

“I am going to give you part of my company if you come work for me.”

By Philip L. Marcus

The majority of the people who read this will be service providers of one kind or another, not providers of goods. In effect, they consult. And people who need consultants often do not want to pay for them. There are a lot of sneaky ways to get free or reduced cost consulting services, but one of the most successful is the “part of my company” ruse.

This is how it works. Company owner contacts you, the consultant, with a proposition.

“I have a great new [fill in the blank—product, service, scam, whatever]. It is guaranteed to make a fortune once it comes to market. But I cannot afford to pay for [accounting, legal, construction ...] that I need. So I am going to go you one better. If this works out I will give you a part of my company, just for having faith in me.”

Sound good? Whoa, boy, are you in trouble now. Here is another variation:

“I can’t afford to pay you the salary you deserve, so I will pay you that amount but deduct a portion every two weeks to pay for the portion of the company I will give you at the end.”

What a favor! Why am I so cynical? It’s inborn—I was reared in the South Bronx—but these tricks justify some cynicism, or at least doubt about the good sense of those making the offer. Why?

We are talking about small or even startup companies. The person making the offer, call him Mr. Smith, is the sole person in control or at least dominates the decisions. He can make sure that there will not soon be any profits that your 10% or 20% or whatever will share in.

Mr. Smith will not take any money out of the company as dividends. Why should he? Dividends of a corporation get taxed twice—once as a tax on the corporation and then again as income to the person receiving the money. Small companies, whether LLCs or

old-fashioned partnerships usually pay taxes federally as “sub-chapter-S” or just “sub-S.” These don't pay dividends; any net profit or loss the company makes goes directly to the owners or partners. The LLC or “p-ship” just pays salary to Mr. Smith or any employees, and they declare the salary on their personal returns. And if he as owner of 70% or 80% or more gets no dividends, then neither do you as owner of 10 or 20. Surprise!

“But the company is going to become valuable.” Maybe, but the Googles and Microsofts of the world make news because they are rare, and even then the cash out does not happen a year or two into the business.

Google came into being about Sept. 1998; it was Aug. 2004 that the first public offering or IPO was announced. That was the first chance for early stockholders to have a market through which they could trade their shares for cash. Six years.

Microsoft began informally in 1975. It was August of 1983 when they had their IPO. Seven years. Can you wait seven years for your first paycheck?

Unless you have a real shared say in the company for which you propose to contribute “sweat equity,” and that say is stated in a ‘lawyered’ writing—not one vetted solely by the founder’s lawyer—you ain’t got nuthin’ buddy. Except later on maybe a chance to file an expensive and uncertain suit for unjust enrichment or fraud.

Finally, keep in mind: the folks who both worked for Enron and owned some of it stock—save only those with inside information—were doubly done in by its collapse. That is, they lost their jobs of course. They also lost the money they had invested, all with dollars that had been taxed.

Get paid fully for your time. It is the only way to build a successful service practice of any type.

This has been general advice. In specific cases, you should always consult with an attorney or tax accountant or both.