

High-touch Legal Services® for Startup and Early-stage Companies

INTRODUCTION

This document outlines several postincorporation matters that every new corporation needs to be aware of. These matters should be addressed promptly after the corporation is formed and should be reviewed each year before the annual stockholders' meeting to confirm that they remain satisfied on a continuing basis.

FORMAL REQUIREMENTS

Bank Accounts.

The corporation must maintain separate bank accounts from those of its owners. The corporation should establish which officers will be authorized to sign checks to disburse funds from the corporate bank accounts. The establishment of corporate bank accounts constitutes activity that the board of directors should approve. A copy of the account signature cards (and accompanying form of corporate resolutions) should be placed in the corporate minute book to confirm the actions taken.

Conducting Business as a Corporate Entity.

The corporation should be sure to conduct all corporate business only in the corporate name and not in the individual name of any director, officer, or stockholder. To ensure that there is no confusion by outsiders dealing with the new corporation, the following steps should be taken:

1. All letterheads, bills, invoices, and other business forms used by the corporation should reflect its full legal name as well as its current address and telephone number.
2. The telephone numbers of the corporation should be listed under its name with the telephone company and in all telephone and trade directories.
3. The corporation's full legal name or fictitious business name should appear on all signs in its building. Business cards should indicate both the name of the corporation and that of the employee.
4. Any existing contracts or leases should be transferred to the corporate name, if permitted (future contracts or leases should be executed in the corporation's name, with the signature blocks clearly identifying the signing party as an officer signing on the corporation's behalf). The other party to any agreement should understand that the agreement is with the corporation and not with its owners individually. This includes correspondence with vendors and trade customers. An example of a corporate signature block is as follows:

[Name of Corporation]

By: _____

[Your Name], [Your Title]

Receipt of Payments.

Checks payable to the corporation should be made to the name of the corporation. If an individual's name is used on a payment check, deposit the payment into the corporate account with an endorsement identifying the corporation as the entity receiving payment.

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Never Commingle Assets.

Always observe the distinction between the corporation and its owners. Do not commingle corporate assets with personal assets.

Board Meetings.

The directors should decide how often the board of directors will meet. They may wish to meet periodically during the year to review business operations and establish corporate policy. It is generally best to have a formal meeting at least quarterly. Advance notice for each meeting is technically required, and the bylaws should specify when and how this should be given. If notice is not given, the directors must thereafter attend the meeting and sign a waiver (or the minutes) confirming the actions taken. When the directors act “without a meeting,” minutes of the actions taken should be prepared, and each director must sign these minutes before the actions become official.

When regular meetings will be held, the minutes of the initial meeting should specify the regular day of the following meetings (and the place and time). When this is done, notices need not thereafter be sent to directors unless the time or location of a later meeting is changed or a “special” meeting is called. The corporation’s bylaws outline the procedures to follow in these matters.

The board of directors is charged with the management of the corporation and is held accountable for the ultimate direction of the corporation’s business and affairs. Although day-to-day management of the corporation is generally delegated to the officers, directors are responsible for approving major corporate action, setting goals and policy for the corporation, and monitoring the performance of management in achieving these goals. In performing these functions, directors are fiduciaries for the stockholders’ benefit. Directors may be liable to the corporation’s stockholders if they fail to exercise “reasonable care” or if they fail to act in the best interests of the corporation (“duty of loyalty”).

Directors exercising a duty of care are required to act as prudent persons would act in similar circumstances. In doing so, although the directors may rely on the advice of independent experts, they must also make a reasonable inquiry into the facts on which such experts base their advice. The directors’ duty of loyalty includes a prohibition against a director profiting from a transaction at the expense of the corporation and its stockholders. A corporate transaction in which a director has a material financial interest will be valid if the transaction is fair to the corporation and the material terms and the director’s interests are disclosed to and ratified by the stockholders or by disinterested directors acting in good faith. Corporations Code §310 outlines specific procedures that may be followed in such cases.

Stockholders’ Meetings.

The corporation should hold a meeting of its stockholders each year. The bylaws indicate when this meeting will be held. If a different date or time is desired on a continuing basis, then the bylaws should be amended. The board of directors may establish a different meeting date or time if this is desired for a given year only. Stockholders must receive advance written notice of the meeting and the actions to be taken. The corporation’s directors are elected by the stockholders annually, and this election should occur at the annual meeting. Whether other actions are taken is a matter for the board of directors to decide. In a closely held corporation, the waiver of some technical formalities may be appropriate. The bylaws describe the quorum that must be present to hold a stockholders’ meeting. The stockholders’ voting rights are also described in the bylaws.

California law requires that the accounting books and records, and the minutes of proceedings of stockholders and board of directors meetings, be open for inspection by any stockholder, director, or holder of a voting trust certificate. See Corporations Code §§1600-1601. Corporations are further required to send an annual report to stockholders within 120 days after the close of the fiscal year. This requirement can be waived in the bylaws by corporations with fewer than 100 stockholders. The annual report must otherwise contain a balance sheet, an income statement, and a statement of changes in financial position for the

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fiscal year and must be accompanied by a report by the company's independent accountants or, if there is no such report, by a declaration of an authorized officer of the corporation that the statements were prepared without audit. Corporations Code §1501 details these procedures.

Corporations with 100 or more stockholders that are not subject to federal securities reporting requirements must also comply with further disclosure requirements. These include describing any significant transactions between the corporation and any director, officer, or stockholder who owns at least 10 percent of the stock.

Approval of Important Matters.

All major business transactions of the corporation should be reviewed and authorized by the board of directors. Whether this is done at a meeting or is accomplished "without meeting" involves decisions the board must make in light of the applicable facts and circumstances. Minutes of the actions taken should be prepared and placed in the corporate minute book, which then becomes the repository of all minutes of the actions taken by the stockholders and directors of the corporation. The minute book is an important document that should be safeguarded.

Annual Information Filing With the Secretary of State.

Newly formed corporations must file a Statement of Information (Domestic Stock Corporation) within 90 days after the date of incorporation. This annual statement requires the disclosure of the names and addresses of the directors and principal officers, the address of the corporation's principal office, the name and address of its agent for service of process, and the number of authorized directors. Every year this form, or a form stating that there has been no change in the information contained in the last filed statement, must be filed by a specified deadline (the form may also be filed up to five months before the deadline). These procedures are required under Corporations Code §1502. There is a \$25 filing fee, and the necessary form can be obtained from the Statement of Officers Unit at the California Secretary of State. The mailing address is P.O. Box 944230, Sacramento, CA 94244-2300. Online filing is available at <https://businessfilings.sos.ca.gov/>. There is no fee when changes are filed to any annual statement of information. The consequences of a failure to file, including a \$250 penalty, are set forth in Corporations Code §2204 and Revenue and Taxation Code §19141.

FEDERAL AND STATE INCOME TAX MATTERS

Employer Identification Number.

Each new corporation must obtain an Employer Identification Number (EIN) from the Internal Revenue Service. Form SS-4 must be filed with the IRS to obtain an EIN. This filing is normally done through the corporation's accountant and may be accomplished via a facsimile. Alternatively, an EIN can be obtained online at <https://sa1.www4.irs.gov/modiein/individual/index.jsp>.

Election of Tax Year.

Generally, a new corporation may elect to be taxed using either a calendar tax year or a fiscal tax year; however, a personal service corporation and an S corporation must generally use a calendar tax year. The period chosen must be the same as that used by the corporation to compute its book income. The initial adoption of a taxable year does not require the consent of either the IRS or the California Franchise Tax Board (FTB). To initiate the filing process, the corporation simply files its initial federal and state income tax returns on the basis of the taxable period that was selected. A subsequent change in the accounting period generally requires approvals from the IRS and state tax authorities. Internal Revenue Code §442 and Revenue and Taxation Code §24633 describe these procedures.

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Election of Accounting Method.

Subject to certain exceptions, a new corporate taxpayer may elect to report its income and expenses for both federal and California income tax purposes on a cash basis, accrual basis, or any other method of accounting clearly reflecting income that is acceptable to the IRS. Internal Revenue Code §446 and Revenue and Taxation Code §24651(b) describe these procedures. This election does not require approval by the IRS or the FTB. The initial federal and California income tax returns are simply filed in accordance with the accounting method chosen. Once an accounting method is used on an income tax return, prior approval of a subsequent change to another method must be obtained. Internal Revenue Code §446(e) and Revenue and Taxation Code §24651(e) describe these procedures. A corporate officer should discuss these matters with the corporation's accountant.

S Corporation Election.

It is sometimes advantageous to elect S corporation tax treatment for federal tax purposes so that the corporation's profits or losses are passed directly to the stockholders. This election avoids double taxation of dividend income and allows stockholders to deduct the corporation's losses against their income. Because of a statutory deadline, this election should be filed with the IRS within 2-1/2 months after the date of incorporation. Internal Revenue Code §1362(b) and Revenue and Taxation Code §§23800-23813 describe these procedures. The respective federal and California forms used to elect S Corporation status are IRS Form 2553 and FTB Form 3560.

Filing Federal and State Tax Returns and Installments of Estimated Tax.

Federal income tax returns and California franchise tax returns are due on the 15th day of the third month following the close of the corporation's tax year. Internal Revenue Code §6072(b) and Revenue and Taxation Code §25401(a) describe these procedures. In addition, most corporations are required to make periodic estimated federal tax payments by depositing such payments at either a Federal Reserve Bank or an authorized commercial bank. See Internal Revenue Code §6154. The corporation's accountant can handle these arrangements, or there is additional information in IRS Form 1120-W, which can be obtained from any office of the IRS. California also requires the filing of a declaration of estimated franchise tax on FTB Form 100-ES. For further information, see FTB Publication 1060 ("Guide for Corporations Starting Business In California") and FTB Publication 1083 ("Frequently Asked Questions About California Corporation Taxes"). Both publications can be obtained from any FTB office, or they can be downloaded from the FTB's website at <http://www.ftb.ca.gov/forms/index.html> (click on "Related Forms"). An officer should consult with the corporation's accountant on the timely filing of these returns.

EMPLOYER TAX AND WITHHOLDING RESPONSIBILITIES

If the corporation is an employer, it will be responsible for certain employer taxes. In some cases, it will have to pay the tax directly; in other cases, employees pay the tax, but the corporation is responsible for withholding the tax payment from their wages and periodically depositing these funds in an authorized bank. See Publication 15 ("Circular E, Employer's Tax Guide") and Publication 334 ("Tax Guide for Small Business"), both of which are available from the IRS online at <http://www.irs.gov/app/picklist/list/publicationsNoticesPdf.html>. See also Publication DE 44 ("California Employer's Guide") and Publication DE 195 ("Employer's Bill of Rights"); both are available online from the California Employment Development Department at http://www.edd.ca.gov/payroll_taxes/Forms_and_Publications.htm.

General Considerations.

The corporation's responsibilities to pay employment taxes, to withhold taxes imposed on its employees, to file tax returns, and to make periodic tax deposits are substantial. Penalties for noncompliance can be severe. Corporate officials charged with tax-withholding responsibilities may be personally liable for 100 percent of the unpaid taxes and also for any tax penalties if

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they neglect their responsibilities. See Internal Revenue Code §6672. A corporate officer should consult with the corporation's accountant to develop proper tax accounting procedures so that timely tax payments are made.

PROPERTY, SALES, AND OTHER TAXES

California Sales and Use Taxes.

All parties engaged in the business of selling tangible personal property at retail in California must obtain a seller's permit from the California State Board of Equalization. As a practical matter, a permit is usually required even if the corporation sells such tangible personal property at wholesale. A separate permit must be obtained for each retail business location and must be conspicuously displayed. A substantial security deposit of up to \$10,000 may be required. A business having a seller's permit can purchase tangible personal property for resale without having to pay sales tax to the seller as long as it gives the seller a signed resale certificate in a form prescribed by the State Board of Equalization.

Tax Payment Requirements.

If a corporation sells tangible personal property at retail in California, it will be subject to the California sales tax unless the property sold is specifically exempted. California also imposes a "use tax" on most retail purchases that occur outside of California but are intended for use within California. Revenue and Taxation Code §§6201-6207 describe this tax. Any retailer engaged in business in California must collect the sales and use taxes and remit them to the state. A retailer is deemed to be "engaged in the business" in California if it has any kind of an establishment in the state or if it has representatives operating in any kind of sales activity in the state. This law applies whether the retailer is involved directly or through a subsidiary or agent. See Revenue and Taxation Code §6203.

The holder of a seller's permit must file sales and use tax returns and pay or prepay the taxes collected, generally on a quarterly basis. Revenue and Taxation Code §6452 describes these procedures. The corporation should promptly consult its accountant for the dates on which these returns must be filed.

Personal and Real Property Taxes.

The corporation must pay annual property taxes based on the value of the taxable real and personal property it owns or possesses on the requisite lien date. The tax rates, due dates, and delinquency dates differ for real and personal property taxes. Usually, this tax is paid to the county assessor of the county in which the property is located. The county has a priority tax lien on the property as of the lien date, which is removed by the payment of this tax.

If the corporation owns taxable personal property with a cost of at least \$30,000, it must file a written property statement each year on or before the date designated by the County Assessor (usually between April 1 and the last Friday in May). Personal property taxes must be paid by the due date specified in the County Assessor's notice. Intangible property is exempt. See Revenue and Taxation Code §11492. When the cities do their own assessing, a separate written property statement should be filed with the city. If the corporation owns taxable personal property costing less than \$30,000, it must file a written property statement only when asked to do so by the County Assessor.

Taxable real property includes ownership and possessory interests (such as a leasehold). Real property taxes are payable in two installments: the first installment is due before December 10, and the second installment is due before the following April 10.

The corporation should consult its accountant for advice on filing property tax statements because there are substantial penalties for late payment and there are numerous special provisions (e.g., an exemption for "intangibles"). This is a complex area, and competent accounting advice is essential to ensure full compliance.

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Other Taxes.

Depending on the nature of the corporation's business, special taxes may be imposed by federal, state, or local governments, such as taxes on alcohol, tobacco, gross receipts, and real estate transactions. The corporation's accountant should be able to assist in preparing the proper tax forms and making the necessary payments.

PERSONNEL PRACTICES

Nearly every business is subject to a variety of federal and state regulations that govern the personnel practices the business must follow. Although a full discussion of the corporation's obligations under these various laws is beyond the scope of this document, the following information should provide a useful overview of some of the rules that apply to an employer.

Hiring Practices and Employee Termination.

Many federal and state laws regulate employment practices and prohibit discrimination on the basis of sex, age, race, color, national origin, religion, or mental or physical disabilities. These antidiscrimination laws apply to almost every aspect of the employer-employee relationship, including hiring, compensation, promotions, work assignments, and working conditions. In addition, if the corporation will be contracting with the federal government, it may be required to establish an affirmative action program depending on the value of the contract, the nature of the corporation's business, and the number of employees.

The U.S. Department of Labor and the U.S. Equal Employment Opportunity Commission are the principal federal agencies that have jurisdiction in this area of the law. The California Department of Fair Employment and Housing also regulates employment practices to protect people from employment discrimination. California's antidiscrimination laws and regulations are more stringent in many areas than the federal requirements. When those requirements overlap, the more stringent standards are usually applied.

Wages, Hours, and Working Conditions.

Through the Wage and Hour Division of the U.S. Department of Labor, the federal government sets minimum wages and also regulates overtime and other aspects of working conditions for nearly all employees of firms engaged in interstate commerce. Notable exceptions to these rules include executives, administrators, professional personnel, and outside salespeople.

Through the Division of Labor Standards Enforcement of the Department of Industrial Relations, California enforces laws on the payment of wages, the minimum wage, hours of work, overtime, conditions of employment, equal pay for equal work, and compliance with compulsory Workers' Compensation laws. The Industrial Welfare Commission of the Division of Labor Standards Enforcement has the authority to eliminate working conditions that are detrimental to the welfare of California workers. The Commission issues special orders setting minimum wages, hours of employment, and overtime, and standards for working conditions, both in general and for specific industries.

The California Division of Industrial Safety of the Department of Industrial Relations conducts safety inspections to ensure that standards of safety and health are enforced and that unsafe conditions and practices are corrected. The Federal Occupational Safety and Health Act of 1970 (OSHA) is implemented through the Division. The California Occupational Safety and Health Standards Board also promulgates safety and health standards for California businesses. There is a substantial overlap between federal and California requirements in this area; again, the state requirements are generally more stringent, and the corporation must usually adhere to the more stringent standards.

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Workers' Compensation.

California law requires nearly every employer to obtain Workers' Compensation insurance for its employees, and it imposes penalties for noncompliance. The Workers' Compensation laws impose liability on the employer for any work-related accident, regardless of the employee's negligence. Workers' Compensation insurance provides a schedule of benefits to the insured employee or his or her heirs if the employee is killed. Workers' Compensation liability insurance can be obtained either from the local office of the State Compensation Insurance Fund or from state-licensed Workers' Compensation private carriers. Alternatively, a business can obtain a certificate of consent to self-insure from the Director of Industrial Relations. See generally Labor Code §3700.

Employee Benefits.

If the corporation decides to provide other benefits to its employees, such as group insurance, or if the corporation adopts a pension or profit-sharing plan, the corporation may be subject to the Employee Retirement Income Security Act of 1974 (ERISA) (29 USC §§1001-1381). ERISA requires an employer to meet specified requirements and provide certain information to employees if an employee welfare plan is instituted. Welfare plans can include benefits such as health insurance, long-term disability insurance, group term life insurance, and accidental death insurance.

Labor-Management Relations.

Nearly all corporate employers are governed in their labor relations by the National Labor Relations Act (29 USC §§151-169), although very small employers are sometimes excluded. Agricultural employers are governed by the California Agricultural Labor Relations Act (Labor Code §1140-1167). As a practical matter, if the corporation faces a union organizing campaign, it will almost certainly be covered by a wide array of governmental laws, regulations, and procedures. Failure to comply with applicable rules could result in either the expense of rerunning the election or the automatic certification of the union.

Notices.

Employers are required to post, in a conspicuous location, a number of notices on employees' rights. Some of the notices most commonly required, and the agencies from which copies may be obtained, are as follows: Industrial Welfare Commission orders (California Department of Industrial Relations, Division of Labor Standards Enforcement); federal minimum wage notice (Wage and Hour Division, U.S. Department of Labor); notice titled "Safety and Health Protection on the Job" (California Department of Industrial Relations, Division of Occupational Safety and Health); notice about the California Fair Employment and Housing Act (California Fair Employment and Housing Commission); federal civil rights notice (U.S. Equal Opportunity Commission); notice of paydays and times and places of payment (Department of Industrial Relations); and workers' compensation notices (which should be obtained from the corporation's workers' compensation insurance carrier). Local and state Chambers of Commerce can provide preprinted copies of the notices for posting.

LICENSING

Federal Licenses.

Most businesses do not require any type of federal license. However, there could be some basis for federal licensing. For example, if the corporation intends to employ an alien to carry on substantial trade principally between the United States and the alien's country, a "Treaty Trader" visa entitling the alien to remain in the United States for extended periods of time may be required.

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State and Local Licenses.

State and local licensing is required for a wide variety of businesses and professions that may be conducted in the corporate form. Information on state requirements is available in the Professional & Business License Handbook (\$15.00), which can be obtained from the Office of Small Business (801 K Street, Suite 1600, Sacramento, CA 95814, telephone: (916) 322-5790). The handbook is also available online at <http://www.commerce.ca.gov/ttca/business/licensehandbook.pdf>.

Licensing requirements imposed by cities, counties, and other local government entities vary widely. Some California cities require certain businesses to obtain a license and pay a tax for the privilege of doing business in that city. This tax is usually imposed on an annual basis. A new business must obtain its registration certificate and a minimum tax must be paid on or before the last day of the month following the date the business commences. The corporation's accountant should be advised of the nature of the corporation's business and of the locations in which it will be carrying on business so that the necessary licenses are obtained and the local taxes are paid.

MISCELLANEOUS MATTERS

Insurance.

Generally, it is advisable to obtain fire and extended peril insurance on all property that the corporation owns or for which it is responsible. A comprehensive public liability insurance policy should be obtained, especially if the corporation's business premises are open to the general public. Such a policy should insure the corporation against liability imposed by law for the operation of its business, its automobiles, and the maintenance of its property. Product liability insurance and other types of insurance may be available. The corporation's potential insurance requirements with an insurance agent.

Securities.

The corporation's issuance of securities is subject to both federal and state securities laws. Although the federal and state definitions of a security are not identical, the definitions are quite broad and include stocks, options, warrants, evidences of indebtedness, investment contracts, and interests in a stock or profit-sharing plan. Officers and directors may be held personally liable for criminal and civil violation of securities laws. Thus, whenever a corporation considers offering, issuing, or selling securities, it must be cognizant of applicable federal and state laws. The corporation should also be aware of "private placement" and "limited offering" exemptions from these laws.

Fictitious Business Names.

If the corporation plans to transact business under a name other than that listed on its articles of incorporation, the corporation must file a Fictitious Business Name Statement with the clerk of the county in which the corporation has its principal place of business. Once the statement is on file with the county clerk, it must be published in a newspaper of general circulation, in the same county, once a week for four consecutive weeks. Within 30 days after completion of publication, an affidavit of publication must be filed with the county clerk.

Fictitious Business Name Statement forms are available from the county court clerk's office or the newspaper that will be publishing the statement. The cost for each county varies, but is around \$50. Fees also vary according to the newspaper used. Some newspapers will also file the notice with the county for an additional fee. The legal advertising department of a newspaper of general circulation can provide information about such fees.

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Intellectual Property Rights.

When a business has developed a name or symbol that has or will become associated with its products or services and that indicates its unique origin with the company, the business may register that name or symbol as a trademark or trade name. Registration with the state and, if appropriate, with the federal government, will protect the valuable trademark and trade name assets against loss through improper usage and infringement.

Filing the articles of incorporation setting forth the corporate name does not itself authorize the use of the corporate name in violation of the rights of anyone else who may have previously acquired rights to the name under some other law, such as the Federal Trademark Act, the Lanham Act, the Fictitious Business Name Act, or under common law, including rights to a trade name.

If a creative process is involved in making products or developing processes, a patent and suitable contractual arrangements may be appropriate to protect and preserve ownership. Trade secrets may be protected by physical security and by requiring employees and third parties to sign agreements that require the safekeeping of confidential information. Literary and other written works may qualify for copyright protection.

Buy-Sell Agreements.

Many start-up companies restrict the transfer of securities held by their stockholders through a buy-sell agreement. These agreements are important because they specify the parties' rights and obligations if a stockholder departs, whether voluntarily or involuntarily. A stockholder's death can be extremely disruptive to the future of the corporation, and a buy-sell agreement can provide the terms on which a deceased stockholder's interest may be redeemed. A buy-sell agreement typically covers:

1. Transfer restrictions on when a stockholder may or may not transfer his or her shares, the persons to whom (if anyone) the stockholder may sell his or her shares without consent from the others, and the terms on which any right of first refusal reserved to the other stockholders will be exercised;
2. Any mandatory repurchase obligations (when the corporation and/or stockholders must repurchase the corporate stock, such as a stockholder's death or involuntary termination of employment with the corporation);
3. Any optional repurchase obligations (when the corporation and/or the other stockholders may repurchase the corporate stock, such as the voluntary termination of a stockholder's employment with the corporation); and
4. The price and terms of sale for the stock (what valuation method will be used to calculate the price paid for the stock and the terms of payment).

The foregoing discussion is a generalized summary of certain corporate legal and accounting issues as they now exist. The laws and regulations applicable to corporations change rapidly and are more detailed than can be covered in this document. Therefore, this document is not intended and should not be considered as legal advice for any particular situation and does not establish an attorney-client relationship. If you need such legal advice, please contact an attorney directly.

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