

Checklist - Small Business Legal Compliance Inventory

I. Choosing Business Structure

There are many forms of legal structure you may choose for your business. Each legal structure offers organizational options with different tax and liability issues. You should research each legal structure thoroughly and consult a tax accountant and/or attorney prior to making your decision.

A. Structure

You may operate your business under one of many organizational structures. The most common organizational structures are sole proprietorships, general and limited partnerships, “C” and “S” corporations and limited liability companies. Each structure offers unique tax and liability benefits. If you’re uncertain which business format is right for you, you may want to discuss options with a business counselor or attorney.

1. Sole Proprietorship

One person operating a business as an individual is a sole proprietorship. It’s the most common form of business organization. Profits are taxed as income to the owner personally. The personal tax rate is usually lower than the corporate unlimited reporting tax rate. The owner has complete control of the business, but faces liability for its debts. There is very little government regulation or required with this business structure.

2. General Partnership

A partnership exists when two or more persons join together in the operation and management of a business. Partnerships are subject to relatively little regulation and are fairly easy to establish. A formal partnership agreement is recommended to address potential conflicts such as: who will be responsible for performing each task; what, if any, consultation is needed between partners before major decisions, and what happens when a partner dies. Under a general partnership each partner is liable for all debts of the business. Profits are taxed as income to the partners based on their ownership percentage.

3. Limited Partnership

Like a general partnership, a limited partnership is established by an agreement between two or more persons. However, there are two types of partners. A general partner has greater control in some aspects of the partnership. For example, only a general partner can decide to dissolve the partnership. General partners have no limits on the dividends they can receive from profit so they incur unlimited liability. Limited partners can only receive a share of profits based on the proportional amount on their investment, and liability is similarly limited in proportion to their investment.

4. “C” Corporation

rights, A “C” corporation is a legal entity created under state law by the filing of articles of incorporation. A corporation is a separate entity having its own privileges and liabilities, apart from those of the individual(s) forming the corporation. It’s the most complex form of business organization and is comprised of shareholders, directors and officers. Since the corporation is a separate legal entity in its own right it can own assets, borrow money and perform business functions without directly involving the owners. Corporations are subject to more government regulation and offer the owners the advantage of limited liability, but not total protection from lawsuits.

5. Subchapter “S” Corporation

Subchapter “S” references a special part of the Internal Revenue Code that permits a corporation to be taxed as a partnership or sole proprietorship, with profits taxed at the individual, rather than the corporate rate. A business must meet certain requirements for Subchapter “S” status. Contact the IRS for more information.

6. LLC’s and LLP’s

The limited liability company is a relatively new business form. It combines selected corporate and partnership characteristics while still maintaining status as a legal entity distinct from its owners. As a separate entity it can acquire assets, incur liabilities and conduct business. It limits liability for the owners. The limited liability partnership is similar to the LLC, but it is for professional organizations.

II. Business Licenses

There are many types of licenses, both state and local as well as professional. Depending on what you do and where you plan to operate, your business may be required to have various state and/or municipal licenses, certificates or permits. Licenses are typically administered by a variety of state and local departments. Consult your state or local government for assistance.

III. Fictitious Business Name

Registering your business name, after doing a search to make sure that it is not already in use, protects you from others who might want to use the same name. For more information, contact the county clerk’s office in the county where your business is based. If you are a corporation, you’ll need to check with the state.

IV. Business Insurance

Like home insurance, business insurance protects the contents of your business against fire, theft and other losses. Contact your insurance agent or broker. It is prudent for any business to purchase a number of basic types of insurance. Some types of coverage are required by law, other simply make good business sense. The types of insurance listed below are among the most commonly used and are merely a starting point for evaluating the needs of your business.

A. Liability Insurance – Businesses may incur various forms of liability in conducting their normal activities. One of the most common types is product liability, which may be incurred when a customer suffers harm from using the business product. There are many other types of liability, which are frequently related to specific industries. Liability law is constantly changing. An analysis of your liability insurance needs by a competent professional is vital in determining an adequate and appropriate level of protection for your business.

B. Property – There are many different types of property insurance and levels of coverage available. It is important to determine the property you need to insure for the continuation of your business and the level of insurance you need to replace or rebuild. You must also understand the terms of the insurance, including any limitations or waivers of coverage.

C. Business Interruption – While property insurance may pay enough to replace damaged or destroyed equipment or buildings, how will you pay costs such as taxes, utilities and other continuing expenses during the period between when the damage occurs and when the property is replaced? Business Interruption (or "business income") insurance can provide sufficient funds to pay your fixed expenses during a period of time when your business is not operational.

D. "Key Man" – If you (and/or any other individual) are so critical to the operation of your business that it cannot continue in the event of your illness or death, you should consider "key man" insurance. This type of policy is frequently required by banks or government loan programs. It also can be used to provide continuity in operations during a period of ownership transition caused by the death, incapacitation or absence due to a Title 10 military activation of an owner or other "key" employee.

E. Automobile – It is obvious that a vehicle owned by your business should be insured for both liability and replacement purposes. What is less obvious is that you may need special insurance (called "non-owned automobile coverage") if you use your personal vehicle on company business. This policy covers the business' liability for any damage which may result for such usage.

F. Officer and Director – Under most state laws, officers and directors of a corporation may become personally liable for their actions on behalf of the company. This type of policy covers this liability.

G. Home Office – If you are establishing an office in your home, it is a good idea to contact your homeowners' insurance company to update your policy to include coverage for office equipment. This coverage is not automatically included in a standard homeowner's policy.

V. Employee Identification Number

An EIN, also known as a federal tax identification number, is used to identify a business entity. Generally all businesses need an EIN. You may apply for an EIN in a variety of ways, e.g., including online, phone, and fax.

VI. Federal Self-Employment Tax

Every employee must pay Social Security and Medicare coverage. If you are self employed, your contributions are made through the self-employment tax.

VII. Sales Tax Exemption Certificate

If you plan to sell products, you will need a Sales Tax Exemption Certificate. It allows you to purchase inventory, or materials, which will become part of the product you sell, from suppliers without paying taxes. It requires you to charge sales tax to your customers, which you are responsible for remitting to the state. You will have to pay penalties if it is found that you should have been taxing your products and now owe back taxes to the state. For information on sales tax issues, contact your state's government.

VIII. Federal Income Tax

Like the state income tax, the method of paying federal income taxes depends upon your legal form of business. The following procedures must be considered:

A. Sole Proprietorship: You must file IRS Federal Form Schedule C along with your personal Federal Income Tax return (Form 1040) and any other applicable forms pertaining to gains or losses in your business activity.

B. Partnership: You must file a Federal Partnership return (Form 1065). This is merely informational to show gross and net earnings of profit and loss. Also, each partner must report his share of partnership earnings on his individual Form 1040 based on the information from the K-1 filed with the Form 1065.

C. Corporation: You must file a Federal Corporation Income Tax return (Form 1120). You will also be required to report your earnings from the corporation including salary and other income such as dividends on your personal federal income tax return (Form 1040).

D. Federal Payroll Tax

- 1. Federal Withholding Tax:** Any business employing a person must register with the IRS and acquire an EIN and pay federal withholding tax at least quarterly. File Form SS-4 with IRS to obtain number and required tax forms.
- 2. State Taxes:** You will need to obtain a form from the state tax office.
- 3. Sales Tax:** Anyone who engages in retail sales of tangible personal property from a state location generally needs a sales tax permit.

4. **Social Security Cards:** All employees must have a social security card. It must be signed by its owner, and you should always ask to see and personally record the social security number. Failure to do so may cause your employee to lose benefits and considerable trouble for yourself in back tracking to uncover the error. Each payday, your employees must receive a statement from you telling them what deductions were made and how many dollars were taken out for each legal purpose. This can be presented in a variety of ways, including on the check as a detachable portion or in the form of an envelope with the items printed and spaces for dollar deductions to be filled in.

IX. Employee Considerations

A. Taxes -- If you have any employees, including officers of a corporation but not the sole proprietor or partners, you must make periodic payments of, and/or file quarterly reports about payroll taxes and other mandatory deductions.

B. Employee Insurance -- If you hire employees you may be required to provide unemployment or workers' compensation insurance. Every employer with one or more employees is generally presumed to have elected coverage under the Workmen's Compensation Act, unless he files a notice rejecting coverage. Coverage may be obtained from a private carrier. For more information, contact an insurance agent.

C. Federal Immigration Reform and Control Act of 1986 (IRCA)

IRCA requires employers to verify employment eligibility of new employees. The law obligates an employer to process Employment Eligibility Verification Form I-9. The U.S. Citizenship and Immigration Services Office of Business Liaison offers a selection of information bulletins and live assistance through an Employer Hotline, E-Verify, operated by the Department of Homeland Security in partnership with the Social Security Administration. E-Verify is the best-and quickest--way for employers to determine the employment eligibility of new hires. It is a safe, simple, and secure Internet-based system that electronically verifies Social Security number and employment eligibility information reported on Form I-9.

X. Safety and Health Regulations

All businesses with employees are required to comply with state and federal regulations regarding the protection of employees. The Occupational Safety and Health Administration outlines specific health and safety standards adopted by the U.S. Department of Labor. Use of hazardous substances in businesses is highly regulated and there are heavy fines for non-compliance.

XI. Building Codes, Permits and Zoning

It is important to consider zoning regulations when choosing a site for your business. You may not be permitted to conduct business out of your home or engage in industrial activity in a retail district.

XII. Bar Coding

Many stores require bar coding on packaged products. Many industrial and manufacturing companies use bar coding to identify items they receive and ship. There are several companies that can assist businesses with bar-coding needs.

The following checklist will help you determine if your company is legally protected in certain areas.

Contracts

- Are all of the company's important agreements in writing? ☐ Yes ☐ No
- Are there good form contracts in place? ☐ Yes ☐ No
- Do the contracts provide for disputes to be resolved in courts in the state where the company's principal office is located? ☐ Yes ☐ No
- Is there an attorneys fees clause in each contract? ☐ Yes ☐ No
- Does the contract say that amendments to the contract may only be made in writing? ☐ Yes ☐ No
- Are there provisions in the company's standard form contracts regarding limiting the company's liability? ☐ Yes ☐ No
- Is the company complying with the terms of its contracts and leases? ☐ Yes ☐ No

Corporate Minute Book

- Do the Articles of Incorporation provide for sufficient authorized number of shares? ☐ Yes ☐ No
- Is a copy of the Articles in the Minute Book? ☐ Yes ☐ No
- Is a copy of the Bylaws in the Minute Book? ☐ Yes ☐ No
- Are there minutes for all meetings of shareholders? ☐ Yes ☐ No
- Are there minutes for all meetings of directors? ☐ Yes ☐ No
- Are there minutes of annual shareholder meetings? ☐ Yes ☐ No
- Are all written consents of shareholders and directors included? ☐ Yes ☐ No

Stock Matters

- Has the company received the consideration for each sale of stock? ☐ Yes ☐ No
- Is the Stock Ledger current? ☐ Yes ☐ No
- Were all sales of stock made in compliance with applicable securities laws? ☐ Yes ☐ No
- Did the Board of Directors properly authorize the sale of all stock? ☐ Yes ☐ No
- If necessary, did the shareholders properly authorize the sale of stock? ☐ Yes ☐ No
- Did the company receive the consideration for the issued stock? ☐ Yes ☐ No
- Were stock certificates issued? ☐ Yes ☐ No
- Did the stock certificates have appropriate legends? ☐ Yes ☐ No

Government Filings

- Has the company obtained its Federal Employer ID number? [☐] Yes [☐] No
- Has the company obtained its State Employer ID number? [☐] Yes [☐] No
- Have any required local and state licenses and permits been obtained? [☐] Yes [☐] No
- Has the company qualified to do business in all states it is required to? [☐] Yes [☐] No
- Have all annual information statements been filed with the Secretary of State? [☐] Yes [☐] No

Intellectual Property

- Have trademark registrations been obtained for company products and services? [☐] Yes [☐] No
- Is the “TM” or “SM” or “®” notice displayed property on all company literature? [☐] Yes [☐] No
- Have patents been applied for company-owned inventions and discoveries? [☐] Yes [☐] No
- Is a trade secret protection program appropriate? [☐] Yes [☐] No
- Have employees signed appropriate Confidentiality and Invention Assignment Agreement? [☐] Yes [☐] No
- Have consultants and independent contractors signed appropriate Confidentiality and Invention Assignment Agreements? [☐] Yes [☐] No
- Is the company infringing the intellectual property rights of others? [☐] Yes [☐] No
- Is there a program in place to determine if others are violating the company’s intellectual property rights? [☐] Yes [☐] No
- Are all needed licenses obtained? [☐] Yes [☐] No
- Is the company complying with all license agreements to which is a licensee? [☐] Yes [☐] No

Employment

- Does the Company have an “at will” employment policy in place? [☐] Yes [☐] No
- Do interviewers of prospective employees know what they can and cant ask? [☐] Yes [☐] No
- Is there a Non-Discrimination Policy in place? [☐] Yes [☐] No
- Is each prospective employee required to fill out a good form of Employment Is each prospective employee required to fill out a good form of Employment Application? [☐] Yes [☐] No
- Are employees treated fairly and evenly? [☐] Yes [☐] No
- Is there a Sexual Harassment Policy in place? [☐] Yes [☐] No
- Are job offer letters to new employees carefully drafted? [☐] Yes [☐] No
- Does the company have all needed forms from employees? [☐] Yes [☐] No

Record Keeping

- Is the company keeping good records of its income and expenses? ☐ Yes ☐ No
- Is the company keeping track of all of its contracts? ☐ Yes ☐ No
- Is the company keeping track of all employee records? ☐ Yes ☐ No
- Is the company keeping track of all tax filings required? ☐ Yes ☐ No

Laws

- Has the company determined the applicability of the following Laws to its business? ☐ Yes ☐ No
- Environmental Laws ☐ Yes ☐ No
- Worker Safety Laws ☐ Yes ☐ No
- Securities Laws ☐ Yes ☐ No
- Consumer protection Laws ☐ Yes ☐ No
- Advertising Laws ☐ Yes ☐ No
- Employment Laws ☐ Yes ☐ No
- No ☐ Yes ☐ No
- Product liability Laws ☐ Yes ☐ No
- Corporate Laws ☐ Yes ☐ No
- Tax Laws ☐ Yes ☐ No
- Commercial and Real Property Laws ☐ Yes ☐ No