

Legal Issues for Freelance Writers



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Presented at AMWA-DVC Third Annual
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Legal Issues



- **Choosing a form for doing business**
- **Liability issues**
- **Recording keeping and accounting**
- **When you need a lawyer**

Choosing a Corporate Form



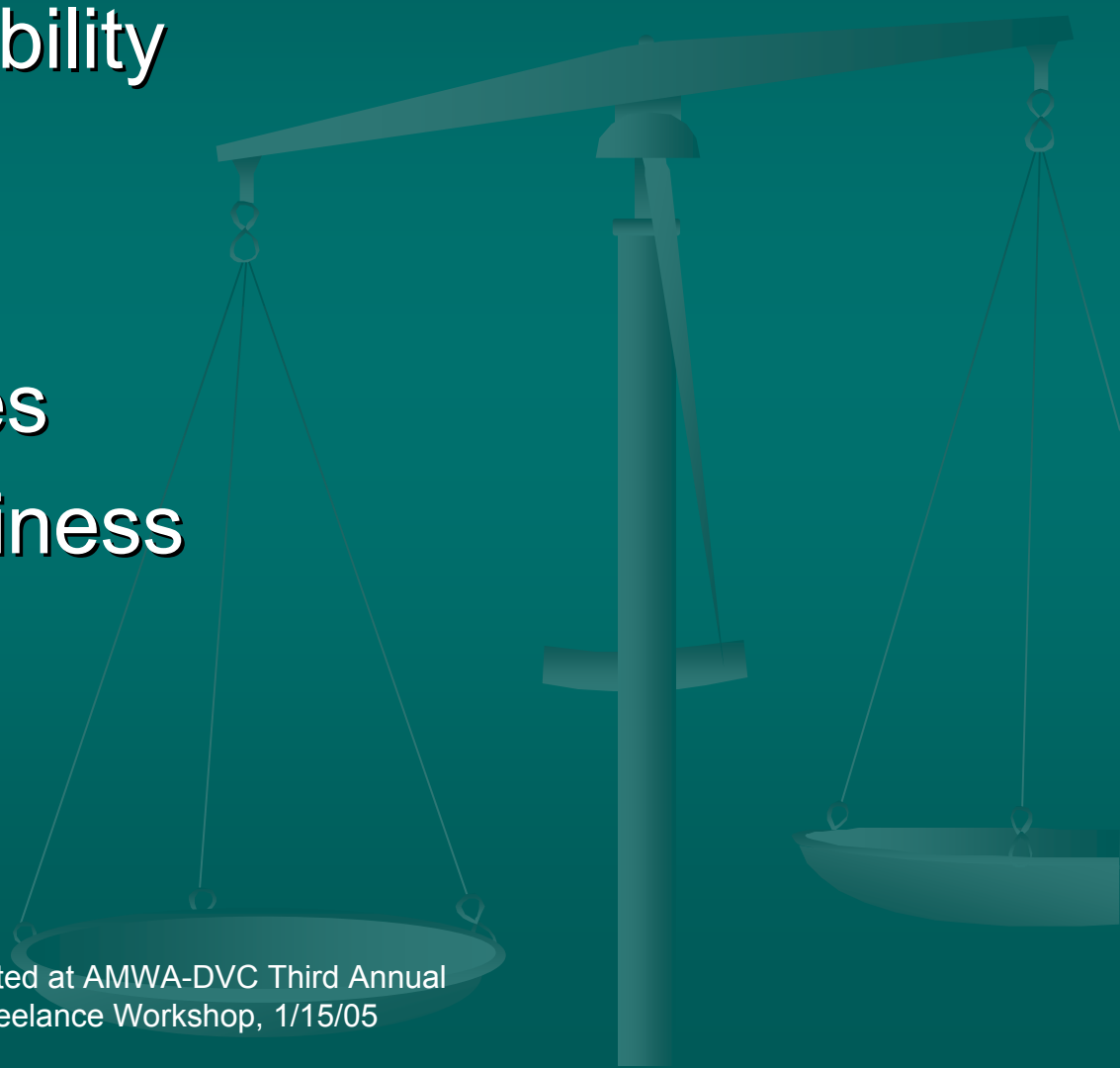
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What form should you choose?

- **Sole Proprietorship**
- Partnership
- **Limited Liability Company**
- S-Corp
- C-Corp

Issues to Consider

- Limitation of Liability
- Tax Status
- Formation
- Legal Formalities
- Closing the business



Sole Proprietorship Characteristics

- One owner
- Not a separate legal identity
- Business income taxed as personal income

Sole Proprietorship: Benefits

- Easy to set up and run
- No filing fees
- No separate business tax return
- Taxes reported as personal income

Sole Proprietorship: Drawbacks

- Personal liability unlimited
- Profits taxed in year made, even if not withdrawn from business
- Personal income tax rates may be higher

Sole Proprietorship: Issues

- Must pay self-employment taxes (partially deductible)
- Must pay quarterly estimated taxes
- Must register fictitious name (e.g., “doing business as”)
- Local business license requirements

Sole Proprietorship: Issues (cont.)

- May deduct business expenses, start-up costs, and capital costs
- Separate bank accounts not necessary
- Separate record-keeping is

Corporation Characteristics

- Corporation is separate legal entity (e.g., a “legal person”)
- Corporation can contract, borrow, be civilly and criminally liable
- Survives its shareholders
- Corporation is a “creature of the state”
- More complicated to set up and manage
- More record-keeping

Corporations: Benefits

- Limited liability -- shareholders only at risk to extent of their investment
- Corporate tax rates may be lower
- Issuing stock is a means of raising capital
- Income splitting
- Can make gifts of ownership without incurring gift tax or forfeiting control

Corporations: Drawbacks

- Must file “articles of incorporation” and maintain registered agent for service
- Must create by-laws, issue stock, appoint directors, hold annual shareholders’ and directors’ meetings, keep minutes and detailed financial records
- Decision-making must respect corporate form
- Must follow securities laws
- Separate tax returns, bank accounts

Corporations: Other Issues

- Exceptions to limitations on liability
- Business licenses and permits
- Employer identification number
- Corporate name must be unique, cannot violate trademark
- Must file for “fictitious” names

Exceptions to limited liability

- Fraud or illegal conduct
- Personal guarantees, co-signing loans
- Inadequate capitalization
- Failure to maintain corporate formalities (board meetings, shareholder votes)
- Mingling of corporate and personal assets

Piercing the Corporate Veil

- Courts can ignore the corporate form when actions of corporation's officers & directors justify it
- "Piercing" veil means shareholders may be personally liable
- Undercapitalization justifies piercing corporate veil
- No liability shield for fraud, illegal conduct, or if court determines corporation set up solely to avoid liability

Partnership Characteristics

- More than one owner
- General vs. limited partners
- General partner helps manage business, limited partner is only an investor
- General partners have unlimited liability for partnership's debts
- Limited partners only liable to extent of investment

Partnerships (cont.)

- Partnership is tax pass-through entity
- No need to file paperwork to create
- BUT, good partnership agreement is critical
- Partnership doesn't survive partners as separate entity
- Dissolution of partnership often dicey

LLC Characteristics

- LLC = “limited liability company”
- Also creature of statute, depends on state law
- Blend of corporate and partnership characteristics
- May have one or more owners, known as “members”
- LLC is a tax pass-through entity
- LLC can be “member-managed” or “manager-managed”

LLC: Benefits

- LLC shields members from unlimited liability
- Easier to set up and run than corporation
- No need for separate tax returns
- LLC can elect to be taxed as corporation

LLC: Drawbacks

- Must file “articles of organization” (“certificate of formation” in NJ, “certificate of organization” in PA) and pay filing fees
- More difficult to set up than sole proprietorship
- LLC should have written operating agreement, even if only one member
- Co-owned LLC must file informational IRS return (Form 1065)
- LLC usually dissolves when one member leaves, forcing members to satisfy obligations
- LLC members must pay tax on allocated profits each year, regardless of whether distributed

LLC Tax Issues

- LLC needs federal employer ID number
- Members must make estimated tax payments and pay self-employment tax
- If LLC elects corporate taxation, cannot switch back to pass through for five years

LLC Operating Issues

- Assets of LLC must be kept separate
- Should maintain separate bank accounts
- LLC needs “registered agent” for service
- State laws have basic operating rules if no operating agreement in effect (“default rules”)
- Liability insurance
- Business licenses

LLC Variants

- Some states tax LLC income in addition to personal income tax members pay
- Some states (including PA) impose annual LLC fee (“franchise tax,” “annual registration fee,” etc.)
- PA’s annual registration fee is \$380

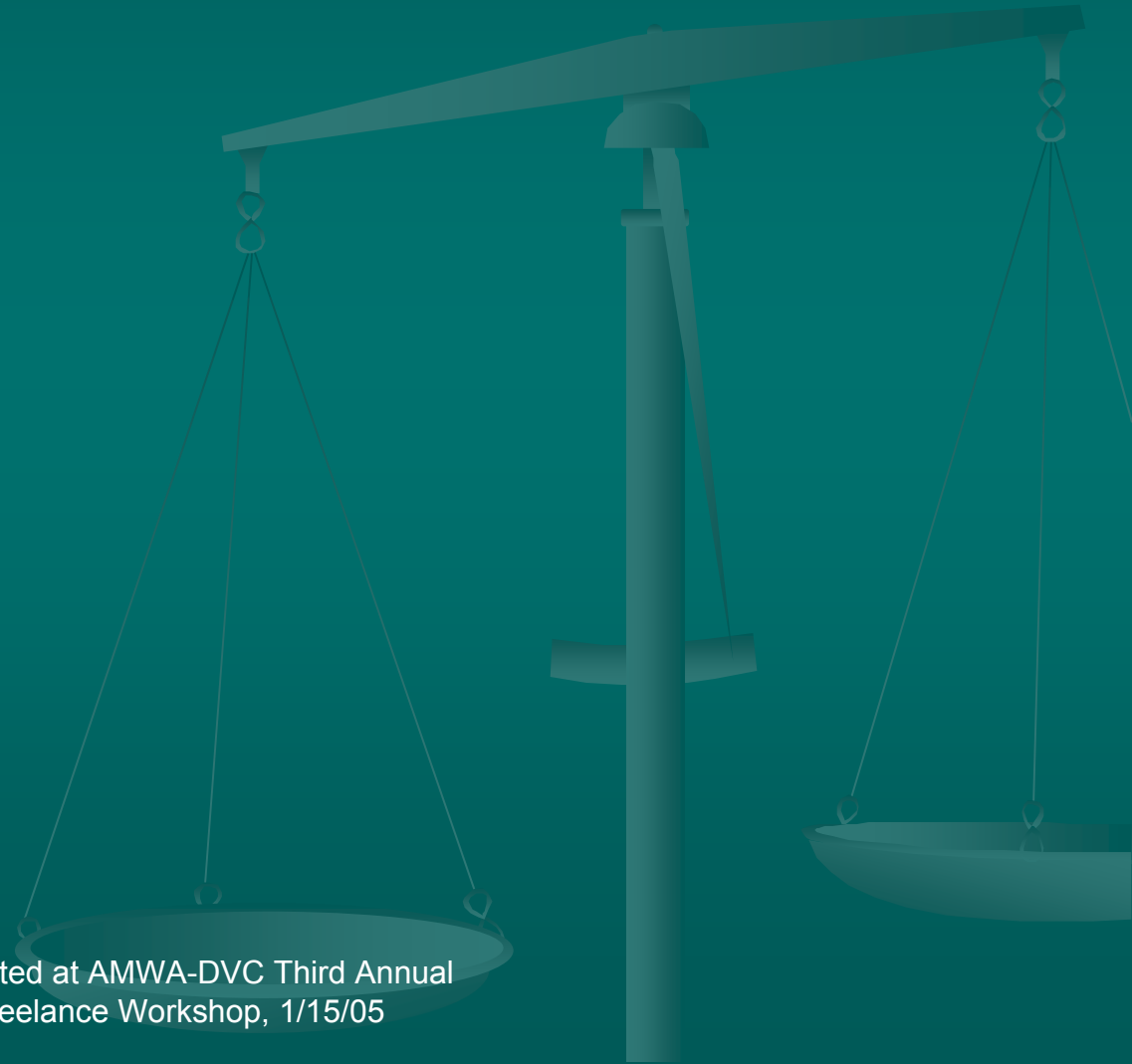
LLC Allocation of Profits

- Operating agreement specifies how profits are allocated and distributed among members
- Even if profits are retained by LLC, members must pay income taxes when profit is made by LLC, not when distributed to members.

Location of LLC

- Can form LLC in any state
- More paperwork if LLC does business in different state than where formed
- Taxes more complicated (and possibly higher) if doing business in more than one state
- Some states restrict certain businesses from forming LLCs.

Liability Issues



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Liability Issues

- Failure to comply with formal requirements
- Injury to others
- Contractual undertakings
- Tax issues

What is undercapitalization?

- To be shielded from liability, LLC or corporation needs to have sufficient funds to meet foreseeable expenses and liabilities
- Sufficiency of capital depends on business
- Not as significant for freelance writers

Do you need a business license?

- Technically, depends on state, county, or municipality
- Not as likely to be an issue if not a business premises open to public

Liability Insurance



- Need depends on potential extent of liability
- If you have business invitees, you need liability insurance
- Homeowners' policies may not cover liability associated with business operations (e.g., injury of delivery person or business invitee, malpractice)

Property Insurance

- Homeowners' policies may not cover theft or loss of business assets (computer equipment, etc.)
- Most homeowners' policies provide insufficient basic coverage for business equipment (computers, copiers, etc.); look into adding coverage

Automobile Insurance

- If you use a personal vehicle for business (appointments, etc), you need to disclose use to insurance company to be covered

Defamation

- Defamation is the publication of a false statement which causes harm to another's reputation
- Libel v. slander
- Only concerns facts, not opinions
- Truth is an absolute defense
- If victim is a public figure, must prove intent or knowledge, not mere negligence

Privacy Torts

- Publication of private information without permission (e.g., health information)
- Use of another's image without permission
- Sometimes statutory (HIV, genetic testing in some states), sometimes common law
- Damages difficult to prove
- Again, public figures have much harder case to prove

Confidentiality Agreements



- Also known as non-disclosure agreements
- Protects trade secrets
- Can be “one-way” or “mutual”
- Must define what is confidential and what is excluded
- Should specify time period

Pitfalls of Agreements

- Some agreements are actually waivers of claims to trade secrets

Noncompete Agreements

- Not enforceable against employees in some states
- Enforceability often depends on duration, geographic area, and scope
- More enforceable if selective
- Must be consideration for entering into agreement (could be hiring or continued employment)

Record-Keeping and Accounting



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Bookkeeping Goals

- Keep track of income and expenses
- Maintain necessary records for tax returns
- Keep personal and business accounts and assets separate

What records should you keep?

- Receipts of all expenditures
- Records of all income
- Make sure you understand what your accountant is doing -- you can be liable for his/her mistakes

Cash vs. Accrual Accounting

- Cash basis: income is realized when payment is received and expenses are incurred when paid for
- Accrual: income is realized when sale occurs or service is provided and expenses are incurred when obligated

Which method is best?

- Most small businesses can choose either, unless you carry inventory
- Cash method is usually easier
- Tax implications

Tax or Fiscal Year

- Generally the same as the calendar year, unless business is a corporation
- Must file IRS form to elect a different tax year

Tax Deductions



- Familiarize yourself with the rules at the IRS website, even if you have an accountant
- You know your own business best
- Leave a good paper trail -- pretend you are being audited every year
- Tax preparation can give you good insight into business profitability

When you need a lawyer



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You need a lawyer when:

- You are sued (heaven forbid)
- You enter into a very complex or long-term agreement
- Some intellectual property arrangements
- You are unsure of your rights/obligations
- You don't understand a contract you are asked to sign

It can be intimidating

- Many offer free initial consultation
- Fee arrangement: hourly v. contingency
- You pay for time and expertise, not just physical product
- Yes, phone calls count
- Give all facts, not just ones you're proud of
- Officer of the court, ethical obligations
- Consider cost-effectiveness

Other resources

- Websites: www.nolo.com; biz.findlaw.com
www.business.gov; www.firstgov.gov;
www.copyright.gov; www.uspto.gov;
www.pa.st.us (“Business in PA”);
www.nj.st.us (“Business”);
www.abalawinfo.org (“Buying and Selling”)
- Books and CDs (Nolo, Dummies)