

# Law 101 - Organizing Your Company

By **Mark Litwak, Attorney at Law**

Filmmakers frequently establish a company to produce and own their movie. While there is no legal requirement to do so, there may be some benefit to operating under the auspices of a company rather than making your film as an individual or as a partner. For example, filmmakers and investors may be willing to accept the complete loss of their film investment, but will hesitate to risk losing their homes and other assets. By establishing a separate business entity, investors can own the company that produces and owns the film, without being personally liable for the actions of the company.

One of the most common business entities used by filmmakers is the limited liability company (LLC). If a company that is a separate legal entity from the filmmaker produces a movie, then the filmmaker may not be liable for the debts and obligations of the company. However, for the filmmaker to avoid personal liability, he must sign all contracts in the name of the company and not give any personal guarantees.

The limited liability company (LLC) is a relatively new form of business entity that combines some of the best aspects of partnership and corporate forms of business while avoiding some of the drawbacks of each. Members of an LLC have the same limited liability protection granted to limited partners and corporate shareholders. Unlike a corporation, however, an LLC has more flexibility as to how to pay taxes, and can largely avoid the problem of double taxation.

An LLC has two classes of members: managing members and non-managing members. Like general partners, the managing members run the business. Like limited partners, the non-managing members are investors who do not operate the business. Both managing and non-managing

members have limited liability.

An LLC can elect to be treated like a partnership for federal income tax purposes, and thereby avoid federal tax at the company level. LLC members report their respective shares of LLC income or losses on their individual tax returns. Although the LLC is not a tax-paying entity, the LLC must still report its taxable income and file an informational return with the IRS.

The laws governing LLC's vary by state. In California, LLC's are subject to state income tax, but the amount of tax is modest, and no tax is assessed until there is total income of \$250,000 or more per year. However, like corporations and limited partnerships, LLC's are subject to an annual tax of \$800 for the privilege of doing business in California.

An LLC can be managed by one or more managers (a "manager-managed" LLC) or by all the members (a "member-managed" LLC). A manager-managed LLC is like a limited partnership with two classes of members: managers that actively supervise the enterprise and non-managers who do not. Similarly, a member-managed LLC is like a general partnership where all the partners are involved in running the business.

In a manager-managed LLC, a manager need not be a member, but can be an outsider hired to manage the enterprise. Managers are considered agents of the LLC and they can bind the LLC to contracts with third parties. In a manager-managed LLC, the non-managing members are not considered agents of the LLC.

The interest of a non-managing member is a security, and securities laws apply. If all the members are active in the management of the LLC (ie, all members are managers),



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there are no passive investors and the members' interests are not considered securities.

As with other business entities, if the LLC operates under a fictitious business name, the company will need to file a DBA (Doing Business As). Since the LLC is a separate legal entity, it will need to apply for an EIN (Federal Employer Tax Identification Number), obtain any applicable state and local business licenses, and file state and federal tax returns.

Which brings us to another reason to establish a company, to reduce taxes. LLCs may be able to deduct certain expenses that would not be deductible, or only be partially deductible, by a sole proprietor. Some fringe benefits (eg, medical insurance, pension plans) that a company provides employees may be tax-deductible for the company rather than income to the employee. Therefore, by setting up a company, paying yourself a salary, and giving yourself generous fringe benefits, you may gain certain tax advantages. On the other hand, the tax benefits may not outweigh the cost of forming the company, which includes legal fees, filing fees, and the annual cost of preparing and filing a company tax return. Moreover, some states assess a minimum annual tax on companies even if they do not earn any income.

While establishing a company may protect you from liability for your company's breach of its contracts, it does not preclude other people from suing you for your own negligence. So, for example, if you are negligent on a movie set and cause injuries to others, you may be liable even if you are operating under the auspices of a company.

When deciding what sort of business entity to form, it's always best to consult with an attorney experienced in company formation in your state, as well as a tax advisor.

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