

Legal Issues in Start-Ups and Businesses

Presented by:

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I. Employees

A. Hiring

i. Independent Contractors (IC's) vs. Employees (EE's)

1. The Test

Very risky to treat EEs as ICs

2. <http://www.irs.gov/pub/irs-pdf/p1779.pdf>

ii. EE – Forms to complete

B. “At-Will” Employment vs. Contractual Employment

i. “At-Will” Employment

ii. Contractual Employment

C. General Employment Forms for New Employees

1. I-9's – to ensure that employee is legally permitted to work in the US

<http://uscis.gov/graphics/formsfee/forms/files/i-9.pdf>

2. W-4's – tax withholding election form

<http://www.irs.gov/pub/irs-fill/fw4.pdf>

3. Notice of New Employee – allows IDES to keep track of employees should they need to attach wages for child support or alimony reasons

<http://www.ides.state.il.us/employer/newhire/newhire2.pdf>

II. Contracts

A. Generally

i. Written contracts best to avoid confusion / performance and ensure enforceability

ii. Greatly enhances ability to recover payment

iii. Helps establish professional relationship and professionalism

B. Employee and Independent Contractor Agreements

i. Important to properly classify workers, identify issues unique to each, and memorialize in contract

ii. For example, IC Agreement contains protections for employer if IRS deemed IC to later be an employee

iii. Careful evaluation of the intended relationship is critical.

Either Agreement would include, in addition to special provisions depending on employment or IC relationship:

iv. Salary, fee or project rates, time for payment,

v. Description of job or project, performance standards or goals

vi. Non-competes, non-solicitation and confidentiality provisions

vii. Termination events, breach and cure periods, renewal terms

C. Client Contracts or Fee Agreements

i. Business process and activities must be evaluated carefully and considered in contract draft. Every business is different in terms of output and concerns.

These are just some topics to cover in a Client Contract:

ii. State term of performance, scope of work, completion periods, resources to be used

iii. Explain fees, prices, reimbursements, time for payment, late fees, reserve right to cease work and recover attorneys fees

iv. Establish events for termination and breach

D. Buy-Sell Agreements

A “buy-sell” agreement is an agreement between partners of a business that describes what will happen in the event of one partner’s death, disability, retirement, or divorce. It ensures that the remaining partner will not be “stuck” with an unwelcome new partner (such as deceased partner’s spouse) or one he or she doesn’t know (if the stock were sold to an unknown 3rd party). In most cases the remaining partner(s) will have the right of first refusal to purchase at a set formula or price. A buy-sell agreement is highly recommended in businesses with more than one partner.

III. Insurance

- A. Professional liability
Covers those licensed to perform their skill or service (attorneys, nurse, electrician, etc.)
- B. Business Liability Insurance
Covers property (computers, etc) and possibly negligence. Very important, since most personal insurance will not cover business, even if you work from your insured home.
- C. Errors and Omissions Insurance
Varies from carrier to carrier; covers negligence in performing services under business
- D. Employment Practices Insurance
Covers litigation costs if employer sued on an employment matter. Employee handbook also critical in defense to demonstrate good faith compliance.

IV. Incorporation, Organization – How to Structure Your Business

- A. Advantages of Incorporating or Organizing
 - i. #1 reason: limitation of personal liability
 - ii. Tax advantages
 - iii. Legal structure defines partner relationship and affords protection to both partners
 - iv. Lends air of professionalism, permanence, inspires confidence, big company
 - v. Ease in transfer of ownership – death, gift, or sale of stock
- B. Timeline
 - i. Should be a step you take as early as possible; definitely prior to signing lease, financing, or other contract to avoid personal liability
 - ii. Especially critical if no insurance is purchased
 - iii. Especially critical if more than one owner
- C. Sole Proprietor
 - i. One owner, default is SP
 - ii. Tax disadvantages
 - iii. Personal liability for debts and obligations of business
- D. Partnership
 - i. Same as SP, but two owners

- ii. Potentially double liability exposure, since you are also responsible for debts and obligations generated by the business AND your partner(s)

E. Corporations

- i. Provide limitation of liability to the assets of the business
- ii. Can have many shareholders
- iii. “S” or “C” – accountant can advise you
- iv. Not as flexible as LLCs in ownership or stock classes

F. Limited Liability Company (“LLC”)

- i. Provides limitation of liability to assets of business
- ii. Can have multiple shareholders with different classes of stock
- iii. More expensive to establish than corporations
- iv. Operating Agreement can serve as Partnership Agreement

G. Which Entity is Best for My Business?

i. Talk to your Advisors

1. Accountant

Role is to evaluate tax position and make recommendations based on best tax advantages for business

2. Attorney

Role is to evaluate business plan and operations and recommend entity that reflects growth, liability protection and ownership.

You should consider both advisor’s opinions carefully and ask them to collaborate (this is common) to ensure you are set up properly. Sometimes tax considerations will outweigh legal, or vice versa.

ii. Considerations

- 1. Number of Owners
- 2. Will there be silent partners now or in the future
- 3. Are all owners US citizens
- 4. Ownership percentages
- 5. Type of business
- 6. Other related entities planned in future

iii. Services Include:

1. Counseling. Conference to discuss concerns, business processes and services, liability considerations, growth plans, ownership and other topics mentioned above to determine which entity is best.
2. Name availability search and name reservation if necessary.
3. Preparations of all incorporation or organization documents
4. Application for Employer Identification Number
5. "S" Election, if applicable
6. Registration of business with County
7. First year of Registered Agent services
8. First year of Corporate Minutes
9. Ongoing counseling and advice included.

Many additional forms and outlines are available on our website. Please visit www.clancyassociates.com and our Start-Up Business Resource Center.

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