

Legal checkup

How yearly business reviews with an attorney prevent costly legal hassles

INTERVIEWED BY ROGER VOZAR

Legal requirements, along with small businesses themselves, change constantly. Annual checkups with an attorney could reveal potential problems before they prove to be very costly for your business.

“There are a lot of small business owners out there who use a customer contract form they had a lawyer review 10 years ago and think they’re good to go,” said Erin Cleary, an associate with Kegler, Brown, Hill & Ritter. “We see owners who try to sell after a long, successful career of building their business, but the transaction proves costly and stressful as a result of neglecting certain legal compliance issues over the years.”

Smart Business spoke with Cleary about why it’s important to meet annually with an attorney and how it benefits your business.

What are examples of problems discovered during checkups?

Some small businesses are organized and taxed as C Corporations for no good reason. Those owners could save significant tax dollars by converting their structure to a pass-through entity. In the current environment of constantly shifting tax laws, it helps to check for such opportunities to improve tax structure or capitalize on other tax credits or incentives. These changes lead to real money in your pocket.

Another issue that can arise during a sale transaction concerns commercial contracts with customers or vendors. Contracts might include prohibitions on assignment, unusual indemnification clauses or warranty provisions that might be disadvantageous to the company. It can pose significant liability to hand out a template contract that’s outdated, for example, one that doesn’t take into account the unique risks and liabilities imposed by e-commerce and social media.

ERIN CLEARY
Associate
Kegler, Brown, Hill & Ritter

(614) 462-5420
ecleary@keglerbrown.com

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Updating contracts that are regularly signed cuts down on future liabilities, especially in the context of a sale transaction where a buyer will inevitably ask the seller/owner to stay ‘on the hook’ for the contractual liabilities the business has accumulated.

One of the most serious liabilities can be the failure to properly pay, collect and report taxes, particularly sales taxes and payroll taxes. Generally, there is no statute of limitations for tax evasion, fraud or the failure to file a return, so those liabilities exist forever. In addition, it’s not possible to pass this liability on to the buyer of a business — a tax authority can always go after either the ongoing business or the original owner who failed to comply. In sale transactions with this kind of liability, the seller always ends up fully indemnifying the buyer for any future penalties, audits or investigations that might occur after closing the transaction.

Are there businesses for which legal checkups are particularly vital?

It’s probably more important among less regulated industries. Businesses that are highly regulated have closer relationships with attorneys and are more attuned to legal compliance. But legal oversight is not just about compliance. It’s also about best practices, like making sure employees sign contracts to protect the business’s intellectual property.

Checkups are worthwhile if you’re anticipating an exit from the business, whether it’s a sale, taking on a major investor, going public or transitioning the business to a family member. Even a sale to someone with whom you have a close relationship might undergo the same scrutiny as if you had a completely unrelated buyer. Many businesses, particularly professional practices, do not plan for succession. Periodic conversations with counsel might encourage you to take the time to think this through. If a professional practitioner passes away, a valuable business could quickly become worthless. Having a succession plan might mean the owner’s estate receives compensation for the business when it otherwise would not.

Some owners might like to hire different lawyers for specific needs. These owners should be careful to make sure that at least one of their lawyers is taking time to look at the overall picture to make sure nothing is falling through the cracks.

Unlike accountants, whom you’re naturally going to see annually to file taxes, there is no periodic event that requires you to update your attorney about your business. But keeping up with best practices would nevertheless make an ultimate transaction less expensive and stressful, and reduce post-closing liability. ●

