

MEMORANDUM

TO: The Officers, Directors and Shareholders

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You have chosen to do business through the use of a Michigan corporation. Your corporation provides you with benefits, such as limited liability for the corporation's shareholders.

To preserve these benefits, however, you must follow certain procedures. This memorandum outlines the extent of your "limited liability" protection, the rights and duties of the corporation's shareholders, directors and officers, the procedures you should follow in conducting the corporation's business and other important considerations regarding your corporation.

LIMITED LIABILITY: KNOW THE LIMITS

A corporation provides its shareholders with so-called "limited liability". This means that the corporation's shareholders have no personal liability for any of the corporation's debts, liabilities or other obligations.

The limited liability shield does not protect you from personal responsibility for all of your actions conducted on behalf of the corporation, however. You will continue to have personal liability in at least the following significant areas:

1. You remain liable for your own personal negligence (such as malpractice in rendering services to the corporation's clients or your carelessness in otherwise rendering services on behalf of the corporation).
2. You will be personally liable under any contracts you make personally. Examples include your personal guarantee of a bank loan to your corporation and your guarantee of the corporation's lease of office space. You may even have personal liability under some corporate contracts if you do not make it clear that you were acting for the corporation when you entered into the contract (described in more detail below).
3. If the corporation is an S corporation, you are personally responsible for income taxes on your share of the corporation's income.
4. "Responsible persons" can be personally liable for income tax liabilities for certain state and federal withholding taxes if not paid in full by the corporation.
5. You can be held personally liable for all of the corporation's obligations if you lose the corporation's limited liability shield. This can happen, for example, if you co-mingle the corporation's funds with your personal fund or otherwise fail to observe sufficient corporate entity formalities (the "piercing" of this shield is discussed in more detail below).
6. You may have additional liabilities to the corporation and others if you serve as a director or officer.

**RIGHTS AND DUTIES OF CORPORATE
SHAREHOLDERS, DIRECTORS AND OFFICERS**

1. **Summary of Shareholder, Officer and Director Duties.** Shareholders, directors, and officers have significantly different management rights, authority, and fiduciary obligations. The following chart shows the key differences (almost any of which can be altered through specific corporate procedures):

Shareholders, Directors and Officers: Summary of Key Differences

Position	Management Rights	Authority to Bind the Corporation	Fiduciary Obligations to Others in the Corporation
Shareholders	Shareholders have no management rights (although they indirectly control the future of management because they elect the Board of Directors).	Shareholders have no authority to bind the corporation.	Shareholders generally have no fiduciary obligations to each other or the corporation (see paragraph 7 with regard to "shareholder oppression," however)
Directors	Directors have all management rights of the corporation.	Individual directors do not have authority to bind the corporation.	Directors have fiduciary obligations to the shareholders and to the corporation.
Officers	Officers have no general management rights. Their rights and duties are described in the Bylaws.	Generally, officers have authority only as determined by the Board. Officers may also have apparent authority to bind the corporation.	Same as Directors.

2. Your Corporation's Articles, Bylaws, and Shareholder Agreement Control its Operation. You should always consult your corporation's articles, bylaws, and shareholder agreement before drawing any conclusions about the relative rights and duties of shareholders, directors and officers. If none of these documents address the subject, the corporation statute likely provides an answer.

- a. **Articles.** Your corporation was formed by filing Articles of Incorporation with the State of Michigan. The Articles are a public document. The Articles typically contain little more than the corporation's name, resident agent, and registered office. Nevertheless, the Articles may contain other provisions significantly affecting the corporation and the rights of its shareholders, directors and officers.
- b. **Bylaws.** Your corporation must have bylaws, but these bylaws are not filed with the State and are not a public document. The bylaws typically contain procedural rules for shareholders and directors regarding meetings, notices of meetings, voting, and taking actions without meetings. Bylaws can typically be amended by the directors without shareholder approval, but this amendment power can be restricted.
- c. **Shareholder Agreement** (or "Buy/Sell" Agreement). If your corporation has more than one shareholder, your corporation should have a shareholder agreement. This agreement among the shareholders typically addresses restrictions on transfer of shares, purchases of shares in the event of death, and other matters among shareholders.

3. Board of Directors Authority to Run the Corporation's Business. The board of directors has the right and duty to manage the corporation's business, subject to whatever limits are contained in your articles, bylaws or shareholder agreement. The bylaws usually describe the shareholders' rights to elect, compensate, remove and replace the directors.

4. Distributions to Shareholders. In the absence of any limitation in the articles, bylaws or shareholder agreement, distributions and dividends are determined by the board, not the shareholders. The board has no authority to approve a distribution when it would make the corporation insolvent. Distributions may also be limited by contractual restrictions with lenders or others.

5. Issuance of Share; Sales of Shares. The board of directors has the authority to issue shares to any person, whether or not that person is already a shareholder. In many cases, the existing shareholders will want to restrict the board's authority to issue additional shares, especially to new shareholders. Shareholders have the right to sell their shares to anyone they want. Typically, however, this right is restricted in the articles, bylaws or shareholder agreement. When shares in a corporation are transferred, the recipient becomes a shareholder and enjoys all shareholder rights previously held by the seller, such as the right to vote, the right to receive distributions, the right to inspect the corporate records, and other shareholder rights, subject to any restrictions in the articles, bylaws and shareholder agreement.

6. Shareholder Voting Rights. Each shareholder owning voting shares has the right to vote on matters requiring shareholder approval, unless the articles, bylaws or shareholder agreement limit or remove that right. Shareholders typically are entitled to one vote per share. Your articles, bylaws or shareholder agreement will describe any deviations from this rule and will also describe what percentage vote is required to approve the action (simple majority or some other percentage) and whether that percentage is applied to all shares or only those that are represented and voted at a meeting.

7. Fiduciary Obligations of Shareholders, Directors and Officers. Generally, shareholders owe no duties of loyalty to each other or to the corporation. In some cases, however, a shareholder may be liable for unfair or oppressive actions taken against other shareholders or the corporation. This is sometimes referred to as shareholder oppression. “Oppression” is difficult to define, and you should consult us for guidance in this area.

Unlike shareholders, directors and officers must act in the best interest of the corporation and its shareholders. They may not favor the interests of one group of shareholders over another group if those actions are “willfully oppressive” to some shareholders. Similarly, directors and officers may not take personal advantage of a business opportunity that could be valuable to the corporation without first offering that opportunity to the corporation.

For example, a director or officer cannot cause the corporation to enter into a contract with one of them personally on terms that are less favorable to the corporation than the terms that the corporation may have reasonable obtained from a third party. Similarly, a director or officer who learns that the corporation is considering purchasing a piece of real estate may not acquire that property for resale to the corporation at a higher price.

CORPORATE FORMALITIES: PROCEDURE TO FOLLOW IN CONDUCTING THE CORPORATION’S BUSINESS

1. Why Do You Care About These Formalities? You should care about these formalities for one key reason: if these formalities are disregarded, you and the other shareholders run a greater risk of being held personally responsible for all of the corporation’s obligations. Following these formalities significantly reduces the chance that the limited liability shield can be “pierced” by creditors or others dealing with the corporation.

2. Look at your Corporation’s Articles, Bylaws and Shareholder Agreement. Your corporation’s articles, bylaws and shareholder agreement may require certain regular meetings, reports, and other ongoing activities. You should make sure that these are followed as closely as possible.

3. What Actions Need Shareholder Approval? Very few corporate business actions require shareholder approval. Generally, shareholders must vote on each of the following:

- Amendment of the articles or shareholder agreement
- Election, removal and replacement of directors
- Dissolution of the corporation
- Merger of the corporation
- Sale of substantially all of the corporation’s assets

4. What Actions Need Board Approval? All significant corporation transactions should be considered and approved by the board. At a minimum, the board should approve each of the following:

- Employment agreements for any corporate director, officer or shareholder;
- Election of officers;
- Borrowing by the corporation or loans from the corporation to others;
- Leases involving the corporation;
- Distributions to the shareholders;
- Approval of any major purchase or sale or other significant corporate transaction, such as real estate purchases;
- Approval of employee benefit plans;
- Approval of transactions involving conflicts of interest;
- Issuance of shares to existing shareholders or new shareholders;
- Amendment of bylaws (unless this is reserved to the shareholders).

5. How Should You Obtain Shareholder and Board Approvals? Shareholder and board approval can be accomplished either through meetings or written actions by consent unless restricted by the articles, bylaws or any shareholder agreement. These documents contain specific procedures you must follow to obtain valid approval through the use of a meeting or action by consent.

6. Recordkeeping. We recommend that you work closely with an accountant in setting up the corporation's financial books and accounting systems. An accountant can also assist in preparing filings to comply with the federal, state and local tax laws and completing the Michigan state tax registration. The corporation must keep certain business records available to shareholders, such as a list of current shareholders, corporation tax returns, etc. Your articles, bylaws and shareholder agreement may require other recordkeeping.

7. Do Not Confuse Corporate Business with Personal Matters or Records. All corporate business should be conducted in the corporation's name, not through the name of any officer, employee, or other agent. All stationery, invoices, advertising, business cards, and telephone listings should carry the corporation's name. When an officer, employee or other corporate agent acts on behalf of the corporation, make certain that everyone understands that the officer, employee or other corporate agent is acting on behalf of the corporation rather than on the person's own behalf. To accomplish this, clearly identify the person's capacity on all documents signed on behalf of the corporation by placing "officer", "agent", or the person's actual corporate title next to the signature as follows:

The Widget Manufacturers, Inc., a Michigan corporation
By: John A. Jones
Its: President

You may wish to have company checks and other corporate documents prepared with the individual's capacity (officer, agent, or other official title) printed under the signature line of each document.

All corporate bank accounts must be established in the corporation's name, not the name of any officer, agent, or other employee. Signature cards should be executed by the persons authorized by the board and the title of each authorized person (president, secretary, treasurer, etc.) should be shown on the cards. Insurance policies for the corporation should be obtained in the corporation's name. Remember that shareholders and directors in a corporation have no right to individually act on behalf of the corporation.

8. Business Transactions Between You and Your Corporation. All transfers of assets to and from the corporation must be properly documented. For example, if you contribute, to the corporation, office furniture or equipment that you purchased in your individual name, you should sign a bill of sale transferring ownership of that property from you to the corporation. If real property is transferred to the corporation, deeds and related real estate documents should be executed and recorded. If the corporation will use real or personal property without taking ownership, the corporation should sign a written lease.

Once your property is transferred to the corporation, the property must be treated as an asset of the corporation and not as your own. The corporation's bank account must not be used for personal purposes. The only three ways money or property can legally be taken out of the corporation are:

- a. A distribution to shareholders under the rules described in the Bylaws and/or Shareholder Agreement;
- b. As wages or salary to an employee, which is taxable to the employee and for which the corporation is permitted an offsetting income tax deduction; and
- c. As a loan, which may have tax consequences to the corporation and the borrower.

Any loan between the corporation and any of its shareholders must be evidenced by a promissory note and should bear a market rate of interest. If the loan bears no interest, or interest at a rate that is less than a published federal rate, the Internal Revenue Service (IRS) may re-characterize the loan as a distribution and adversely affect your taxes.

If a shareholder lends cash or property to the corporation without documenting the loan, that cash or property may be subject to the claims of the corporation's creditors and any attempt to remove that cash or property from the corporation could trigger income tax.

If the corporation is taking over certain obligations that existed before the corporation was created, those obligations should be assigned in writing to the corporation. In many cases, you will need the consent of other parties to the assignment before the corporation can take over any of those obligations. If the agreement was originally signed by you in your personal capacity, and you want to avoid any further personal liability, then the corporation and the other parties must agree in writing to release to you.

OTHER CORPORATE BUSINESS MATTERS

A. Federal and State Securities Matters

Corporate shares are “securities” under federal and state securities laws. Shares cannot be issued, sold or even offered for sale unless adequate disclosure is made to the potential investor and the securities are registered with the Securities and Exchange Commission and state securities agencies. Certain types of securities and securities transactions are exempt from federal and state registration requirements.

Failure to comply with the securities laws may permit each purchaser to rescind the transaction and recover the purchase price plus interest. Violations can also expose the corporation and its shareholders to criminal penalties and to liability for each purchaser’s damages, and reasonable attorneys’ fees. You should consult us before any shares are issued by the corporation or transferred by any shareholder.

B. Federal Tax Matters

1. **Federal Employer Identification Number (“EIN”).** The corporation must obtain a federal employer identification number when it begins to do business, even if the corporation expects to have no employees. We can obtain this number for you at your request.

2. **Federal Income and Withholding Taxes.** You should consult your accountant with respect to the necessary income tax filings on behalf of the corporation. The corporation is responsible for reporting and withholding taxes for federal income taxes and Social Security (FICA) taxes on non-member employee salaries and wages.

C. State and Local Tax and Regulatory Matters

We suggest that you discuss the following with the corporation’s accountant:

1. **Michigan Tax Registration.** The corporation must register with the Michigan Department of Treasury by filing Form 518, “Michigan Department of Treasury Registration for Michigan Taxes.” This application covers registration for the Michigan Single Business Tax, employee withholding taxes, and the Michigan Sales and Use Tax.

2. **Michigan Single Business Tax.** The Michigan Single Business Tax (“SBT”) is a value-added tax. Quarterly estimated tax payments may be required in some cases. A corporation with business activities taxable both within and outside the State of Michigan may apportion its tax base.

3. **Sales and Use Tax.** The Michigan sales tax generally applies to retail sales that take place within the state. A corporation purchasing or renting property from an out-of-state source must pay Michigan use tax. If a corporation does not have a retail location in Michigan but intends to sell or lease tangible personal property to Michigan customers from an out-of-state location, it must obtain a use tax registration.

4. **Unemployment Compensation.** The corporation must register with the Employment Security Agency of the Michigan Department of Labor whether or not it has employees and whether or not it will be liable for unemployment taxes. This registration occurs automatically when the corporation files Form 518, "Michigan Department of Treasury Registration for Michigan Taxes."

5. **Worker's Disability Compensation Insurance.** Certain corporations with employees must have workers' disability compensation insurance. This insurance may be obtained through a commercial insurance company or, with prior approval, an employer may be self-insured.

6. **Property Taxes.** All real and tangible personal tangible property located in Michigan is subject to property taxation. The corporation must file a personal property statement in February of each year in each city, township or village where the corporation has assessable personal property. Appeal deadlines are extremely short (often less than two weeks) and you should carefully review any assessment notices as soon as you receive them.

7. **City Income Taxes.** Some cities in Michigan impose a local income tax. If your corporation does business in one of these cities, your corporation must file an income tax return whether or not it has a place of business in that city.

8. **Michigan Annual Report and Registration as a Foreign Corporation in Other States.** Every corporation formed or authorized to do business in Michigan must file an annual report with the Michigan Corporation Division. The State sends the report form to the registered agent for your corporation each year. In order to maintain the corporation's status, you must complete and return the Michigan Annual Report or send it to us to complete on your behalf. Failure to file it will result in automatic dissolution of the corporation. If the corporation does enough business in other states, the corporation may have to register in those states to do business as a foreign corporation.

9. **Licensing.** Many businesses may be required to obtain one or more licenses to conduct business. In some cases these licenses contain conditions that restrict certain corporation or corporation member activities.

HOW WE CAN HELP

We want to take every step to insure that you and your corporation are protected. We will assist you in conducting annual corporate meetings and will make sure that your corporate minutes are up to date. Naturally, if you have any questions about how to handle certain corporate matters, or how to document specific corporate transactions, we encourage you to call us between the dates for the annual corporation meetings.