

**CONDUCTING BUSINESS ACROSS STATE LINES:
Choosing the Right Business Entity; Protecting
Yourself and Your Business; Tax Issues; How to
Safeguard Your Corporate Identity and Intellectual
Property; Understanding Website Ownership Issues;
Key Issues re Doing Business in Multiple Jurisdictions
June 9, 2004**



W. Patrick Scott, Esq.
Joseph A. Bellinghieri, Esq.
Denise C. Werkley, Esq.
Presenters

TIM PHELPS: Welcome to of our fourth of what I call Business Law 101, helping small mid-size business owners understand the environment that surround us. I think today's program is very key on where we sit in conjunction to Delaware and Maryland for us doing business in the community at large. As the idea of regionalism grows the laws don't and so we need to know what's happening in Delaware and Maryland as well as Pennsylvania. At this time I would like to turn it over to Lance Nelson who will introduce our guest panel.

Lance Nelson: Good morning. My name is Lance Nelson. I'm the Managing Partner of MacElree Harvey and we've got three attorneys from our Business Department here this morning. I believe you have in your seats a little scenario that we'll operate from the mythical widget manufacturer and sales person. We have with us today Pat Scott, Joe Bellinghieri and Denise Werkley. They are all in our Business Department and they will be running the seminar this morning. As with our past seminars we will try to transcribe this and e-mail or hard mail a copy of the seminar to everybody who attended as well as possibly some supplemental materials. At the end of the seminar we will be doing a drawing for a gift certificate for dinner at Vincent's Restaurant in West Chester. Toward the end of the program Joe will make an

announcement and we will collect business cards and pull one out of the hat. So, without further ado, I'll turn it over to these guys.

Joseph Bellinghieri: Good morning everyone. My name is Joseph Bellinghieri and this is Pat Scott and Denise Werkley. What we are going to try to accomplish this morning is go through the various issues that confront an individual or a group of individuals trying to set up a business in Pennsylvania and then eventually trying to expand that business into other jurisdictions, if they are going to do it bricks and mortar or via the internet.

The way we are going to do that is TO go through a hypothetical case study, which you guys should all have, and we wrote down various issues that we thought of, but we're not limited to those issues. We may or may not speak about those issues. Please feel free to interrupt us. We want to try to make this as interactive as possible, so if you have any questions for yourselves, your clients or your friends, please speak. We'll call on you and try to answer the best we can.

One thing you need to keep in mind is that Pat, Denise and I are Pennsylvania attorneys. We practice law in Pennsylvania. If you are going to go into another jurisdiction, one of my biggest things of advice that I can give you is seek competent legal counsel from whatever jurisdiction you're going in. I think we are competent enough to know the issues, but to deal with the nitty-gritty of those issues in other jurisdictions may

be best served by getting legal counsel in those jurisdictions.

So, let's go with the case study and I'll go through the first part. Ms. Paula Enterprising has come to MacElree Harvey (where else would she go) for legal advice in starting a business in West Chester. The nature of the business will be the retail sale of widgets. Ms. Enterprising wants to know the various issues involved in setting up a business in Pennsylvania. There are a whole host of issues. If we went through very issue, we would be here for days, but we've listed a few here. Pat, do you want to start with the choice of entity issues?

Pat Scott: Sure. Of course the first thing you need to do when you want to start to do business is set up a business. You could act as a sole proprietor, which is just doing the business and reporting the income from that business on your personal tax return. We don't advise that simply because you don't have any liability protection and your personal assets are subject to the claims of creditors or any other claimant against the company. So, when a person comes in asking me what type of entity should I establish, there are basically three options that I give people. One is a partnership, two is a limited liability company, and three is a corporation. The benefit of a corporation is that when you create it, and let's assume that Paula is going to be the sole shareholder or the only person that owns the enterprise. She would be the one hundred percent shareholder of this entity. So long as Paula complies with the corporate

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formalities, that is, she has regular meetings, she has resolutions, she acts only as a director, she acts within the company's by-laws, her business is going to be separate from her personal assets. It's very important. There are tax issues that Joe can give more detail on, but the bottom line is with a corporation, a corporation is a separate entity so that if Paula takes a salary or takes income out of the corporation, she would potentially be taxed on money coming into the corporation, the corporation has a tax that it pays on its income. Money going out as a distribution to Paula is also taxed.

Enter the limited liability company, which solves the problem. A limited liability company permits you as an individual to set up a business. You would have the liability protection that you have with a corporation, but you would be taxed as a partnership - meaning that any income that this company earns passes directly through to the individual shareholders. You cut out the step of income coming out of the corporation to the individual. There is no double tax. It all passes through to the individuals as a general matter.

A partnership operates much as a limited liability company except under the law you don't have the statutory liability protection. So, a partnership, I just haven't seen a whole lot of those anymore. Typically partnerships will be setup for passive real estate investments if there are not a lot of liability risks. You may want to save the cost of setting up a limited liability company.

The question with regard to doing business across state lines or even if an individual is not going to do business across state lines -- Paula comes in and she says I'd like to set up a corporation or I'd like to set up a limited liability company. I'd say okay. It is very easy to do. We prepare a certificate of organization or we prepare your articles of incorporation and file them with the Pennsylvania Department of State. It is relatively inexpensive to do that. We're talking anywhere from \$200 to \$400 to get it up and running just for your costs not the legal fees of course. People will say, well, should I incorporate in Delaware, which seems to be the big question, and the answer is I don't know. It's up to you.

Joseph Bellinghieri: The question I always get is they say we always heard it is better to incorporate in Delaware. I think the reason people say that is Delaware's corporate laws have been around for much longer and there have been more cases and whatnot, and I do think the laws in Delaware may provide a little more protection, but I think its just because there have been more cases out there and I guess the law is more certain.

Pat Scott: The pitch in Delaware is that Delaware will say our statutes or corporate laws are more flexible, we've set the trend, we've been around forever, we provide a statutory scheme that essentially allows the corporation to set its own rules, to set its own by-laws, to run its own company to provide that individual directors can be indemnified by the company

such that directors of the company don't have a disincentive to participate because they're concerned about being liable. All of those provisions essentially exist in Pennsylvania. I can't give you a substantive analysis of well, Delaware provides A, B, C, Pennsylvania provides A, B, C. The bottom line is if you are a small or medium sized business, Pennsylvania does provide everything that you need. It is local; we're familiar with the Department of State. If your business is in Pennsylvania, you don't have issues of having offices in Pennsylvania being incorporated in another state, which leads to other issues that we'll talk about in a minute. It's all central - it's all right here.

Denise Werkley: There are additional costs to also be incorporated in a different state, correct?

Pat Scott: Which would come up when let's say Ms. Enterprising does want to set up a Delaware corporation and she goes, well, you know, I'm going to take this company public. It's huge and I want to have this established body of case law. I want it to be very clear that my directors are protected. I want the law to be clear. I want to have the benefit of having the Delaware Court in the event there is any dispute between any shareholder or director of the company. I say, okay. We set up a corporation in the State of Delaware.

The additional costs that are associated with that for the Pennsylvania business person start at you need a registered agent in the State of Delaware

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because you need a registered address in the State of Delaware to accept legal process or accept service of papers. If you are just operating out of Malvern, a registered agent would provide that business address for you in the State of Delaware. That doesn't come without cost. There is usually an annual cost of anywhere between \$200 to \$400 to maintain that. That is an expense if you don't intend to creep outside of Pennsylvania's borders, you would not have.

Joseph Bellinghieri: Plus you may also have the cost of having to file a tax return in whatever jurisdiction that you incorporate in as well.

Pat Scott: Right. I guess I'm kind of bleeding into the second part of the analysis, but the question is if you are operating in Pennsylvania but you want to be incorporated in Delaware, you have two essentially governments that you need to be worried about in terms of tax reporting and in terms of corporate law. If you are incorporated in Delaware and you operate in Pennsylvania, you are a foreign entity. Your entity is created outside the State of Pennsylvania so you need to do a filing with the Pennsylvania Department of State stating that I, Pat Scott Business, am incorporated in the State of Delaware but I hereby notify the state that I am operating in the State of Pennsylvania. Why do we do that? So now the Pennsylvania Department of Revenue knows that you are here. They know you are doing business in this state and they want you to file a tax return and pay taxes.

Pennsylvania Form 100
Combination Registration...

Joseph Bellinghieri: Actually, before we get that, one of the things I think you didn't mention, what about an S Corporation? I think there are ways you can still be a corporation and get the protection without doing an LLC. A lot of people also set up S Corporations, which is basically a corporation, and there are some limits on it. You can only have 75 shareholders, everyone has to be a U.S. citizen, but basically gives you all the protection of a C Corporation, which is a regular corporation, but when Pat said you are going to have double taxation - you're going to get taxed at the corporate level and that at the individual level once you take the money out. The S Corporation is a flow-through, meaning it is just like a partnership or an LLC in that any money that comes into the corporation will flow through eventually to the shareholders and they will get taxed. They get a K-1 basically when they file the tax return and that is how they get taxed. That's another way that you can be protected from liability and not get the double taxation of a corporation.

Question: I am still confused about whether I should go LLC or S Corporation. I'm sole proprietor right now and don't have employees so I was thinking LLC, but then I was told that if I intend to have employees down the road, an S Corp would probably be the way to go. Do you have an opinion on that?

Pat Scott: My answer is it is easier to set up the LLC for your purposes simply because an LLC is one filing. There is a simple agreement called an operating agreement, which can have a little flexibility in it if you eventually want to add people into your company. It's easier from an organizational standpoint to set up an LLC. To set up an S Corp like Joe is talking about, it's not very difficult, but it's a matter of steps. You incorporate, you notify the public of your incorporation, and you do filings within the IRS and the Pennsylvania Department of Revenue. From my perspective it is easier to setup the LLC for you because you are not intending to do anything terribly complicated in terms of your share ownership and investments in the company. But, for tax reasons and employment tax, I don't know if Joe has an opinion on that, because I would say whether you want to go with an S Corp or whether you go with an LLC may be driven by the tax consequences of the payment of employees.

Joseph Bellinghieri: I think if it's just going to be a small organization and even if you have a few employees, you can still set up an LLC. It would be a sole member LLC. You'd file a Schedule C on your personal; you wouldn't even have to do a separate tax return so you're going to save money there. The LLC is definitely less cost, less formalities, you don't have to advertise when you set it up. That's what I would do.

Pat Scott: Another point about that is that a sole member...we

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say that well, a limited liability company acts like a partnership but under Pennsylvania law a partnership has to be one or more people. If you are by yourself, the question is well can I set up an LLC as one person and the answer is yes you can. States vary on that. I think most State laws now state that one person can be a member of a limited liability company and actually act as the company. In that case for tax purposes the company would be disregarded as an entity separate from the individual such that the company itself I don't think does separate filings. Is that right?

Joseph Bellinghieri: If it is a sole member LLC, I don't think you have to do a federal tax filing, but I think Pennsylvania still requires...

Denise Werkley: There is a reporting form that Pennsylvania requires.

Pat Scott: Are there any other questions following up on that?

Question: Do all the States recognize LLC's now?

Pat Scott: I don't know. I would imagine that they do, but I haven't done a comprehensive check. I think what happens is you come in and say I want to set up an LLC and I'm going to buy property in the State of Colorado, can I set up an LLC there or should I do that, and we would check. The answer, I think is yes. I'm almost certain that all States recognize limited liability companies. The question that may come up is there a difference between setting up a Pennsylvania LLC

and setting up that Colorado LLC. So, will Colorado recognize the Pennsylvania limited liability company?

Audience Member: At least for liability protection, yes?

Pat Scott: I don't know the answer to that question because I've never seen it.

Joseph Bellinghieri: I wouldn't see why not. If it is a legitimate entity set up in Pennsylvania and you follow the statute in setting up the LLC. You're saying you're doing business in Colorado?

Question: Doing business across state lines. The concept is that you have a business here and doing business in Colorado and some other states.

Catherine Marrone (MH Paralegal): Certain States do not recognize limited liability companies. There are very few and I think Colorado is one of them.

Pat Scott: The question here is if you set up a Pennsylvania LLC and, for example, get sued in Colorado; that is the LLC is the defendant in a lawsuit in the State of Colorado, would the Colorado State or Colorado Courts recognize the existence of that limited liability company or would the sole member of that company be subject to liability? The legal answer is you look to the choice of law provisions of the state of Colorado.

So, you are sued in Colorado. Colorado has a body of law called choice of laws. Generally, that choice of law will state that

it will apply the law of the state of incorporation to determine the existence or the validity of that particular entity. But, let's say the company manufactures widgets and the company is being sued in the State of Colorado by a Colorado resident for negligence in the design of the widgets because somebody was killed or injured. If I had to guess, the courts in Colorado would say, Okay, we're going to look to whether John Smith or the LLC is liable because John Smith wants to get out of the lawsuit. He is the sole member of the Pennsylvania LLC. If I had to guess, Colorado would look to Pennsylvania law to determine whether the limited liability company was established properly consistent with the laws of the State of Pennsylvania. If the answer to that question is yes, John Smith is out. With respect to whether the LLC is liable in tort to the injured Colorado plaintiff, most likely Colorado would apply Colorado law to determine the substantive liability of the Pennsylvania LLC. So, in the same court case you would have the court applying two different state laws. Pennsylvania to determine the validity of existence of the LLC and then Colorado law for the substantive issue of whether or not the LLC is liable to the injured plaintiff. Again, that's my guess on what Colorado law would say, but I'd be willing to bet on it.

Question: Wouldn't you be concerned at all about the limited amount of LLC case law?

Pat Scott: Again, I would look at Pennsylvania law. If I were confident, which I am, that the

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Pennsylvania statute provides for protection for individuals who are the members of the company, I would rely on that. And I'm confident based on the statute because the statute is going to take precedent over the non-existence of case law because you have the statute. You see what I mean? The courts would interpret the statute, so if the statute is clear and the statute says Pat Scott sets up a limited liability company and Pat Scott provided that he complied with whatever he needs to comply with will be insulated from liability of creditors of the company. I'd rely on that. As your legal counsel, I would say you're in great shape. I'm not too concerned about the fact that these are new companies. The reality is there are new since 1988 or the mid-eighties, so we're talking about case law that is coming.

Joe Bellinghieri: I agree with Pat. I think you would be fine under Pennsylvania law, but I do know that there are a lot of attorneys out there that still to this day will refuse to set up an LLC for that exact reason. They'll say, let's be an S Corporation. I know that law is out there. It's been around forever. But, I do agree with Pat that the statute has been set and as long as you follow the guidelines in the statute, you should be fine.

Question: What happens if you are doing business on an international basis. You're contracting for a product made in China, for example, and you're selling that to someone in the United States who resells it

and there is a product liability issue, what is the best position for us to be in, in terms of these entities to avoid consequences of a judgment against us?

Joe Bellinghieri: I would think that you would either want to be a C Corporation, an S Corporation or an LLC. I don't know how big your organization is.

Question: It doesn't make any difference then that we're making something out of the country?

Pat Scott: I think you could make it as complicated as you want in terms of where all the business is going. I think we still come back to the answer to the question I just gave which is where are you incorporated, are you properly incorporated under that state's laws, and have you complied with that law? If the answer to all those questions is "yes", end of question. You may get into issues of Japanese law applies to determine the liability of the individuals, and I don't know the first thing about Japanese law, but what I can see is that consistently in the United States I'm very confident that as long as you are setup here in the State of Pennsylvania and you've complied with the laws, you're going to be insulated.

If you know, and this actually brings up a pretty good point, that you're going to be manufacturing in Japan, you come to me and say, I live in Malvern. I'm going to start producing this product. I think it's a great product, but I'm going to manufacture that product overseas because its going to be a great cost savings

to me, which, frankly, is what a lot of companies do. This is a very typical scenario. I would recommend to you let's set up your Pennsylvania LLC, but before we file the papers, let's check with somebody in Japan (if that's where you are manufacturing the product), a lawyer or counsel over there to give us advice on whether this is the proper way to set it up, because we may get advice from Japanese counsel that says you need to set up a separate company and do some structure over in Japan. I don't know the answer to that question, but my advice would simply be let's go with what we know, but before we cross the t's and dot the i's, if we know we're going to be doing business in Japan or Europe or wherever, let's check with counsel over there because you want to posture yourself correctly.

Audience Member: Just a little side nuance to what your are talking about between an LLC to a S Corp. from workers' comp standpoint insurance companies consider an LLC a partnership so if an owner is in a high hazard field where they are looking to have medical and stuff covered by workers' comp and the LLC is not able to cover that owner or member of the LLC where as an S Corp you're treated as an employee automatically and then they have the option to opt-out. And, state-to-state it is not clear because the work we've seen on it is that some states will consider you a partnership and some will consider you a corporation and it varies widely.

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Joe Bellinghieri: That's for the workers' comp so it doesn't matter what you choose to be taxed as, whatever state that is they'll just say you're going to be treated as a partnership or as a corporation. Good to know.

I think we were talking about the PA 100. One of the things we have listed here is the Pennsylvania Form 100 Combination Registration. That is just a form that, once you set yourself up, you need to complete in Pennsylvania and it kind of give Pennsylvania an idea of basically what forms to send you. If you are going to sell stuff, they're going to send you Sales and Use Tax Forms to be taxed. I think there is cigarette tax on there, motor vehicle taxes, a whole host of taxes, I think you can even set up, if you are going to have employees and whatnot, so it is a very important form that you need to complete. Basically, it sets forth what you are going to do and tells Pennsylvania, okay this is what we should expect from this company. I believe you can get that form right on line. I think it is a 12 or 15 page form you would fill out and a lot of things may not apply. You would just tell Pennsylvania what it is you're doing and then they will know what forms to send you and what taxes you would be liable for.

Pat Scott: I just learned last week that in Pennsylvania there is a tax on the sale of tires, so if you set up an automotive business or body shop and want to get into the sale and/or repair of tires. If you sell a tire, there is a tax that is different from the Pennsylvania sales tax. It does show up on the form. Are you

going to sell tires; are you going to sell cigarettes; are you going to sell beer; whatever. All of those articles have tax consequences. What happens when you say, I'm going to set up my tire business. I'm paying my tire tax in the State of Pennsylvania, but I'm going to set up my shop in Wilmington because there is big tire business in Wilmington. We've got to go through the same process. We have to check out what the taxes are in the State of Delaware with respect to the sale of those tires. It may be that if you are paying the tax on the tires here in Pennsylvania when you take that tire across state lines you may not be subject to the tax in Delaware. I don't know how the states interact in terms of multiple taxes.

Joe Bellinghieri: Well, you either pay a sales or a use tax. I don't think most people pay use. They should, but... for instance, if you go to Delaware and buy a TV or whatever and you don't pay sales tax, when you bring it into Pennsylvania, it is my understanding that you're still liable for a use tax. I mean you're using that product in Pennsylvania. I don't think anyone does it and I don't know how Pennsylvania tracks it, but there is a tax out there for it.

Audience member: For your information, we had a flying club in Delaware and we moved it to Pennsylvania. We put three airplanes on a field over in Toughkenamon. These were old, used airplanes and the Pennsylvania tax people came after us for a use tax and we

moved the flying club by air back to Delaware.

Joe Bellinghieri: How did they find out?

Audience member: I don't know how they found out.

Joe Bellinghieri: I figure an airplane is a little more conspicuous than a television in someone's house.

Audience member: Anyway, they did come after us and they wanted a use tax on the three airplanes. It was a significant amount of money.

Joe Bellinghieri: One of the last parts of this first part is a lot of times clients will come in and say, well, as part of setting up the business we're thinking about either buying a piece of real estate and working out of that or leasing it and if we do buy it, should we own it in a separate entity or should we own it individually?

Denise Werkley: That issue will really be driven by economics when you get started, whether you're going to have enough money to buy an actual piece of property where you're going to operate your business out of or whether you just want to lease it so you can just get started and get some revenue into the business before you think about buying.

The choice of entity to own real estate is something that you would need to discuss with an attorney depending on where you want to do business and how you want to operate. There are also tax benefits in investing in real estate. Obviously, most

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of you probably own your home. You know there are tax benefits to owning your home as opposed to renting a piece of property, so there are tax benefits of owning a piece of property for your business as well. There is lower cost like I said at the beginning to rent, but you may not get anything out of renting. There may be fit out costs that you're going to have to put into a rental space and trade fixtures that you are going to attach to the premises that you may not get back when you leave. Those are just some extra issues for you to think about when you are getting started.

Joe Bellinghieri: If my clients are going to purchase the real estate, I normally tell them to set it up in a separate entity especially if they are going to be a corporation or even an S Corp. I would definitely tell them not to have that inside the entity because there are various tax consequences of having real estate in the corporation or an S Corp. ***** So, you would either own it individually and buy yourself an umbrella policy or you can stick it into an LLC and get treated as a partnership, but you still get the liability protection.

Are there any other questions on part 1?

Joe Bellinghieri: Part 2. A year later, Ms. Enterprising has done quite well in Pennsylvania and is inquiring about expanding into the State of Delaware. Her main competitor is contemplating retirement and has asked whether she would be interested in purchasing his business. His business consists of a retail store

located on a parcel of real estate owned by the competitor as well as two warehouses in North Carolina and California. There are numerous issues.

The first thing is if Ms. Enterprising is going to buy the entity, she needs to know whether or not she wants to purchase the stock or the assets. I always tell my clients you're the buyer or you always want to purchase the assets because you get away from any of the liabilities of the previous owner meaning that if you are just buying the assets, any liabilities that corporation or whatever had, you're not involved in those liabilities. You're just buying the assets and that's it.

The other issues you need to be aware of are that once you go into the State of Delaware and here in North Carolina and California, obviously there are a whole bunch of tax issues. I mean there may be sales and use tax issues, there are going to be corporate income tax issues, various other taxes that you may be responsible for that I think you would really need to look into before you decide to do it.

Denise Werkley: You also need to make a decision whether you are going to be purchasing the business in Delaware, the assets in Delaware, within your current operating company which is incorporated in Pennsylvania or whether you are going to set up a new entity in that state that you are buying from to own those assets.

Pat Scott: Joe's question about assets versus stock, if you are buying a Delaware corporation, for example you're buying

Delaware stock, now you get into two different laws and two different states applying to your now two companies or maybe one company. One company is the Pennsylvania company that you own 100% of the shares of the membership interest in that entity. Second is you buy the stock in the State of Delaware, now you are a shareholder in a Delaware company, so somebody has to run that Delaware company. You've now got two entities going at the same time. What you could possibly do there is buy the stock of the second company in Delaware then merge the two entities into one and then your question becomes do I want to merge as a Pennsylvania corporation, do I want the surviving corporation to be a PA corp. if I'm familiar with that law, or do I want the surviving corp. to be a Delaware corporation given that I'm doing business in both states? I don't know the answer to that question. We'd have to look at it.

Question: Is there a limit on how many you can merge?

Pat Scott: Not that I'm aware of.

Question: So you could merge all the companies - Pennsylvania, Delaware, California?

Joe Bellinghieri: Well, these weren't separate companies, but I think you could. Sure.

Pat Scott: I don't know if we would do it all at one time, or if it would be Pennsylvania corp. merges with Delaware corp. then the surviving corporation

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merges with the California corporation. Eventually what would happen is you would want to "roll up" all those companies into one big company. There are a lot of different ways to structure that. The answer is yeah, that could definitely happen.

Joe Bellinghieri: Do you usually tell your clients to purchase the stock or the assets when they're thinking about buying a business?

Pat Scott: The assets.

Joe Bellinghieri: Hopefully, it will never come to that because you really shouldn't be buying the stock, you should be buying the assets.

I guess once you are in Delaware again, like we discussed in the first part, you would have to get a registered agent in Delaware. You could be sued in Delaware so you are going to have all those issues if you buy the stock.

Pat Scott: An important thing to not let slip through the cracks as we talked about, well, you've got to check with the State of Delaware, etc., but if you're the Pennsylvania corporation and you buy the assets in the State of Delaware and you are operating in the State of Delaware. It's not a situation where you bought the assets and you brought them across the state line and everything is now in Pennsylvania, which creates its own issues, but if you're going to operate in the State of Delaware, you need to file an application as a foreign entity operating in the State of Delaware with the Delaware

Department of State. The reason you need to do that is very important because if you are a Pennsylvania company operating in the State of Delaware and you have not done that, and I think it is almost no cost. I mean, maybe its fifty bucks to file this certification or file this form. If you have not done that, as a corporation you cannot take advantage of the courts of that state unless it is done. So, if you are operating and somebody doesn't pay you and you want to sue that person, you can't do it unless you're registered in the State of Delaware. The question becomes can we correct it? Can we operate, we're moving along, we're filing tax returns, we're doing everything we have to do, but we just haven't filed the form with the Department of State notifying the state that we're operating there. Now I want to bring suit and its not just a little suit, it's a big suit. Can we cure our failure to have filed the form and take advantage of the state's laws after we file the form? I don't know. I know that in Pennsylvania you can. You can just file the registration, that's just one more step that you have to take before you commence the litigation, but you run the risk of if you don't do it, you file the litigation and then you discover that you haven't done it or your lawyer discovers that you haven't done it, you risk dismissal of the suit, filing it. It could become a big headache.

Joe Bellinghieri: There could be a lot of back-end costs for a small front-end cost.

Pat Scott: We have actually seen that happen where it was a New York corporation that was doing business here. The lawsuits all started and then we discover that the form had never been filed, so we just went crazy trying to get it done. The bottom line is you can correct that failure, but why put yourself through that. Go to the lawyer in Delaware or you go to a Pennsylvania lawyer and say, I want to expand to the State of Delaware, what do I need to do? You get a nice checklist. You do everything. You pay an upfront cost. You go like I can't believe the attorneys are so expensive, but you've just saved yourself a huge headache six months or a year from now.

Tim, did you have something?

Question: Where does the name of that company in Delaware you are purchasing, is it an asset or a part of the stock if you want to go through and the company has been there for 80 years and they have a great client list, how do you deal with that?

Pat Scott: I'm not sure I understand the question. What I heard was, is the name itself an asset of the company?

Denise Werkley: Yes, it is.

Pat Scott: It's just the Chamber of Commerce. What is that? The answer is it is an asset of the company. I think that was your question. Which actually kind of runs into another, maybe we don't even have it on this form, but if the name of your company, let's use Coca Cola for example, and this is another seminar topic which

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I'm not going to spend a lot of time on, but it could be a trademark issue where Tim Phelps is operating as Coca Cola. I mean you couldn't do that because Coca Cola would sue you, but let's just call it that. Let's call it Coca Cola and that doesn't exist. You're selling your product. You're selling your widgets in the State of Pennsylvania only. You have common law trademark rights in that name, meaning that an individual who buys a product knows, just by virtue of the name, that they're buying a product that was manufactured by the Tim Phelps Company in West Chester, Pennsylvania. When you sell that product in the State of Delaware, now you're going across the Pennsylvania state line and selling the Tim Phelps' Coca Cola product in the State of Delaware, what you have done now is you are now engaging in interstate commerce, meaning that you're selling to individuals in more than one state. Now you have the right to apply for federal trademark protection in that name. So, yes, the name is the asset of the company, but in order for you to keep anybody else from using the good will associated with that name, the best thing to do is get your federal trademark protection.

You can't get federal protection which is an assumption essentially that no one else in the company can use that name unless you are doing business across state lines. If you are doing inside Pennsylvania only, you still have state trademark protection inside the State of Pennsylvania. You still have what's called common law protection meaning that you

have the protection of the law so that if somebody is operating in the State of North Carolina in your company's name, you could theoretically keep them from doing that, but you get into a lot of very difficult evidentiary issues because the question is going to be do the members of the general public associate that name with your company. If you have the federal protection, there is a presumption that they do.

Denise Werkley: Protecting your corporate identity brings us right into number three here. We talk about Ms. Enterprising wanting to further expand her business by creating a website and offering internet sales. She hopes she's going to be doing business in every state. Some of the issues she faces are just that--protecting her corporate identity is probably the most important. When you put a website out there, it makes you available to the entire country and, hopefully, the world. You want to make sure that your name, your products, your content that's on that website are protected and one of the ways to do it is what Pat just mentioned which is filing a federal trademark. If you are doing interstate commerce, doing business across state lines, and putting a website out there and selling a product, its definitely doing business across state lines, or you hope it will be. You can go ahead and get a federal trademark. That process is not very difficult; it just takes a long time because the trademark office is slow.

Some of the other issues you are going to face in protecting your corporate identity are some

of your trade secrets. You're going to want to make sure that you keep things confidential if you have things that you're working with in a small group of people. If I'm trying to sell products, its necessary to keep your important trade secrets confidential when you start to expand, grow your business, move across state lines, sell your products, put your information out on the internet, you've got to be very careful about how you put it out there.

One of the other things is that people can easily steal your information from the internet and you may never know it. So, if you have a website that you've put out there to start growing your business and selling across the country and the world, you have to make sure that you're looking, maybe do a search every once in a while, for your corporate name, things that are on your website, some of the exact language that's on your website, because you'd be surprised how easily you'll find it elsewhere. Its not uncommon for people to assume that everything that is out on the internet is free to the public and free for their use. So, you'll see sometimes people's pictures of products, pictures of their building, things like that, on someone else's website. You need to make sure you do your own little police work just to double check.

Some of the other issues for the internet, we're talking about selling products, we're doing e-commerce, would be sales tax and how to handle that and whether you need to charge sales tax.

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Joe Bellinghieri: I have a question for you. One of the issues we have down there is litigation issues. If you have a website and someone in California says I want to buy a widget and you ship it to California, can you now get sued in the State of California?

Denise Werkley: Probably. The answer really depends on whether your website is commercial and the interactivity of your website. If you are actually selling products, there are three types of websites the courts look at. The first is a passive website which is just information, a brochure site. If you look at MacElree Harvey's website, we're just a passive website. We just have information. We talk about ourselves. You can do a little bit of interaction like signing up for a newsletter, that kind of thing. The second type is an interactive website which really requires people to put in a lot of information in order to get something out of the site, so there may be a membership portion to the website, something like that. The third, and the one that is the most troublesome for people is an e-commerce site, one where you are actually doing business over the internet. You're selling products and, the thing your talking about, where you are selling a product over the internet and shipping it to another state, definitely could make you subject to the laws of that other state. So, every time you ship a product to say California, that person that you shipped to could sue you in California for a defect in that product or for some other reason, so you do have to be

aware of some of the other laws of the other states.

Joe Bellinghieri: I would even think if you were shipping products to California or any other state, you would have to also be aware if that state has a sales tax that you may need to collect. I think there is a lot that you really need to look at if you are going to set up an internet site and start selling product. You need to figure out where you're going to be sending it to and what type of taxes you may be liable for.

Question: Have they made a differentiation between websites where you print out the order form, fill it out and fax it back versus a website where you actually go in, put in all the data, put a secured credit card information in there and it is a direct shipment from the website?

Denise Werkley: The interesting thing about the internet is it is not clear and there is not a lot of great law on it. It is not clear whether that's going to be an issue or not, whether you're going to be sued in that state or not, and most likely you would be because just printing out and faxing it still means you are doing business in California or to California.

Question: We are a medium-sized company and we do business in about 30 to 35 states and we're running into this thing now where we feel we almost need to be registered in each and every state. And it is a huge, huge nightmare.

Pat Scott: You probably do. They way it usually comes up when I see it, I'll see it when you come in and you say, we want to sell the company. We have a buyer who has come in and who is going to pay us millions of dollars for this company and we operate in 35 states. And, I would say to you, great. Are you registered in 35 states to do business? And you would say, I don't think so. And I would say, well, we better get you registered. And the reason that we say that is because, in the sale of the company to the buyer who is probably also a local company now because now you're talking about multiple states, there will be representations and warranties that we will not be able to negotiate out of that will say we are qualified to do business in each state in which we conduct business, meaning that you are representing to the buying company that you are qualified to do business in each of those states. So, you say to me, well, wait a minute, how do I know that I am qualified to do business in each of those states or whether I need to register, and the answer is we need to research each state to find out the requirements of that state because you may find that some states, if you have for example is inventory in that state, that may not meet the test of doing business in that state. You just have a warehouse that sits there and you drag inventory out of it, but if have a retail shop in that same state, now you're probably doing business there. So, what does that mean? Does that mean that you need to register with that state? In the state of Pennsylvania it does, but in the

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State of California it may not. We don't know that until we check out each statute and the problem is it is a huge nightmare. There are companies that would help with that. CT Corporation is a big corporation that will give you essentially guidance on what you need to do in each state and for a fee will get you registered in each state.

Denise Werkley: But they don't provide legal advice, so they may just tell you that you need to register everywhere.

Question: One of our biggest customers has sites in just about every state in the nation so we go and do work for them in every state, but basically all the bills are paid by the mother company in New York State. What does that mean?

Pat Scott: It depends what meets the state's definition. That's the, we're going in a circle and I would tell you the same thing every time which is we need to check each state to see what that means because I don't know what it means. It is your presence there. What you're doing is you're talking about presence in a state and you're saying, well, is our presence in that state enough to qualify as doing business in that state. I think what I said, inventory, that's a lot of times where the line is drawn because some states will say that just having inventory there is not considered doing business. I don't know where each state has its line drawn so you need to get a list together of all those states and we need to check them all out. That is not a cheap undertaking

because here you have one law firm looking into 35 states. We know Pennsylvania like this, but we don't know North Carolina. We don't know South Carolina. The only people who know South Carolina are generally the South Carolina lawyers or Pat Scott who does the research to figure it out or we call a lawyer in South Carolina and we ask him. There are a hundred different ways to skin the cat, but the answer is somebody needs to do that due diligence and figure it all out. It may be as easy, just for your purposes, somebody in the accounting department or somewhere would check the website to each of those states.

Joe Bellinghieri: Right, that's what I would say. You could check the websites of each of those states. You can get a lot of information on-line on that and even the forms probably right on-line.

Question: We're a close Delaware corporation a Pennsylvania something. We're manufacturing component parts in China for Company A. Company A is reselling these parts to Company B, who incorporates them in a finished product and that finished product is sold to Company C. You know, a whole bunch of different players. I guess the product liability situation is buried pretty deeply in here, but what I'd like to ask you is where are the sales tax issues here?

Pat Scott: Generally, sales tax, at least in the state of Pennsylvania, there is no sales tax if you are selling with the intention to resell. If you're

selling a product then that product will be resold to another person. So you're preparing your component part and selling it to Company B.

Audience Member: Making it in China and selling it to Company B in Wisconsin.

Pat Scott: And you have no affiliation with Company B? They're paying you X amount of dollars for that? My guess is that you need to check the sales tax statute of (a) Pennsylvania and (b) where the sale occurred. That is another question - where did the sale actually occur? The sale probably occurred at the point of order, which would probably be in China. You may owe sales tax to China. I don't know that.

Audience Member: We've got letters of credit in here so that issue as to where the sale actually takes place is a little foggy.

Joe Bellinghieri: But you say once it gets to Wisconsin it is going to be sold again. Correct?

Audience Member: It is going to be resold to somebody in California.

Pat Scott: It's out of your hands at that point. From your company's perspective you're out. Once you sell to Company A.....

Question: So the only possible tax issue then is between us and Company A?

Pat Scott: Whether your company needs to collect the

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sales tax on the sale of that product to Company A.

Joe Bellinghieri: What you need to look is if you know it is going to be resold, a lot of times you may not be liable for sales tax because it is not the final product. So, it's only on the final product.

Audience Member: Aren't you protected on the sales tax by federal law in that federal law establishes right to interstate commerce and says for the state to tax you, you must have some form of nexus and that has to be in the form of property, real or tangible property, or employees in that state. To the extent that you don't have an employee, you don't warehouse property, your goods in Wisconsin and you don't have leased or own property in that state, that state has no nexus and no right to pay you tax, so unless you have people, inventory or property, you don't need to investigate that state because it is governed by the federal.

Denise Werkley: Well, that may be, but the internet makes it much more complicated. We're talking about internet sales because, well, particular to the internet is that the large retailers on the internet, there was a disconnect between them. Take Amazon. They had two operations. They had property, they had a warehouse in two states. So, they only had to pay sales tax when people of those two states were buying on their website. Wal-Mart has property in every state so they were having to have people pay sales tax for every state, so there was a disconnect there and some of

the states were arguing...Wal-Mart set up this new company where walmart.com only had 9 offices and distributions centers, so they only had to have people pay sales tax from nine states, which made it much better for their customers. They could compete much better with say Amazon or many of the other on-line retailers. So, what happened was that the states were arguing that Wal-Mart needed to pay sales tax in all 50 states because people returned products to all 50 states. They knew Wal-Mart tried to get around it by setting up this separate company that had nine different state operations. So, the large retailers, instead of having to deal with sales tax in every state and trying to figure it out on their own, just agreed that their customers would have to pay sales tax if they were buying from a state that had a sales tax. So, if you actually go on Amazon or Target, Wal-Mart, if you are from a state that has a sales tax, you'll often be paying sales tax. That is how the internet has been adjusted without a law to address it, without having to worry about and fight over it because, you're right, that is how it normally happens, but the internet has kind of made its own mark so that the large retailers didn't have to deal with it. That way, they were protected from back taxes. One of the conditions of this agreement for all of these retailers was that they didn't have to worry about paying back taxes, no penalties, nothing, just going forward. So, they protected themselves from potentially billions of dollars in back taxes and litigation. So, the internet itself is kind of going

on its own path away from where federal law really takes you.

Question: If we buy a part in Chicago on the internet and they shipped it, there may not be tax on it?

Denise Werkley: Right.

Question: If there is no presence that Chicago corporation may not have to charge tax?

Denise Werkley: Right.

Question: Will that ever change? I would rather have tax because otherwise I'll have to pay a use tax.

Denise Werkley: Right. There is a lot of legislation out there right now which is asking that sales tax be paid by every retailer for every time they ship to any state that has a sales tax because right now, a small retailer, practically they're just not able to figure out the sales tax that needs to be paid in different places. Its just too hard for the small people so they're not doing it when they should be and people have to pay the use tax, which they're not doing. So, again, there's billions of dollars in taxes, which are out there which should be being paid and are not. There's legislation trying to uniform it and simplify it.

Question: Following up on this gentleman's question, we do business on a tax-exempt basis-- buy and sell. Are we required to get the tax-exemption certificate numbers from the people we sell to and keep those on record? I

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know several of our vendors request our tax-exemption number, but we haven't done a good job of collecting from our customers although we know that they are tax-exempt.

Denise Werkley: You are expected to get those certificates and keep them on file because if you ever get audited, they want to see them.

Question: I see people embedding a copyright statement in the source codes of web pages. What is the best method to protect your copyright or trademark?

Denise Werkley: The first thing is to make sure you own the copyright of your website and that is a big issue because the person who creates that website is the owner of that website, unless they are your employee. So, if you hire an outside designer, they own the

copyright to your website unless they are your employee; unless you have something in writing which transfers the copyright to you. This is a common misconception with the internet and it's a huge issue because what will happen is they will create a website for you, and then two days later they will create the identical website for someone else and they are permitted to do so because they own the copyright. Just because you paid for it doesn't mean you own it. So, that's the number one thing -- you need to make sure you own it so that you can protect it.

The second thing is to put copyright notices on the things that you have, you aren't required in order to have a copyright to put a notice on it or to do anything in particular to get a copyright, but you should put a notice so everybody knows. If you have a picture, you should put a copyright notice right

under the picture or on the picture just to protect that a little bit more. Then, you also need to police and find out what else is out there on the internet that somebody may be taking your pictures, your content, and then go after them the best you can.

You don't have to have any notice at all. You can put it behind the website in the source code and meta tag or you can put it on top of the website. I prefer to put it where people can see it, but oftentimes you see it in the source code because the designer or software programmer, who is creating that source code, they are copyrighting the source code, not necessarily what you are seeing. So, you might see it back there for a different reason.

Joe Bellinghieri: I think we're wrapped up here.