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Some Legal Issues for Small Business

Small Business Development Center
Illinois State University

April 2007

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Some Legal Issues for Small Business
Small Business Development Center
Illinois State University
April 2007 outline

Choice of entity

Contracts and leases

How to Work with a Lawyer

Team of Advisors

Questions/Answers/More Questions

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Small Business Development Center
Illinois State University
Bloomington-Normal, Illinois

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Leighton & Mobley, LLC

Thinking



The lawyers and staff of Leighton & Mobley, LLC provide high quality legal, business and financial advice in our areas of practice. We believe that our clients benefit when their professional advisors communicate and collaborate with the client and each other. Clients should be confident that their professional advisors are keenly focused on the Clients' needs and interests.

Primary Areas of practice

- * Business Planning and Formation
- * Estate and Trust Planning
- * Estate Administration (Probate)
- * Trust Administration
- * Family Law (Dissolution, Child Custody, Post-Decree, Adoption)
- * Civil Litigation
- * Alternative Dispute Resolution (Mediation, Arbitration)
- * Criminal Defense
- * Real Estate Transactions
- * Financial Planning
- * Estate Litigation
- * Tax Exempt Organizations

G. Timothy Leighton, JD, CFP®, Managing Director
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C. Timothy Leighton, JD, CFP®

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Tim Leighton counsels clients in Central Illinois and metropolitan Washington, DC on trust, estate, business planning, succession, transactions, charitable and tax matters.

Most business clients are closely held enterprises and tax-exempt organizations. They rely on Tim for formation, transition, transaction, employment and development needs. Tim also helps with strategies to recruit, retain and reward key people. Through the National Arbitration Forum and the Eleventh Judicial Circuit in Illinois, as well as privately, Tim helps resolve business and financial disputes as mediator and arbitrator.

He helps clients find better ways to secure peace of mind and to preserve, protect and grow assets. Tim serves families with meaningful net worths and others with dependency concerns such as school-aged children and people with disabilities. As trustee, he implements client priorities while managing substantial assets. Clients also rely on the firm for trust administration and probate.

As a Certified Financial Planner™ practitioner, Tim combines expertise and experiences as both lawyer and financial professional. Tim has taught Investments and Introduction to Risk Management at Illinois Wesleyan University and Insurance at Illinois State University. He was Director of Business and Estate Planning for Northwestern Mutual Financial Network. Tim partners with financial professionals in advising clients.

As Executive Vice President and General Counsel of a 400 employee enterprise based in Central Illinois, Tim was chief financial and administrative officer. He led teams in development, human resources, risk management and strategic planning.

Tim earned his law degree from George Washington University while working as a Congressional staffer and association executive. He earned his honors baccalaureate from Georgetown University, financing his education as a consultant in the tax-exempt community. He was a White House Intern in Office of Intergovernmental Relations.

Tim has helped some forty non-profits secure tax exemption determinations, define business structures, negotiate contracts and manage other challenges. He enjoys the overall direction and details of organizational dynamics, advising Boards and officers on strategic planning, transitions, management and compliance.

Bar Admissions include state and federal courts in Illinois, Maryland, Virginia and District of Columbia, plus the U.S. Supreme Court. Tim is a Fellow of Illinois Bar Foundation and member of Robert C. Underwood Inn of Court. He serves on Illinois State Bar's Business Advice & Financial Planning Council. Tim is part of American Bar Association's General Practice, Solo and Small Firm Division leadership team.

Tim leads National Association of Insurance and Financial Advisors as President of the Bloomington-Normal chapter. He serves on the boards of Illinois Wesleyan University Associates, Easter Seals and McLean County's new "Recovery Starts Today" Drug Court. The Economic Development Council of the Bloomington-Normal Area has enlisted him as a co-chair of the "Navigating a New Direction" growth campaign. For Community Players Theatre, he is General Counsel. Tim was McLean County Bar Association Treasurer, BroMenn Foundation Planned Giving Council member, and McLean County Chamber of Commerce Ambassador and Legislative Forum Chair. He served as Special Counsel to Episcopal Bishop of Washington, Vestry member for two faith communities, president of Convention II, Inc. (America's model constitutional convention of high school students) and President of the Alliance of Small Business Owners.

Debra Leighton is an active Hospice Volunteer. With their children, Kathryn, Caroline and Grace, the Leightons make their home in Bloomington, Illinois.

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1. Choice of entity
 - a. principal forms
 - i. Sole proprietor
 - ii. Partnership a/k/a General Partnership
 - iii. Corporation
 - (1) C corporation
 - (2) S corporation
 - iv. Limited Liability Company
 - (1) Disregarded entity
 - (2) Taxpayer entity
 - v. Limited Liability Partnership
 - vi. Limited Partnership
 - vii. Family Limited Partnership
 - viii. Limited Liability Limited Partnership
 - ix. special options for professionals
 - x. Trust
 - (1) Revocable
 - (2) Irrevocable
 - xi. Privately Held
 - xii. Publicly Traded
 - xiii. Hybrids

b. factors

i. Traditional 4 factors

- (1) Simplicity/complexity to form and maintain
- (2) Limited liability a/k/a asset protection
- (3) Income tax - entity or passthrough
- (4) Transferability/continuity

ii. More comprehensive - "Start With The End In Mind"

(1) Number of owners

- (a) 1
- (b) Up to 35
- (c) Up to 75
- (d) Over 75

(2) Classes of owners

- (a) 1
- (b) Multiple

(3) Types of owners

- (a) People
- (b) Trusts
- (c) Other business entities

- (i) Others own this one
- (ii) This one own others

(4) Type of enterprise

- (a) Real estate (investment properties; rentals)
- (b) Not real estate
- (c) Licensed or regulated
- (d) Home based or free-standing

(5) Limit liability

- (a) Asset protection / creditor protection
 - (i) Business assets
 - (ii) Non-business assets of owner(s)

- (b) Legal structures
 - (i) Limited liability entities inside Illinois
 - (ii) Limited liability entities outside Illinois inside U.S.
 - (iii) Limited liability entities outside U.S.
- (c) Other risk management tools
 - (i) Reputation
 - (ii) Prevention
 - (iii) Retention
 - (iv) Transfer
 - 1) Insurance
 - 2) Contracts
 - 3) Indemnification
 - (v) Avoidance
 - (vi) Other
- (6) Income tax options
 - (a) Taxed at entity level
 - (b) Taxed at owner level
 - (c) Taxation of distributions
 - (d) Owner may deduct health insurance and LTC premiums
 - (e) Owner may deduct business losses on personal return
 - (i) Net operating loss carryforwards
 - (f) Phantom income tax exposure
 - (g) Social Security Wage Maximum (\$97,500 in 2007)
 - (h) Self Employment Tax
- (7) Duration / Continuity of ownership / succession
 - (a) Founding owner's death, disability, retirement
 - (b) Death or other exit of other owners
 - (c) Perpetuity
 - (d) Key employees - family
 - (e) Key employees - non-family
 - (f) Mergers and acquisitions
 - (g) Transfer and transferability

- (8) Raising capital
 - (a) Insiders
 - (b) Outsiders
 - (c) Rights and responsibilities
 - (9) Distributions
 - (a) Ordinary profits
 - (b) Non-liquidating distributions
 - (c) Liquidation and dissolution
 - (10) Retirement funding options
 - (a) Self-fund
 - (b) Business contributes
 - (c) ESOP
 - (11) Citizenship/resident aliens
- c. formalities to formation
- i. hoops and costs for each type
- d. formalities to maintain benefits; operations
- i. "Pierce the corporate veil"
 - ii. For the record
 - (1) Articles
 - (2) Bylaws / Operating Agreement / partnership agreement
 - (3) Certificates; non-certificated
 - (4) Annual filing
 - (5) meetings
 - (6) Minutes of meetings
 - (7) records
 - iii. Service of process
 - iv. Decision-making and management; governance
 - (1) Ordinary decisions
 - (2) Extraordinary decisions
 - (3) Documentation

2. Contracts and leases

- a. writing
- b. consideration
- c. unilateral v mutual
- d. enforceability
- e. keep your promises
- f. while the horse is still in the barn

3. How to Work with a Lawyer
 - a. The only dumb questions ...
 - b. Stock in Trade (A. Lincoln)
 - c. A Neurosurgeon is not a Podiatrist
 - d. While Horse in Barn

4. Team of Advisors

- a. Accountant
- b. Analyst
- c. Architect
- d. Attorney
- e. Banker
- f. Bookkeeper
- g. Clergy
- h. Coach
- i. Consultant
- j. Contractor
- k. Detective
- l. Doctor
- m. Engineer
- n. Environmentalist
- o. Family
- p. Family Office
- q. Financial Advisor
- r. Financing Sources/Brokers
- s. Human Resources
- t. Insurance Agent/Broker
 - i. Property & Casualty
 - ii. Health & Life
 - iii. Commercial Lines
 - iv. Special Lines
- u. Intellectual Property Rights
- v. International
- w. Investment Banker
- x. Lawyer
- y. Legislator
- z. Lobbyist
- aa. Manager
- bb. Marketing
- cc. Mentor
- dd. Nurse
- ee. Philanthropist
- ff. Risk Manager
- gg. State borders
- hh. Strategic Planner
- ii. Technology
- jj. Translator
- kk. Venture Capitalist
- ll. Other

- mm. same or different re personal / business

5. Questions/Answers/More Questions

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September 2006 supplemental outline

Any entity:

- X factor

- business plan

- SWOT

- financial projections (A/L/I/E); pro formas

- periodic review

- exit strategy(ies)

- ownership; control

- taxes

- licenses

 - professional regulation

 - Department of Labor

 - liquor; weights and measures

 - county clerk

- name

- child support enforcement

- immigration reform and control

- intellectual property

- environmental

- marketing/development

- doing business with the state

- business advisors

 - accountant and bookkeeper

 - attorney

 - risk - insurance, noninsurance, transfer, retention, avoidance

 - banker

 - employee recruit / retain / reward

 - legislators

 - family

 - family office

- financing

 - debt

 - equity

 - incentives

 - successors

 - private

 - public, especially incentives, women and minority owners

- resources

 - private - Associations, foundations, universities, think tanks, SCORE

 - public

 - federal (SBA, various departments/agencies)

 - Illinois

 - Small Business Development Centers;

 - Procurement Technical Assistance Centers;

International Trade Centers
Small Business Environmental Assistance Programs
First Stop Business Information Centers
Guide for Organizing Non-Profits in Illinois:
business.illinois.gov/startup.cfm and
http://www.ilsos.net/publications/pdf_publications/cl6524.pdf

county, local, regional, international

All employers must post posters conspicuously in every workplace:

State of Illinois

Child Labor Law (Regulates Work of Those under 16)
One Day Rest in Seven Act (Odrisa)
Illinois Wage Payment and Collection Act
Equal Pay for Equal Work (Men/women)
Minimum Wage Law and Overtime
Toxic Substances Disclosure
Unemployment Insurance Benefits
Victims' Economic Security and Safety Act
Workers Compensation

Federal

Equal Opportunity - Race, Color, Religion, Sex, National Origin - Title VII of the Civil Rights Act
Disability - the Americans with Disabilities Act
Age - the Age Discrimination in Employment Act of 1967, as Amended
Sex (Wages) - Title VII of the Civil Rights Act and the Equal Pay Act of 1963
Employee Polygraph Protection Act
Family and Medical Leave Act
Job Safety and Health Protection (OSHA)
Migrant and Seasonal Agricultural Worker Protection Act
Fair Labor Standards Act
 Federal Minimum Wage; Overtime
Child Labor Act
Notice to Workers with Disabilities (re special minimum wages a/k/a Commensurate Wage Rates)
Uniformed Services Employment and Reemployment Rights Act of 1994

new hire reporting

Employers in Illinois required to report persons hired or rehired within 20 days of first day on the payroll: Employee's name, address and social security number, (the employee's first day of work is also requested, but is not mandatory); and the employer's name, address, and federal employer identification number (FEIN). An employer is also asked to provide an address where income withholding orders should be sent, if different from the FEIN address, but this information is optional.

Employee classification

Volunteer Employee

Reliance on donated services to accomplish mission, purposes

Show intention for implied contract of employment:

1. the intent of the parties
2. evidence of payment
3. bargaining for a quid pro quo

To determine whether a person is truly a volunteer and not an employee, the U.S. Department of Labor considers the following factors:

1. Does organization receives benefit from services performed;
2. Is position regularly scheduled and/or performed or whether it comes and goes;
3. how much time is spent in the volunteer activity
4. whether the services performed are of the kind typically associated with volunteer work; and
5. compensation expectations and/or given

Impact / application - FLSA / overtime

Employee v Independent Contractor

IRS test (20 points): control, training, tax, relationship, contract, etc.

US Dept of Labor test: economic reality test

Illinois Worker Compensation test: gratuitous relationship no coverage

Illinois Unemployment Insurance test:

Control/Direction

Outside scope of usual service or of the business of enterprise

Independently established trade, profession, business

Exempt v non-exempt

FLSA exempt: professional, administrative, managerial; sales; highly skilled tech/computer; salaried

Nonexempt: hourly skilled and non-skilled

Liability for unpaid overtime

Non-profits: voluntary services at special times of need

DOL factors in determining if truly a volunteer and not an employee:

- a. whether services are voluntary, no coercion, advancement, penalty
- b. whether activities are predominately for employee's own benefit;
- c. whether employee does not replace another employee or impair the employment opportunities of others
- d. whether the employee serves without contemplation of pay;
- e. whether the activity takes place during the employee's regular working hours or scheduled overtime hours;

f. whether the volunteer time is insubstantial in relation to the employee's regular hours

Full-time v part-time: eligibility for benefits? 40? 32? 30?

Regular v seasonal: eligibility for benefits?

Introductory v probationary: beware at-will doctrine; employment contracts and employee handbooks

Compensation

Employment contracts v at-will

Key person or not:

disclosure of compensation, benefits, expense allowances;
excessive pay, private inurement; ordinary and necessary

Liability issues

Errors and omissions arise from employed, compensated and volunteers

Vicarious liability; respondeat superior - three elements impose liability

- 1) employment or volunteer relationship
- 2) caused by negligence of employee or volunteer
- 3) employee/volunteer acting within scope of employment/assignment

Diminution of Doctrine of Charitable Immunity in Employment Torts

Divert resources from charitable mission; benefit humanity, not org
Might mitigate but probably not eliminate

Federal Volunteer Protection Act of 1997: not liable if

- 1) acting in scope
- 2) duly authorized
- 3) no willful, intentional, criminal misconduct, flagrant disregard
- 4) no licensure issues

Limited Liability of Directors and Officers

Must maintain corporate (or other) formalities
Can still be sued so check D&O duty to defend language

Non dischargeability of federal and state tax liabilities

Employment related insurance

Unemployment Compensation Insurance
Workers' Compensation Insurance
Directors and Officers Liability Insurance
Professional Acts and Omissions Insurance
Fidelity Bonds

Employment Practices Liability Insurance
Employee Benefits Liability Insurance

Personnel Practices for Employees and Volunteers

At-Will Employment in Illinois
Content of Personnel Policy Manuals and Employee Handbooks
Complex area; important; can't cover in this time

Equal employment opportunity
Disability issues
At-will employment policy
General employment issues such as hiring, orientation and training, working hours, preference for notices, performance appraisal, progressive discipline policies, job transfers and promotion, outside employment, employee classification, layoff, termination, and retirement
Compensation and pay practices, including compensatory time and overtime
Benefits, including holidays and vacations, retirement and savings plans, and educational assistance
Expense reimbursement
Safety and health issues
Meals/rest breaks, sick days, personal days, other short-term absences, FMLA, other long-term
Personal behavior issues such as use of drugs, smoking, sexual harassment, use of information systems (e-mail), conflicts of interest, and the policy on nondiscrimination and a productive work environment
Access to personnel files and updating personnel information

Language

"Personnel policy manuals", "Employee handbooks"
clear, accurate, and up-to-date
Permissive v mandatory terms

Personnel Information Storage

Typically four types of records on applicants, employees, and former employees

- 1) Personal employment records file
- 2) Supervisors' records
- 3) Human resources management records
- 4) Employee medical records

Exclude from files

How long: statute of limitations

Employee access

The Health Insurance Portability and Accountability Act of 1996 (HIPAA)
excellent summary of HIPAA Privacy Rule at
www.hhs.gov/ocr/privacysummary.pdf

Selection, Screening and Hiring Issues

Beware exposure for negligent selection, screening and hiring - if knew or should have known of harm to third persons; distinct from respondeat superior

Supervision and Supervisor Liability

Some is respondeat superior
Individual liability under FLSA, Equal Pay Act (up to \$10k or 6 mos or both)

Performance Evaluation Issues

no obligation to conduct; if do so, no discrimination or arbitrary/capricious

Sexual Harassment Issues

covered extensively elsewhere: quid pro quo and hostile environment

Conflict of Interest Issues

Employee duty of loyalty to Employer
When do Conflicts of interest arise?
Written policies
Some outside activities may be protected by law

Termination and Severance Issues

At-will; Contracts; Retaliatory discharge

Reference check: restrict information to avoid post-termination defamation charge.
Limit to name, dates of employment, job title, employment status, and confirmation of salary.
No discrimination.

EMPLOYMENT-RELATED LAWS

Federal Laws

- Age Discrimination in Employment Act of 1967
- Americans with Disabilities Act of 1990
- Bankruptcy Code §525
- Civil Rights Acts of 1866, 1964, and 1991
- Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)
- Consumer Credit Protection Act
- Drug-Free Workplace Act of 1988
- Employee Polygraph Protection Act of 1988
- Employee Retirement Income Security Act of 1974
- Equal Pay Act of 1963
- Executive Order No. 11246
- Fair Credit Reporting Act
- Fair Labor Standards Act of 1938
- Family and Medical Leave Act of 1993

- Federal Election Campaign Act of 1971
- Federal Unemployment Tax Act
- Higher Education Act of 1965
- Immigration Reform and Control Act of 1986
- Jury System Improvements Act of 1978
- National Labor Relations Act
- Occupational Safety and Health Act of 1970
- Older Workers Benefit Protection Act
- Pregnancy Discrimination Act
- Rehabilitation Act of 1973
- Uniformed Services Employment and Reemployment Rights Act of 1994
- Vietnam Era Veterans' Readjustment Assistance Act of 1974
- Whistle-Blower Claims
- Worker Adjustment and Retraining Notification Act

State Laws

- Child Labor Law
- Disclosure of Offenses Against Children Act
- Equal Wage Act
- Human Rights Act
- Medical Examination of Employees Act
- Minimum Wage Law
- One Day Rest in Seven Act and Eight Hour Work Day Act
- Personnel Record Review Act
- Right to Privacy in the Workplace Act
- School Visitation Rights Act
- Unemployment Insurance Act
- Uniform Conviction Information Act
- Wage Payment and Collection Act
- Whistle-Blower Claims
- Workers' Compensation Act

Local Laws - any applicable ordinances

Churches and Other Religious Organizations – Federal Law Regarding Clergy and Church Employees

- The Church as Employer
- The Minister as Employee
- Clergy Housing Allowance
- Exemption from Social Security Coverage
- Self-Employed Social Security Contributions
- Income Tax Withholding
- Judicial Involvement in Clergy-Related Employment Disputes

Legal Audit - Associations

1. Corporation (or other entity); structural formalities; notice; agendas; records
2. Antitrust matters and due process
3. Real property rights; leases; environmental matters; zoning
4. Insurance; exposures; policies; indemnification; risk management; insolvency
5. Tax; exemptions; filings; payments; compliance; notices; audits [federal and state]
6. Personnel; records; procedures; employment practices liability; compliance
7. Compensation; benefits; overtime/FLSA; COBRA; FMLA; independent contractor
8. Americans With Disabilities Act; members; staff; public
9. Sexual harassment and hostile workplace environment prevention
10. Intellectual property (copyright, trademarks, patents); status; obligations
11. Technology, Internet, web sites, protocols, privacy issues
12. Regulatory requirements; federal, state and local; OSHA; notices; compliance
13. Finance and administration; budgets; procedures; reports; policies; protocols
14. Conflicts of interest
15. Programs; contracts
16. Publications; advertising; Postal Service; UBIT; liability; copyright
17. Services; confidentiality; competition; data sources/uses
18. Chapters/affiliates; relationships; control; exemptions
19. External operations; affinity groups; international matters
20. Obligations; rights and responsibilities
21. Advocacy; lobbying; substantiality; disclosures; PAC; ethics
22. Fiduciary matters; ERISA; privacy
23. RICO; investigations; outside professionals; claims; financial audits

	Sole Proprietor	Partnership	Corporation	Limited Liability Entity	Trust
Formation and Maintenance					
Liability and Asset Protection					
Taxation Owner Or Entity					
Continuity and Succession					