) the two entities **commingle funds** and assets; (3) the two entities maintain **inadequate corporate records**; (4) the nature and form of the entities' ownership and control facilitates **misuse by an insider**; (5) the corporation or LLC is "used as a **'mere shell'** "; (6) "the business [i]s **thinly capitalized**"; (7) **legal formalities** are disregarded; and (8) corporate funds or assets are used for **noncorporate purposes**. *Id.* (quoting *Leonard v. McMorris*, 63 P.3d 323, 330 (Colo. 2003)); Courts examine the specific facts of the case and need not find the existence of every factor to find an alter ego
- + *Dill v. Rembrandt Grp., Inc.*, 2020 COA 69, ¶ 29, 474 P.3d 176, 183-84, reh'g denied (May 7, 2020), cert. denied, No. 20SC460, 2020 WL 6325871 (Colo. Oct. 26, 2020).

Duties of Members and Managers

- + § 7-80-404. Duties of members and managers
- + (a) **Account** to the limited liability company and **hold as trustee** for it any property, profit, or benefit derived by the member or manager in the conduct or winding up of the limited liability company business or derived from a use by the member or manager of property of the limited liability company, including the appropriation of an opportunity of the limited liability company;
- + (b) Refrain from dealing with the limited liability company in the conduct or winding up of the limited liability company business as or on behalf of a party having an **interest adverse** to the limited liability company; and
- + (c) Refrain from **competing** with the limited liability company in the conduct of the limited liability company business before the dissolution of the limited liability company.

Duties of Shareholders, Directors and Officers

- + 7-108-404 C.R.S. requires the discharge of a **director's and officer's duties** in good faith and more in line with the business judgement rule. The statute requires discharge of duties:
 - + (a) In good faith;
 - + (b) With care; and
 - + (c) In a manner the director or officer reasonably believes to be in the best interests of the corporation.
- + A director or officer of a corporation, in the performance of duties in that capacity, **does not have any fiduciary duty to any creditor** of the corporation arising only from the status as a creditor, whether the corporation is solvent or insolvent. C. R. S. § 7-108-401.
- + Unless otherwise provided in the articles of incorporation, a **shareholder** or a subscriber for shares of a corporation is not personally liable for the acts or debts of the corporation; except that such person may become personally liable by reason of the person's **own acts or conduct**. C. R. S. § 7-106-203. They are liable for the cost of the shares.

Types of Entities in Colorado

- + Sole Proprietorship
- + General Partnership
- + Limited Partnership
- + Limited Liability Partnership
- + Limited Liability Limited Partnership
- + Corporation C or S
- + Limited Liability Company

Proprietorship

- + 1. With no entity, a business for profit is referred to as a proprietorship. This can be a sole proprietorship, or one can have partners. This means the **owner is liable** for all debts, liabilities and obligations of the partnership. It can extend your exposure.
- + 2. It is a pass-through entity for taxes.
- + 3. It is a **default** and can be created without a written agreement. A "partnership" is defined as "an association of two or more persons to carry on, as coowners, a business for profit." See § 7-60-106(1), C.R.S. *Batterman v. Wells Fargo Ag Credit Corp.*, 802 P.2d 1112, 1117 (Colo. App. 1990).

General Partnership

- + A "partnership" is defined as "an association of two or more persons to carry on, as coowners, a business for profit." *Batterman v. Wells Fargo Ag Credit Corp.*, 802 P.2d 1112, 1117 (Colo. App. 1990).
- + Each general partner is personally liable for the debts and liability of the partnership.

Limited Partnership

- + A limited partnership (“LP”) is a partnership formed by two or more persons which has both one or more **general partners** and one or more **limited partners**.⁸ A certificate of limited partnership must be filed with the Colorado Secretary of State.
- + While the liability of the limited partners for partnership liabilities is generally limited, **all general partners are personally liable** for the debts and liabilities of the LP.¹⁰ In order to preserve their limited liability, limited partners are not permitted to actively participate in the conduct of the business of the LP.
- + Taxed as partnership unless election.

Limited Liability Partnership

- + A limited liability partnership (“LLP”) is a partnership consisting entirely of partners with limited liability.¹¹ An LLP must register with the Colorado Secretary of State to be considered an LLP.
- + Generally, each partner has equal rights and authority. The personal liability of the partners for partnership debts and liabilities is generally limited. However, partners have the same fiduciary duties as partners in a general partnership rather than the much lower duties of shareholders in a corporation.

Limited Limited Liability Partnership

+ A limited liability limited partnership (“LLLP”) is similar to an LP in that it has one or more **general partners** and one or more **limited partners**.¹³ A combined certificate of limited partnership and statement of registration must be filed with the Colorado Secretary of State to register as an LLLP.¹⁴ LLLPs will almost always be governed by a partnership agreement entered into among the partners. Unlike an LP, an LLLP provides limited liability to the general partners to the same extent as a partner in a limited liability partnership.¹⁵ LLLPs can make the same elections to be taxed as other partnerships.

Corporation

- + A corporation is an entity formed by filing Articles of Incorporation with the Colorado Secretary of State in order to carry on a business for profit.¹⁶ Unlike a partnership, only one owner is required. A corporation is managed by its directors and officers and is governed by its Articles of Incorporation, Bylaws, and, often, a shareholders agreement. Neither the directors nor officers need to own shares in the corporation.
- + A corporation is considered a **C corporation** for tax purposes unless an election has been made by all of the owners to be treated as an **S corporation**. In a C corporation, profit is taxed to the corporation when earned and then is taxed to the owners when distributed.

Limited Liability Company

- + Articles of Organization must be filed with the Colorado Secretary of State to form a Colorado LLC.¹⁹ LLCs are usually governed by an Operating Agreement. An LLC provides liability protection to its owners to the same extent as a corporation but is generally considered a partnership for federal income tax purposes unless it affirmatively elects to be taxed as a corporation.
- + Unlike limited partners, the members of an LLC may participate directly in management activities or designate certain members or non-members to manage the business.

Bank Accounts

- + Don't just open another account with personal bank.
- + Formation documents should include authorization, but financial institutions may have their own.
- + Goals, lending, services, check with chamber of commerce, SBA, trade organizations.
- + In person and on-line business. Fees. Investing.
- + Will likely need a Federal Tax Identification Number.

Federal Tax Identification Number FEIN same as EIN (employer tax identification number)

- + Application is SS-4. Correct website is www.irs.gov many knock offs who want to charge for their service. Link for Apply for an Employer ID Number (EIN).
- + If no prior or inconsistency, one can be obtained electronically the same day. Otherwise, you may need to fax application.

Employee vs. Independent Contractor

- + Federal and State laws implicated.
- + The employer will face a variety of other liabilities since it will not have taken withholdings, made the required contributions to FICA, provided any voluntary benefits its other, properly classified employees received, or paid premiums for unemployment insurance or workers' compensation insurance. Contractors misclassified as employees may also be owed minimum wage and overtime. Of course, someone who was misclassified as an independent contractor will also have an employee's protections such as those under employment discrimination laws and wage laws; so, the employer may face liability under those laws if it took an adverse action against the worker.

Employment

- + The key fact in determining whether a person engaged to do work for another is an independent contractor or an employee depends on the **control** over the work to be done. If the power to control, whether exercised or not, includes controlling the details of how the work will be done, that is, the "**means as well as the end,**" then the person engaged is an employee. Colo. Jury Instr., Civil 8:5

Independent Contractor

If the person engaged has the **right to control** the manner in which the work will be done and is subject to the control of the other work, essentially only in terms of being responsible for a **certain end product or result**, then the person engaged is an independent contractor. Colo. Jury Instr., Civil 8:5

Presumption C.R.S. § 8-70-115 (c)

person for whom services are performed does not:

- + (I) Require the individual to work exclusively for the person for whom services are performed; except that the individual may choose to work exclusively for the said person for a finite period of time specified in the document;
- + (II) Establish a quality standard for the individual; except that such person can provide plans and specifications regarding the work but cannot oversee the actual work or instruct the individual as to how the work will be performed;
- + (III) Pay a salary or hourly rate but rather a fixed or contract rate;
- + (IV) Terminate the work during the contract period unless the individual violates the terms of the contract or fails to produce a result that meets the specifications of the contract;
- + (V) Provide more than minimal training for the individual;
- + (VI) Provide tools or benefits to the individual; except that materials and equipment may be supplied;
- + (VII) Dictate the time of performance; except that a completion schedule and a range of mutually agreeable work hours may be established;
- + (VIII) Pay the individual personally but rather makes checks payable to the trade or business name of the individual; and
- + (IX) Combine his business operations in any way with the individual's business, but instead maintains such operations as separate and distinct.

Proprietary Property

- + Inventions or trade secrets need to be transferred prior to entity maybe. Capital contribution.
- + Confidentiality

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13. *Sheffield Servs. Co. v. Trowbridge*, 211 P.3d 714, 720 (Colo. App. 2009).
14. C.R.S. § 7-60-106(1).
15. C.R.S. § 8-70-115 (c).