

EXITING BUSINESS RELATIONSHIPS

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Some very successful businesses have been started by friends working together in a comfortable relationship. Frequently, however, there comes a time when the relationship ends and each individual goes their separate way. The manner in which a business relationship is created and concluded is critically important in protecting each person from financial loss and possible tax issues.

Mike and Joe opened and ran a very profitable lawn mower shop. They established a corporation and had a buy/sell agreement. Everything seemed to be fine. Mike decided to return to college to complete his degree. He sold his one half interest of the business to Joe under the terms of their prior agreement.

Joe got into financial trouble and quit paying payroll taxes on his employees and himself. Joe eventually went bankrupt. These taxes which are not dismissed through bankruptcy, survived bankruptcy. Four years later, the Internal Revenue Service and the Louisiana Department of Revenue and Taxation came knocking on Mike's door for payment of these taxes. Why would they look to the ex-owner who sold his interest in the business years before? Because his name was still on the corporate documents filed with the Secretary of State in Baton Rouge as an officer and director of the corporation.

The sale of a business does not have to be recorded in the parish records. However, with the sale and removal of an owner of the corporation, the non-owner should resign as an officer and director of the corporation. This resignation needs to be registered with the Secretary of State to put third parties on notice. Now Mike will have to prove when he sold his share of the business, when this sale occurred and when he was removed from the bank accounts to be released from the liability of paying the taxes.

Frank and Billy opened a web-site business. Frank handled the business aspects of running the corporation while Billy handled the creative element. The creative person knew little about bookkeeping or paying of taxes timely. The business owner was not creative.

After five (5) years, one of the owners wished to exit the relationship. In their corporate structure, Frank and Billy, who are equal owners, did not execute a buy/sell agreement or issue shares of stock. Notwithstanding the lack of a buy/sell agreement, the parties were able to agree to an equitable solution. Frank, in addition to the sale of his right to shares of stock to Billy, will provide the Secretary of State with a letter wherein he resigns as an officer and director of the corporation. Likewise, Frank will have his name removed from all corporate accounts and confirm same by letters.

In this scenario, each individual will prosper provided he hires someone to compliment his weaknesses.

Harry and John are neighbors and are in the same line of business. They decide to enter

into a business arrangement. Harry, who has the business knowledge and more experience, enters into an equitable verbal agreement with John. However Harry maintained the upper hand in the relationship. Additionally, no buy/sell agreement is ever formalized. After two years of a profitable relationship for both parties, Harry decided that he wants all of the cake and terminated John. John has two (2) choices. He can negotiate a settlement with Harry or go to court. John decided to negotiate a less favorable settlement and not go to court in order to exist from the relationship immediately and get on with his career.

An appropriate vehicle for these two (2) friends at the offset would have been to establish a limited liability company and execute an operating agreement wherein Harry would have had the majority ownership. John would have been a minority owner. Most operating agreements contain a basic buy/sell agreement relative to the termination of the relationship.

Not only is it important to commence and end business relationships with great care, it is equally important to realize that the gentleman's hand shake to start a business does absolutely nothing to protect yourself, your assets and your family at the termination of the relationship.

As the end of the year draws near, I hope you have implemented changes in your lives and businesses to protect yourself and your family from the inevitable problems that occur in every day living.

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