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THE  
**COMPLETE  
IDIOT'S  
GUIDE<sup>®</sup> TO**

"Having *The Complete Idiot's Guide<sup>®</sup> to Law for Small Business Owners* is like adding another professional to your business support circle."

—Jacky Sach,  
cofounder of  
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# Law for Small Business Owners

- ◆ **Straightforward tips** on protecting your business and yourself
- ◆ **Idiot-proof legal strategies** for starting your business with partners or on your own
- ◆ **Expert guidance** for dealing with employees, attorneys, and accountants

Stephen M. Maple



THE  
**COMPLETE**  
**IDIOT'S**  
**GUIDE**<sup>®</sup> TO

**Law for Small  
Business  
Owners**

*by Stephen M. Maple*

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books**

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# Foreword

Owning your own business is an exciting, confusing, and often terrifying experience. It's something you don't want to do alone. Enlisting the help of professionals, such as accountants, lawyers, and other small business owners, is essential to the success of any business startup. And having *The Complete Idiot's Guide to Law for Small Business Owners* is like adding another professional to your business support circle.

From starting your entrepreneurial endeavor to creating a business successor plan, this is the handbook to make you feel at ease as you manage your own small business. When choosing the type of business you want to start—a partnership, corporation, limited liability company, sole proprietorship, or limited partnership—and the professionals who will help you every step of the way, discovering your insurance needs, answering your tax questions and liability fears, and addressing your needs for obtaining startup cash, *The Complete Idiot's Guide to Law for Small Business Owners* is an invaluable tool.

The in-depth discussions on employment law, ins and outs of contract negotiation, protecting intellectual property—from copyrights to patents to trademarks and trade secrets—and the distribution of your income are essential topics you won't want to miss. The clear and concise explanations of tax implications, allocating income among owners, timing of taxes, and dealing with the IRS will all help allay your fears and arm you with the knowledge you need to be a prepared and forewarned business owner.

I find choosing financial and other professional advisors stressful, so the sections on hiring professional advisors were particularly helpful to me. The tips on interacting with lawyers; the detailed list of services you should expect your accountants, lawyers, insurance brokers, and others to provide; and the advice on computer sourcing were also extremely useful. The book is also full of common sense pointers, such as avoiding those who speak a language only other consultants would understand and sticking with a financial planner who concentrates on planning and not selling.

This book is easy to understand and chock full of funny and thought-inspiring quotes and tips. Some of the quotes made me laugh out loud, and I tacked one up on the wall next to my computer for inspiration. I even found myself reading the chapters that did not apply to me, such as the sections on franchising. (One can dream big, right?)

Owning your own business is a dream come true. Don't let it turn into a nightmare by being unprepared and making unwise business decisions. Read *The Complete Idiot's Guide to Law for Small Business Owners* and fortify your dream with the facts, resources, and priceless information it provides.

—Jacky Sach, Cofounder of BookEnds, LLC

Jacky Sach is the cofounder of BookEnds, LLC, an editorial services and book packaging company. She and her partner, Jessica Faust, left their corporate publishing jobs to make a new start in book packaging. Together with the BookEnds staff, they offer an array of professional editorial services, including book producing, book doctoring, copyediting, developmental editing, rewriting, and proofreading. They can be reached through their Web site at [www.bookends-inc.com](http://www.bookends-inc.com).

# Introduction

If you're just starting out to create a new business, you'll need a guide through the laws that can cause more than a little consternation. I wrote this book to help you, the small business owner, who can't afford to call an attorney every time trouble appears. This book is not intended as a substitute for legal advice, but it does help you know *when* to ask for advice and *what* to ask.

Consider this book to be a preventive maintenance law manual. Scan the chapters. All of them may not pertain to your business right now, but most will be relevant at some point in the future. Read what applies, then shelve the book next to your personnel manual. Pick it up the next time you have a question of law.

Keep in mind that laws change and state laws vary so I can provide you with only a general understanding of the law. Often this is enough to protect you from being ensnared in legal traps. Fortunately, the Internet often will provide you with updates for free.

I admire small business owners for their hard work and enterprise. I hope that this book will help you avoid legal problems that could inhibit your success. Thank you for reading it.

## What You'll Find in This Book

**Part 1, "Choosing Among the Business Entities,"** permits you to review your business choices. You can choose to become a sole proprietor, limited liability company, or corporation, even though there is just one of you, or if two or more of you are in business, then a partnership, LLC, or corporation may be appropriate. Your personal liability for business debts and taxes depend on your choice.

**Part 2, "Beginning Your Successful Business,"** discusses buying a going business or becoming a franchisee. Since you may need to rent or buy a building, my chapters take you through these transactions step-by-step. Then you must come up with the capital, so this part shows you how to do so.

**Part 3, "Your Employees Matter,"** helps you traverse your way through the maze of hiring, managing, compensating, and firing employees.

**Part 4, "Running the Business,"** covers insurance, contracts, torts, and lawsuits—the basic challenges you'll face when you operate your own business.

**Part 5, "Protecting Your Business Assets,"** leads you through the numerous consumer protection laws. This part discusses selling on credit, getting collateral, and collecting from reluctant debtors. You may want to begin an e-commerce business or a home-based business, both of which are included in this section.

**Part 6, "Looking Ahead and Closing Down,"** is frankly a potpourri of legal subjects, including business bankruptcy, business taxation, and estate planning.

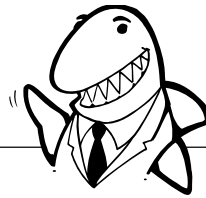
## Extras

As you go through this book you will note several boxes that provide you with various types of helpful information. Let's take a look at them.



### **Legal Eagle**

This box provides legal advice for free (except for the price of this book).



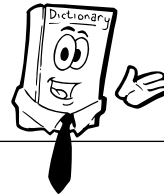
### **Shark Attack!**

This box alerts you to potential pitfalls so that you can avoid troubled waters.



### **Notes & Quotes**

Statistics can inform us, and quotes entertain us. That's what you'll find here.



### **Legalese**

Legal terms demand definition. This box provides you with what you need to understand them.

## **Acknowledgments**

To Renee Wilmeth, the acquisitions editor, I offer my thanks for her support and encouragement. To Suzanne LeVert, my development editor, Susan Aufheimer, copy editor, and JoAnna Kremer, production editor, I express my appreciation. For the rest of the book team, I deeply appreciate your dedication to the world of the printed word. Finally, I want to thank my wife Sarah for her advice and support, and our school of business secretary, Debby McGary, for helping me transmit all my manuscript through the mysterious channel of e-mail attachments.

## **Special Thanks to the Technical Reviewer**

*The Complete Idiot's Guide to Law for Small Business Owners* was reviewed by an expert who double-checked the accuracy of what you'll learn here, to help us ensure that this book gives you everything you need to know about the points of law encountered by many small business owners. Special thanks are extended to Deborah Henry.

## **Trademarks**

All terms mentioned in this book that are known to be or are suspected of being trademarks or service marks have been appropriately capitalized. Alpha Books and Pearson USA, Inc. cannot attest to the accuracy of this information. Use of a term in this book should not be regarded as affecting the validity of any trademark or service mark.

## Part 1

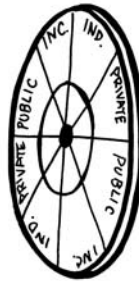
# Choosing Among the Business Entities

*To be or not to be was Hamlet's dramatic dilemma. Yours is more prosaic—to be a partnership, a corporation, a limited liability company, or a sole proprietor.*

*The choice of entities is yours to make, with the minor exception being that one person alone can't form a partnership. Your choice determines certain legal and tax consequences. If, for example, you and your co-owners create a partnership, then each one of you may be personally liable for the business debts, and each of you must report on your 1040 your share of the partnership's income or loss.*

*In this part, you will learn about the various entity choices, how you create the entity, and the consequences of each choice. You will be able to gain a thorough understanding of partnership, corporation, limited liability company, and sole proprietorship law. Taxes matter, so I discuss the tax results of your choice, which may help you to keep Uncle Sam from digging too deeply into your pocket.*

*You always can use some help, so I suggest ways of obtaining that help, some of which comes at little cost. Attorneys aren't cheap, but you can read this book and reduce your costs by doing some of the work yourself.*









# The Business for You

## In This Chapter

- What business entity is right for you
- How to get the money you need
- Contracts from A to Z
- Thinking of the end at the beginning

Since you're reading this book, chances are, you're an entrepreneur or want to become one. Owning and/or running your own business can be exciting and rewarding, but it is also a demanding master. For one thing, relatively complicated but essential legal matters are an integral part of any business, and without some knowledge of the law, you risk making potentially devastating decisions that can undermine your financial livelihood. This book won't get you past the bar exams, but it can help you make good business decisions based upon the law.

This chapter provides a brief overview of the book. It is somewhat like a movie teaser. You get a feel for business law without having to absorb too many details. Once you've seen what the book has to offer, you should feel free to skip ahead to read the chapters that are most relevant to your business, or read straight through. I've tried to make this book as comprehensive as possible, a working manual for business owners. Enjoy!

## Choosing Your Entity

The first decision you'll need to make when you create a new business is just what type of new business you want to create. Here are your choices:

- **Sole proprietor.** This is a one-owner model; the owner receives all the income and is liable for the debts. It's easy to form and dissolve. The owner is taxed on the income.
- **Corporation.** One or more shareholders own the business, which is liable for its debts. It's formed and dissolved by filing documents with the state Secretary of State. Small business corporations may be taxed or elect to have the shareholders personally taxed.
- **Partnership.** Two or more persons establish this business and they are personally liable for its debts. Usually the partners enter into a partnership agreement that governs their rights and duties. Each partner is taxed on his or her share of the business income.
- **Registered limited liability partnership.** The basic features are the same as the partnership, but the partnership, not the partners, is liable for the business debts. The partnership has to register itself with the state Secretary of State.
- **Limited partnership.** One or more general partners and one or more limited partners form this business by filing an agreement with the state Secretary of State. Only the general partner is personally liable for the business debts. Each partner is taxed on his or her share of the business income.
- **Limited liability company.** One or more members may establish this business by filing its articles of organization with the state Secretary of State. The business, not its members, is liable for its debts. Each member is taxed on his or her share of the business income.

Going into business for yourself, with no partner, limits your choices to sole proprietorship or corporation (although some states recognize a one-member limited liability company). Co-owners have every choice except the sole proprietor.



### Notes & Quotes

"Being good in business is the most fascinating kind of art."

—Andy Warhol, artist

When you select the entity that best fits your needs, you should ask at least three basic questions:

- Are you personally liable for the business debts?
- Who pays the taxes on the business income?
- How easy and expensive is the business to form?

The answers to these questions will determine the best entity choice for your business.

## Personal Liability

Because bad things happen to good businesses, you'll want to limit your personal liability for business debts as much as possible. Corporate shareholders, partners in a registered limited liability partnership, and members of the limited liability company do not have any personal liability for business debts.

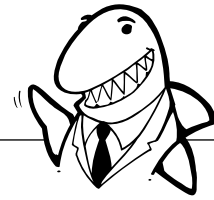
If you are a sole proprietor, I would suggest switching to a corporation, particularly if you have employees. Negligent employees cause damage. If they are on the clock when negligent, you as their employer will be liable. Insurance can cover only so much risk; after that, the business assets are subject to creditors' claims, and then you personally as the sole proprietor are liable (but not if you were a corporate shareholder).

If you are a co-owner, and concerned about liability, choose the registered limited liability partnership, limited liability company, or corporation. Personal liability is limited to your own negligence in these entities.

## Taxing Matters

Needless to say, you should not pay any more taxes than absolutely necessary. The Sixteenth Amendment to the Constitution allows the federal income tax, but it doesn't require you to be generous to Uncle Sam. Choosing the right business entity can save cash that you can put to better use than Congress can.

Sole proprietors report business income and deductions on their personal returns (1040 Schedule C). Partners and limited liability company members report their share of the business income on their personal returns (1040 Schedule E). Corporations with 75 or fewer shareholders may elect to be treated the same as partnerships under Subchapter S of the tax code and report their share of the business income on their personal returns (1040 Schedule E). Or a corporation can be taxed on its income, and then the shareholders are taxed on dividends received (1040 Schedule B).



### Shark Attack!

Your guaranty of a business debt—for example, cosigning a promissory note—could result in personal liability if the business defaults on the loan. Try not to mix personal and business finances; however, many business lenders insist on a personal guaranty from a partner or officer of a corporation.



### Notes & Quotes

"What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin."

—Mark Twain, author