Professional Liability Fund present

From Startup to Endgame: Form of Entity Considerations for Your Law Practice

Thursday, June 1, 2017

2.75 MCLE General or Practical Skills Credits

Jay Richardson, Buckley Law PC
Scott Schnuck, AltusLaw LLC

www.osbplf.org
503-639-6911
1-800-452-1639

OSB Center
Tigard, Oregon

MCLE FORM 1: Recordkeeping Form *(Do Not Return This Form to the Bar)*

Instructions:
Pursuant to MCLE Rule 7.2, every active member shall maintain records of participation in **accredited** CLE activities. You may wish to use this form to record your CLE activities, attaching it to a copy of the program brochure or other information regarding the CLE activity.

Do not return this form to the Oregon State Bar. This is to be retained in your own MCLE file.

Name:	Bar Number:
Sponsor of CLE Activity: OSB Professional Liability Fund	
Title of CLE Activity: From Startup to Endgame: Form of Entity Consd. for Your Law Practice	Program Number: 558*2160
Date: 6/1/2017	Location: OSB Center, Tigard Oregon

❑ *Activity has been accredited by the Oregon State Bar for the following credit:*

2.75 ____ **General** or Pract. Skills
____ **Prof Resp-Ethics**
____ **Access to Justice**
____ **Child Abuse Rep.**
____ E**lder Abuse Rep.**
____ **Practical Skills**
____ **Pers. Mgmt/Bus. Dev.***

❑ **Full Credit.**
I attended the entire program and the total of authorized credits are:

____ **General**
____ **Prof Resp-Ethics**
____ **Access to Justice**
____ **Child Abuse Rep.**
____ E**lder Abuse Rep.**
____ **Practical Skills**
____ **Pers. Mgmt/Bus. Dev.***

❑ **Partial Credit.**
I attended _____ hours of the program and am entitled to the following credits:*

____ **General**
____ **Prof Resp-Ethics**
____ **Access to Justice**
____ **Child Abuse Rep.**
____ E**lder Abuse Rep.**
____ **Practical Skills**
____ **Pers. Mgmt/Bus. Dev.***

***Credit Calculation:**
One (1) MCLE credit may be claimed for each sixty (60) minutes of actual participation. Do not include registration, introductions, business meetings and programs less than 30 minutes. MCLE credits may not be claimed for any activity that has not been accredited by the MCLE Administrator. If the program has not been accredited by the MCLE Administrator, you must submit a Group CLE Activity Accreditation application (See MCLE Form 2.)

Caveat:
If the actual program length is less than the credit hours approved, Bar members are responsible for making the appropriate adjustments in their compliance reports. Adjustments must also be made for late arrival, early departure or other periods of absence or non-participation.

*Personal Management Assistance/Business Development. See MCLE Rule 5.11 and Regulation 5.300 for additional information regarding Category III activities. Maximum credit that may be claimed for Category III activities is 6.0 in a three-year reporting period and 3.0 in a short reporting period.

About Our Speakers

Jay Richardson

Jay Richardson is senior counsel at Buckley Law and practices in the business, tax, estate planning, and real estate practice groups. His practice emphasizes taxation, business formation and transactions, estate planning, and employee benefit plan consulting. Prior to joining Buckley Law, Jay was an ERISA consultant for Pricewaterhouse Coopers. Jay has advised small and medium-sized business owners for more than 20 years and they include service, technology, and manufacturing companies.

Jay is a Certified Public Accountant, Certified Management Accountant, and is certified in Financial Management by the Institute of Management Accountants. Jay is also a member of the American Institute of CPAs and holds a Certified Global Management Accountant designation from the AICPA. He is also Chair of the OSCPA Board of Directors. Due to his extensive accounting background, Jay is able to bring economic and financial perspectives to real world legal problems.

Jay has published numerous articles for the Oregon Society of Certified Public Accountants, the Oregon State Bar and the Oregon Legal Management Association, among others. In an effort to educate new business owners, Jay speaks at the annual Small Business Fair, a day-long seminar sponsored by every major Oregon governmental agency and the IRS. Jay is also a member of the Small Business Fair's steering committee.

Scott Schnuck

Scott is a partner in AltusLaw LLC, a firm that represents small and mid-size businesses, including contractors and professional service providers, throughout litigation, transactions, and regulatory compliance matters. He brings a wealth of business education and experience to his clients. He has an MBA, and prior to becoming a lawyer, Scott spent 18 years in management positions in operations, operation control, and business development for several major corporations. Scott has a diverse education background that enhances his understanding of issues his clients face. He holds a bachelor's degree in structural engineering, a master's degree in business administration, and a law degree with an emphasis on business law, graduating with honors. Scott has been recognized by Super Lawyers in the area of construction law.

Scott is also a frequent lecturer on business law, contracts, construction, and management issues. He is an annual speaker with the University of Oregon Lundquist graduate business school and was an adjunct professor at Lewis and Clark Law School, where he taught Law Practice Management. Scott has also presented numerous CLEs for the OSB and multiple industry groups. Scott is also active with the Oregon State Bar Association. He is the chair-elect for the solo/small firm section and is a member of the OSB Futures committee.

Professional Liability Fund CLE – June 1, 2017

FROM STARTUP TO ENDGAME: FORM OF ENTITY CONSIDERATIONS FOR YOUR LAW PRACTICE

In this CLE, we will attempt to navigate the sometimes confusing realm of entity choices discussing the state-law distinctions, tax implications, and practical concerns for each of the major entity types by means of answering the following oft-asked questions.

Question 1: Choice of Entity

Do I really need to form and operate my law practice under an LLC or corporation (S or C), or is "sole proprietorship" or "general partnership" acceptable?

1. Yes, you ***really*** need to practice law under an entity for all of these reasons:
    a. At the bottom of the reasons why, operating under an LLC or corporation simply has more cache. An entity extension implies permanence. And you can name yourself as "president" under either.
    b. While a legal entity does not provide liability protection from *your* professional malpractice, an LLC, corporation, LLP, or PC provides a layer of protection between your personal assets and liabilities that result from the obligations of the business (aside from your professional advice). That is, the entity separates your personal affairs from those of your business, cabining the liabilities and obligations *of the* business *to the* business.
    c. A limited liability entity will protect you from:
        i. Contract disputes—think landlord and tenant disputes
        ii. Disputes with vendors such as tech providers
        iii. Liability associated with an employee
        iv. Tort injuries of clients and others visiting your office. Yes, commercial liability insurance – if you have it - would probably cover this event. Still, why not provide all of the protection you can?
            1. Also, insurance always has a policy limit and it is generally bad business to fully insure against all perils—i.e., you will be paying for protection you are unlikely to need. While on the other hand, an LLC/Corporation can give you the protection from those uninsured liabilities
2. If you plan on hiring associates and want them to help in your succession planning, you will need to operate as a partnership, LLC, or corporation anyway (unless you plan on selling out entirely when you retire), so why not form an LLC now? If you form the LLC now, you get to choose the name, create the operating agreement, etc.

Question 2

Ok, I really should practice under an entity. I looked on the web and through "choice of entity" CLEs. What do I need to know about what entity to choose?

1. A brief word on state-law v. IRS designations—i.e., the "deal" between the owners versus the "deal" with the IRS.
    a. Companies are categorized in two separate ways:
        i. State-law designation— partnerships (ORS Ch. 67); corporations (ORS Ch. 60); LLCs (ORS Ch. 63); and professional corporations (PCs) (ORS Ch. 58 and 60).
            1. Decision-making – who can bind the company
            2. Control – who gets to make which decisions
            3. Distributions – how and when distributions can be made
            4. Ownership Transitions – when can an owner be added to leave and when can ownership interest transfer
            5. Dissolution – ending the business' existence
        ii. IRS distinction
            1. Pass-through taxation
            2. Entity level taxation
            3. Status of the worker/owner with the company
2. General – For any of the selected entities, follow the Rules. Perhaps the best piece of advice applies independent of the type of entity you choose. When you choose an entity, **follow all of the rules for that entity**. For example, if you form a corporation:
    a. do not call your fellow shareholders "partners."
    b. hold an annual shareholders meeting and elect directors if you decide to be a corporation. If you form an LLC, decide whether you want to hold annual meetings and then stick to it.
    c. if an owner "loans" money to the entity, then document the transaction as a loan. Set an appropriate interest rate and a term.
    d. Remember that a corporation is owned by its shareholders, who elect a board of directors responsible for managing the business. The board elects officers to run the company.
3. General Partnerships.
    a. A Partnership is a recognized entity classification, but not recommended.
    b. Remember—partnerships can be formed inadvertently!
    c. In a partnership, all partners have the capacity to act on behalf of one another and with full authority on behalf of the practice. Unfortunately, this also means that each partner is personally liable for any acts of the others, and all partners are personally responsible for the debts and liabilities of the practice.
    d. It is not necessary that each partner contribute equally to the practice or that all partners share equally in the profits; these terms will be reflected in the partnership agreement.
    e. Partnerships are a recognized form of business entity. They can obtain credit, file for bankruptcy, and transfer property, etc. They file an income tax return (form 1065). However, a partnership is not itself a tax-paying entity, and generally files only an information income tax return (Form 1065); each partner receives a Schedule K-1 from that return (the income, gains, deductions, and losses of the partnership). Each partner

then reports the information from the Schedule K-1 on Schedule E of Form 1040, Schedule E.

f. Partners treat their share of business income and guaranteed payments for services or use of capital as self-employment income.
g. Health and some other benefits for partners are treated as a guaranteed payment or a distribution.

4. Corporations
    a. Formed by filing articles of incorporation
    b. Can select either a sub-chapter "c" or sub-chapter "s" style of taxation
    c. Ownership/Management
        i. Owned by shareholders
            1. Shareholders do *not* have a say in the management of the company unless s/he is also on the Board or is an officer
        ii. Overall management by a Board of Directors elected by the shareholders
        iii. Day-to-day operations can be delegated by the Board to corporate officers
        iv. Only the Board or its designee can bind the company to third parties
    d. S Corporations
        i. To a great extent, an S corporation is treated for tax purposes like a partnership. However, the S corporation retains some features of the corporation, such as limited liability of shareholders. S corporations also require some operational formalities, including regular meetings of shareholders and board of directors, written minutes of those meetings, etc.
        ii. The election of S status is made by filing Form 2553 with the IRS after incorporation. The law firm will be taxed as a C corporation unless it makes an S corporation election. All shareholders must agree to the S election. An S corporation elects to have its income, deductions, capital gains and losses, charitable contributions, and credits passed through to its shareholders.
        iii. An S corporation files an income tax return (Form 1120S). Each shareholder receives a Schedule K-1 from that return (for the income, gains, deductions, and losses of the S corporation) and reports the information from the Schedule K-1 on Schedule E of Form 1040.
        iv. Though the business may consist of many owners, and is taxed like a partnership, it is considered a single entity, separate from the owners.
        v. An S corporation has some noteworthy limitations
            1. The company must be a domestic corporation;
            2. There is a limit in the number and nature of shareholders it can have; and
            3. Can have only one class of stock same rights with regard to allocation of earnings/loss and distribution of cash, thought there may be differences in voting rights—i.e., voting versus non-voting shares.
            4. All but the last of these factors, however, are usually not a problem in new law firms.

vi. The S corporation, like a partnership, is attractive because income is taxed only once—not twice, as is the case with a C corporation.
vii. Generally, if you are a shareholder lawyer, you are paid both as an employee of the practice with a W-2 and as an owner of the practice via a K-1 distribution. The main difference is that you pay Medicare and Social Security tax on W-2 income, but not on K-1 distributions.
viii. Most of us who practice in this area, including CPAs, is that the W-2 "salary" an owner receives must be reasonable; this is the amount you could earn if you worked somewhere else in a similar capacity. The remaining amount would then be paid as a distribution to avoid paying Social Security and Medicare taxes on that income.
ix. Generally S corporations are audited less frequently than sole proprietorships.
x. State law is somewhat more "developed" due to the longer history of corporations.
xi. Health and some other benefits for shareholders owning more than 2% of stock are treated as compensation or a distribution.

e. C corporation
   i. C Corporations pay taxes at the entity level; they file a corporate tax return (Form 1120), and then may distribute the remaining earnings as dividends to the owners.
   ii. The dividends are not deductible to the corporation and are income for the owners of the corporation. Thus, a C corporation is subject to double taxation on earnings. This double taxation of corporate earnings was reduced by the 2003 tax act, which made dividends taxable at the same rate as capital gains.
   iii. A C corporation that accumulates income is taxed at the highest marginal corporate income tax rate. That said, with careful planning done before the end of the year, most if not all earnings can be paid out as salaries.
      1. Must be mindful, however, that the compensation of the owner/employees passes the "reasonable compensation" test
   iv. Similar to S corporations, C corporations share these characteristics:
      1. They are formed by filing articles of incorporation with the state.
      2. They require a great many operational formalities including bylaws, regular meetings of shareholders and board of directors, written minutes of those meetings, and corporate resolutions authorizing certain actions.
      3. The liability of shareholders for the corporation's debts and obligations is limited to the amount of their investments.
   v. Very different from S corporations, they can have several classes of stock, such as common and preferred stock (in contrast, an S corporation can only have two: voting and non-voting, discussed below).
   vi. There are no special rules for shareholders when it comes to fringe benefits for owners.

5. Limited liability partnership (LLP)
    a. To form an LLP, the partners must file a form with the Oregon secretary of state, and then renew the registration annually to maintain the protection from liability. The name of the business entity must include a designation that it is a limited liability company. ("LLP" or "Limited Liability Partnership" must appear in the name).
    b. Provides a liability shield for the partners to insulate their personal (non-partnership assets) from the obligations of the business
        i. The partners of an LLP have more liability protection than partners of a general partnership, but still have unlimited personal liability for obligations of the practice.
        ii. The partners' liability for any professional malpractice of other partners is limited to partnership assets.
    c. An LLP is managed by its partners
        i. Each partner has a say in the decision making for the company
        ii. Each partner may bind the company to third parties.
    d. An LLP is taxed like a partnership—i.e., pass-through taxation where the entity does not, itself, pay taxes. Rather all the economic effects "pass-through" each tax year to the partners
    e. Partners treat their share of business income and guaranteed payments for services or use of capital as self-employment income.
6. Limited liability company (LLC)
    a. An LLC is formed by filing articles of organization with Oregon's secretary of state and must be renewed annually to preserve the entity and the liability shield. The name of the business entity must include a designation that it is a limited liability company. (e.g., "Limited Liability Company"; "LLC"; or "L.L.C." must actually appear in the name).
    b. An LLC can be managed either similar to a corporation or a partnership
        i. Manager-managed LLC is corporate-like where the "manager" is similar to a corporate Board
        ii. Member-managed LLC is partnership-like with each member participating in management and able to bind the company to outside obligations
    c. Members contribute cash, property, or services, and income is apportioned according to the members' contributions. As a default, the LLC is taxed as a partnership or sole proprietor (if it only has one owner/lawyer).
    d. The LLC can elect to be treated as a corporation. It can then elect to be taxed as an S corporation. The panelists have differing experience with so-called s-corp elections
        i. Jay has seen this maybe twice in 30 years (and neither instance involved a professional service entity) and it is fraught with issues (see formalities, above).
        ii. Scott has encountered these frequently and find them to be a good option when the owners wish to have a partnership-like management structure but want to avoid incurring employment taxes on the entirety of the company's profits—especially when generated through non-owner employees activities

1. It is essential to consider the “reasonable compensation” test, which is the opposite of the compensation test for C corporations

e. Unlike an S corporation, an LLC permits unequal allocation of profit and loss, while affording the same limited liability that the equity owners receive when organized as a corporation.
f. Unlike partners in a limited partnership, all LLC members can take an active role in the operation of the business without exposing themselves to personal liability. In Oregon, professionals are allowed to form an LLC; they are not limited to a professional corporation (PC) or a limited liability partnership (LLP).
g. While an LLC does not have the required formalities of a corporation, that “benefit” can sometimes be a disadvantage. Ask yourself: what is wrong with at least an annual meeting of owners, managers, etc. where minutes are kept?
h. If you are the only owner of the LLC, the LLC is a “disregarded entity” under federal and Oregon income tax laws. That means the LLC does not need to file a separate tax return. The LLC’s income or loss is reported directly on your form 1040, Schedule C. By contrast, if you were the only owner of an S corporation or C corporation, the corporation would need to file income tax returns.
    i. Note: the single-member LLC is only disregarded for income tax purposes. It is recognized for all other purposes as a legal entity.
i. Members treat their share of business income and guaranteed payments for services or use of capital as self-employment income.

7. Professional corporation (PC)
    a. Organization and management similar to corporations
        i. To form a professional corporation, you must file articles of incorporation with the secretary of state and pay a filing fee. In contrast to an ordinary corporation, which may be formed for any lawful purpose, a professional corporation’s articles must limit its corporate purpose to practicing the profession its shareholders are licensed to perform.
        ii. Unlike ordinary corporations, professional corporations must also usually obtain approval from the state’s applicable professional licensing board. The state licensing board will ensure that all shareholders are licensed professionals in good standing. Such corporations must also identify themselves as professional corporations by including "PC" or "P.C." after the firm's name.
    b. PCs, or professional corporations, are a special type of corporation composed of professionals who require a license to practice. The tax code defines a qualified personal service corporation as one formed under state law in which substantially all activities involve services in health, law, engineering, accounting, actuarial science, performing arts, or consulting.
    c. The IRS imposes 2 tests to ensure that a corporation qualifies under state law as a personal service corporation. These tests focus on what the corporation does (the "function test") and how it is owned (the "ownership test"). If a PC does not qualify as a

personal service corporation, it is generally treated under the tax code as a C corporation. However, a PC can elect to be treated for tax purposes as an S corporation.

d. Although the tax treatment will depend largely on how much of the outstanding stock is owned by employee-shareholders, a PC generally is a separate entity from its owners, similar to a C corporation. Therefore, it must file its own corporate tax return every year, and it may offer many of the fringe benefits available to C corporations. As noted, however, a PC can elect to be treated as an S corporation.
e. Qualified personal service corporations must use a calendar tax year unless a business purpose for a fiscal year is established. PCs are not taxed at the same graduated rates that apply to C corporations; they are taxed at a flat 35% rate on their taxable income. PCs are subject to the passive activity loss rules and the at-risk rules. For more information regarding these rules, be sure to speak with your accountant and attorney.
f. Review ORS chapter 58 carefully, particularly ORS 58.185.

Question 3

If it is just me, do I really need partnership agreement, bylaws, or an operating agreement?

1. What is a partnership agreement, bylaws, or an operating agreement anyway?
    a. This is the agreement between the owners—partners, shareholders, or members—setting forth the "deal" between themselves
    b. Should cover: contributions; allocation and distribution of profits/losses; allocation of decision making; admission or expulsion of an owner; transfer of ownership; circumstances and manner of dissolution; etc.
2. Needing one depends on what you need by the word "need."
    a. If you are the only owner, then there will no disputes about income allocation, capital calls, name changes, etc.
    b. If there are multiple owners the agreement truly is essential to orderly (read predictable and, hopefully, uncontentious) co-venturing
3. For true solos, though, why would you not want to have all organization documents that a mega-firm or entity would have? A bank might (and often does) want to see them. You might want to merge practices and the acquiring/other firm might want to see them. Wouldn't it better to have the documents (and follow them – see above) than to not have them?
    a. Also, consider this situation: Let's assume that you may want to add a junior "owner" some day. That junior owner may, or hopefully should, want to see your organizational documents. Why not draft for multiple owners now, with provisions that will benefit you? It is a lot easier to maintain control when your documents already have the controlling language in it. For example, have a list of actions requiring a majority of the owners to approve. If you are a corporation, require majority consent to appoint the directors.
4. When enacting, remember that while these agreements can be amended, any such future changes must be agreed on (at least to the extent required in the document, if stated, or unanimously). Said a different way, there might not be sufficient unanimity later when

circumstances change to forge an amendment. Therefore, careful consideration of the obvious "what ifs" should be frankly discussed—e.g., do you want your child to join the firm, what happens when a founder wants to "slow down" but not retire, how to allocate firm profits between owners with differing productivity/profitability/revenue generation, etc.

Question 4

What happens if I want to change the way my firm was organized?

Of course, it depends on what entity you started with:

1. If you were a sole proprietorship or single-member LLC, you can easily convert to a multi-member LLC, S corporation or C corporation.
2. If you were a partnership or LLC and want to elect corporation status, the tax issues are contained in Rev. Rul. 84-111. What you need to watch out for, generally, is if partners have bases in their partnership interests that are different from their share of the partnership's basis in its assets.
3. If you were a corporation and want to elect S status, then you need to file form 2553 and realize that the built-in gain rule of IRC 1374(d) may apply. This rule requires that the corporation pay any tax on any gain on corporate assets within 5 years from the date of the election.
4. If your firm is a corporation and you want to become a partnership or LLC, then the corporation is deemed to have liquidated. The corporation can recognize gain. The shareholders will potentially recognize gain if the proceeds exceed the basis in their stock.
5. Bottom line: conversion can be done but seek the advice of a qualified tax advisor long before you think you need to convert.
6. Note: Oregon Revised Statutes for business entities have generous conversion and merger language. That language only applies for entity-level changes; it does not control federal or state income tax issues.

Question 5

If I want to add non-owner employees, does it matter what type of entity I have?

1. If you are a sole proprietor or a general partnership, you ***do not*** want to hire employees until you have had a chance to form a limited–liability entity. As a sole proprietor/general partner, you are *personally* liable for your employee's actions while acting within the scope of their employment.
2. There are really no issues regarding the types of benefits you can offer to employees. That said, if you decide to start a SEP or qualified retirement plan, make certain that you understand what the eligibility, vesting and contribution rules are! You don't want to commit any mistakes with your employee.
3. If you are a corporation or LLC, there are really are no direct practical issues to face. If you are an LLC or partnership and you hire non-owner lawyers as employees, we have seen one indirect issue arise. A non-owner employee receives a form W-2 because they are paid a salary. An LLC

or partnership owner (except in VERY narrow circumstances—i.e., members of LLCs having made the s-corp election) cannot be an employee. They will receive an annual K-1 and will need to make quarterly estimated federal and state income tax payments. Your agreement will need to be clear about when cash distributions will be paid. It is important to tell these new owners that income is AUTOMATICALLY allocated and distributions of cash depend on what the document says (majority, unanimous – see above).

Question 6

I want to join my practice with a colleague I have known for years. We will "really" just operate as sole practitioners and share expenses equitably. Is that acceptable?

A. It depends on what you mean by "just operate as." Two sole proprietorship lawyers can share office space and share expenses without forming a business between them. Do more than that and you risk inadvertently forming a partnership.
    a. ORS 60.005(7) defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit . . ."
    b. Partnerships are determined by a multi-factor test that extend beyond the putative partners' intentions
B. Practically speaking, if you want to form a business with one or more other lawyers, forming the entity and creating its operating documents is just the first step. Continuing to operate as sole proprietors after you become co-owners is common. Even if you do all of the formalities, people tend to operate as they did before.
C. One area to watch out for, and this can apply to firms operating as corporations too, is trying to reward someone with "fake equity."
    a. The law is as we all know a pigeon-hole world. In this context, we have partners, shareholders, members, and sole proprietors.
    b. If you make someone a shareholder, then for all purposes, they are a shareholder. Do not create a "shareholder in title only," or a "member/partner in title only." Did they sign a subscription agreement? Did they agree to the value of their stock? Did they get a stock certificate? Did they sign the firm buy-sell agreement? Do they get notices of shareholder meetings? Do they get to vote for directors?
    c. In the partnership world, giving someone the title "partner" but it is only in (what you think) is title only is a big mistake. If they are held out as partners, then practically they might be held legally as true partners with full authority to act for the partnership. With that said, it is not uncommon for "large firms" to have non-equity partners.
    d. Do not create a "shareholder in title only" or "member in title only" either. While the consequences may not be as dire as the partnership example, if they are a shareholder, then they are entitled to all of the rights under ORS chapter 60 including the right to inspect records. ORS 60.774 and 60.777.
    e. The "in title only" also has other issues: assuming that you are not committing some kind of "deception" in calling someone a shareholder when they may not be, why do that to your employee? Call them what they are, and treat them accordingly.

Question 7

These (millennial) kids these days. I have an associate who wants to become an owner. What should I do?

1. Consider, very carefully, who you want to be in business with. Once an ownership interest is acquired, it cannot be taken away capriciously.
2. Most owners are concerned with "voting." "I still want to retain control." Some firms create non-voting stock and issue only non-voting stock. In the context of employees working in the business (law firm), I have never been a fan of "non-voting" stock. Even if an employee is also a non-voting shareholder, they have all the rights of a shareholder under Oregon law (e.g., inspect records) except voting. So why not just create voting stock and issue/sell voting stock in smaller numbers?
3. Issuing voting stock does not mean an end to control. If it up to the corporation how much equity it wants to issue, so just issue enough that allows the owner(s)/founder(s) to maintain control.

Question 8

What are the main issues facing a law firm when a lawyer or lawyers want to leave, and what can we do about it now?

1. The single biggest issue for a departing owner/lawyer is valuing that individual's interest
2. Valuing the firm, and therefore the interest of the departing lawyer:
    a. As a practical matter, most of a firm's worth is the fair market value of its accounts receivable.
    b. If the firm has many clients with recurring work (think a CPA firm with audit and tax return clients), then there may be some going concern value.
    c. Similarly, if the firm has a long, long history and has significant word-of-mouth respect, there may be some goodwill/going concern value.
3. Valuation mechanisms
    a. Have a buy-sell agreement with realistic valuation method and terms that both sides can live with.
    b. If you want to use, and can afford to pay for, an appraisal, then it is likely the least dispute-laden way to determine value. If you come up with an "agreed" value, then make sure you have a mechanism to adjust the value periodically to account for what everyone thinks the firm is worth.
        i. Mistake: don't say that value is based upon an initial value and thereafter as mutually agreed? What happens if you don't agree?
    c. Make certain that the interest rate and payment terms are reasonable. No one wants a creditor around any longer than they have to, so allow for prepayment of the unpaid purchase price.

4. Not following the PLF guidelines about client files, work papers, etc. These issues are beyond the scope of this topic but they apply regardless of the type of entity you have. In general, those issues are:
    a. The ethnical obligation to communicate with certain clients
    b. Which clients to tell
    c. How to tell clients
    d. Other people who would be told
        i. Malpractice carriers
        ii. Professional organizations
        iii. State Bar
        iv. Courts
        v. Opposing Counsel
    e. Trust account issues
    f. Fee divisions
    g. Files
    h. Telephone inquiries
5. Not coordinating the date that the owner stops practicing with the firm with the sale date of their equity.

Question 9

What happens when a law firm dissolves?

1. Tax issues are same as any organization that is not a law firm. Know them!
2. Unfinished business doctrine.
3. Ethical Issues – Ethical rules not only don't stop, they get even more complicated in a law firm dissolution.
    a. Client Files. They are not chattel, the client has the right to select the lawyer and discharge a lawyer.
    b. Continuing Obligations Owed to a Client. Duty of the lawyer to be competent, diligent and communicate regularly with the client.
    c. Practice Restriction Covenants. Oregon has a bright line prohibition on lawyer non-compete provisions. A firm cannot prohibit directly or indirectly a lawyer's ability to practice law after ceasing employment or termination in a law partnership. Doesn't matter if the lawyer agrees to the restriction.
    d. Publicity. The lawyer may not make false or misleading communications. What contact can the departing lawyer have with clients of the firm. There are many ethics opinions on this issue.
    e. Client Conflicts. Lawyers must take necessary steps during the dissolution to ensure that they do not have impermissible conflict in the future.
    f. Confidentiality. These obligations continue even upon dissolution of the firm.
    g. Safekeeping Property. Custody of physical client files.
4. Malpractice Issues. Negligence based upon neglect is common.

FROM START-UP TO END-GAME

FORM OF ENTITY CONSIDERATIONS FOR YOUR LAW PRACTICE

Jay Richardson – Buckley Law P.C.
Scott Schnuck – AltusLaw LLC

Professional Liability Fund CLE – June 1, 2017

ENTITY CHOICE CONSIDERATIONS

- Owner liability
- How the money flows
- Control
- Adding/subtracting owners

QUESTION 1 - DO I REALLY NEED TO FORM AN ENTITY?

- YES—Really
- Protection from business liabilities
- Insurance has policy limits and exclusions
- Does NOT protect from legal malpractice liability

QUESTION 2 – OK, WHAT ENTITY SHOULD I FORM?

State Law Distinction

No Liability Shield | Liability Shield

- Management/control
- Owner's risk for entity liabilities

Idiots and the unaware

QUESTION 2 – OK, WHAT ENTITY SHOULD I FORM?

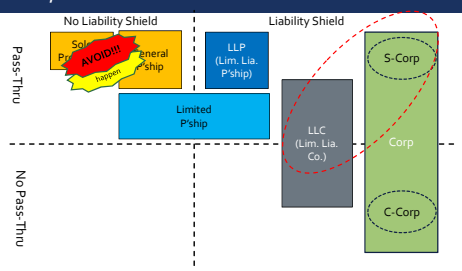
No Liability Shield | Liability Shield

Pass-Thru

No Pass-Thru

- Pass-thru v. entity level taxes
- Retaining profits
- Carry-forward losses
- Allocation of profits/losses

QUESTION 2 – OK, WHAT ENTITY SHOULD I FORM?



QUESTION 2 – OK, WHAT ENTITY SHOULD I FORM?

- Follow the rules of your entity type
- Make sure form follows function—e.g., loans to the company, etc.
- For corporations – make sure to follow the reasonable compensation test

QUESTION 3 – DO I NEED AN OPERATING AGREEMENT?

- This is the agreement between the owners
- Covers: contributions; allocation and distribution of profits/losses; decision making; admission, expulsion, transfer of ownership;
- Single owner: Not necessarily
- Multiple owners: absolutely!
- Make sure to answer the hard questions

QUESTION 4 – WHAT IF I WANT TO CHANGE MY ENTITY FORM?

- Sure, but it depends on what you started with
- Sole-prop/GP to an entity – Easy
- LLC/LLP to corporation – Easy, but watch out for built-in gain
- Corporation to anything else – Not so easy, is a liquidation event
- Get help!

QUESTION 5 – WHAT TO DO IF I WANT TO ADD EMPLOYEES?

- Form an entity!
- Only entities electing corporate styles of taxation can have owner/employees
- Employee benefits are generally expenses to the company
- Owner's health benefits can be deemed compensation

QUESTION 6 – JOINING PRACTICES, WHAT IF WE OPERATE "AS IS"?

- Office sharing does not, necessarily, create a partnership
  - Be aware of inadvertent general partnerships and ethical rules
- Answer the hard questions about co-ownership—*see* Question 3
- Be aware of creating "non-equity" shareholders/members/partners

QUESTION 7 – WHAT TO DO ABOUT ASSOCIATE BECOMING AN OWNER?

- Make sure ownership is the right answer
- Voting versus non-voting interests
- Control and allocation/distribution of profit issues
  - Make sure to have a mechanism to balance equities

QUESTION 8 – WHAT ABOUT A LAWYER LEAVING?

- Valuation
  - Fair market value of the AR
  - Reoccurring work – maybe
  - Goodwill – maybe
- Have a buy-sell or operating agreement
  - With a realistic valuation method—formula, appraisal, updated value

QUESTION 9 – WHAT HAPPENS WHEN A LAW FIRM DISSOLVES?

- Unfinished business doctrine
- Articles of dissolution
- Authority to wind up the business and close accounts
- Ethical issues
- Malpractice issues