2016

NFIB’S GUIDE TO SMALL BUSINESS LEGAL MISTAKES

AN NFIB E-BOOK

YOUR GUIDE TO AVOIDING THE FIVE MOST COMMON LEGAL PITFALLS.
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STAY OUT OF TROUBLE

When you launched your small business, it was likely because you had a winning concept for a product or service, not because you were passionate about the legal intricacies of running a company. With thousands of pages of state and federal laws to keep track of, it's not surprising that many small business owners don’t know about or understand all of them.

To keep you out of legal trouble, Karen Harned, executive director of NFIB’s Small Business Legal Center, weighs in on the five most common legal mistakes small business owners should avoid.
MISTAKE 1: PICKING THE WRONG BUSINESS STRUCTURE

The five most common types of business structures — which primarily impact how you pay taxes and what you’re liable for — are:

**Sole proprietorship:** A single business owner owns all the assets and profits and is responsible for all the liability and debt of the business. The owner reports losses and profits on his or her personal income taxes.

**Partnership:** Similar to a sole proprietorship but involves two or more people who share ownership of the business and its assets, profits, liability, and debt. All partners report their share of profits and losses on their personal income tax return.

**C corporation:** A unique entity, separate from its owners, in the eyes of the law. It is taxed, can be sued, and can enter contractual agreements. Corporations are more expensive and complicated to set up, more heavily monitored and regulated, and taxed more, but they offer limited liability to owners.

**S corporation:** Similar to a C corporation, but the business is not taxed; owners assume responsibility for income and losses on their personal tax returns.

**Limited liability company (LLC):** A hybrid structure combining the limited liability feature of a corporation and the tax structure of a partnership.

CHANGE AS YOU GROW

Most small business owners start out by structuring as sole proprietorships or partnerships, but they can run into trouble if they don’t shift to a C corporation, S corporation, or LLC once the business grows. The key here, Harned says, is protecting yourself from personal liability — and ensuring your business structure remains separate from personal assets. Keep evaluating whether your business structure is the right one for you, and ask yourself if you could handle the liability and financial loss if something happened to the business.
MISTAKE 2: MISCLASSIFYING EMPLOYEES AS INDEPENDENT CONTRACTORS

The freelance (independent contractor) economy is on the rise, which offers freedom and flexibility for workers and cost-effective labor for small business owners.

It may seem like a win-win scenario, but take caution. Misclassifying a worker as an independent contractor instead of an employee — whether intentionally or not — can come with a staggering price tag involving fines, back taxes and wages, and interest payments.

In the past six years, the U.S. Department of Labor has spent millions to pursue misclassifications, but the error also can be discovered if workers apply for unemployment benefits and the state labor department audits the classification.

EMPLOYEE OR INDEPENDENT CONTRACTOR?

So what’s the difference between an employee and an independent contractor? The primary consideration is control, Harned says. The more the business controls where, when, and how the work is done, the more likely the worker in question is an employee.

Supplies and equipment: Employees use supplies and equipment provided to them by an employer. Independent contractors provide their own supplies and equipment.

Hours: Employees are expected to work specific hours (say, from 9 a.m. to 5 p.m. Monday through Friday), often at a specific location. Independent contractors complete the work on their own time and typically without location requirements.

Another factor now being considered is the degree to which the worker depends on income from the business. According to Harned, if a worker loses the contract or job with a business and doesn’t have enough income from other clients to live on, the worker could be considered an employee.
MISTAKE 3: FORGOING NONCOMPETE AGREEMENTS

Small businesses are often more relaxed companies with fewer formal paperwork procedures than large corporations. If a business owner is lax about basic documents that protect the company, however, it can lead to trouble.

PROTECT YOUR BUSINESS

Noncompete agreements are a key example. These agreements, which are often left out of employee paperwork, protect sensitive business information like trade secrets and customer lists and help prevent losing employees to competitors.

For example, if you own a hair salon and taught your employees a brand-new hair coloring technique, a noncompete agreement might stipulate that departing employees may not disclose your company’s proprietary coloring method nor work at another hair salon within five miles for a year.

To protect yourself and your business, have employees sign noncompete agreements and keep these tips in mind, Harned says.

A noncompete must be in place for a legitimate business reason. That includes protecting trade secrets or customer lists.

A noncompete must come with benefit to the employee. That includes benefits like a promotion or raise if the employee is already on staff. For new employees, you may make their job offer contingent upon signing the agreement.

A noncompete must be specific and reasonable. It should specify a time frame (six months to a year is typical), geographic area (a given radius around the business, not nationwide), and types of businesses included.
MISTAKE 4: IGNORANCE OF WAGE AND HOUR LAWS

When it comes to labor laws, the stakes for noncompliance are high.

Trial attorneys have gotten very involved in employment law, particularly wage and hour requirements, because many businesses, often by mistake, are not following the law, Harned says. If found noncompliant, your business could face civil and criminal penalties resulting in significant costs.

PAY ATTENTION TO THE NEW OVERTIME RULE

In addition to the minimum wage, one of the most important laws to be aware of is the Department of Labor’s new overtime rule, which more than doubles the threshold at which salaried white-collar employees are exempt from earning overtime pay — from $23,660 to $47,476.

Under the Fair Labor Standards Act, employees are exempt from overtime eligibility if they are paid by salary; if their job is professional, administrative, or executive in nature; and if they are paid at a minimum wage level (previously $23,660). The new rule amends the FLSA by requiring all salaried white-collar workers earning less than $47,476 to be paid for overtime work.

START PREPARING NOW

The overtime rule goes into effect Dec. 1, 2016, so take action now to prepare for compliance. Keep these factors in mind, Harned says:

40 is the magic number. As long as nonexempt employees don’t work more than 40 hours per workweek — within the same time frame each week — they will not earn overtime pay. Some states, however, like California, impose overtime requirements if an employee works more than 8 hours in a single day.

Overtime can include:

- Checking and responding to work emails after hours
- Answering phone calls after hours
- Attending events held during non-business hours
- Making business trips
- Working through lunch

Requirements for meal and rest periods vary by state. Check out the Department of Labor’s website for meal period requirements and rest period requirements under your state’s laws. For meal breaks: www.dol.gov/whd/state/meal.htm; for rest periods: www.dol.gov/whd/state/rest.htm

Comp time can be given only within the week the overtime takes place. It can’t be carried over to the following week or banked for later personal or vacation use.

Options for complying with new overtime rule include:

- Shift any salaried employees making less than $47,476 a year to an hourly wage
- Don’t supply equipment like smartphones, laptops, and tablets that nonexempt employees could use to work after hours
- Institute a time-tracking system
- Discontinue telecommuting options for nonsalaried employees
- Require your employees to stop working when their shift ends

Learn all you need to know about the Fair Labor Standards Act with the “NFIB Guide to Wage and Hour Laws,” available here.
MISTAKE 5: LAX CONTRACT PROCEDURE

When you think of contracts, you may be envisioning dozens of pages of indecipherable “legalese,” but it doesn’t — and shouldn’t — be that way.

“Legalese does not mean it’s a good contract,” Harned says. “A good contract is one that very clearly articulates what you’re trying to say, and that can be done in simple terms.”

You also might think a handshake is all that’s necessary to ensure agreements are honored, but this is asking for trouble. Even if you’re starting a business with your best friend, Harned says, have a contract and sign it at the beginning, while everyone’s happy. Signing a contract will not hurt anything, but if there’s a dispute later, the absence of a contract will jeopardize your business agreements and relationships.

PROTECT YOUR BUSINESS WITH THESE CONTRACT BEST PRACTICES

1. Use written contracts. It’s best to rely on written contracts, which are the most enforceable and help avoid misunderstandings and disputes that can lead to lawsuits.

2. Remember to cover four key items:
   a. Who is doing what and when
   b. What is NOT being done
   c. What is the cost
   d. When is payment due

3. Address the unexpected:
   a. Under what circumstances may a contract be canceled?
   b. Who will assume the risk of damage or loss?
   c. How will disputes be resolved?
   d. What are the penalties for noncompliance?

4. Always ask your attorney. Have an attorney review any contract you draft and other people’s contracts before you sign them. And always, ALWAYS read contracts — including your insurance policies and credit card agreements — before signing them.

Learn more about legal issues that impact your small business and find more guides to help you navigate these issues at NFIB.com/Legal.
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