

CYTOWSKI<sup>LLC</sup>

bitspiration

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***Essentials of American Tech Start Up Law -  
Formation***

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# ***Disclaimers***

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# ***Where to Incorporate? Delaware, Nevada, Wyoming, etc***

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## **Delaware**

- Management protection from personal liability
- Efficient and flexible procedural formalities
- Annual Franchise Tax
- Income tax - 8.7%

## **Nevada and Wyoming**

- Low maintenance costs
- No income tax or corporate tax

## **California**

- Usually do not incorporate in CA. If you do business in CA as foreign corporation need to file application and comply with CA law with regard to employment, etc.

## **Doing business in other states**

- Need to register as a foreign corporation.

# ***Limited Liability Company (LLC)***

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## **Entity Type**

- Can either operate as partnership or legal person.

## **Management**

- Managed either by members (*member management*) or managers (*manager management*)
- Represented outside by managing member. No board of directors.

## **Liability**

- No liability of members

## **Taxes**

- LLC pass through entity for tax purposes. Tax paid by members of LLC not LLC.
- **Foreign Members will have to pay tax in the US as individuals.**

## **Capital Structure**

- Units not shares. Can have multiple class of units.

## **Exit**

- Have to describe in operating agreement.

# Corporation – C- Corp (Inc., Ltd)

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## Capitalization

- No statutory minimum capitalization requirement for the company.
- Equity for cash, debt (*promissory note*), IP or work.

## Management

- Board of Directors
- Directors presumed to have acted in good faith and best interest of company
- Advisory Board is not Board of Directors

## Liability

- No shareholder liability, unless piercing the corporate veil

## Capital Structure

- Multiple classes of stock i.e. common stock, preferred stock (Series A, Series B), options (Non Statutory Options or Incentive Stock Option)

## Taxation

- Taxed at corporate level and then taxed at dividend to shareholders. Dividend paid out to foreign shareholders based on US double taxation treat.

## Exit

- No statutory buy in/buy out of shareholders. Need buyout clause.

# ***LLC vs. Corp***

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## **Ownership**

- LLC and C-Corp unlimited ownership. *S-Corp* only for US citizens and residents Only 100 shareholders and no-multiple class of stock.

## **Governance/Structure**

- LLC not clear before review of operating agreement. C-Corp board of directors

## **Taxation**

- LLC taxed like a partnership. Corp taxed as a separate legal entity. Taxation depends on goals of founders.

## **Fundraising**

- C-Corp liked by angels/VC funds. LLC liked by US domestic investors for small business.

## **Employee Compensation**

- C-Corp stock option (ISO or NSO) or vesting share plan defer tax until sale of share and grant employees certain fringe benefits tax free. LLC *it's complicated.*

# ***Corporate Formation and US/Poland Double Taxation Treaty***

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**(1974)**

## **Branch Profit Tax**

- 5%

## **Dividends**

- 5% if shareholder owns at least 10% of corporation, in all other cases  
15%

## **Royalty**

- 10%

## **Interest**

- 0%

## **VAT**

- **You need VAT services analysis between US Co and Pol Co**



## ***C- Corp: Annual Fees and Maintenance Obligations***

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### **Registered Agent**

- Agent for process in the state of incorporation, who receives official mail on behalf the corporation. Mandatory by law.

### **Franchise Tax and Information Statement**

- Delaware annual fee.

### **Income Tax Return**

- Prepared by CPA by April 15 for both federal and state filing. Extension October 15.

### **Annual Meeting of Board of Directors**

- Annual meeting to approve actions of directors.

### **Corporate Secretary Fee**

- Company Officer responsible for maintaining corporate records

# ***Incorporation Documents - Formation***

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## **Certificate of Incorporation**

- Filed in DE Secretary of State. Initial authorized # shares, par value, registered agent, address.
- Anti-dilution provisions, investor preference rights and minority protection rights.

## **Bylaws**

- Document spells out procedural mechanics of board of director operations. Not filed, but very important.

## **Action by incorporator**

- Appointing of initial directors, bank account and settling post-incorporation matters.

## **Organizational board consent**

- Authorizing initial stock issuances, among other things.

## ***Incorporation Documents – Founder and Director & Officer***

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### ***Documents***

#### **Stock Purchase Agreement**

- Documents transfer of shares from company to Founders.

#### **Indemnification Agreement**

- Director and officer's minimizes potential personal liability of directors.

#### **Voting Agreement**

- Agreement between Founders as to election of directors and voting of shares.

#### **Buy-back Agreement**

- In the event there is no vesting describes procedure and mechanics of Founder exit and buy back of shares.

## ***Incorporation Documents – Miscellaneous***

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### **Capitalization Chart**

- List all shareholders and shares.

### **Stock Ledger**

- Documents transfer of shares and share numbers

### **Invention Assignment Agreement for Employees or Consultants**

- Transfers IP from any consultants and employees.

## ***Most Common Formation Mistakes of Founders***

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- No 83(b) election
- Improper issuance and sale of shares
- Corporate and organizational requirements not satisfied
- IP not assigned to Company
- No Employment and Consulting Agreement (executed)
- No buy back provision between Founders/minority founder protection
- Management and Shareholder interest misalignment

## ***Most Common Formation Mistakes of Polish Founders***

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- Translating Polish corporate law into American corporate law.
- Obtaining info from the internet. Fishing for information.
- Saving on essentials. Huge cost of clean up.
- US tax compliance of founders and start up (FBAR, FATCA)

## ***Capital Structure***

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- Common initial structure is to authorize 10 million shares and blank preferred stock provision. Par value at \$0.001
- Reserve 20% of common stock for future employees (issued and outstanding).
- Debt (*convertible note*) vs. equity

### **Example:**

- 10 million authorized
- 5 million issued and outstanding to Founders
- 3 million issued and outstanding for VC and angel investors
- 2 million issued and outstanding for Employee Incentive Plan.

## ***Founder's Stock***

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- Founder's stock must be document through SPA.
- Founder's Stock should be vested and limit transfer.
- Minority shareholder protection for Founders. Buyout clause or shot gun clause.
- Comply with Federal Securities Law. Make sure that investor is an ***Accredited Investors*** and stock issuance fit into the safe harbors.
- Obtain stock certificate from company or information where stock certificate is.
- Non-compete Agreement.



# Founder's Stock - Vesting

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## Vesting

- In the event one of the original founders leaves the company he can only keep the shares that have vested. Eliminates free riding. Founders do not like this, but good for company.
- Upfront vesting for past service.
- Standard four (4) year schedule.
- **One year cliff** from vesting commencement date (issuance of stock or earlier date). With monthly or quarterly.
- Termination for cause.
- Change of control
  - **single trigger** (change of control)
  - **double trigger** (change of control plus termination 12 months subsequent)

## ***Founder's Stock - Right of First Refusal***

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### **Right of First Refusal**

- Company automatic buy back at original price.
- Founder leaves company or stops providing service.

## 83(b) Election

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- Tax election by Founder to recognize income before stock vests.
- Need to file 30 days after the issuance of stock to Founder. No exceptions.
- If Founder does not make election he will to pay the difference between purchase price and current fair market value.

**Example:** Founder purchased share at \$0.01 and after one year cliff stock is worth \$1.00. Recognize income tax at \$0.99.

## ***Formation: Employment and Consulting***

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Agreements should be signed.

Make sure details are spelled out for the following:

- Employment Agreement
- Consulting/Service Agreement
- Confidential Information and Invention Assignment Agreement
- NDA

NY law presumption there is an employment agreement. Employee has to prove otherwise.

# ***Formation: Equity Compensation***

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## **Compensation Range**

- CEO – 5-8%
- VP – 2-3%
- Advisory Board Member - 0.15% per year
- Lead Engineer – 0.5 -1%
- Senior Engineer – 0.33% -0.66%
- Junior Engineer – 0.22-0.33%

# Q&A

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➤ **THANK YOU!**