

PASSIVE INCOME, CONT.

A. PRESENTLY, PERSONAL RATES ARE HIGHER THAN CORPORATE RATES, CREATING AN INCENTIVE FOR S CORPS NOT TO DISTRIBUTE.

1. BUT LOSSES CAN ONLY BE PASSED AND OFFSET AGAINST ACTIVE INCOME.

2. IF A COMPANY WITH LOSSES IS ACQUIRED IN:

a) AN ASSET SALE + DIFFERENCE BETWEEN ASSET BOOK VALUE AND PURCHASE PRICE IS PROFIT, AND IS TAXABLE

1. THIS KIND OF PURCHASE LEAVES LIABILITIES WITH THE SELLER

2. SHAREHOLDER AGREEMENT WILL BE REQUIRED

MEDI PRO ENTITY SELECTION

A. PARTNERSHIP → THIS IS A BLOOD PRODUCTS COMPANY → YOU WANT BETTER LIABILITY PROTECTION. LLC PROBABLY LACKS SUFFICIENT CERTAINTY.

B. WHOSE THE CLIENT? THE REALITY IS THAT THE FIRM CAN'T FUND THE HIRING OF LAWYERS FOR EVERY FOUNDER. ATTORNEY-CLIENT PRIVILEGE CAN BE COMPROMISED IF YOU'RE NOT CAREFUL.

<u>PLAYER</u>	<u>GOALS/ISSUES</u>	<u>AMOUNT TO INVEST</u>	<u>OTHER ASSETS</u>	<u>INCOME BEFORE</u>	<u>INCOME</u>
STEVE	CONTROL AND VISION, MAKE MORE \$	\$90K	\$160	\$200K	\$100K
DAVE	HAPPY, RELATIONSHIP PROBLEMS	\$45K	\$?	\$100K	\$20K
BROTHER-IN-LAW	CURRENT INCOME	\$125K	OK	OK	OK
MICHAEL	TECHNICAL	\$0	\$0	\$60K	\$0

C. NOTES

1. IF THE RELATIONSHIP PROBLEMS RESULT IN DIVORCE, THE FOUNDER'S SHARE MAY BE DISTRIBUTED
2. SHAREHOLDER AGREEMENTS + SET OUT TERMS OF THE AGREEMENT BETWEEN THE SHAREHOLDERS; INCLUDES THINGS LIKE WHETHER YOU GET TO KEEP YOUR STOCK IF YOU LEAVE AFTER A YEAR.
3. DAVID COULD HAVE A PERSONAL SITUATION WITH RELATIONSHIP PROBLEMS, NO MONEY, ETC.
4. NOTE: ALL MONEY IS NOT THE SAME. AN EXPERIENCED INVESTOR WHO HAS LOST MONEY BEFORE KNOWS HOW IT WORKS.
5. IF A TECHNICAL FOUNDER AND A CAPITAL PROVIDER START A COMPANY, § 83 OF THE TAX CODE CREATES A PROBLEM. IF \$1M IS ~~LOANED~~ INVESTED AND SHARES ARE ISSUED TO TECHNICAL FOUNDER, THE TECHNICAL FOUNDER HAS EXPERIENCED A TAXABLE GAIN.
 1. "UNLESS THERE IS A SUBSTANTIAL RISK OF FORFEITURE"
 2. § 83(b) IF YOU FILE AN ELECTION WITHIN 30 DAYS OF GETTING THE STOCK, THE VALUE IS TAKEN AS OF THAT DAY.
 3. WITH VESTING, THIS CAN CREATE A TAX BILL W/O A TRANSFER OF CASH.
 4. THE TRIGGER IS A "TRANSFER" OF VALUE
 - a) SO, GET THE STOCK OUT EARLY SO THE VALUATION IS BELOW THE FUNDING. THIS GETS YOU OUT OF § 83.
6. OPTIONS HAVE A DIFFERENT TAX TREATMENT → YOU EXERCISE WHEN YOU HAVE LIQUIDITY.
7. IF INVESTORS TAKE PREFERRED SHARES, MICHAEL SORT OF HAS AN OPTION ON THE PROCEEDS COMING IN ABOVE THE INVESTMENT AMOUNT.
 1. MICHAEL'S VALUATION IS TYPICALLY BETWEEN 5-15%.

2. PROBLEM: PREFERRED SHARES MEANS YOU CAN'T HAVE AN S CORP.
8. SUPPOSE STEVE CONTRIBUTES \$20, BROTHER-N-LAW \$80, AND THEY LOSE \$100 IN THE FIRST YEAR.
1. BECAUSE STEVE'S LOSSES ARE ACTIVE, HE CAN TAKE LOSSES UP TO AMOUNT OF HIS BASIS, B-N-L CAN'T TAKE LOSSES BECAUSE FOR HIM, THEY'RE PASSIVE.
 2. THEY COULD DO BETTER IF BROTHER-N-LAW LOANS \$30 TO STEVE, ALLOWS STEVE TO INVEST \$50, AND RAISE HIS BASIS TO \$50 AND TAKE THE LOSSES UP TO \$50.