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Inside This Issue

Tax Incentives Drive Bridge Loan Changes

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Recent tax legislation providing substantial tax incentives to investors is changing the simple convertible bridge loan so common to Silicon Valley start-ups to hybrid equity rounds.

Financing is the life blood of many start-up companies. When the blood thins before the next financing round, investors sometimes provide funding to bridge the company to its next funding round. Bridge funding is typically provided in the form of debt that converts into shares issued in the next round, often less a discount from the per share purchase price.

For any qualified small business stock, or QSBS, purchased before December 31, 2011, the recently enacted 2010 Tax Relief Act allows 100% of the gain recognized from the stock to be excluded from taxable income up to certain limits. Many start-up companies issue stock that qualifies as QSBS.

Because of the reduction in tax exposure, bridge loan investors have a great incentive to purchase stock in exchange for their bridge funds instead of a convertible note. This has provided a number of challenges to start-up companies and their investors.

First, a temporary valuation must be determined. The key advantage to a convertible note, that value need not be negotiated, is eliminated because stock is issued. This creates the need to negotiate a valuation, which adds time to the transaction.

Second, price-based antidilution adjustments may be triggered. If so, capitalization estimates have to take account of corresponding changes in the conversion rate.

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Third, the bridge stock must convert into the stock sold in the subsequent round.

Fourth, a new series of stock will usually need to be created.

The upshot is that the tax benefits will come at some cost in the form of more complex documentation and expense for the start-up. The structure, however, may provide just the right incentive to secure that extra funding.

Contact Structure Law Group if you would like any assistance financing your business.

Success Story

A local start-up company had received commitments for a multi-million dollar bridge financing if the investment instrument could be structured as qualified small business stock under the 2010 Tax Relief Act. Structure Law Group attorneys created a series of preferred stock that satisfied the requirements of the Act and the parties' original business deal, allowing the start-up to get the funding it needed.

Doing Business in California -- New FTB Ruling


Tamara B. Pow, Esq.

Because California franchise taxes can be much higher than taxes in other states, companies often try to avoid being considered as doing business in California. In the past, one way to do this was to form in another state, not register the company in California, and set up a subsidiary entity. Then you have just that subsidiary entity do business in California, thus saving the parent company from having a filing requirement in California and from paying California franchise taxes.

The Franchise Tax Board has now addressed the question: "Is the sole owner of a disregarded entity "doing business" in California if the owner has no other activities in the State other than those of its disregarded entity?" It looked at QSubs (Qualified Subchapter S subsidiaries) and single member limited liability companies, and found that where a disregarded entity's activities constitute "doing business" in California, the owner is "doing business" in California. In other words, the Franchise Tax Board is taking the position that activities will be attributed from a disregarded entity to its owner so that if the disregarded entity is doing business in California, then the owners will be considered to be doing business in California. This is on top of previous rulings that a company will be considered to be doing business in California if the managing person is in California, even if all of the activities are out of state.

A corporate owner of a disregarded entity is "doing business" in California even if the owner has no other activities in the State.

Contact Structure Law Group if you would like assistance registering your entity in California.

Tax Corner

California is Focusing on Cancellation of Debt Income

California is looking for taxpayers that gave their investment properties back to the bank and thought that they could use the Mortgage Forgiveness Debt Relief Act to exclude the cancellation of debt income. According to the March 1, 2011 issue of Spidell's California Taxletter, (Volume 33.3), California is sending out letters to taxpayers who had debt relief on properties that were reported on a 2007 or 2008 Schedule E. The letters compute the potential additional tax owed, plus a 20% accuracy penalty, plus interest on the unreported income.

Local Sales Tax Rates Increase

Local sales tax rates took effect on April 1, 2011. The sales tax increases were voter-approved in the November 2010 election. The following table summarizes the voter-approved local sales and use tax increases in 14 California cities.

District Tax Area	County	New Rate
City of San Leandro	Alameda	10.00%
City of Union City	Alameda	10.25%
City of Concord	Contra Costa	9.75%
City of El Cerrito	Contra Costa	10.25%
City of Placerville	El Dorado	8.75%
City of Eureka	Humboldt	9.00%
City of Santa Monica	Los Angeles	10.25%
City of South El Monte	Los Angeles	10.25%
City of Novato	Marin	9.50%
City of Marina	Monterey	9.25%
City of Tracy	San Joaquin	9.25%
County of Sonoma	Sonoma	9.00%
City of Santa Rosa	Sonoma	9.50%
City of Wheatland	Yuba	8.75%

Spring Cleaning Tips

The flowers are blooming, the birds are chirping, and the bees are out in droves. It's that time of year again when we bring out our sponges, pails, cleansers, and trash bags and scrub the house from top to bottom. The annual rite of spring cleaning is a time for us to freshen up our homes, gather our winter gear for storage, and get organized before we are embraced by warm weather. Spring cleaning may never become effortless or fun but there are a few things you can do to manage this project.

Tips for Spring Cleaning:

- Create a list

  Planning ahead helps make spring cleaning more efficient. Make a list of each room in the house that needs to be cleaned. Break down the large projects into smaller parts by creating a bulleted list of items that need to be cleaned and organized in each room.

- Divide the tasks

  Spring cleaning doesn't have to be a daunting task and is not a one-person-job. Divide the tasks between your family members and schedule a weekend to get the job done. You can even make it fun by creating friendly competition, such as seeing who can clean their side of the room the quickest.

- Have your supplies ready

  Make sure you have all the equipment and cleaning supplies you'll need for the job. Stock up on gloves, rags, pails, sponges, cleaning solutions, trash bags and containers. Cleaning dirt is not one-size-fits-all. Remember to use the right tools and products when cleaning various surfaces and types of dirt.

- Clean one room at a time

  Pick the most cluttered or dirtiest room first and work your way down. When you work room by room and check things off your project list as tasks are completed, you'll feel like you've accomplished a lot and spring cleaning will feel less overwhelming.

Real Estate Corner

Are You a Real Estate Pro?

A recent Tax Court Memo (Anyika, TC Memo. 2011-69) reminds us how hard it is for someone with a full time job to try to claim they are a real estate professional in order to get around the passive loss restrictions. For the passive loss restrictions not to apply to you, you must spend over half your working hours and more than 750 hours each year on your real estate investments. So, if you are already working full time, you have to put in more hours than that in real estate. (Kiplinger Tax Letter, April 1, 2011, Vol. 86, No. 7)

Take note: Time spent on properties with average rental periods of seven days or less does not count towards the 750 hour test. Short terms rentals are also ineligible for the $25,000 deduction for losses from actively managed real estate. (Kiplinger Tax Letter, March 18, 2011, Vol. 86, No. 6)

Employment Corner

President Obama Calls For Hike in FUTA For Employers

Under his budget proposal, President Obama is calling for an increase in the wage base Federal Unemployment Tax Act (FUTA) tax that employers pay on behalf of employees. With the increase in unemployment claims, many states have depleted unemployment funds. Under the current law employers pay 6.2% on the first $7,000 of earnings paid to each employee. The increase, if passed, would change the wage base to $15,000 and as a result would increase the maximum FUTA contribution per each employee to $930 per year from $434 per year. If the proposal is passed, the increase would go into effect in 2014. (The HR Specialist, April 2011, Vol. 9, No. 4)

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Dates To Remember

Earth Day	April 22
Administrative Professionals Day	April 27
Mother's Day	May 8
Armed Forces Day	May 21
Memorial Day (Courts and government offices closed)	May 30
Father's Day	June 19
Summer Begins	June 21

Did You Know?

- Gatorade was named for the University of Florida Gators where it was first developed.
- A rat can last longer without water than a camel.
- The dye used to stamp the grade on meat is made from grape skins.
- One plain milk chocolate candy bar has more protein than a banana.
- Colgate claims "Tooth Fairy" as a registered trademark.
- Coca-Cola sold 25 bottles in its first year.

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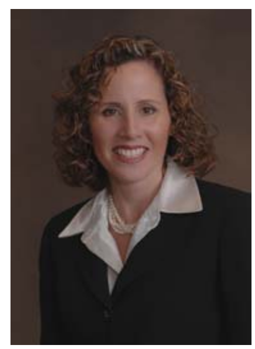

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We appreciate your referrals!

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