# Business Essentials

## Starting A Small Business Or Non-Profit

**Dominique J. Carroll** J.D., M.B.A.

Trenton Choice Neighborhood Leadership Series
April 28, 2021



Fox Rothschild LLP
ATTORNEYS AT LAW

# Who are we?

## FOX ROTHSCHILD AT A GLANCE

900 lawyers

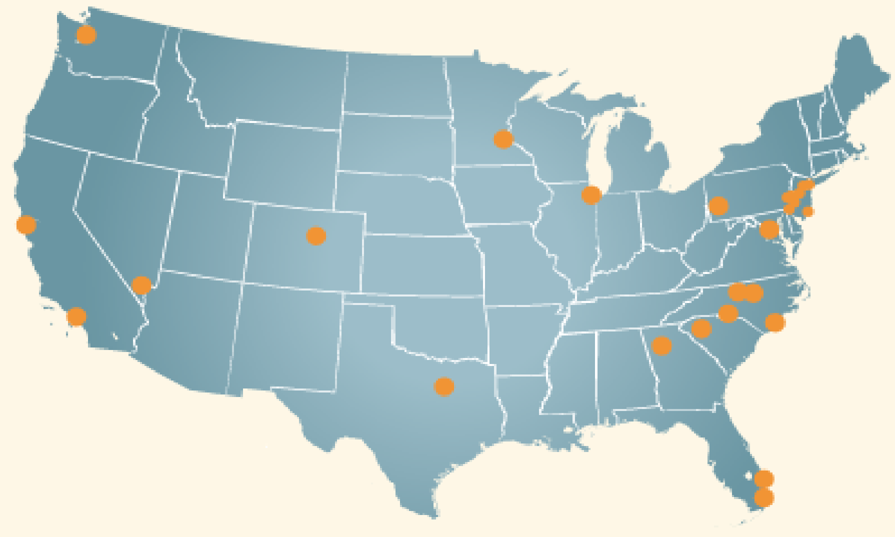
**Am Law 100 firm**

27 offices coast to coast

**Established more than 100 years ago**

60+ diverse practice areas

HOSPITALITY **TRANSPORTATION**
**ENERGY/INFRASTRUCTURE** HEALTH LAW
INSURANCE CANNABIS **EMERGING COMPANIES & VC**
LABOR & EMPLOYMENT
**INTELLECTUAL PROPERTY** FRANCHISING IMMIGRATION
**EMPLOYEE BENEFITS** GAMING
MEDTECH SPORTS LAW CONSTRUCTION TAX **LITIGATION**
**CORPORATE** INTERNATIONAL
MANUFACTURING **PRIVACY & DATA SECURITY**
ENTERTAINMENT **BANKRUPTCY**



- Atlanta, GA
- Atlantic City, NJ
- Blue Bell, PA
- Charlotte, NC
- Chicago, IL
- Dallas, TX
- Denver, CO
- Exton, PA
- Greensboro, NC
- Greenville, SC
- Las Vegas, NV
- Los Angeles, CA
- Miami, FL
- Minneapolis, MN
- Morristown, NJ
- New York, NY
- Philadelphia, PA
- Pittsburgh, PA
- Princeton, NJ
- Raleigh, NC
- San Francisco, CA
- Seattle, WA
- Warrington, PA
- Washington, DC
- West Palm Beach, FL
- Wilmington, DE
- Wilmington, NC

Fox Rothschild LLP
ATTORNEYS AT LAW

# Basics of Separate Corporate Entities

Advantages of forming separate entities:

- Limited Liability
- Asset Protection
- Once established, courts are reluctant to pierce the corporate veil



Fox Rothschild LLP
ATTORNEYS AT LAW

# Basics of Separate Corporate Entities

## Limited Liability Advantages:

- Large Class Action Lawsuits
- Catastrophic Tort Claim
- Breach of Contract Action for separate business activities



Fox Rothschild LLP
ATTORNEYS AT LAW

# Basics of Separate Corporate Entities

## Asset Protection Advantages:

- Minimize the amount creditors can recover from the Company

- Assets will be protected under "Corporate Veil" of a separate corporate entity



Fox Rothschild LLP
ATTORNEYS AT LAW

# Basics of Separate Corporate Entities

## Common Types of Entities:

- Limited Liability Company
- C-Corporation
- S-Corporation
- Limited Partnership
- Nonprofit

*One size does not fit all – each entity has legal and tax considerations that need to be considered prior to formation.*



Fox Rothschild LLP
ATTORNEYS AT LAW

# Common Question

For-Profit of Not-for-Profit: What's the (Legal) Difference?



Fox Rothschild LLP
ATTORNEYS AT LAW

# Definitions

Profit:

*Revenues (income) in excess of expenses*



Fox Rothschild LLP
ATTORNEYS AT LAW

# Definitions

For-Profit:

*With the intention of making <u>and distributing</u> profit.*

# Definitions

Not-For-Profit:

*With the intention of making <u>but not distributing</u> profit.*



Fox Rothschild LLP
ATTORNEYS AT LAW

# Definitions

For-profit = Taxable

But

Nonprofit ≠ Tax-exempt



Fox Rothschild LLP
ATTORNEYS AT LAW

# What’s the Difference?

- A business entity can distribute profits; a nonprofit organization cannot.
- A business entity can transfer property to owners without charging them fair market value; a tax-exempt organization cannot.
- A tax-exempt organization is limited to paying reasonable compensation to employees; a business entity can pay more.

# What’s the Difference? (cont’d.)

- Donations to a certain type of tax-exempt organization give rise to a charitable contribution deduction, and such organizations are generally eligible to receive grants from private foundations and the government; business entities generally are not eligible.
- A business entity can raise start-up money from private investors, and issue them an equity stake (e.g., shares of stock, or membership interests in an LLC) in return for their investment; a tax-exempt organization cannot.

# Sources of Revenue

Where will my start-up money come from?

- If from private investors in return for issuance of stock or membership interests, use business entity.
- If from grants from private foundation or government, check eligibility—only a tax-exempt organization may be eligible

Where will most of my operating revenues come from?

- If from sales of goods or services, consider business entity first.
- If from contributions or grants, consider nonprofit organization first.
- If from admission to events or facility, consider other factors.

# Sources of Revenue

## What type of activities will the entity conduct?

- If activities will be charitable, educational, literary or religious, consider nonprofit entity that will seek recognition of tax-exempt status
- If activities will be commercial, consider business entity

# Overview of Nonprofits

- A "nonprofit" organization:
  - May or may not generate profits
  - Does not distribute profits to owners – no dividends
  - Has no owners – no shareholders
  - May have members, but members have no rights other than those expressly conferred in articles and bylaws
  - May pay <u>reasonable</u> compensation to members, directors or officers for services rendered

# Overview of Nonprofits

- Two levels of regulation:
  - State
    - Formation of entity
    - State income and franchise tax
    - Directors duties and liability
    - Fundraising
    - Management of Institutional Funds
    - Sales tax
  - Federal
    - Federal income tax
    - Tax-exempt status
    - Unrelated business income tax
    - Intermediate sanctions/excess benefit transaction
    - Excise taxes on private foundations
    - Public disclosure requirements
    - Annual reporting requirements

# Overview of Nonprofits

- Tax-exempt entities – different types, described under Section 501(c), Internal Revenue Code:
  - 501(c)(3) charitable, religious, educational or scientific organization
  - 501(c)(4) social welfare organizations
  - 501(c)(6) business leagues and trade associations
  - 501(c)(7) social clubs

# Overview of Nonprofits

- Advantages of 501(c)(3) status:
  - Exemption from federal income tax (except federal tax on unrelated business income)
  - *Donors can claim charitable deduction*
  - Note: To be eligible, the organization must be organized and operated for a religious, charitable, educational, scientific, testing for public safety, or literary purpose.

# Overview of Nonprofits

Surprising Fact:

- The most valuable attribute of recognition under Section 501(c)(3) is not that the organization does not have to pay income tax; it is that contributions to the organization qualify for a charitable contribution deduction

Fox Rothschild LLP
ATTORNEYS AT LAW

# Piercing the Corporate Veil

- Disregarding the corporate entity
- Holding a shareholder or parent owner of the corporation personally liable for the debts or liabilities of the corporation despite the general principle that shareholders or parent owners are immune from suits in contract or tort in which only the corporation would normally be liable

Fox Rothschild LLP
ATTORNEYS AT LAW

# Piercing the Corporate Veil

Fraud or Bad Faith is a Common Reason for Piercing Corporate Veil

- Fraud or bad faith can be the sole independent ground for piercing the corporate veil
- Plaintiff typically must show element of injustice of fundamental unfairness



Fox Rothschild LLP
ATTORNEYS AT LAW

# Piercing the Corporate Veil

## Additional reasons for Piercing the Corporate Veil

- Gross undercapitalization of one corporation
- Siphoning of funds by one corporation to the detriment of another corporation
- Failure to observe corporate formalities
- Absence of corporate records
- Operating as a single business of enterprise



Fox Rothschild LLP
ATTORNEYS AT LAW

# Questions?

Dominique J. Carroll, Esq.

Fox Rothschild LLP
ATTORNEYS AT LAW