

SMALL BUSINESS LIABILITY GUIDE

What is **Liability** ?

Being legally obligated or accountable.

What is **Vicarious Liability** ?

When one party is held responsible for the actions of another party because of a special relationship between them, like employer and employee.

Managing Liability Through Entity Selection

Business Entity Types	Formation	Liability	Other Comments
<i>Sole Proprietor</i>	<ul style="list-style-type: none"> Single person engages in business activity No formal action required 	<ul style="list-style-type: none"> Individual is personally liable for business liabilities Business is liable for the individual's personal liabilities 	<ul style="list-style-type: none"> Spouse of sole proprietor is also personally liable for business debts Estate of sole proprietor is liable for business debts
<i>General Partnership</i>	<ul style="list-style-type: none"> Two or more persons associate to carry on a business for profit Operates in accordance with partnership agreement 	<ul style="list-style-type: none"> Partners and business are separate legal entities Each partner is individually liable for entire debt of the business Business is not liable for personal debt of the partners 	<ul style="list-style-type: none"> Spouse of general partner is also personally liable for all business debts Each partner's share of the business profits and losses are reported on personal tax return
<i>Limited Partnership</i>	<ul style="list-style-type: none"> File certificate of formation filed with Secretary of State Operates in accordance with partnership agreement 	<ul style="list-style-type: none"> Limited partner's liability is limited to amount of investment in partnership Limited partner is not liable for partnership debts, as long as not participating in control of business 	<ul style="list-style-type: none"> Each partner's share of the business profits and losses are reported on personal tax return General partners have same liability as set out in "General Partnership"
<i>Limited Liability Partnership (LLP)</i>	<ul style="list-style-type: none"> Register LLP with Secretary of State 	<ul style="list-style-type: none"> Each partner is only liable for her own acts or omissions, unless (i) another's acts or omissions were supervised by her, (ii) she was directly involved in the act or omission, or (iii) she had notice of the act or omissions and failed to act to cure 	<ul style="list-style-type: none"> Must have \$100K of insurance or sufficient funds to cover any claims made
<i>Corporation</i>	<ul style="list-style-type: none"> File certificate of formation filed with Secretary of State Owners are "shareholders" 	<ul style="list-style-type: none"> Business does not have liability for personal debts of shareholders Shareholders liability is limited to amount of investment (see Piercing the Corporate Veil) 	<ul style="list-style-type: none"> Corporation is a legal person Shares are personal assets, which can be seized by the creditors of a shareholder to satisfy a debt
<i>Limited Liability Company (LLC)</i>	<ul style="list-style-type: none"> File certificate of formation with Secretary of State Owners are "members" 	<ul style="list-style-type: none"> Members liability is limited to amount of investment (see Piercing the Corporate Veil) Business does not have liability for personal debts of members 	<ul style="list-style-type: none"> Membership interest is personal property LLC property is not personal property

What is **Piercing the Corporate Veil** ?

A court may find an owner liable for the activities of a corporation or LLC when it is:

1. Organized and operated as a mere tool or alter ego of another corporation or person;
2. Used to commit fraud;
3. Used to evade an existing legal obligation; or
4. Used as protection from criminal liability or to justify a wrong.

Small Business Tax Liability Issues

Business Taxes	Managing Tax Liability	
<ul style="list-style-type: none"> ▪ Texas Sales Tax ▪ Texas and Federal Unemployment Taxes (if you have employees) ▪ Federal Employment Tax (if you have employees) <ol style="list-style-type: none"> 1. Social Security and Medicare withholding from employee paychecks 2. Federal Income Tax withholding from employee paychecks 3. Employer's portion of Federal Insurance Contributions Act (FICA) tax 	<ul style="list-style-type: none"> ▪ Keep accurate records ▪ File accurately and on time ▪ Pay on time ▪ Get professional help (e.g. CPA, bookkeeper, attorney) 	
Tax Liability Accrues Fast	Employment Taxes	Sales Taxes
<ul style="list-style-type: none"> ▪ Penalties accrue quickly and can exceed the original amount of tax due <ol style="list-style-type: none"> 1. Sales tax penalties can be 50% of original amount due 2. Federal payroll tax penalties can be 75% of underpayment 	<ul style="list-style-type: none"> ▪ Cannot avoid liability by calling employees independent contractors ▪ Personally liable if responsible for withholding 	<ul style="list-style-type: none"> ▪ Must remit and turnover to state ▪ Governing person of entity is personally liable for unpaid taxes if fraud is found, including failure to file a return

Managing Liability Through Insurance

What is Insurance ?	<ul style="list-style-type: none"> ▪ A promise of compensation for specific potential future losses in exchange for a periodic payment ▪ Designed to protect the financial well-being of an individual, company or other entity in the case of unexpected loss ▪ Agreeing to the terms of an insurance policy creates a legally binding contract between the insured and the insurer
Read the Policy	<ul style="list-style-type: none"> ▪ Read the policy and know the terms before signing ▪ Understand: (1) what property and events are covered; (2) what property is excluded; (3) how the value of lost property is calculated; and (4) what is the timing for filing claims
Types of Insurance	Effect on Liability
<i>General Liability Insurance</i>	<ul style="list-style-type: none"> ▪ Covers general claims of negligence
<i>Product Liability Insurance</i>	<ul style="list-style-type: none"> ▪ Covers defective products that causes personal injury or bodily harm
<i>Professional Liability Insurance</i>	<ul style="list-style-type: none"> ▪ Covers against malpractice in carrying out professional services, errors, and negligence in provision of services to customers
<i>Commercial Property Insurance</i>	<ul style="list-style-type: none"> ▪ Covers loss / damage to business property due to a variety of events (e.g. fire, smoke, wind / hail storms, civil disobedience and vandalism)
<i>Home-Based Business Insurance</i>	<ul style="list-style-type: none"> ▪ Covers home-based business losses
All-Risk Insurance Policies	<ul style="list-style-type: none"> ▪ Cover a wide-range of incidents and perils, except those specifically excluded in the policy
Peril-Specific Insurance Policies	<ul style="list-style-type: none"> ▪ Cover losses from only those perils specifically listed in the policy

Managing Liability Through Contracts

What is a Contract ?	<ul style="list-style-type: none"> ▪ An agreement creating obligations enforceable by law ▪ The basic elements of a contract are mutual assent, consideration, capacity and legality
Provisions in Contracts	Effect on Liability
<i>Liability Waivers / Releases</i>	<ul style="list-style-type: none"> ▪ Must be clearly written and easily visible to be valid ▪ Texas courts have declined to enforce parental waivers of accidents on behalf of their minor children
<i>Indemnity Clauses</i>	<ul style="list-style-type: none"> ▪ Make someone whole or protected from any losses which have occurred or will occur
<i>Personal Guarantee</i>	<ul style="list-style-type: none"> ▪ One person guarantees the obligations or performance of another (e.g. guaranteeing payment of another's debt)
<i>Liquidated Damages</i>	<ul style="list-style-type: none"> ▪ Pre-negotiated calculation of damages in the event of breach of contract or other predetermined event
<i>Dispute Resolution</i>	<ul style="list-style-type: none"> ▪ Mediation – a non-binding process in which the parties attempt to arrive at a mutual agreement ▪ Arbitration – a binding or non-binding process in which both parties present their sides to the arbitrator