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Business Start-Up Issues

The following material is meant to make you aware of some of the issues that may be involved in the formation of a new business, particularly in Kentucky. This material is not intended to be an exhaustive list of issues, nor is it meant to be a how-to manual. This material is not intended to serve as legal advice. If you are considering starting a new business, please consider obtaining appropriate professional guidance. [Click here to return to the home page for John Meyers, business attorney, at www.johndmeyers.com.]

1. Form of Business Entity.

One of the first decisions to make when forming a new business is the choice of business entity. A number of issues can impact this decision, including the type of business activity, legal liability, tax treatment, capital needs and financing, management, and the number of anticipated owners and their relative roles, rights, and responsibilities.

Several possible business entity forms exist. Some examples include:

- Sole Proprietorship
- Partnership
- Corporation (including C-corporation and S-corporation tax status), and
- Limited Liability Company (LLC) (with a choice of tax status)

It should be noted that **state law** governs how certain entities are formed and their legal characteristics. For example, the process of forming a corporation or an LLC is determined by state law. Similarly, the characteristic of limited liability for corporations and LLCs is provided by state law.

At the same time, **federal tax law** principally addresses how the business entity will be taxed (with state tax law often following the federal tax treatment, but not always). A corporation formed under state law will need to determine whether it prefers, and qualifies, to be treated under federal tax law as an S-corporation or C-corporation. These tax treatments are substantially different. Similarly, an LLC formed under state law will need to determine whether it prefers, and qualifies, to be treated under federal tax law as a sole proprietorship, partnership, C-corporation, or S-corporation (the internal revenue code doesn't mention LLCs, so LLCs must be fit into other tax categories).

These tax treatment choices may require the timely filing of particular forms and elections with the IRS. You should consider getting professional guidance on these matters.

Additional information on choice of business entity is available at the following website:

http://www.sba.gov/smallbusinessplanner/start/choosestructure/START_FORMS_OWNERSHIP.html

2. **Business Name Issues.**

Several issues can affect your choice of a business name. Some of these issues include:

a. Name Availability. The Kentucky Secretary of State's office will only allow the filing of Articles of Organization (for LLCs), Articles of Incorporation (for corporations), Certificates of Assumed Name, and similar documents, if the business name being registered is not being used by another business that has filed in Kentucky. Therefore, a search of the Secretary of State's records is recommended before selecting a name and filing any documents with the Secretary of State. But remember that this search is limited to only those businesses that have filed and are active in Kentucky. The availability of any name with the Secretary of State does not mean that you won't possibly run into other conflicts or concerns.

b. Domain Name Availability. If you wish your business to utilize an Internet domain name identical to or similar to its legal name, a search of available domain names is recommended. If the domain name you want is available, you should consider purchasing it before someone else does.

c. Trademark. Federal law provides for the protection of trademarks. You should consider whether your use of the name you choose may infringe on an existing trademark (possibly of an identical or similar name being used by another business) and whether you should seek to register your own trademark to prevent the use of the same or similar name by any other business.

d. Assumed Names. Your business may choose to use a trade name other than, or in addition to, its legal name. In that case, the issues discussed above have similar application to your choice of the assumed name. The use of an assumed name for your business requires the filing of a Certificate of Assumed Name.

3. **Formation Formalities.**

After the type of business entity has been selected, the actual formation may involve various actions and documents. The appropriate formation steps will depend on the type of entity and the circumstances involved.

A sole proprietorship is generally considered the simplest type of entity to form, but even it may require certain actions such as the filing of a Certificate of Assumed Name with the local County Clerk. Partnerships should have written partnership agreements describing and documenting how the entity is owned and operated, and the roles, rights, and responsibilities of the partners.

LLCs and corporations are initially formed by filing a document with the Secretary of State and paying a fee. After filing with the Secretary of State, a copy of this document is filed with the County Clerk the County in which the business is located. In addition to these filings, other

organizational documents are also involved with the organization of these entities. LLCs generally have Operating Agreements (somewhat similar to partnership agreements) describing the organizational framework and the roles, rights and responsibilities of the owners and management. Corporations generally have bylaws, corporate minutes or resolutions, stock certificates, and possibly shareholder agreements.

Whichever type of entity you select, you should obtain guidance on the proper organizational formalities.

4. Tax Compliance.

A number of tax issues need also be addressed in the formation of a business. A few of these include:

a. Federal Tax ID Number. Many businesses are required to obtain from the IRS an Employer Identification Number (EIN). The assigned EIN is the unique federal tax identification number for the business entity. Many organizations with which the business may conduct business will use this same number for identification purposes. Some types of businesses, such as sole proprietorships with no employees, may be allowed to operate using the owner's social security number and are not required to obtain an EIN. However, such businesses may optionally choose to obtain and use an EIN rather than use and disclose the owner's social security number.

In addition to obtaining an EIN, the business must understand its ongoing federal tax compliance obligations.

b. Other Tax Registrations. In addition to federal taxes, the business must understand its obligations to state and local tax authorities, and register for these taxes as appropriate. A number of different state taxes can apply depending on the activities of the business, including employers withholding tax, sales and use tax, income tax, tobacco tax, motor fuels tax, property tax, and others. Many cities and counties also impose a local business license, occupational, or similar taxes on individuals and firms conducting business within their jurisdiction.

5. Capitalization.

Businesses generally need some amount of cash and/or other property to begin operations. The company's initial capital needs can be satisfied in various ways, particularly including the owners' capital investment and borrowing.

a. Capital Investment. Capital investment is the payment of cash or other property to the company in exchange for an ownership interest. In an LLC or corporation, the capital investment is related to the concept of limited legal liability for the owner. This concept provides that the owner's risk of loss is limited to the amount of capital invested, and that the owner is not individually liable for the company's debts beyond that investment (unless the owner has guaranteed or otherwise agreed to be personally liable for those debts). The amount of capital to be invested in exchange for an ownership interest may be affected by a number of factors. The capital investment also has tax ramifications for the owner and the company. Therefore, you should obtain appropriate professional guidance on the matter of capital investment.

b. Loans. The company's financial needs might also be served by borrowing money, including borrowing money from the owners. Borrowing money from owners can present various issues, including the appropriate balance between capital investment and loans, and related tax issues. As with the issue of capital investment, you should obtain appropriate professional guidance on the matter of loans between you and your business.

6. Licenses, Permits, and Regulations.

Your business may require various licenses or permits, and may be subject to various regulations regarding its operations. Some examples include:

a. State Licenses and Permits for Certain Business Activities. Kentucky requires a license or permit for over 400 different types of business activities. The following website provides a list of many of the regulated activities and a link for more information regarding each license or permit: <http://www.thinkkentucky.com/BIC/license.aspx>

b. Local Licenses and Permits. Some cities and counties require a general license or permit for businesses to operate within their jurisdiction, which registration is often related to a local tax or fee. In some cases, a license or permit may be required for specific types of business activity. You should investigate what is required by the jurisdictions in which you will be operating. The following website provides information about cities and counties in Kentucky that require businesses to register: <http://www.thinkkentucky.com/BIC/local.aspx>

c. Environmental Regulation. The following website provides information about the regulation of business activities impacting the environment: <http://www.thinkkentucky.com/bic/environmental.aspx>

d. Building, Zoning, and Other Premises Regulations. If your business has a physical location, it may be subject to a wide variety of rules and regulations regarding those premises. These issues may include zoning, building code (which can limit permissible uses of a structure, as well as requiring a building permit for any improvements to be made), fire safety, accessibility (ex. Americans with Disabilities Act), historical preservation, and other regulations. The following website provides additional information regarding building and zoning regulation: <http://www.thinkkentucky.com/BIC/building.aspx>

7. Employee Issues.

Employees can present your business with a number of additional issues, potentially including:

a. Employee or Independent Contractor. Initially, you must determine whether an individual working for you is to be treated as an employee or independent contractor. This distinction will impact, among other things, how you handle compensation (and the related taxes) and whether the worker is entitled to various benefits that you provide to employees. It is important to note that the nature of the employment arrangement is determined by the facts and circumstances rather than what you call it. Furthermore, an incorrect treatment can create significant financial exposure. The following web page provides additional guidance on the determination of the employment relationship: <http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>

b. Additional Employee Issues. Your business may also need to consider the following additional issues:

i. Employment Eligibility Verification. Employers must verify employment eligibility information provided by new employees.

ii. New Hire Reporting. Federal and state law requires certain information on new hires be reported.

iii. Employee-Related Taxes. Employers are obligated to withhold and pay various taxes in connection with employee compensation.

iv. State Unemployment Insurance. Employers must register and pay into the state unemployment insurance fund. A federal unemployment tax is also likely to apply.

v. Workers' Compensation Insurance. Most employers are obligated to provide Workers' Compensation insurance coverage for employees.

vi. Mandatory Posters. Employers are required to display certain posters to provide employees notice of various employment-related laws and regulations.

vii. Occupational Safety & Health. Employers may be subject to various occupational safety and health regulations.

viii. Americans With Disabilities Act. The ADA is a federal anti-discrimination law for individuals who are disabled, and it impacts businesses with regard to employment practices and their accessibility to the public.

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