



DESCHUTES DISCOVERY

A LEGAL NEWSLETTER PUBLICATION

Merrill O'Sullivan, LLP, Attorneys at Law 541.389.1770 • Fax 541.389.1777 • www.merrill-osullivan.com

VOLUME 2, ISSUE 1
WINTER 2006

IN THIS ISSUE

*Honoring business formalities
regardless of type of entity 1*

*1. Liability for failing to follow
formalities 2*

*2. Steps to take to protect the
entity..... 2*

*Departure of partner
David W. Smiley..... 3*

Meet Nancy Ryan..... 4

HONORING BUSINESS FORMALITIES REGARDLESS OF TYPE OF ENTITY

BY DAVID G. BROWN, ATTORNEY AT LAW

In the previous issue of this newsletter, we discussed the pros and cons of using a limited liability company ("LLC") or a corporation as your business entity. Regardless of the type of entity you choose, you must meet or exceed the minimum level of paperwork documenting your entity as required by the Oregon Revised Statutes ("ORS") and the Internal Revenue Code ("IRC"). This paperwork documenting your entity is referred to as the "formalities" of the entity. Different entities have different minimum required formalities.

The ORS require the shareholders and directors of a corporation to hold at least one meeting per year. This meeting is typically referred to as the "annual meeting." Of course, meetings may take place more frequently. The annual meeting should be documented with minutes or a statement of actions in lieu of the meeting. The minutes or statement of actions should include information from the business' accountant so that it can support the positions taken on the business' tax returns. The minutes would also ideally include the participation of the business' attorney so that transactions that might otherwise present a potential conflict of interest (such as a loan by a shareholder to the corporation, or vice versa) can be properly documented. The IRC requires corporations to file income tax returns.

The ORS do not require the same level of documentation for LLCs. For example, LLCs are not required to have annual meetings. Nonetheless, we strongly recommend having an annual meeting for an LLC (even one that is a single-member LLC) so that the member(s) can document any potential conflict of interest transactions and so that the annual documentation can support the positions taken in the LLC's tax return. Because we recommend that an LLC hold annual meetings and prepare other documentation to preserve the separateness of the LLC from its members (and thereby preserve the limited liability of the members), this article refers to "business formalities" and applies equally to corporations and LLCs. If a single-member LLC is taxed as a sole proprietorship, the IRC does not require it to file a separate tax return; a single-member LLC's income can be included on a Schedule C on the owner's income tax return. LLCs with two or more members must file a separate income tax return.

continued on page 2



Shari Morris, God's Creations Photography, LLC ©

Shari Morris, God's Creations Photography, LLC.©



continued from page 1

1. LIABILITY FOR FAILING TO FOLLOW FORMALITIES.

Though business formalities are easily overlooked or may seem trivial, they serve the important function of preserving the identity of the business as a separate entity from its owner(s). When business entities are sued and opposing counsel seeks to “pierce the corporate veil” to impose personal liability on the owner(s), they will seek to show that you have not met your business formalities.

As an owner of a business entity you can inadvertently open yourself up to potential personal liability by failing to follow business formalities, such as by failing to:

- keep separate business records
- keep personal and business finances separate
- hold annual shareholder meetings
- keep current meeting minutes
- file separate business tax returns and reports

You can help protect yourself by following and honoring business formalities.

Another business formality that is often overlooked or ignored, with potentially dire consequences, is commingling the funds or assets of the business with those of the owner(s). For example, occasionally members will use

business funds to make mortgage payments on their personal residence, purchase cars that were really for personal use, or use the business assets to pay for that long overdue bone fishing trip to the Bahamas. When the funds or assets of the business are used for personal items of the owner, the legal separateness of the entity is jeopardized. Owner(s) should take care to maintain separate business and personal accounts to avoid any confusion.

2. STEPS TO TAKE TO PROTECT THE ENTITY.

The best way to ensure compliance with business formalities is to establish formal policies, procedures, and guidelines for your business. This has the effect of professionalizing the business. You should establish sound management systems, operating budgets, and formal employee performance reviews for your business. Such steps can help to minimize the risk that your business' “corporate veil” will be pierced and that personal liability will be imposed on you as its owner(s).

In order to minimize the risk of losing the limited liability status of an entity, you should take the following precautions:

- Make clear distinctions between the assets of the business and the personal assets of the owner(s). Do not make payments of personal obligations from business funds, purchase assets with business funds that are essentially for personal use, or make payments from personal funds to cover business obligations.
- Thoroughly document all transactions between the owner(s) and the business, such as loans to or from the owner(s).
- Hold annual formal shareholder and director meetings, or work with your attorney and accountant to prepare a statement of actions in lieu of annual meeting.

continued on page 3

continued from page 2

- Maintain up-to-date minutes of all shareholder and director meetings.
- Obtain a copy of the State of Oregon statutory requirements, and develop a plan to meet those requirements.
- File separate state and federal business income tax returns.
- Establish a formal business control structure under which the same individual is not the majority shareholder, president, manager, and director. Consider establishing a board of directors that includes non-family members.
- Maintain adequate capital in the business, and avoid situations where the business has ongoing negative net worth.
- Distinguish between salaries paid to shareholders and/or shareholders' family members and dividends declared by the board of directors.
- Establish public recognition of the business as a separate legal entity. Sign checks on behalf of the business as an officer of the business and not as an individual, and obtain loans or lines of credit for the business in the name of the business even if a personal guarantee is required.
- Designate the business as a limited liability company or corporation on business cards, signage, letterhead, and in all contracts, work orders, receipts and the like.

In sum, regardless of the type of entity chosen, it is important that you honor and follow the legal, statutory and business formalities for your chosen entity. By taking a few simple and easy steps now, you can avoid a lot of expense and headaches later on.

DEPARTURE OF PARTNER DAVID W. SMILEY

After seven years of practice with Merrill O'Sullivan, LLP, David W. Smiley has opened his own law practice, David W. Smiley, P.C. Mr. Smiley's practice will focus on business and employment law, tax, trust and estate planning, elder law and probate. His new office telephone number and address are (541) 318-1288, 168 NW Greenwood Avenue, Bend Oregon 97701, and his new e-mail address is david@dwsmile.com. We have enjoyed our association with David through the years and wish him all the best in his new practice.



Shari Morris, God's Creations Photography, LLC.©

MERRILL O'SULLIVAN, LLP
1070 NW BOND STREET, SUITE 303
BEND, OREGON 97701

PRSR STD.
U.S. Postage
PAID
Bend, OR
Permit No. 3

MAX MERRILL
TERRENCE B. O'SULLIVAN
DAVID E. PETERSEN
STEPHEN D. DIXON
PATRICIA L. HEATHERMAN
RODNEY P. MOCK
DAVID G. BROWN

MEET NANCY RYAN

Nancy Ryan has worked for partner Max Merrill as his legal assistant since 1988. With roots in North Dakota and Minnesota, she came to Bend in 1978. Upon coming to Bend, she worked as a firefighter for the Forest Service for 4 years and then worked for the District Attorney's Office for several years.

Nancy is an avid photographer and loves watching, photographing and feeding birds. She also enjoys kayaking, bicycling, gardening, dirt biking, camping and fishing. She is a member of a local dance troupe. Nancy served on the Alyce Hatch Center board of directors for seven years. She and her husband of 23 years, Mike, have a beautiful 13-year-old daughter, Niki.



Circular 230 Notice: We must inform you that this message, if it contains advice relating to federal taxes, was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties that may be imposed under federal tax law. Under these rules, a taxpayer may rely on professional advice to avoid federal tax penalties only if that advice is reflected in a comprehensive tax opinion that conforms to stringent requirements under federal law. Please contact an attorney in our office if you would like to discuss our preparation of an opinion that conforms to these new rules.

For more information regarding our legal services, please contact our office at (541) 389-1770 or visit <http://www.merrill-osullivan.com>.

Patricia L. Heatherman is the Editor of Deschutes Discovery. If you have questions regarding this issue, please contact Ms. Heatherman at (541) 389-1770 or e-mail feedback to lawfirm@merrill-osullivan.com.

The contents of this newsletter are intended for general informational purposes only and should not be construed as legal advice or a legal opinion with respect to any specific facts or circumstances.