

EXPECTING TO START A NEW BUSINESS?

*Steps to minimize your risk and build
a strong foundation*

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Effective Solutions

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Working Backward From Litigation



What do you want to prevent?
What keeps you from making money?
A lawsuit.



What mistakes or lack of knowledge lead to a lawsuit?
They are largely foundational.



What makes judges and juries side with the employer?
Fair treatment.

Work Backward From Litigation

Foundational issues that lead to lawsuits or other problems include:

- Organizational documents (or lack thereof);
- Contracts (or lack thereof);
 - Property, vendors, customers, contractors...
- Employees;
 - Hiring, promotion, discipline, termination, insurance, taxes, discrimination, retaliation, workers' compensation, employment agreements including arbitration, wage and hour...
- Insurance;
 - Right coverage, enough coverage, choice of attorney...

Work Backward From Litigation

Foundational issues that lead to lawsuits or other problems include:

- Document retention;
- Trademark or patents;
- Copyright.

Organizational Documents

What kind of business do you want to be?

- Sole proprietor;
- Partnership;
- Corporation; or
- Limited Liability Company.

Organizational Documents

Sole Proprietor

- You and the business are one and the same;
- No real business or corporate formalities;
- If the business is sued – you are sued;
- Your personal property is at stake;
- Pass through taxation, but no liability protection.

Organizational Documents

Partnership

- You, your partners, and the business are one and the same;
- No real business or corporate formalities;
- But can have a contractual partnership agreement;
- If the business is sued – you and your partners are sued;
- Individual personal property is at stake;
- Pass through taxation, but no liability protection.

Organizational Documents

Corporation

- Business is a separate entity from the holders;
- Corporate formalities;
 - Bylaws, shareholder meetings, board of directors, stock, accounting.
- If the business is sued – the buck stops there;
- Liability protection, but double taxation – corporation is a separate legal entity and is taxed before distributions made

OR

Sub-S Corporation

- Same as above, limited shareholders & pass-through taxation

Organizational Documents

Limited Liability Company

- Partnership/Corporation Hybrid;
- Business is a separate entity from the members;
- Less corporate formalities;
 - Generally accounting – keep separate accounts and books – treat LLC like own entity.
- If the business is sued – the buck stops there;
- Liability protection and pass-through taxation – corporation is a separate legal entity but is not taxed at LLC level and only members are taxed on earnings or losses.

Choice of Entity Tax Considerations



- Three primary types of entities
 - Sole proprietor
 - C corporation
 - S corporation
 - Partnership

Sole Proprietor



- One and the same as the individual owner
- All income, loss and other tax items are reported on the Schedule C of the individual's Form 1040

C Corporations



- C Corporations subject to an entity level tax at a flat rate of 21% (recently reduced from 35%)
- Any distributions to shareholders are also taxed at the shareholder level
- Commonly referred to as “double taxation”

Flow-through Taxation

- Taxation occurs only at the owner level. Income is determined at the entity level and then allocated to the owners.
- The owners must report the allocated income on their tax returns even if the entity does not actually distribute cash.
 - The highest individual tax rate is currently 37%
- Business owners may be eligible for the pass-through deduction.
 - Which is a 20% deduction of qualified business income
- This treatment is commonly referred as “flow-through” or “pass-through” taxation

S Corporations



- S Corporations are flow through entities, meaning no entity level tax
- S Corporations can have no more than 100 shareholders
- These shareholders must generally be individuals or eligible trusts for the benefit of individuals and U.S. citizens or resident aliens.
- S Corporations must have single class of stock for distribution purposes.

Partnerships*

- Partnerships are flow through entities, meaning no entity level tax
- Unlike S Corporations, partnerships have great flexibility in ownership and distribution rights

*State law multi-member LLCs by default are taxed as partnerships

Contracts

Types of contracts

- Property;
- Acquisition or Asset Purchase;
- Vendor/Service provider; and
- Customer.

The goal in all contracts is to limit your liability and anticipate future problems.

Potential considerations

- Arbitration
- Mechanics' lien

Contracts

Common Property Contract Issues:

- Who owns what;
 - Fixtures, personal property, other tangible/intangible assets associated with property.
- Right to cancel; remedies; length; renewal
 - What do the penalties look like for breaking a lease?
 - Responsibility for repairs? Termination at end of lease or renewal?

Common Asset Purchase Agreement Issues:

- Letter of Intent; due diligence period
 - Exclusivity – business or asset taken off market
 - Buyer investigation of assets, books, etc.; timing; deadlines
- Termination;
 - Right to terminate; cause or no cause; earnest money
- Property Taxes/Appeals/Government Rebates

Contracts

Common Vendor Contract Issues:

- Ensuring timely and correct product;
 - What is the vendor's liability if you cannot get what you need when you need it?
- Liability; warranties; indemnification
 - Liability for defective product; warranties for performance; indemnification for failure
- Venue and Choice of Law (make sure you address this in your contracts);
 - Where is the lawsuit going to be and what law will apply?
- Arbitration and class action-waiver (do you want this, too?);
 - What is arbitration? What is a class action? Would you prefer either?

Common Customer Contract Issues:

- Payment;
 - When does the client have to pay and what happens if they do not?
- Liability;
 - Include appropriate liability waivers in contracts with customers.

Working back from litigation: Employees

Issues in employment lawsuits include:

- Discrimination and retaliation;
 - Hiring, promotion, discipline, termination, workers' compensation;
 - employment agreements;
 - wage and hour claims.
- Types of suits;
 - Title VII (race, gender, religion)
 - Age Discrimination
 - Disability Discrimination
 - Wage and Hour (FLSA, Wage Payment Act)

Employee or Independent Contractor

“But, I paid them 1099.”

How you paid them does not matter.

They may be employees.

- Independent Contractor v. Employee;
 - Do you control the method, timing, manner of work?
 - Are you training them? Giving them tools?
 - Do they have an opportunity for profit or loss?

Exempt or Non-Exempt

Employees are NOT “salaried” or hourly.

They ARE legally exempt or non-exempt.

- How you pay an employee is inconsequential to whether that employee is entitled to overtime and/or minimum wage.
- The Fair Labor Standard Act (FLSA) will determine whether an employee is exempt or non-exempt.
 - FLSA rules updated to take effect on July 1, 2024 for exempt determination for white collar employees (EAP exemption) and Highly Compensated Employees (HCE)

FLSA EAP and HCE Exemptions

- Effective July 1, 2024, the Department of Labor implemented new rules white collar employees, including Executive, Administrative or Professional employees (EAP) and Highly Compensated Employees (HCE)
 - The new rule for EAP exemption raises the salary minimum to the 35th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region (\$58,656 annually), phased in with adjustments made every three years
 - The new rule for HCE exemption raises the salary minimum to 85th percentile of full-time salaried workers nationally (\$151,164 annually), also phased in with adjustments made every three years

Employment Agreements

Considerations:

- **General;**
 - Can make employment contingent on signing. Must give them reasonable opportunity to review agreement. Do not allow some to sign and others not to.
- **Non-compete/Confidentiality/Non-Solicitation;**
 - FTC ruling; likely court challenge. Confidentiality and non-solicitation are easier.
- **Arbitration;**
 - Employees give up right to lawsuit in court.
- **Class-action waiver;**
 - Employees give up right to be part of class action.
- **EEOC cooperation;**
 - Make sure to include a carve-out that employees can participate in EEOC investigations. Can void entire agreement.

Insurance

Considerations:

- Types of coverage;
 - General/premises liability (CGL); Employment Practices (EPLI coverage); workers' compensation; Directors and Officers (D&O) coverage.
- Coverage amounts;
 - Make sure that coverage amounts satisfy the risk of possible loss.
- Choice of counsel;
 - If you do get sued, do you want the right to select your own attorney? You can ask.

Tax Implications of Remote Working

- Nexus
 - Does a single remote worker create sufficient nexus to permit a state to tax the business when the business has no other activities in the state?
 - Varies by state
 - Types of tax
 - Wage withholding obligations,
 - income, franchise, or gross receipts
 - Sales and use

Tax Implications of Remote Working

- Income tax
 - Does the employee increase sales or back office support
- Wage withholding
 - Convenience of the employer rule
- Local Taxes

Online Sales—Sales and Use Tax Implications

- Do online sellers need to collect and remit sales and use tax?
 - Yes, if the business has sufficient nexus with the state.
- Nexus
 - The word "nexus" is used by the law to describe the connection sellers must have with a particular area before they are required to charge and collect taxes for online sales there.



Online Sales—Sales and Use Tax Implications

- Physical Nexus
 - Prior to 2018, nexus was physical
 - If your business has a physical presence, in a state, you must collect applicable sales taxes from online customers in that state.
 - A physical presence means that you have some business facility in that state. It could be any type of business operation, such as:
 - A storefront
 - An office
 - A warehouse
 - Employee or contractor soliciting sales

Online Sales—Sales and Use Tax Implications

- Economic Nexus
 - In June 2018, the Supreme Court decided the Wayfair case, providing for economic nexus
 - Even if no physical presence, a business makes a sufficient number of sales into the state, nexus is created

Online Sales—Sales and Use Tax Implications

- Economic Nexus
 - The thresholds for creating economic nexus vary by state
 - Some number of sales into state and/or total dollars sold
 - MO: effective January 1, 2023 - \$100,000 of sales
 - KS: effective July 1, 2021 - \$100,000 of sales
 - Marketplace facilitators
 - Third party platform can be required to collect and remit sales tax

Growing your business—bringing on investors

- Business Perspective
 - How much control are you willing to give?
 - Evaluate your capital needs
 - Negotiate who manages the business and makes major decisions
 - Distributions and preferred returns
 - Create a new entity
 - Update governing documents

Merging, Acquiring, Selling

- Tax-Free Reorganizations
 - Corporate mergers or reorganizations can be structured to be tax-deferred
 - Requires careful planning

Merging, Acquiring, Selling

- Taxable Acquisitions
 - Equity v. Assets
 - Sellers prefer to sell equity
 - Buyer prefer to buy assets

Merging, Acquiring, Selling

- Equity
 - Seller is selling and Buyer is buying the entity
 - This transfers “everything” to Buyer
 - Contracts
 - Assets
 - Liabilities
 - Etc.

Merging, Acquiring, Selling

- Equity
 - Seller generally receives capital gain treatment on the sale
 - Special rules for certain partnership assets
 - Buyer basis in equity (e.g. stock or membership interests) equal to purchase price, but takes the entity's basis in its assets

Merging, Acquiring, Selling

- Assets
 - Seller continues to own the entity and is only selling assets (or those specified)
 - Contracts, leases, etc. must be assigned and potentially approved by third party
 - Agreement must be reached as to whether Buyer will assume liability.



Merging, Acquiring, Selling

- Assets
 - If Seller is C corporation, then potential for double tax.
 - If seller is not a C corporation, then gain on the sale of assets will flow through to owners.
 - Could be capital or ordinary

Merging, Acquiring, Selling

- Assets
 - Buyer prefers an asset sale because the purchase price is allocated to the assets
 - Leading to greater depreciation

Questions?

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