



Business Law

(Bankruptcy, Federal Laws and Regulations, and Business Structures)

Area II — Acronyms & Notes

**SUMMIT
CPA REVIEW**





VI: Bankruptcy: Part 1

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

none

Page B — Notes

Notes

Chapter 7 Liquidation: Trustee Appointed

1. A trustee has been appointed
2. Trustee collects debtor's assets, liquidates them, and uses the proceeds to pay off creditors to the extent possible
3. If debtor is an individual (or married couple), the debtor's debts are then discharged, with certain exceptions
4. If the debtor is an artificial entity (corporation), it is dissolved. No discharge is given, but debts are also wiped out.
5. Entities who can't file: Railroads, savings institutions, insurance companies, banks, and small business investment companies
6. **Dismissal or Conversion:** May be dismissed (or, with the debtor's consent, be converted to a case under Chapter 13) upon finding that granting relief under Chapter 7 would constitute abuse or because the debtor has sufficient income to pay debts
7. **Means Test:** Testing debtor's disposable income
 - a. Calculate the debtor's average monthly income
 - b. Subtract allowable expenses to get disposable income
 - c. Multiply disposable income by 60 (months)
 - d. **Thresholds:**
 - i. **Qualifies for Chapter 7:** $60 \times \text{Disposable Income} < 9,075$
 - ii. **Area In between:** Gray Area
 1. Debtor can pay about 10% of unsecured claims, Chapter 7 allowed
 2. Debtor can pay 25% or more, the case will likely be converted to Chapter 13
 3. Courts decide on a case-by-case basis
 - iii. **Does NOT Qualify for Chapter 7:** $60 \times \text{Disposable Income} \geq 15,150$

Chapter 13: Adjustment of Debts of Individuals with Regular Income - Trustee

1. The debtor repays all or a portion of his debts over a three-year period to a maximum of a five-year period
2. No liquidation, A trustee oversees the handling of the proceedings
3. At the end, the remaining debts of the debtor are discharged



Chapter 11 Reorganization: No Liquidation, Trustee Not Required

1. In a Chapter 11 reorganization case (usually used by business but also available to individuals), a trustee usually is not appointed
2. Debtor remains in possession of his or her assets and a plan of reorganization (plan to pay off debts at a different time and/or amount from what was originally due) is adopted
3. Creditors are paid to the extent possible, and the business continues
4. Entities who can't file Savings institutions, insurance companies, banks, and small business investment companies

Chapter 9: Municipal Debt Adjustment

1. Designed to help these entities reorganize the debts
2. Goal: Allow municipality to continue operating while adjusting its debts
3. Public entities: cities, towns, villages, counties, school districts, municipal utilities

Chapter 12: Family Farmers with regular income

1. Plan to repay all or part of their debts over time (Similar to chapter 13)
2. Helps to keep the family farm or fishing operation running while managing debt repayment

Chapter 15: Ancillary and Cross-Border Cases: The US adoption of the Model Law on Cross-Border and Insolvency promulgated by the United Nations. It was adopted to promote a uniform and coordinated legal regime for cross-border insolvency cases.

Automatic Stay

1. When a bankruptcy petition is filed in either a voluntary case or an involuntary case, an automatic stay becomes effective against most creditors
2. The stay stops almost all collection efforts
3. Does not apply to criminal prosecutions, paternity suits, and cases brought to establish or collect spousal or child support obligations
4. Stops the enforcement of judgment liens against property in the bankruptcy estate

Duties of Debtor: After a petition is filed a debtor must file:

1. List of creditors and their addresses
2. Schedule of assets and liabilities
3. A schedule of current income and expenditures
4. A statement of the debtor's financial affairs
5. Copies of pay stubs received within 60 days before filing
6. Copies of federal tax returns from the last tax year. If the debtor has not paid taxes for the previous tax year, he or she must do so before the bankruptcy may proceed.



Voluntary Case (Chapter 7 and 11)

1. Debtor files for Order of Relief
2. Debtor Need Not to be Insolvent but Must Pass Income Tests: Debtor need not be insolvent to file, but a Chapter 7 case may be dismissed if the debtor has too much income.

Involuntary Case (Chapter 7 and 11)

Grounds: Creditors must show that the debtor generally is not paying debts as they become due

Ineligible debtors: Farmers and Charities cannot be involuntarily petitioned into bankruptcy

Who Must Join Petition: Owed at least 18,600

1. Only creditors who are owed, individually or aggregate, at least 18,600 in unsecured, undisputed debt may petition a debtor involuntarily into bankruptcy. The number of creditors who must file depends on the debtor's total number of creditors
 - a. **Fewer than 12 Creditors: One or more owed 18,600:** Any one or more creditors who are owed at least 18,600 in unsecured debt may file
 - b. **12 or More Creditors: Three Owed 18,600:** At least 3 creditors who are owed at least 18,600 in aggregate, unsecured, undisputed debt must join in the involuntary petition

Section 341 Meeting: Gives Creditors an opportunity to examine the debtor. All interest parties, including creditors, the bankruptcy trustee, and the debtor, must be notified of the meeting

Rights and Powers of a Trustee

1. Treated as a hypothetical lien creditor as of the bankruptcy filing date
2. Power to require delivery of the debtor's property
3. Power to require delivery of the debtor's property
4. Power to prevail over unperfected security interests
5. Right to use any grounds available to the debtor to recover property
6. Subordinate to prior perfected security interests and statutory liens.

Additional Powers

1. Power to set aside fraudulent transfers
2. Power to disaffirm preferential payments
3. Collect and liquidate nonexempt property
4. Distribute assets according to priority rules



Property of the Bankruptcy Estate

1. Debtor's estate generally includes all the debtor's real and personal property **at the time of the filing**
2. Estate also includes income generated from estate property received **180 days** after the filing of the petition for relief (Example: Interest in Bonds)
3. Property the debtor receives from divorce, inheritance, or insurance **within 180 days** after the filing
 1. Example: Proceeds from a life insurance policy received 90 days after the petition was filed
4. Leases of property may be assumed and retained by trustee, assumed and assigned to another, or rejected by trustee

Excluded Estate Property: Post-filing earnings (wages) and household items needed to live. Debtor gets to keep the wages earned to be able to continue living after the filing.

Fraudulent Transfers: Any transfer of less than equivalent value made with the intent to hinder, delay, or defraud creditors. The trustee has the power to set aside fraudulent transfers made within two years of the filing date.

Preferential payment: A transfer for the benefit of a creditor on account of an antecedent debt made within 90 days (one year for insiders) prior to filing the petition while the debtor was insolvent, and the creditor receives more than the creditor would have received under the Bankruptcy Code. Contemporaneous exchanges for new value are excluded, as are payments of ordinary business bills.

Claims Against the Estate: A claim to payment from the debtor's estate. The debtor must file proof of claim and must file proof of interest. An unsecured creditor who fails to file a timely file may not take part in the distribution of the estate.

Miscellany: Trustee can serve as a professional (tax preparer) for the estate if the court approves and may receive compensation for these services if the court approves.



IV: Bankruptcy: Part 2

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Six Non dischargeable debts (Chapter 7) - WAFTED

1. W - Willful and malicious injury
2. A - Alimony
3. F - Fraud
 - a. Example: Claims arising out of an extension of credit based on false representations
4. T - Taxes
5. E - Educational Loans
6. D - Debts undisclosed in the bankruptcy petition

Chapter 7 Priority Claimants Include the Following (From Highest to Lowest) SAG WEG CTI

1. First: Secured Creditors

2. S - Support: Support obligations owed to spouses and children (Alimony + Child Support)
3. A: Admin Expenses: Expenses of the bankruptcy admin
 1. Filing fees, Court fees, and Trustee fees
4. G: Gap Claims: Claims that accrue in the ordinary course of business after an involuntary petition is filed. (Example: Claims by supplier for inventory in the ordinary course of business)
5. W: Wages Wage claims of employees for sums earned within 180 days of bankruptcy (15,150)
6. E: Employee benefits: Sums owed for employee benefits up to whatever of the 15,150 above is left
7. G: Grain farmers and fisherman: Claims of grain farmers and fishermen up to 7475
8. C: Claims: Consumer deposits up to 3350
9. T: Tax Claims: Tax claims
10. I: Injuries from DWI: DUI: Personal injury claims arising from intoxicated driving

11. Last: Unsecured Creditors



Page B — Notes

Notes

Chapter 7 Liquidation

Objections To Discharge

1. Debtor Not an Individual: Artificial entities seeking relief under chapter 7 usually are dissolved at conclusion, and debts are wiped out
2. Fraudulent Transfers or Concealment of property
3. Unjustifiably failed to keep books and records
 1. Debtors must maintain adequate financial records that clearly show their financial condition and business transactions
 2. Fails to keep or preserve these records, court may deny discharge
 3. Why? Ensures transparency and fairness to creditors by allowing proper review of the debtor's financial affairs
4. Prior charge within eight years
 1. Debtor cannot receive a discharge for chapter 7 if they have already received one within the last 8 years
 2. Why: Prevents abuse of the bankruptcy system by repeatedly discharging debts in a short period

Reaffirmation of Discharged Debts: Allowed if the agreement to reaffirm is made before the granting of the discharge

Distribution of Debtor's Estate. Three Basic Categories:

1. Secured Claimants: Paid first to the extent of the value of the collateral
2. Priority Claimants: Paid next, in order of the categories below; each category being paid in full before moving down to the next (**SAGWEGCIT**)
 3. S - Support: Support obligations owed to spouses and children
 4. A: Admin Expenses: Expenses of the bankruptcy admin
 1. Filing fees, Court fees, and Trustee fees
 5. G: Gap Claims: Claims that accrue in the ordinary course of business after an involuntary petition is filed
 6. W: Wages Wage claims of employees for sums earned within 180 days of bankruptcy (15,150)



7. E: Employee benefits: Sums owed for employee benefits up to whatever of the 15,150 above is left
8. G: Grain farmers and fisherman: Claims of grain farmers and fishermen up to 7475
9. C: Claims: Consumer deposits up to 3350
10. T: Tax Claims: Tax claims
11. I: Injuries from DWI: DUI: Personal injury claims arising from intoxicated driving
12. General Creditors: Paid Last

Chapter 11 - Reorganization Plan

1. Only the court confirms the reorganization plan
2. Creditors and shareholders vote to accept or reject but DON'T confirm it
3. A trustee is generally not appointed, but can be when there is fraud, dishonesty, incompetence, or gross mismanagement by the debtor

Reorganization Plan: Unless a trustee is appointed, the debtor has an exclusive right to file a plan during the first 120 days after the order for relief is effective

1. Creditors may file a plan if:
 1. a trustee has been appointed
 2. The debtor has not filed a plan within 120 days
 3. The debtor has filed a plan but has not obtained acceptance of the plan by every impaired class within 180 days of the entry of the order of relief

Voting: Shareholders: Acceptance is measured by $\frac{2}{3}$ interests (% of ownership)

Cram Down Provision: Court may confirm the plan even if only one impaired class of creditors votes to accept the plan, by passing the need for uniform acceptance

Final Decree: Issued by the bankruptcy court after confirmation of the reorganization plan and completion of the case (Marks the official closure of the bankruptcy proceedings)

Effect of Final Decree on Debts and Liabilities

1. Debtor is discharged from all debts and liabilities that arose before the confirmation of the plan
2. Exceptions apply: Debts may remain if specifically excluded by
 1. Reorganization plan itself
 2. Courts order of confirmation
 3. Specific provisions in the bankruptcy code
3. Discharge applies to all creditors
 1. Effective even against creditors who voted against it
 2. Prevents creditors from pursuing debtor for discharged debts



Six Non dischargeable debts (Chapter 7) - WAFTED

1. W - Willful and malicious injury: Drunk driving injuries
2. A - Alimony
3. F - Fraud
4. T - Taxes
5. E - Educational Loans
6. D - Debts undisclosed in the bankruptcy petition

Chapter 15 Case

1. US Court can recognize as a “foreign main proceeding” (Country where the debtor’s main interests are located) or a “foreign non main proceeding” (Country other than the one where the debtor’s main interests are located)
2. Automatic Stay: Takes effect upon recognition of a foreign main proceeding
3. Prohibits discrimination against foreign creditors and requires cooperation with foreign courts and representatives



V: Federal Laws and Regulations

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

- (No acronyms detected in module text.)

Page B — Notes

Notes

Worker Classification: Employee or Independent Contractor

	Employee	Independent Contractor
Has their own tools		x
Business controls what the worker does and how they do it	x	
Paid by job		x
Salary/Hourly	x	
Limited Duration		x
Continuous Employment	x	
Receives benefits	x	



FICA (Federal Insurance Contributions Act)

Purpose

1. Funds Social security and Medicare benefits
 - a. Social Security Benefits
 - i. OASI: Old age and survivors' insurance
 - ii. DI: Disability Insurance
 - iii. Medicare
 - iv. Supplemental security income

Who must participate?

1. Taxes wages + salaries of employees and net earnings of self-employed individuals
 1. Example: Car received as a productivity award
2. Employer AND employee pay:
 1. 6.2% Social Security up to wage cap
 2. 1.45% Medicare no cap
 3. Tax Base: Employee's gross wages (Income before income tax or retirement contributions are deducted)
3. Self-employed pay both shares via self-employment tax:
 1. Tax Base: Net Profit from Self-employment
4. Employer Responsibility
 1. Employer must withhold employee portion and match it
 2. An employer who fails to withhold is liable to pay for the employee's half but has a right to reimbursement from the employee
 3. An employer can voluntarily pay the employee's half and that is deductible
 4. Penalties apply to employers who fail to make timely FICA deposits or who fail to supply their federal taxpayer identification number



FUTA (Federal Unemployment Tax Act): State-run system of insurance to provide income to workers who have lost their jobs. Although FUTA provides federal guidelines, the states actually administer the program, set standards, and determine payments.

Who Must Participate?

1. Taxes EMPLOYERS
 1. Employers who have quarterly payrolls of \$1,500 or who employ at least one person for 20 weeks in a year must participate
 2. Employers must meet minimum payroll or employment duration thresholds to be liable
 3. Deductible by the employer as a business expense for federal income tax purposes
 4. Self Employed persons do not participate in FUTA

Funding:

1. Generally assessed only against the employer.
2. 6% on the first \$7,000 per year of compensation for each employee
3. Employers can get a credit against the federal tax due for payments made on account of state unemployment taxes of up to 5.4% of the first \$7,000.
4. State rate can be reduced if the employer has a below-average rate of unemployment claims from prior employees

Workers' Compensation

Purpose: A state-run insurance program that provides benefits to employees who suffer work-related injuries or illnesses.

1. Ensures employees get medical care and partial wage replacement without needing to prove employer fault
2. Employee can collect even if the employee was negligent, grossly negligent, or assumed the risk. An employee CANNOT recover for injuries resulting from intoxication, fighting, or self-inflicted wounds.

Funding: The employer pays for the workers' compensation by purchasing insurance from the state or a private carrier. Some states also allow employers to be self-insuring if they can prove that they are financially responsible. In most states, coverage is compulsory.

Deductibility: Workers' compensation insurance premiums are ordinary business expenses deductible by the employer. Because employees do not pay, there is no deduction for the worker.



Coverage

1. Applies to employees injured within the scope of employment
2. **Covers occupational diseases and aggravations of preexisting conditions**
 1. **Occupational Disease:** Grace worked in a glitter factory and inhales the glitter so much she got a glitter allergy.
 2. **Aggravation of Preexisting Conditions:** Grace worked in a glitter factory and has asthma; the inhaling of glitter made her asthma dramatically worse and had to get medical treatment and miss work.
3. Casual/temporary workers are ineligible

Employer Obligations

1. Employers must provide coverage for all eligible employees by purchasing insurance from the state or private carriers
2. Employers pay the premiums
 1. Deductible business expenses
3. Employers are strictly liable for an employee's injuries

Employee Eligibility

1. Injured accidentally on the job are eligible even if due to negligence
2. Injuries must be accidental, not intentional or self-inflicted
3. Benefits are generally denied if the injury is caused by intoxication or fighting

Benefits provided

1. Medical expenses related to the injury
2. Partial wage replacement during disability
3. Compensation for prosthetic devices, burial expenses, and payments to surviving dependents if the injury is fatal



Affordable Care Act (ACA)

Purpose: Improve access to health care in the US by providing workers with access to affordable health care coverage

Who's required to participate?

1. Employers: Certain employers must offer health care coverage or pay a penalty
 1. Employers with >50 full-time employees are required to provide full-time employees with the opportunity to purchase affordable minimum essential health care coverage for themselves and their dependents under an eligible employer-sponsored health care plan
2. Employees: An individual must obtain health care coverage for himself or herself, a spouse, and tax dependents
3. Employer and employee contribute to the purchase of affordable coverage

Premium Tax Credit

1. Refundable Credit that helps eligible lower or moderate-income taxpayers recover some of the costs of their health insurance premiums
2. Eligibility: Taxpayer must have a household income between 100% and 400% of the federal poverty level, cannot use the Married Filing Separately Status, cannot be claimed as a dependent, and must be enrolled in a Health Insurance Marketplace

Foreign Corrupt Practices

1. Prohibits bribes to foreign officials in order to obtain or retain business
2. Punishable by civil fines, criminal penalties, imposition of an independent auditor, and imprisonment



IV: Business Structures: Part 1

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

None

Page B — Notes

Notes

Sole Proprietorship

1. Not considered a legal entity separate from the owner
2. Unlimited liability of the single owner
3. Sole proprietorship profits or losses go on the owner's Form 1040 on a Schedule C
4. No papers need to be filed with the state to form (unless doing business under an assumed name)

General Partnership/ Joint Venture under the Revised Uniform

Formation: A general partnership is formed whenever two or more people intend to carry on as co-owners a business for profit

1. No state approval or filing needed
2. Formation:
 1. Agreement (express or implied)
 2. Between at least two competent persons
 3. To carry on as co-owners a business for profit

Joint And Several Liability

1. All partners are jointly and severally liable for partnership debts

Must first exhaust partnership assets before pursuing the personal assets of the individual partner

When Intent Is Unclear: Sharing of Profits

If it is unclear whether the parties intended to enter a partnership, an agreement to share profits gives rise to a presumption that the parties intended to form a partnership



Death of A Partner in a General Partnership

1. A partner's death is an event of dissociation. Where a partner dissociates, the partner's right to participate in the management ceases; the partner's execution does not take the partner's place
2. The partner's estate remains liable for the partner's obligations to the partnership and has a right to the deceased partner's share of distributions
3. Under the Revised Uniform Partnership Act, a partnership does not automatically dissolve on the death of a partner, **rather it will dissolve only if 90 days pass and the remaining partners do not wish to continue the partnership and do not wish to continue the partnership.**

Partnership Decisions

1. **Ordinary Business Decisions (Day-to-Day operations):** Do not require unanimous consent. (Example: Making contracts to sell inventory, firing employees, ordering business cards)
2. **Extraordinary decisions – Require unanimous consent:** Big fundamental changes or commitments. (Example: Admitting new partners, Confessing a judgment or admitting liability in a lawsuit (e.g. Liability for a breach of contract), Making fundamental changes to the partnership business.)
3. **Management Decisions:** Majority vote of partners is sufficient unless agreement says otherwise
4. **Apparent Authority:** Partners have apparent authority to bind the partnership in ordinary business transactions, but not for extraordinary acts without unanimous consent.

Rights within a General partnership

Right to be indemnified: A partner incurs liability while acting on behalf of the partnership, they have the right to be made whole (indemnified) by the partnership.

Example: Indemnification for liability incurred in a suit brought by a third party while acting on behalf of the partnership

Right to be reimbursed for loans: If a partner loans money to the partnership, they have the right to be repaid

Right to Inspect Books and Records

1. Every partner (inactive or active) has the right to inspect and copy the books and records of the partnership
 1. **Inactive Partner:** Someone who has purchased a partnership interest as an investment but does not participate in managing the business. (Passive Investor)

Right to participate in management: Partners generally have the right to take part in managing the partnership's business

Right to Share in profits and Losses: Partners share profits and losses according to the partnership agreement or, if silent shared EQUALLY among all partners



Rights in Partnership Interest

1. Creditors May Attach a Partner's Interest (Called a Charging Order)
 1. A creditor may obtain from a court a charging order against an individual partner's share of profits
2. Upon Death, Heirs are Entitled to a Deceased Partner's Share of Profits
 1. When a partner dies, his or her rights to profits vest in his or her heirs. The partner's rights to partnership property vests in the surviving partners

Dissolution of a partnership

1. Bankruptcy of a partner and the remaining do not vote to continue
2. Death of a partner and the remaining partners do not vote to continue
3. Wrongful dissociation of a partner and the remaining partners do not vote to continue

Order Of Distribution

1. General partner loans
2. Partners' capital accounts
3. General partners' profits

Profit Sharing: Profits are shared 50/50

Partnership at will: A partnership with no specified duration or definite term

1. Can be terminated by any partner without cause
2. Default legal status if no fixed term is agreed upon

Disassociation: Loses the right to participate in management and control of the partnership

Liability

1. Remains liable for all partnership debts and obligations incurred before dissociation
2. Continue unless the partnership and creditor explicitly release the dissociated partner

Reasons to disassociate

1. Personal reasons
2. Avoid future liability

Hold Harmless agreement: Internal agreement among partners in a partnership where the other partners agree to reimburse a withdrawing partner for any amount that the partner must pay to creditors for partnership liabilities



Limited Partnership – At LEAST One General Partner

1. Limited partners are like shareholders in a corporation
2. **Consent:** May sell or assign partnership interest without the consent of other partners
3. Liable only for partnership obligations to the extent of their investment
4. No right to participate in management of the partnership
 1. In states not following 2001 ULPA: Liable as general partners if they do
5. **Must have a general partner** who **manages** the partnership and has unlimited legal liability
6. A general partner may own a limited partnership interest within the Limited Partnership
7. **Profits:** Based on each partner's contribution to the partnership
8. **Formation:** Requires filing within the state it operates in

Limited Liability Partnership – All partners have Limited Liability

1. Provides limited liability protection to partners
2. Partners can participate in management and control the business
3. **Liability:** Not personally liable for the wrongful acts of other partners or employees
4. **Formation:** Requires a filing with the state in which it is operating
5. **Profits:** Partners share profits and losses according to the partnership agreement or, if silent shared EQUALLY among all partners
6. **Taxation:** Treated as flow-through entities for tax purposes (no entity-level tax)

LLCs - Limited Liability Company

1. Limited liability for all its owners
2. Can permit all its owners to participate in management and control of the entity
3. Absent an agreement to the contrary, is dissolved on the death, withdrawal, or bankruptcy of an owner
4. Voting Power: Based on each member's capital contribution

Operation: Unless the articles or an operating agreement are provided otherwise, all members have a right to participate in the management decision of the LLC

Operating Agreement: Internal agreement among LLC members: Governs the internal workings and relationships among members

1. Details how the LLC will be managed and operated
2. Rules for management structure, voting rights, profit sharing, and transfer of ownership interests
3. Designed to prevent and resolve disputes among members
4. It is not filed with the state and is generally optional but highly recommended



Articles of Organization (Filed with the state to form the LLC)

5. Name of the LLC
6. Name and address of the registered agent (person or entity designated to receive legal documents)
7. Whether the LLC is managed by members or managers
8. Does NOT include shares of stock information, LLCs have members with ownership interests, not shareholders with shares

Ownership Transfer: Not allowed without the consent of other members

Voting Authority: Proportional to capital contributions

Member managed

1. Each Member acts as an agent of the LLC
2. All Members share management rights equally (unless otherwise stated)

Manager managed

1. Manager as Agent
 1. The manager acts as an agent of the LLC
 2. This agency relationship means the manager owes fiduciary duties to the LLC
2. Duty of Care
3. Duty of Loyalty
4. No Duty of Obedience

Liability: Members of an LLC are not personally liable for the LLC's debts or obligations

Profits

1. States: Divide proportionally to contributions
2. Uniform Limited Liability Company Act: Divides profits equally by member



VI: Business Structures: Part 2

Page A — Calculations, Acronym Key & Thresholds

Acronym Key

Articles of Incorporation (Also Called Corporate Charter) – NAST: Formally create the corporation as a legal entity under state law. This establishes its basic structure, authority, and stock structure. **Governing Document.**

1. N- Name: Corporation name
2. A: Agent/ Address: Name and Address of the corporation's registered agent
3. S: Shares Number of authorized shares
4. T: Team of incorporators: **Incorporator:** A person who takes the initial steps to form a corporation. They are responsible for preparing, signing, and filing the articles of incorporation with the state to legally create the corporation.

Directors Powers – RUDE

1. R - Repeal bylaws
2. U – Use Information to Manage the corporation's affairs and can rely on information provided by officers or professional
3. D - Declare dividends
4. E – Establish their own compensation

Key Grounds for Piercing – FUC

1. F - Fraudulent use of corporation
2. U - Undercapitalization (Thin Capitalization) at Formation
 1. Not started with enough capital to meet its prospective liabilities
3. C - Commingling of Personal and Corporate Funds:
 1. Shareholders mix personal assets with corporate assets, ignoring corporate formalities
 2. This breaches the separation between corporations and owners



Page B — Notes

Notes

Corporation

Formation: Must file with the articles of organization with the state and obtain approval

Purpose: Legal entity distinct from its owners (shareholders) and managers

Piercing the Corporate Veil: Courts may disregard the corporation as a separate legal entity and hold shareholders personally liable for corporate obligations

Key Grounds for Piercing - FUC

1. F - Fraudulent use of corporation
2. U - Undercapitalization (Thin Capitalization) at Formation
 1. Not started with enough capital to meet its prospective liabilities
3. C - Commingling of Personal and Corporate Funds:
 1. Shareholders mix personal assets with corporate assets, ignoring corporate formalities
 2. This breaches the separation between corporations and owners

Revised Model Business Corporation Act (RMBCA)

Articles of Incorporation (Also Called Corporate Charter) – NAST: Formally create the corporation as a legal entity under state law. This establishes its basic structure, authority, and stock structure. **Governing Document.**

5. N- Name: Corporation name
6. A: Agent/ Address: Name and Address of the corporation's registered agent
7. S: Shares Number of authorized shares
8. T: Team of incorporators
 1. **Incorporator:** A person who takes the initial steps to form a corporation. They are responsible for preparing, signing, and filing the articles of incorporation with the state to legally create the corporation.

Bylaws: Internal rules for running the corporation. They are adopted by the incorporators or the board of directors and typically cover management structure, meeting procedures, officer rules, and other governance details. (Not filed with the state.) **Govern how the corporation operates day-to-day**

1. Separate from articles
2. Bylaws contain the corporation management rules
3. Initial Bylaws can be adopted by either incorporations or BOD

Shareholders' Agreements: Contracts among shareholders

Resolutions: Formal decisions by the board or shareholders

Voting trust Agreement: A trust agreement by which shareholders transfer their legal ownership in their shares to be voted a certain way by a trustee.



Officers

1. Run the day-to-day operations of the corporations
2. Appointed + removed by BOD
3. Agents and fiduciaries of corporation
4. May also serve on BOD simultaneously
5. A corporation may be authorized to indemnify its officers for liability incurred in a suit by stockholders

1. **Indemnify: reimburse or compensate someone for expenses or losses they incur while acting on behalf of a business or organization**

Board of Directors

1. Cannot serve on competing boards or profit from insider information
2. Cannot unilaterally amend articles of incorporation (shareholder approval required)
3. Fiduciary Duties and the Business Judgement Rule
 1. Must act in the best interests of the corporation
 2. Will not be liable to the corporation for acts performed or decisions made in good faith
 3. Directors will be liable to the corporation only for negligent acts or omissions
4. **Fiduciary Duty was violated**
 1. No Care
 2. No Loyalty

Directors Powers – **RUDE**

5. R - Repeal bylaws
6. U – Use Information to Manage the corporation’s affairs and can rely on information provided by officers or professional
7. D - Declare dividends
8. E – Establish their own compensation



Shareholders

1. An amendment to the corporation's articles of incorporation, changing the duration for which the corporation was formed
2. Right to vote for directors
3. Receive dividends
4. Participating in the distribution of assets upon dissolution
5. Right to reasonable inspection of corporate records
 1. Upon five days written notice stating a proper purpose
 1. Related to the shareholders' rights in the corporation
 2. May send an attorney, accountant, or other agent to inspect
 3. To commence a stockholder's derivative suit
 4. To solicit stockholders to vote for a change in the BOD
 5. To investigate possible management misconduct
 6. Commence a stockholder's derivative suit
6. **DAMS - what the shareholder is entitled to do**
 1. D - Dissolution
 2. A - Amendments: To the corporation's articles of incorporation (e.g. changing the number of authorized shares)
 3. M - Mergers
 4. S - Sale
7. **Preemptive Rights**
 1. Shareholders have the right to purchase a proportional share of newly issued stock to maintain ownership percentage
 2. The right of first refusal to purchase newly issued shares
 3. To allow shareholders to maintain their proportionate ownership percentage and voting power in the corporation
 4. This right applies only to newly issued stock, not to stock already outstanding or transferred
 5. Right to purchase a proportionate share of newly issued stock to prevent dilution of ownership



Fundamental Corporate Changes

Definition: Major changes that affect the corporation's structure or existence

1. **Dissolution**
2. **Meger**
3. **Consolidation with one or more corporations:**
4. **Amendments to articles of incorporation that materially affect shareholders**
5. **Sales of substantially all corporate assets**
6. **Share exchange:** Transaction in which one corporation acquires all of the outstanding shares of one or more classes of stock of another corporation. Both corporations continue to exist as separate entities
7. **Voluntary Dissolution**

Key Rule: These changes require approval by the shareholder after the BOD adopts a resolution and proper notice is given

General Procedure for Fundamental Corporate Changes

1. Board Resolution: Majority of the BOD must adopt a resolution setting forth the proposed action and submitting it for a vote at a shareholder meeting.
2. Notice: Corporation must notify ALL shareholders even if they are not entitled to vote
3. Shareholder Approval: Majority
4. Filing of Articles

Corporate Actions Not Requiring Stockholder Consent: Routine or less significant decisions that directors can make unilaterally

Right to Dissent/Appraisal Rights: Shareholders who have a right to vote on a fundamental corporate change typically have a right to dissent/appraisal right (i.e. the right to have the corporation purchase their shares at a fair price) if the shareholder votes against the fundamental change and it is nevertheless approved.



Corporate Existence: Perpetual existence

Corporate Debt Securities

1. Convertible Bonds: Corporate debt securities that can be converted into a predetermined number of the corporation's stock at the bondholder's option
2. Debenture bonds: Unsecured bonds and are not backed by collateral. Rely on corporation.

Stock Dividend: Corporation's ratable distribution of additional shares of stock to its stockholders

Business Judgment Rule: Protects corporate directors and officers from personal liability

Conditions

1. Good faith
2. Believed to be in the best interest
3. With the care that a reasonably prudent person would exercise in a similar position
4. Within the authority and power of the corporation

Shareholder consideration

1. Some can be paid in cash or property
2. Dissenter's rights: if they vote against the merger

Derivative Suit: Enforcement of Shareholders Rights

Definition: A lawsuit brought by a shareholder on behalf of the corporation to enforce a right that belongs to the corporation, typically against a third party

Key Point: Used when the corporation fails to enforce its own rights, especially against third parties who have harmed the corporation.

- Legal cause of action against someone but refuses to bring the action, the shareholders may have a right to bring a shareholder derivative action to enforce the corporation's rights

Promoters

Promoters enter contracts before the corporation is formed to obtain financing and things the corporation will need once formed. Promoters are personally bound on the contracts they make.

Novation: When the third party, the corporation, and the promoter enter into an agreement to substitute the corporation for the promoter

Role: Someone who takes initial steps to organize and form a corporation before it legally exists

1. Includes
 1. Funding
 2. Entering contracts
 3. Recruiting investors

Liability

1. Personally liable for any contracts they enter on behalf of the corporation before they are formed



Release from Liability: When the third party, the corporation, and the promoter enter into an agreement to substitute the corporation for the promoter

S Corporation

The tax laws permit certain corporations to elect to be taxed like partnerships (not taxed at corporate level). There are a number of restrictions on this such as:

1. Stock cannot be held by >100 persons
2. Shareholders must be individuals, estates, or certain trusts
3. The corporation must generally be a domestic corporation
4. There can be only one class of stock
5. Foreign shareholders are generally prohibited

Created under a statute and must file a copy of its certificate with the proper state authorities.

Articles of incorporation still applies