

INTERNET BUSINESS LEGAL OPTIONS



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Internet Marketing Legalities

Staying Legal In Your Internet Business

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Staying Legal In Your Internet Business

In the conventional online business world, no start-up is complete without the help of a high-priced attorney. This rather expensive form of hired help is necessary to ensure that the new business is completely legal: no business wants to deal with the inauspicious start of under-the-table shadiness.

With the explosion of home-based Internet businesses, however, online marketers are finding that a highly successful business can be run right out of a spare bedroom. And unless you've got some secrets your neighbors don't know about, you probably don't have a knowledgeable attorney sitting in that spare bedroom.

On one hand, this is great: it takes a huge wad of expenses off the table from the very start. On the other hand, however, it leaves you in a bind: how can you keep everything legal without professional help? You want to avoid making costly blunders, but it's difficult to know where to start.

One of the fastest ways to sink a fledgling business is to get into a legal bind. In order to ensure the success of your business, you need to take pains to avoid the legal pitfalls

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that have felled so many before you. This means being smart and on top of all the possibilities, situations, and remedies.

So how do these courageous, confident businesspeople (the ones who DON'T get into major trouble with the FTC) set up an effective business model? And how do they wade through the huge number of laws surrounding business?

How do they make these laws work for them while still protecting their liability and their clients? And, more importantly, how can you make those laws work for YOU?

The Truth Is That You CAN Make These Laws Work In Your Favor, And We Will Show You Exactly How To Do It!

Even though the U.S. is a very pro-business environment, the simple fact of the matter is that the law frequently sides with the customer. It goes without saying that the customer needs plenty of protection. It's your responsibility as a business owner to stay on top of legal requirements in order to protect your customers – and, in turn, yourself.

As a business owner, this is your responsibility: Everything you do must be within federal limitations in order to ensure fair business practices and avoid any and all possible legal retaliation that could put your business . . . well, out of business.

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When it comes to the Internet, the Federal Trade Commission, or FTC, is constantly trying to keep up with advances in technology. The Internet represents an exponential growth factor for advertising and businesses of all types. Because of this, it can start to seem that your business is under siege: it's easy to feel like you're being attacked from all manner of legal angles in rather unfair ways.

The truth is, however, that the FTC should be your friend rather than your foe. If you manage to keep your business entirely above water, you'll have nothing to fear from the FTC – and truly savvy business owners learn to make FTC regulations and rulings work to their advantage.

Plus, this means that your customers will always be dealing with a business that is fair and equitable to their needs – and that's the kind of business decision that will only serve to boost your business.

In order to stay on top of your game and make money in this complicated legal world, you need insider information, like the answers to these questions:

Should I set up my business as a limited liability company or a sole proprietorship?

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How do I know when it's time to incorporate?

Is it true that Nevada doesn't exchange information with the IRS?

What states are the best for my business to be legally based in?

Sound like Greek to you? If so, you're a great candidate for the advice and information in this book, all of which is aimed at Internet entrepreneurs like YOU who need a little expert advice to supplement the great business smarts you were born with.

If you are an Internet marketer – if you have managed to build and continue to operate a successful business online – you've come to appreciate just how much easier Internet commerce is than selling offline. Many of the traditional issues faced by small businesspeople – such as setting up an actual storefront and having to pay rent or a mortgage on the building, having to have liability insurance, finding storage space for merchandise (if applicable), not to mention having to deal with municipal codes and zoning laws, licensing, and more – are not applicable in cyberspace. An internet business can be operated right from a spare bedroom in your house, and if you're actually dealing in tangible goods, you may never have to store or even see them as successful online auctioneers will attest.

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An internet business faces many of the same tax and liability issues as a brick-and-mortar business, however. And unless you've been on a desert island for the past twenty years, you've probably come to realize that the business law in the U.S. tremendously favors corporate interests, providing them with rights, privileges and protections that are simply no longer available to individuals and the mythical "little guy" (by which we mean the "Sole Proprietor" – read on).

The reason goes back to a little-known amendment inserted by a law clerk on a case dating back to 1888. In this case, *Santa Clara Co. vs. Southern Pacific Railroad*, a law clerk wrote his own words into the judge's opinion that essentially gave corporations the same rights under the 14th Amendment of the Constitution as natural human beings. The 14th Amendment states:

"All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

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Since then – and especially over the past twenty-five years – large corporations have used this status to get involved in the political process, influencing lawmakers to pass legislation in their favor that have allowed them to grow tremendously in size and power.

Because of various abuses and the healthy, traditional American fear and distrust of any person or institution grown too large and powerful, recent years have seen the beginning of a backlash against corporate power and the doctrine of “corporate personhood.” This has in turn led to some strange perceptions among many that corporations are somehow evil and destructive to democracy.

The fact is, a corporation, in and of itself, is neither good nor evil. It is simply a tool – a “legal fiction” that allows entrepreneurs to incur some risk without danger of losing everything they own. While it may be true that these laws have been misinterpreted, twisted and abused by many powerful, wealthy groups of men (and the occasional woman), these same laws can be used to your advantage when it comes to protecting yourself and your assets. These laws don’t care whether yours is a multi-billion dollar operation or consists of just one person. Your small, home-based Internet business can enjoy the same protections as Bechtel or Halliburton – and having an “LLC” or “Inc.” after

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your name can add a great deal of credibility as well as open the doors to the same types of opportunities! Best of all, you will enjoy the same protections and tax advantages.

These issues are covered in the first part of this book and can be applied to both online and “brick and mortar” businesses. The second part – starting in Chapter 5 – deals with an area of business law and regulation that *does* favor the consumer over Big Business as well as Small. Recently, a major manufacturer of athletic shoes was sued in the California courts over misleading ads. The corporation’s defense was that they had a right to lie under the First Amendment. Oddly, the ACLU filed an *amicus curiae* brief on behalf of the defendant. Despite this and the economic power of the corporation, the California Supreme Court ruled in favor of the plaintiff, stating that false statements are in fact, *not* protected as “free speech” under the First Amendment.¹ This judgment was appealed to the U.S. Supreme Court, who (to the disappointment of both sides) chose not to hear the case.

The point here is that even in the current pro-business, pro-corporate legal and political environment, when it comes to deceptive or unfair advertising and marketing practices, the law continues to side with the consumer. The Federal Trade Commission has always had its hands full trying to stay ahead of the technology and techniques used in advertising. The advent and exponential growth of e-commerce and Internet

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business has accelerated this whole process, as technology changes almost on a daily basis. Currently, the FTC has come up with a series of guidelines for online advertisers, which are discussed in the second part of this book.

As an online marketer, it's a good idea to understand where the FTC stands on the issue of fair advertising practices, and what the expectations are. This way, not only will you stay out of trouble, but your business will gain respect and loyalty from customers who always know what to expect.

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Chapter 1 –

Getting Started: Online Structures

People and groups of people have been doing business with each other since before the dawn of recorded time. The purpose then – as now – was to obtain something one did not have by exchanging it for something one *did* have.

It seemed like a good idea, but as society became more complex and transactions became more numerous and complicated, it became necessary to create specific rules governing these transactions in order to protect both parties. Often in history, these rules favored the seller, although the enactment of consumer protection laws over the past century also hold sellers and manufacturers liable.

Business structures such as LLCs, S-Corporations and others are designed to shield one's *personal* assets should one incur such liability. Under the terms of a corporate charter, an injured party can under normal circumstances sue only the *company*, not the *person* who operates it. Furthermore, it protects one's personal credit and assets from business debts, which are considered separate and apart from those of the business owner(s).

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In order to understand how and why these protections came about and why even small online businesses should avail themselves of such protection, it's helpful to understand the history of commerce in general.

Doing Business: A Short History

As stated above, all commerce begins as a simple exchange. You have something I need or want, I have something you need or want, and each of us is willing to give up what they have for the other. Children learn this on the playground early on when exchanging marbles, toys or other items.

Anthropologists speculate that formal courtship and mating rituals among early humans started out as business transactions; men – who did most of the hunting - wanted sex, women wanted meat for themselves and their offspring. Later, this expanded into other sorts of exchanges: hides for dried food, simple jewelry for tools and spear points, etc.

With the development of agriculture and the concept of private property, commerce became a much more complex activity. Agriculture resulted in population growth and the formation of the first urban communities. New kinds of laws were required to sort it all out. Currency, or money, was

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developed as a convenient way to assign values to a wide range of goods and services, since simple barter exchanges – depending as they did on a “double coincidence of wants” – were rarely practical. For example, suppose I was a furniture maker and you were a wheelwright. I may need a new wheel for my delivery wagon – but you may not necessarily need or want a new table and chairs. Money allowed me to exchange my furniture for something of recognized value that could be easily collected and stored, then used in another, completely different exchange.

The Origins Of Corporations

Corporations were a very early development. As trade expanded beyond localized areas – as in the case of the Phoenicians, who maintained trade connections from India to present-day Britain – the process of trade became too unwieldy and expensive for one man to deal with. Even one ship loaded with valuable goods represented a considerable investment as well as considerable risk. Early corporations formed for the purposes of (A) raising more capital for business ventures that any one man could raise on his own, and (B) spreading the potential losses so no one individual took the brunt of a liability. Therefore, an association of Phoenician merchants could pool their investments to purchase multiple ships and cargoes, secure in the knowledge

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that the inevitable loss of one or two ships would not be catastrophic for the investors (lives of the captains and crews notwithstanding).

This relatively simple type of corporate structure continued to be used through Roman times. Typically, these were *not* permanent organizations however, but groups of investors assembled for a specific purpose. The idea that a group of people could have an identity separate from that of its individual members was a concept introduced by the Germanic tribes that invaded Rome starting in the fourth century of the Common Era. By the Middle Ages, this concept found its way into canon law, which held that the Church organization was more than its members – and that as an organization, it was for all intents and purposes, immortal. This, combined with theories and customs governing the relationship between the organization (in this case, the Church) and its head (the Pope) laid the foundation for the basis of modern corporate law and structures.

Early Modern Commercial Corporations

The first “modern” corporations date from the mid-13th century, formed under crown charters, for the purpose of embarking upon ventures deemed too risky or expensive for an individual or the crown itself. Many corporations were

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charted by kings and queens for the purpose of establishing commercial colonies overseas. The most famous one in American history was the British East India Company. A series of special tax exemptions extended to this company by Parliament that were denied to small businessmen and local merchants in the colonies was one of the major issues leading to the Revolutionary War. Memory of these abuses kept corporate law in the U.S. firmly focused on protection of the public interest for the first eighty or so years of the Republic. For that reason, many private firms such as U.S. Steel and Standard Oil were set up as limited partnerships or trusts. Eventually, state governments began to relax such regulations, realizing that more permissive corporate laws would result in greater tax revenue. Corporate “enabling” laws were passed in several states, Delaware being one of the first to do so. To this day, Delaware is considered the most corporate-friendly state in the U.S. (see below).

Economic Self-Defense 101: Setting Up Your Business

So far, we have seen that the purpose of setting up a corporation is to protect one’s self and one’s assets – nothing more, and nothing less. That’s the basics, although in practice it’s a bit more complicated than that. The next section deals with the various ways in which businesses set themselves up

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in order to maximize income and productivity while minimizing potential for loss and liability.

Sole Proprietorship

This is the most basic structure. You became a sole proprietor the minute you hung out your shingle, whether that was on the Web or on the street. You are generally doing business under your own name, and you are the sole owner of that business. Since your sole proprietorship is not a corporation, you don't wind up paying corporate taxes. Instead, you simply pay taxes on the profits of the business. This simplifies the accounting chores a great deal.

A Sole Proprietor may elect to do business under a fictitious name. This is not as sinister as it sounds; it simply means the person in question is doing business under a registered trademark. For example, John Smith may have named his business "Anytown Doodads and Supply." That would be considered a fictitious name, and his license would say "John Smith, DBA (Doing Business As) "Anytown Doodads and Supply." This also enables Mr. Smith to open a separate business account at the banking institution of his choice.

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The advantages of a Sole Proprietorship:

- You have the greatest control over business decisions, since typically you have nobody else to answer to.
- A Sole Proprietorship is easily formed and dissolved, requiring little in the way of legal formalities.
- Accounting is much simpler. Tax forms are usually only 1-2 pages long, and recent changes in tax laws allow Sole Proprietors to file annually instead of quarterly.²
- A Sole Proprietorship is subject to very little in the way of government regulations.
- Company profits go directly to the business owner.

Disadvantages of a Sole Proprietorship:

- Raising capital is more difficult, since you cannot sell shares of the company, and a Sole Proprietorship has a smaller degree of perceived "legitimacy" than a corporation or an LLC.

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- It is more difficult to secure bank financing.
- Hiring of employees can be more of a problem.
- You can be subject to *both* the Federal Tax Rate *and* a “self-employment tax,” effectively being subject to double taxation.
- The “biggie:” UNLIMITED LIABILITY. This means that if your business is sued, your own *personal assets* are at risk.

Sole proprietors can experience a major benefit by joining Association 105. This is available through the Benefits Administration for the Self-Employed, or B.A.S.E. (<http://www.association105.com>). Not only does this organization provide several helpful resources, it can make 100% of your medical expenses (insured and out-of-pocket) tax-deductible (normally, you would only be able to deduct amounts in excess of \$6500). These and other benefits are available to other types of business entities as well – visit the B.A.S.E. website for more information.

Limited Liability Company

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The “Limited Liability Company,” or LLC, is a corporate-type business organizational structure that is ideal for small businesses and companies, combining as it does the advantages of Sole Proprietorship with the protection and tax advantages of incorporation. An LLC can consist of one person – which is very likely your case, if you are operating an online business. As an LLC, your personal assets are separate from those of the business, and therefore protected from loss in case the business should be sued for any reason.

In addition, an LLC is not taxed unless it chooses to be (see below); typically, you will pay Self-Employment tax on any profits you take out of the business.

LLCs will be discussed in more detail in the following chapter.

The advantages of a Limited Liability Company:

- No board of directors or shareholder meetings are required; an LLC can consist of just one person.
- An LLC is an enduring entity, usually separate from the member(s), and can be passed on, transferred or sold; fewer legal complications result should the owner unexpectedly die.

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- Administrative paperwork and recordkeeping is easier.
- Your assets are separate from those of the business, therefore you are not liable for damages caused, or debts incurred by the LLC.
- Taxation is typically on profits taken out by you, not on the LLC. You may however elect to be taxed as a sole proprietor, an S-Corp or a "regular" C- corporation; your tax advisor can determine what is best for your particular situation.

Disadvantages of a Limited Liability Company:

- Several states³ levy a franchise tax on LLCs. This is essentially a fee paid for the privilege of shielding one's personal assets.
- It is more difficult to raise capital, since most investors are looking toward an eventual initial public offering of stock.

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- Any income you receive from an LLC is taxed at “ordinary income” rates, and is subject to FICA taxes (unlike dividend or share income).

Note that last point. Currently, dividends are taxed at a maximum rate of 15%, whereas – depending on the amount – wages and salaries are taxed up to 38% and may be subject to an additional “self-employment tax” of over 15%. In the next chapter, you’ll find that there are several types of corporate set-ups, and not every one is right for the small, single-person on-line operation.

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Chapter 2 –

Picking A Corporation Style

So, now we know that a corporation is, at the most basic level, nothing more than a group of people (even if it's a group of one) banding together under some type of law or regulation, for the purpose of minimizing risk and protecting assets. You should also know by now that corporations are taxed differently than individuals, enabling the owners to keep more of what they make. Since a corporation exists as a separate entity, it has continuity in the event of the principal's death, and ownership interest can be easily transferred.

The kind of corporation you'll want to form depends on a number of factors. Are you still planning to run your net-based business by yourself, with a partner or partners, or will you be hiring employees or contracting with third parties? You may wish to consult with your tax advisor or accountant when considering which kind of corporate entity to form with your business.

C-Corporations

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This is the most common kind of corporate entity. Most major companies as well as numerous smaller ones fall into this category. Although widely used, a C-Corp structure may not be the best one for a small net-based business run by one person. The reason is that Federal and most State laws require that the operations of a C-Corporation be overseen by a board of directors and that shareholders be consulted on major business decisions. This Board of Directors manages the corporation and appoints officers to run things on a day-to-day basis.

If you plan to expand your Internet business substantially – if you believe it has a shot at becoming the next Google or Craig’s List - a C-Corporation is definitely the way to go. As a C-Corporation, you have no limit to how many shareholders you may have, allowing you to raise unlimited amounts of capital through the sale of stock. A C-Corporation is also able to deduct the cost of employee benefits (such as health insurance) as a cost of doing business. Otherwise, if you plan on staying small and intend to maintain maximum control over as much of the operation of your business as possible, formation of an LLC or an S-Corporation is a better choice.

S-Corporations

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An S-Corporation – sometimes called a “small business corporation” - is really little more than a C-Corporation that has chosen to operate under specific tax laws as outlined under Chapter One, Subchapter S of the Internal Revenue Code. The initial administrative paperwork required is the same, regardless of whether you are forming a C-Corporation or an S-Corporation, since this is done at the state level. Once this paperwork has been approved by the state in which you are incorporating, you’ll need to fill out and submit IRS Form 2553, also called “Election by a Small Business Corporation” (see below).

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Election by a Small Business Corporation
 (Under section 1362 of the Internal Revenue Code)

▶ See Parts II and III on back and the separate instructions.
 ▶ The corporation may either send or fax this form to the IRS. See page 2 of the instructions.

Notes: 1. Do not file Form 1120S, U.S. Income Tax Return for an S Corporation, for any tax year before the year the election takes effect.
 2. This election to be an S corporation can be accepted only if all the tests are met under *Who May Elect* on page 1 of the instructions; all shareholders have signed the consent statement; an officer has signed this form; and the exact name and address of the corporation and other required form information are provided.

Part I Election Information

Please Type or Print	Name (see instructions)	A Employer identification number
	Number, street, and room or suite no. (if a P.O. box, see instructions.)	B Date incorporated /
	City or town, state, and ZIP code	C State of incorporation
D Check the applicable box(es) if the corporation, after applying for the EIN shown in A above, changed its name <input type="checkbox"/> or address <input type="checkbox"/>		
E Election is to be effective for tax year beginning (month, day, year) / /		
F Name and title of officer or legal representative who the IRS may call for more information		G Telephone number of officer or legal representative (.....)
H If this election takes effect for the first tax year the corporation exists, enter month, day, and year of the earliest of the following: (1) date the corporation first had shareholders, (2) date the corporation first had assets, or (3) date the corporation began doing business / /		
I Selected tax year: Annual return will be filed for tax year ending (month and day) ▶..... If the tax year ends on any date other than December 31, except for a 52-53-week tax year ending with reference to the month of December, complete Part II on the back. If the date you enter is the ending date of a 52-53-week tax year, write "52-53-week year" to the right of the date.		

J Name and address of each shareholder or former shareholder required to consent to the election. (See the instructions for column K)	K Shareholders' Consent Statement. Under penalties of perjury, we declare that we consent to the election of the above-named corporation to be an S corporation under section 1362(a) and that we have examined this consent statement, including accompanying schedules and statements, and to the best of our knowledge and belief, it is true, correct, and complete. We understand our consent is binding and may not be withdrawn after the corporation has made a valid election. (Sign and date below.)		L Stock owned or percentage of ownership (see instructions)		M Social security number or employer identification number (see instructions)	N Shareholder's tax year ends (month and day)
	Signature	Date	Number of shares or percentage of ownership	Date(s) acquired		

Under penalties of perjury, I declare that I have examined this election, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of officer ▶ _____ Title ▶ _____ Date ▶ _____

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With an S-Corporation, the shareholder (that's you) is able to pass corporate earnings and profits directly through to his/her own personal tax return. Anyone providing work for an S-Corporation (including yourself) needs to receive a wage or salary meeting "the standards of reasonable compensation."

An S-Corporation Or An LLC...?

Let's face it, not everyone is into paperwork...and formation and maintenance of a corporate entity requires a fair amount of it. On the other hand, it's a relatively small matter to form an LLC. According to Nolo's Guide to Starting and Running a Small Business:

"...the relative simplicity and flexibility of the LLC make it the better choice. This is especially true if your business will hold property, such as real estate, that's likely to increase in value."

That statement about property is something to think about if your Internet business is an informational website that generates income on its own, such as Craigslist or a pay-per-use site. Digital property has the same potential to rise and fall in value as real property (just ask AltaVista). Even if your website doesn't generate income directly, if you're getting a

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fair number of hits per month – say, 100,000 or more – simply the domain name (if you have one) can be valuable.

Beyond the fact that forming an LLC is a one-step process requiring little in the way of red tape, you won't have to worry about annual meetings and keeping minutes of those meetings in the way corporations must do. Dividends of S-Corporations must be distributed among shareholders based on the number of shares they hold, regardless of whether or not they contributed to the business in any tangible way (in other words, YOU could put in the hours of actual labor while THEY sit around the pool waiting for the dividend check – which in theory, could mean your shareholders may wind up with the lion's share of profits!) With an LLC, profits and losses are divided up among the members in any way they see fit. Finally, an LLC can be owned and operated by anyone, whether they are a citizen, a resident alien, or another person or corporate/business entity inside or outside of the U.S. An S-Corporation, on the other hand must be owned by a "natural person" who is a U.S. citizen or a legal resident – it cannot be owned by another corporation or person outside of the country.

Members of an S-Corporation pay Medicare and Social Security taxes only on money they actually receive as compensation in the form of wages or a salary – profits received as a dividend are exempt. In contrast, members of

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an LLC may be liable for these taxes on all profits made. This is especially true if yours is an online business that provides professional services in the fields of health care, the law or engineering and design. If this is the case for you, it's a good idea to consult with your account or tax advisor on what is best for your business.

Another caveat for licensed professionals residing in the State of California: an LLC may not even be an option for you, since California law prohibits LLCs from rendering professional services as an individual. Other than that, California charges LLCs a yearly tax of \$800 just for doing business in that state, plus an additional annual LLC fee based on a percentage of total yearly income from all sources.

This brings us to our next issue – once you've decided to incorporate, where should you do it? This is no small question, since the Internet has made boundaries between states – and even nations – a lot more permeable than they once were, especially when it comes to commerce. Nonetheless, if your business is a corporate entity, you'll be required to have a "designated agent" as well as a physical address in each state in which you're doing business. Fortunately, this is not as daunting a task as it may seem, and there are organizations online that will assist you in just this sort of thing for a nominal fee. Before we move on to that

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subject however, it's worthwhile to consider the pros and cons of running a non-profit (503c) corporation.

The Way Of The Profits (And Non-Profits)

Most netpreneurs are hoping to strike it rich – and if you're one of those clever enough and lucky enough to come up with something that people will pay good money for, chances are you'll be one of them.

On the other hand, more and more people are discovering that there are things in the world to which a monetary price cannot be attached – and the value of which may not necessarily be measurable in dollars and cents. For example, the fine arts – contemporary painting or sculpture, modern classical music, and great theatre are institutions that rarely find any kind of support from commercial markets (in fact, the technical definition of "classical" music is that which is primarily state-supported – something commonly done in Europe, Japan and China, but almost never in the U.S.).

If you are among those who aspire to be a patron of the arts and are content to make a modest living while doing so, a Non-Profit entity may be for you.

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Also called a "Not-for profit corporation," a Non-Profit is a non-stock entity (in other words, it cannot issue stock to shareholders) that as the name implies, is not intended to make profits. Such corporations are founded with a specific goal or purpose in mind, usually – but not necessarily – related to education, charity work or the arts. As such, they may be – and often are – exempt from many taxes and tax regulations.

A Non-Profit may certainly generate income, and indeed needs to do so in order to stay in operation. It can accept, hold and trade monetary instruments as well as tangible goods, and – despite the name – can legally make a profit – technically called "revenue" - on such transactions. The use of such revenue – and how much revenue can be made legally - is subject to scrutiny, however, and is tightly regulated. Since it has "members" (like an LLC) rather than "shareholders" or "stockholders," capital is generally raised by soliciting donations from the public, or from private industries. Depending on the purpose of your Non-Profit organization, such donations may be tax-deductible for the donor.

At this point, you may be wondering what the point is. After all, if you're not allowed to make a profit, how is having a Non-Profit Corporation supposed to provide you with a livelihood? While it is true that a non-profit cannot issue stock nor pay dividends, it is still like any other corporate or LLC

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entity in that it can retain employees and provide *reasonable* compensation for its director(s).

Another major advantage to having a non-profit corporation – especially in the arts – is the ability to apply for government grants, such as those offered by the National Endowment for the Arts (NEA). In 1995, the new Congress changed numerous laws, making these grants unavailable to individuals. However, a non-profit organization can apply for these grants on behalf of individuals, should they wish to commission a work of art.

The same is true of charitable and educational organizations. Numerous Federal and State grants are available to non-profit organizations that cannot be applied for any other way. So – what is your passion? The arts? Education? Providing affordable housing to low-income people? Historical preservation? There are even non-profit sports organizations. You won't get rich, but by incorporating as a non-profit entity, chances are good that you'll be able to pursue activities that nourish your soul while retaining the ability to pay the bills.

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Chapter 3 –

Deciding Where To Incorporate

So far, we've learned that a corporation is a legal fiction that is used to protect one's personal assets. A Limited Liability Company serves a similar function, but is easier to form and requires less work to operate while offering many of the same protections as C or an S Corporation. As a corporation, you have certain obligations to set up operating procedures and hold annual meetings, and your accounting gets a lot more complicated. However, as a corporation, it's a lot easier to raise capital through the sale of shares.

We've also learned that different states have different regulations governing corporate entities. If you plan to do business in any state other than your own, it is required that you have a representative – known as a “designated agent” – as well as a physical address in each state where you plan to do business.

Whether you decide on an LLC or an S-Corporation really depends on a number of factors. You might ask yourself:

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- Does this business have a great deal of growth potential? Could I be sitting on top of the next Ebay or Amazon.com?
- Am I providing goods or services that people run the risk of injury using? Could I be sued for damages arising from the use of my service or product?
- Can I deal with large amounts of paperwork? Alternatively, am I willing to incur the expense of hiring a professional accountant?
- Will I be conducting business outside of my home state?

If your answer was “no” to all four, chances are the LLC entity will work just fine for your business. If, for instance, you operate a website that is a “portal” – in other words, a collection of related links that websites pay you to maintain or advertise on because yours gets a great deal of traffic (examples would be Restaurant.com or RV.net), chances are small that you’ll ever be sued unless you break some type of contractual agreement (and that would *never* happen to you, right?).

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On the other hand, if you answered “yes” to one or more of these, you should seriously consider forming an S-Corporation.

Once you’ve decided to “take the plunge,” you’ll need to decide in which state you wish to incorporate. If you’re not planning to do business outside your home state, there’s really little reason to incorporate elsewhere. However, it’s a fact that some states are more “corporate-friendly” than others. They offer greater protections, fewer regulations, and greater privacy. It’s one of the reasons that most businesses operating nationwide incorporate in Delaware or Nevada.

Incorporating In Delaware

If you recall our brief review of American History, you’ll remember that the great state of Delaware was one of the first during the last half of the nineteenth century to pass legislation that was extremely business-friendly, and remains a corporate haven to the present day. It’s small wonder that nearly 60% of all Fortune 500 companies and over 50% of public U.S. corporations are registered in Delaware. With well over a century of experience, Delaware has the most extensive body of corporate case law of any state in the Union.

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Legal matters related to corporations in Delaware are overseen by Delaware's Chancery Court - which is a "court of equity" as opposed to a "court of law." As such, there is no jury. All legal decisions are rendered in writing by the judge (known as a "chancellor" in this case), and cases tend to move more quickly through the system. Whereas a Court of Law can provide only monetary relief on a given issue, a Chancery Court can actually issue injunctions prohibiting or requiring a course of action - which is very handy when a major acquisition or hostile takeover is imminent.

Delaware law also allows for some flexibility if yours is a business that offers more than one type of service. For example, perhaps you make part of your living as a computer graphic designer, part of it as a professional blogger, and yet another part of it fixing motorcycles - and on top of that, you get royalties from published writings and play guitar in a country-western band on the weekends. This can make for some very complicated bookkeeping, and technically necessitates the formation of a separate business entity for each.

Delaware law allows you to create what is known as a "Serial LLC," which can cover several lines of business under one entity while treating them separately from each other for purposes of liability. Originally, the purpose of Delaware's Series LLC law was to allow money management funds to

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operate as LLCs. Today, people who own multiple rental and/or investment properties are using this law to simplify their own bookkeeping and avoid the necessity of creating a separate entity for each. You can read the full text of Delaware's Series LLC Law at <http://www.delcode.state.de.us/title6/c018/sc02/index.htm>. You'll probably want to consult with your tax advisor, who can tell you exactly how formation of a Serial LLC can help you in your state, if at all.

Beyond that, other advantages include a relatively low initial fee for incorporating, which may be under \$90. Should you decide to issue stock, you'll also find that such shares are tax exempt in Delaware, providing you – as the owner of the corporation – do not reside there.

As far as transacting business over the World Wide Web, the State of Delaware does not treat this any differently for tax reasons than any other type of foreign (out-of-state) business – *unless your server is physically located in Delaware*. According to state law, this would create what is called “nexus” – meaning that your company would be treated as an in-state corporation for tax purposes.

This brings us to some of the disadvantages of incorporating in Delaware. There is a franchise tax – based on the number of shares you have issued or the amount of your assets – that

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may be substantially higher than that of other states which levy such a tax (not all do). This tax – which starts out at a minimum of \$50 – must be paid by 1 March every year. Failure to do so will result in an additional \$60 penalty and an annual interest rate of 18% applied until the balance is paid in full. In addition, there is an annual Registered Agent Fee that must be paid at the same time. This fee is \$95 per year for corporations in the 48 contiguous United States, and \$130 for those located in Alaska, Hawaii or a U.S. territory. On top of all that, there is a \$200 annual tax that is due 1 June of every year.

Essentially, if you incorporate in Delaware, you'll be paying between \$345 and \$380 every year *at a minimum* to keep your charter – and if you issue stock or your company's assets go up substantially, this tax bill could get significantly higher. (Incidentally, you may have heard that Delaware does not charge income tax on corporations that do not operate in Delaware. This is true – but it is also true of every other state in the Union, since no state taxes the income of a corporation unless it is actually doing business in that state.)

The Delaware Division of Corporations charges a fee for information regarding the status of an entity – i.e., if your own corporation owes anything in the way of fees or taxes (essentially, they're charging you a fee for telling you whether or not you owe a fee).

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Finally, there have been complaints – not fully substantiated – that the Delaware Division of Corporations gives preferential treatment to some registered agent service providers over others. If you plan to use such a service, you'll want to do a bit of due diligence before signing on.

Incorporating In Nevada

Nevada is another state known for being a corporate haven, and is the state of choice for many public and private corporations located in the western U.S. Like Delaware, there are several advantages – and a few disadvantages – to having your business entity chartered in Nevada. Before going into that however, it's worthwhile to explore some of the misconceptions surrounding the reasons as to why one should incorporate in Nevada.

Misconception #1: "Nevada Has No State Income Tax"

Indeed it doesn't – and as long as your business is physically located and operated in the state of Nevada and your employees are legal Nevada residents, you'll benefit. It won't help you when it comes to registering in your home state as a "foreign entity" if your state does have an income tax, however.

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Misconception #2: "Nevada Protects Your Privacy"

Only to a minor degree. Your shareholders are not listed in the records of the Nevada Secretary of State, but can be if you obtain a business license in Nevada – and definitely in your home state, regardless.

Misconception #3: "Nevada Doesn't Exchange Info With The IRS"

True, but this only helps if your location and operations are confined to Nevada. If you have to register in any other state other than Texas however, those states DO have information exchange agreements with the IRS.

It's That Old "Corporate Veil"

No doubt you've heard about "The Corporate Veil," but you may not know exactly to what the term refers. Most people – especially in recent years – have come to believe the "Corporate Veil" is what allows multi-national corporations to abscond with billions of dollars of federal money or to raid employee pension accounts for the personal use of their CEO's while never being held to account for any of it.

While this misconception is understandable in light of recent history, it's hardly accurate. It actually goes back to the

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whole *raison d'être* for the formation of a corporate entity – which is to shield one's personal assets and property from being seized to cover liabilities of the business. There are situations however in which a court may decide that it is indeed completely appropriate to hold shareholders or members liable for a corporation's debts. This can occur if a court decides that it would be unfair to a plaintiff to simply hold a corporation liable. This doctrine is called "Piercing the Corporate Veil," and is usually invoked if there is evidence a shareholder attempted to pass personal liabilities on to the corporate entity. The "Corporate Veil" is the legal presumption of limited liability. Since the burden of proof is on the plaintiffs, these courts are highly reluctant to "pierce the corporate veil," and the decision to do so is usually made on a case-by-case basis.

A corporate veil may be pierced if the court decides it is "too thinly capitalized" – in other words, the corporation doesn't appear to have enough money in the bank to operate properly. Here's where it pays to incorporate in Nevada; capitalization levels as low as \$200 have been found to be adequate. In fact, the corporate veil has been pierced in Nevada only two times in the past quarter-century – and both cases involved a corporation that was operating in Nevada and had committed fraud against a Nevada resident. (In California on the other hand, piercing the corporate veil is

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common – especially when it comes to “foreign,” i.e., out-of-state corporations.)

In Nevada, a plaintiff must prove three things in order to pierce your corporate veil:

1. The corporation must be shown to have no separate existence from the principal, and is therefore under undue influence of that principal;
2. The plaintiff must show that the line between interest and ownership has been blurred, made permeable, or removed altogether;
3. This proof must clearly show that adhering to the legal fiction of the corporation as separate entity would promote or sanction a fraud under the given circumstances.

Again, this burden of proof is on the *plaintiff* – and s/he must prove *all* three circumstances were present. Otherwise, a Nevada court will dismiss the case altogether.

Other Advantages To Nevada

As a small, possibly single-person corporation, you’ll also be interested to know that in Nevada, all of the corporate offices

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– President, Secretary, Treasurer – can be held by a single person. Under most state charters, your corporation is required to have at least these three officers, but as a Nevada corporation, you have the option of being the sole director.

You always have the option of bringing other members and shareholders on board, of course – and when it comes to liability issues, Nevada again offers a great advantage. This is Nevada’s abolition of what is known as “joint and several liabilities.” Normally in a liability judgment, all members of the corporation are held equally responsible, regardless of how much each individual may have had to do with causing the actual damages – if anything. This means for example that if one of your members goes out and markets a defective product or performs a service that is inadequate – *with or without your knowledge* – you and all shareholders can be held equally responsible for damages. Under Nevada laws, however, the courts must assign a percentage of the liability to each defendant, who are required to pay a share of the total judgment equal *only* to his or her actual responsibility.

There are several other reasons you may want to consider incorporating in Nevada, although many of these helpful only if your business grows to a substantial size and/or plans to issue stock. Further information on these is available at the Nevada Secretary of State Website, which you can visit at http://www.sos.state.nv./comm_rec/cnrslink.html. As a small

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business or individual however, you'll be interested to know that filing fees in Nevada are considerably lower than most other states, running at \$125 at the time of this writing. (Compare this with states such as Massachusetts and California, where these fees run \$500 and \$800, respectively.)

Of further interest to the small netpreneur is the fact that in Nevada, an LLC is treated just like a corporation – meaning if you choose to form an LLC rather than a corporate entity, you'll enjoy all of the same protections. Nevada is also one of 36 states in which an LLC may be formed for “any lawful purpose” – including the holding of one's assets. LLCs in any of the following states must be formed for the purposes of doing business:

- California
- Indiana
- Iowa
- Louisiana
- Maryland
- Michigan
- Minnesota
- New York
- North Dakota
- Oregon

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- Pennsylvania
- Rhode Island
- Texas
- Virginia

Because Nevada statutes allow for the creation of an LLC for any lawful purpose, an extra layer of privacy and protection of one's assets is in place that is not available in the fourteen states named above.

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Incorporating In Other States

Delaware and Nevada by far have the most favorable corporate and business laws on the books. You may however find a reason to incorporate or form an LLC elsewhere, and since each state's laws are different, some may actually be better for your type of business and situation than others.

Arizona

Starting up a business entity in Arizona is also significantly less compared to other states, and can start out to be as little as \$50. Furthermore, as of January of 2001, the state of Arizona lowered its corporate tax rate to a flat 6.968%, regardless of profits or losses throughout the year. In addition, certain industries receive preferential treatment and incentives, although these generally must be businesses operating within the State of Arizona. There is no entity level tax on an LLC, and your tax return – Form 65 – can be turned in on 15 April.

Florida

Florida has the advantage of tax laws that are highly favorable to businesses. Not only are personal income taxes prohibited by the provisions of the Florida state constitution, there is no corporate income tax on S Corporations.

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New York

The big advantage to incorporating in New York State is privacy; there is no requirement stating that corporate officers must be listed in the articles of incorporation. Shareholders enjoy limited personal liability under New York law. Normally, the corporation pays a state franchise tax as well as a tax on corporate income, and shareholders pay a tax on the portion of that income they receive as dividends. However, there is a limited exception made for S Corporations. Beyond that, if you are located and/or intend to operate in the State of New York, several cities around the state have incentives called "Empire Zones." Visit <http://www.nylovesbiz.com/> for more information.

Where To Get Started

If all of this seems overwhelming, you'll be glad to know that there is no shortage of organizations that are willing and eager to help you get started with the process. None of the paperwork requires a legal professional and virtually all of it can be filled out by anyone. As you've learned however, business law can be highly complex, and it can be easy to make costly mistakes.

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Option A: Hire a Professional

The logical place to start would be with your tax advisor or accountant. If you do not have one of these, it's best to shop around and even interview a few of them. Find out what their training is, how much experience they've had, and what they know about setting up business entities outside of your home state.

You can also consult with and hire an attorney. At prices starting at around \$230 per hour, this is not an option for very many small businesses. Many attorneys will give you a 30 minute initial consultation for free, but this may not be nearly enough time to set up your chosen business entity correctly. Fortunately, recent years have seen the birth of a number of "legal clubs" or "legal plans" offered by several companies around the country. These plans work very much like health insurance; for a monthly fee that ranges from \$12 to \$45 per month, you'll have access to a qualified law firm in your state from which you can get a specified number of hours of service and/or representation each year, as well as a discount on hours and areas of the law beyond those covered by your particular plan. Some of these "legal plans" are available through trade associations or non-profit organizations such as auto clubs.

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Option B: Hire Para-Pros

The most popular – and economical - route these days is to go through a business specializing in the incorporation process. There are many reputable – as well as a few not-so-reputable - paralegal organizations online that can provide assistance in navigating the maze of paperwork involved in setting up your C or S Corporation, as well as establish your presence in all states in which you plan to do business. Entering terms such as “legal help setting up corporations” or “incorporate my small business” into any major search engine should bring up a fair number of these organizations. Fees and range of services can vary widely, so it definitely pays to shop around. Also keep in mind that the fees charged by these organizations – which can be anywhere from \$35 to over \$500 – are *on top* of any state incorporation and filing fees.

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Chapter 4 –

The Offshore Corporation: Is It For You?

Before we delve into this subject, a couple of things need to be made clear.

First of all, the information in this chapter – as in all of this book - should be taken as being *informational in nature*, and not meant to represent any sort of bona-fide legal counsel. Incorporation in a foreign country while continuing to operate inside the United States is a highly complex process that requires uncommon legal and financial expertise. Given the current geopolitical environment, Federal agencies are taking a hard look at individuals and small businesses who attempt to set up in offshore locations. Mistakes in the process can incur scrutiny from Federal agencies that you may not want, and in some cases, can land you in prison (or worse).

Secondly, you may have heard that many large U.S. corporations are based off-shore in order to escape U.S. tax liabilities. Without getting into the ethical questions this raises – mainly, the internalization of profits and enjoying free use of U.S. infrastructure while externalizing the costs of maintaining that infrastructure onto the backs of the average

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U.S. worker – remember that these corporations have far more economic clout than many small nations. For the past quarter century, abandonment of anti-trust laws and deregulation has made many of these corporations laws unto themselves, backed by a small army of lobbyists in Washington DC who are paid millions of dollars every year to influence members of Congress to pass laws that favor *them* – not *you*.

While most of this lobbying activity over the past quarter century was completely within the law, a good deal of it was not – and the U.S. electorate finally lost patience. If the elections of 2006 were any indication, change is in the wind. These changes tend to take place very slowly however, and it may require another generation or more as well as an entire cultural shift of values before true social responsibility becomes a legal requirement of engaging in free-market capitalism.

Since most of these laws are written for large, multi-national corporations, chances are good that setting up your small company in say, the Bahamas or the Cayman Islands will probably not afford you any benefits you couldn't enjoy by simply incorporating in Delaware or Nevada. On the other hand, if you have the time and the money as well as access to expert legal advice, are not troubled enjoying the benefits of using American infrastructure while putting the

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responsibility for maintaining that infrastructure on someone else and are fairly confident that your operation has nothing to hide from the Federal government, read on...

According to Rhiannon Williamson, who is the proprietor of *Shelter Offshore* (<http://www.shelteroffshore.com>), incorporating offshore can incur one or more of five benefits to the member(s):

- 1.) **Simplified operations.** Depending on where the corporation is chartered and the nature of the business, auditing and accounting procedures are far less demanding. (This is not true of financial service industries, incidentally.) Basically, you'll spend less time doing paperwork.

- 2.) **Simplified reporting.** As you remember from the last chapter, every state has its own reporting requirements, whether or not you actually operate inside that state. Since business activities of an "offshore" corporation rarely take place in the jurisdiction of incorporation, there are generally far fewer reporting requirements. In addition, you most likely won't need to provide much in the way of personal information about your company's director(s) - in other words, yourself.

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- 3.) **Reduced taxation.** Most rules state that a company set up in a particular jurisdiction must pay taxes only on income derived from the local economy – so if you're set up in the Bahamas yet never make any actual money there, you can legally operate tax-free. Basically, the way large multi-national corporations operating in the U.S. do it is to use an offshore company as part of their overall international business structure, then post their profits in the offshore jurisdiction – thereby incurring no tax liability.

- 4.) **Asset protection.** Incorporating in a jurisdiction different from the one in which you actually do business can enable you to shield assets from potential lawsuits and actually keep business transactions out of view from potential competitors.

- 5.) **Personal privacy.** Not only are reporting requirements far less stringent when it comes to personal info on the company's owner(s) and members, many jurisdictions allow you to protect your own identity by appointing proxies for your offshore corporation.

Popular Offshore Jurisdictions

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Most of these are located in the Caribbean, with a handful in Asia. At least one of these jurisdictions – Puerto Rico – actually offers the best of both worlds. An entity can operate under the protection of U.S. law while enjoying many of the benefits of an offshore jurisdiction (see below).

When selecting an offshore jurisdiction in which to incorporate, you'll need to ask yourself several questions, as each jurisdiction has its own set of rules and regulations. For example:

- 1.) How much privacy will you need?
- 2.) Will you be using "Double Taxation" treaties (agreements that allow profits from high-tax countries to be extracted to tax havens as interest, royalty payments or management fees)?
- 3.) In which countries do you intend to do business?
- 4.) Is your company a business, a consulting firm or a financial and investment services provider?
- 5.) How much are you prepared to spend on annual fees?
- 6.) Will you be issuing shares?

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7.)Do you intend to use proxies?

8.)What are your current profits?

9.)What is your capitalization level, and what are the repayment terms?

Your answer to these questions will have a great deal to do with where you choose to set up your off-shore company.

British Virgin Islands

A BVI Corporation can be formed in 3 business days. The main advantage is that only one director or shareholder is required. This can be one and the same person, or it can be another corporation. There is no requirement to appoint local shareholders, directors or a secretary. A BVI Corporation can maintain a bank account in the BVI as well as hold shares of another BVI company. It *may not* carry on business activities with BVI residents, act as an insurer, or initiate any business connected with banks or trusts without special licensing.

Seychelles

This is an island group located in the Indian Ocean just off the east coast of Africa and north of Madagascar. An offshore corporation can be set up in Seychelles faster than almost

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anywhere else – often in as little as one day. Since passage of the International Business Companies Act of 1994 – regulating offshore trusts, offshore banking, offshore insurance, international shipping and aircraft registration – offshore financial services has become the major industry. A Seychelles Corporation requires one director and one shareholder – however, either or both of these may be a natural person or a corporate entity. Local residents may act as proxy directors or shareholders, and corporate meetings may be held anywhere in the world. Legal requirements regarding management structure is possibly the most flexible of anywhere in the world.

Hong Kong

Since the first Portuguese traders arrived in 1513, Hong Kong has been a center of trade and commerce. The former British Crown Colony reverted to the control of the communist government in Beijing in 1997, however the agreement between the U.K. and the People’s Republic of China insures that Hong Kong will remain virtually autonomous and continue to maintain its own systems of law, monetary policy and customs through the year 2047.

If you plan to do any business in Asia at all, you should investigate setting up a Hong Kong corporation. Aside from

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having the least restrictive economy in the world, Hong Kong is virtually the crossroads of Asia with easy access to the Philippines, Indonesia, Singapore, Vietnam, Thailand, Taiwan and the PRC. Taxes are low and the taxation system is much simpler than many other places. In addition, flow of information is virtually unrestricted over a state-of-the-art infrastructure.

Belize

Formerly known as British Honduras, this country offers many of the same benefits of other off-shore locations as far as privacy, taxation and ease of operation. In fact, under Belize corporate law, bookkeeping and annual accounts are not even required! The Belize IBC Registry is fully computerized, and a corporate entity can be formed in as little as an hour.

There are some caveats, however, as the stability of this country may be in question. Although legally an independent member of the British Commonwealth, neighboring Guatemala has long claimed Belize as a province of its own country. As of this writing, the border dispute has yet to be resolved.

In January 2005, there were civil disturbances among the citizens over substantial tax increases in light of government incompetence and corruption. Union employees refused to

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report for work for two days, and citizen frustration boiled over into a violent demonstration in front of the National Assembly Building in Belmopan. It was the third such disturbance in twenty years.

Panama

In Panama, there are no minimum capital requirements – in fact, a corporation may operate without any issued shares whatsoever. You will be required to have three directors, however these do not need to be Panamanian nationals – or even reside in the country, and their information is not public record. A Panamanian corporation must keep a share register as well as a book of minutes, but this too can be located anywhere. There are no income tax returns required, no taxes on capital, and no accounts or summaries that need to be filed with the Panamanian government except for the annual franchise tax, which must be filed by the registered agent. There is also no obligation to hold specific meetings, except as specified by your own company's by-laws .

Cayman Islands

The Cayman Islands are home to the largest offshore banking center on the planet. While the Cayman Islands offer exceptional political and social stability as well as very flexible rules when it comes to incorporation and banking, it is also

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rather expensive to get set up there; licensing fees run from \$500 to \$1750, depending on the size of your company. That said, the Cayman Islands have never had taxes of any sort on income, profits, capital, assets or capital gains. In that respect, a Cayman Islands Corporation is treated exactly like a natural person. In addition, there are few restrictions on corporate freedom or a company's ability to transact any kind of business with anyone, in any part of the globe.

Puerto Rico

As mentioned above, Puerto Rico – as a U.S. Territory – furnishes your business with the protections of U.S. laws while offering almost absurdly low tax rates. The top tax rate in Puerto Rico is 7%; certain “pioneer industries” are taxed at rates ranging from 4% all the way down to zero.⁴ Because it is a U.S. Territory, goods from Puerto Rico are not subject to tariffs, and profits on U.S. sales are tax-exempt. The government of Puerto Rico also offers many incentives, tax credits and deductions, cash grants and other assistance designed to ease the burdens of business and encourage economic growth. Visit the Puerto Rico Federal Affairs Administration website at <http://www.prfaa.com/eng/QuestionsGovE.asp> for additional information, particularly as it relates to high-tech industries.

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Where To Get Started

Again, an online search will bring up over a million different paralegal service providers, willing and eager to help out. Some of the services that will help you incorporate in different states also offer assistance should you want to set up an offshore company. Due diligence is once again necessary, as many of these organizations are of dubious reliability. Even among the reputable ones, fees can vary widely – and are always added *on top* of any and all fees that are charged by the jurisdiction in which you intend to establish a business entity.

If you are determined to set up an offshore company, your best course of action is to consult with an attorney – preferably one specializing in international banking and business laws who is familiar with the jurisdictions in which you plan to incorporate. Such consultation does not come cheap, but is part of the cost of doing business – and is an investment that will save you a great deal of money and headaches up the road.

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Chapter 5 –

Advertising & Marketing Online

The law is a two-edged sword that is (ideally) there to protect you *as well* as your customer. Business and corporate law protects your Internet shop and your assets from liabilities, but it also places certain responsibilities on your shoulders. Boundaries in cyberspace may not be as obvious or as defined, but they *do* exist. Regardless of where you are operating, fraud and deception are still just that – and are treated as such by the Federal Trade Commission.

While more and more companies are doing business and advertising online, the number of shoppers going online is keeping pace. Most legal principles of advertising apply to the Internet as well as radio, TV and print.

The problem is that Internet technology changes on an almost daily basis, and each change brings up new issues. In this final chapter, we'll attempt to cover most of the vital issues that should be considered when promoting an online business.

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Federal Trade Commission Laws and The World Wide Web

What the FTC labels as “unfair or deceptive acts or practices” refers to:

- advertising claims
- marketing and promotional techniques
- general sales practices

These rules are applicable to all forms of communication, from print advertising to live demonstrations. Since the dawn of the Internet Age back around 1994, over 100 legal actions have been taken against on-line businesses allegedly engaged in “unfair or deceptive acts or practices.” FTC issues *rules*, which are clear prohibitions against these acts, and *guidelines*, which are examples designed to help online marketers such as yourself in complying with FTC rules.

Fair Play

The three basic principles of advertising law are no doubt familiar to you, but they bear reviewing:

- Ads must be truthful and contain *no* misleading material

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- The advertiser must provide evidence, or “substantiation” of any claims
- Ads must meet a test for fairness.

Whether you write your own ad copy or hire a professional, you should readily be able to identify any claims of product or service benefits and determine if any express (stated) or implied claims might be misconstrued. Any claims that fall into that category require *disclosure*, or qualifying information.

Disclosures

It may seem unfair to you as an honest merchant or service provider, but legally, you are required to phrase your advertising message in such a way that it absolutely cannot be misconstrued in any way – and failing to do that can leave you or your company liable. Fortunately, compliance is not difficult. A common way to fulfill this obligation is to use disclaimers such as: “Your results may vary,” or “not proven to work for all situations.” It is however your responsibility to determine (A) which claims may require substantiation, and (B) what information should be included in any disclosure.

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Now, it's important to understand that a *disclosure* can only qualify a claim or limit it so your potential customer doesn't receive a misleading impression. It's not a license to make a false claim. If a disclosure completely contradicts your claim, that claim is false and requires modification.

Beyond qualifying claims about a given product or service, a *disclosure* is also required in order to provide your potential client about the terms of the transaction. You'll see good examples of this if and when you start searching online for paralegal help in incorporating your business. The most reputable firms will have a clear statement on at least one of their web pages (and usually more) that goes something like this:

"Fees listed here are in addition to required state or jurisdiction fees."

In other words, while they're shouting to the heavens that "YOU can INCORPORATE in CORPORATE HEAVEN TODAY for only \$99.95!" they're also letting you know beyond all doubt that it will actually cost you more than that.

Which brings us to the next topic: the "Clear and Conspicuous" Rule.

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No Fair Hiding It in Fine Print

FTC rules require that any disclosures be “clearly and conspicuously” displayed in an on-line advertisement. In the old days of early print ads, unscrupulous merchants, service providers and companies used the “fine print” to get around any disclosure requirements, knowing that few people ever read an entire advertisement.

Here, you’ll have to think like your potential customer. Just as almost *nobody* reads every word on a printed page, almost *nobody* reads every single page on a web site. While it can be argued that consumers have control – and even an obligation to control – what material they’re viewing online and in what quantities, the fact is that they’re probably not looking for disclosures. They probably aren’t even expecting to find them, because frankly, they’re searching for an answer to their pain, their problem or their desires. It’s human nature to see that which we want to see and find that which we want to find.

Therefore, the burden is on *you* as the advertiser to place disclosures where your potential customers cannot possibly miss them.

What Constitutes “Clear and Conspicuous”?

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Unfortunately, there is no “one-size-fits-all” solution here. Some creativity and flexibility is required, and the kind of disclosure necessary is going to depend on the information and how it’s presented. Online ads can be text-only, use different kinds of graphics, or even audio and video. The bottom line: disclosures must be crystal clear.

While there are no hard-and-fast rules as to what constitutes “clear and conspicuous disclosure,” there are a few guidelines:

- Disclosures should be placed in reasonable **proximity** to the claim which it is qualifying
- Disclosures should be reasonably **prominent** (easy to see); this refers not only to placement, but to font and choice of colors (high contrast between background and text colors)
- Other elements of the advertisement should not **distract** from the disclosure
- If the advertisement is lengthy, consider whether or not a disclosure bears **repeating** over multiple locations and even pages

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- If audio and/or video is used, disclosures should be ***audible, understandable***, and in the case of video, appear ***long enough*** to be fully read and understood
- ***Language*** used in disclosures should be targeted to the intended audience. For example, if your product or service is aimed at fans of monster truck rallies or the Atlanta Braves, chances are you won't want to use a lot of complex legal terms in any disclosure.

In the next section, we'll look at a series of fictional ads to show how these guidelines can be incorporated (and it's not as tricky as you think).

Disclosures

An entire volume could be dedicated to the subject of disclosures and all the different ways they might be presented, how to ensure they get attention, and more.

While there is no way to be 100% sure your disclosure(s) will be noticed and read, the general rule of thumb is K.I.S.S. (Keep It Simple, Silly). By studying the above examples and combining creative thinking with good study and analysis of your website as to which pages are getting the hits and how traffic flows through your site⁵, you can be *almost* 100%

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certain that your disclosure messages are receiving the required attention.

Although it may seem self-evident, it should nonetheless be pointed out that the requirements for disclosures also apply to any expressed warranties as well as terms of sale (i.e. return/refund policies). These are typically hyperlinked – in which case, they need to be prominent and clearly labeled for what they are. In addition, they need to be viewable *prior to sale* and have “printer-friendly” options. The reason of course is to give the customer access to this material while making the decision to buy, or while comparison shopping.

These guidelines are also *extremely important* if you run some type of subscription service with a “negative option plan” – in other words, you’re going to continue to charge their credit card or other payment account until the buyer notifies you in writing to discontinue. In this case, you have a legal obligation to notify in writing up front and prior to initial sale of such conditions that include:

- A) the amount of the recurring charge
- B) the monthly date of the recurring charge
- C) the procedure and conditions for discontinuing

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Additionally, e-mail communication should be used each month to remind the customer of the impending charge, identifying your company, what merchandise or subscription is being shipped or charged for, and when the customer can expect to receive the merchandise or be able to access their subscription. You will need to put this information into the subject heading; additionally, you may need to advise your customers on your site to adjust any "spam" filters they may have so your notices do not get routed to a "bulk mail" folder and disregarded.

Direct Marketing

Before wrapping everything up, we're going to take a look at FTC rules and guidelines when it comes to direct marketing.

Direct marketing refers to a range of targeting advertising techniques. In the "old" (pre-Internet) days, direct marketing techniques consisted primarily of direct mail (the "junk mail" that clogs your inbox) and everyone's favorite, telemarketing.

Today, direct marketing on the Internet is primarily through one of two ways:

- 1.) Targeted ads
- 2.) E-mail

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Targeted Ads

Targeted ads use sophisticated algorithms and “data mining” software (sometimes called “spyware”) to analyze browser “cookies” - the little bits of data left on people’s hard drives by websites they have visited. This analysis can usually provide a pretty good picture of what kinds of websites the surfer visits and give a good indication of his or her tastes, needs and/or desires

For example, if the data analyzed in a surfer’s cookies indicated that they had visited a number of haberdasheries online, the software used in targeted advertising might bring up a banner ad for a line of hats you’re selling. Hopefully upon seeing the banner, the surfer will click your banner ad and come to your site.

While this type of marketing can be very effective, it’s also very expensive. First, it usually requires an expert to set it up. Secondly, high-traffic digital property can be very expensive when it comes to renting ad space. The problem however is that targeted advertising of this type is really only effective when used on high-traffic sites.

Direct Email

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E-mail marketing and solicitations have become a huge issue in recent years, and a number of laws regarding the practice of “spamming” (sending out unsolicited e-mail advertisements) are now on the books in several states. In fact, while being unethical, it really isn’t effective and indeed may very well have the opposite effect of what is intended. In any event, reputable businesses no longer engage in this practice, if they ever did.

Since “spam” specifically refers to “unsolicited email advertisements,” it begs the question of just how an honest merchant is supposed to promote his or her wares and/or services without having to shell out for expensive targeted ads or search engine optimization. The good news is that there are affordable and low-cost options out there, although they have varying degrees of effectiveness.

There is a single legal loophole to all the “spam” rules: you may legally send *a single* (1) unsolicited email to any address, which *must* contain a notice similar to this example:

“This is a one-time communication. No further information will be sent to you at this email address regarding this (product/service) unless you specifically request it by replying to info@mybiz.com.”

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That way, it puts the customer in control, and absolves you from any formal spam complaints. You should also be aware that even if a potential client chooses to receive mail from you, your messages must legally contain an "opt-out" link or a reply-to address the recipient can use to unsubscribe from any mailings.

Purchasing "Opt-In" Lists

Several companies will provide lists of "leads" – names and emails (often along with telephone numbers and addresses) in groups of 500 – 50,000. These can run anywhere from .25¢ to as low as .02 per name and email address. These are people who have "opted-in" – that is, given permission – to receive emails about a particular product, service or opportunity. These lists can be very focused, but because of "free" email accounts that many people change as regularly as their stockings, they may not always be the most effective choice. If you have the money and an auto-responder set up however, it can be as good a way to get started as any.

Create Your Own Opt-In List

There are several ways to do this. If you have a sizeable budget for prominent banner ads and/or other ways to drive traffic to your site, it's a simple matter to set up a link on your home page where people can choose to receive more

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information about your product or service. An even better way to do this is to offer customers the opportunity to receive a **FREE** subscription (make sure to use the word FREE – it's a powerful one) to an informational e-newsletter. If such a newsletter is of sufficiently high quality and provides something of real value, chances are your customers will forward them on to their friends – doing a lot of your advertising for you!

If you can't afford prominent ad space or optimization services, a good way to develop a list is to join an online group, listserv or BBS that is oriented toward people who have an interest related to whatever it is you're offering. These are usually free to join, and as a member of a group, you have the privilege of emailing all members. One caveat: unless the group is specifically set up for it or allows it, do *not* blatantly promote your goods and services. It's okay to mention that you deal in these things, and you may (and should) certainly invite people to subscribe to your newsletter, but blatant attempts to market to the group will probably land you in trouble and incur a good deal of negative feelings.

In General...

While the Internet provides some of the most awesome opportunities for commerce the world has yet seen, today's

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consumer is more jaded than ever. Nothing will erode consumer confidence in this still relatively-new medium than repeated deception and outright fraud. Technology can offer some protection for consumers, but as in all things, what can be used will invariably be misused – and there are numerous technologies (with more being developed all the time) that make fraud easy to commit and difficult to detect. Therefore, it is still up to individual flesh-and-blood human beings to form the front line of defense against illegal and unethical business practices – because when consumers lose confidence in the marketplace, *everyone* loses.

Federal Trade Commission rules regarding e-commerce are constantly changing to keep up with advances in technology. In addition, many existing FTC rules – such as those governing telemarketers – may be applied to email marketing. As a businessperson, you should visit the Federal Trade Commission website periodically for the latest guidelines (<http://www.ftc.gov>).

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Chapter 6 –

Conclusion

By now, you should be thoroughly aware that there are basically two sets of laws in the United States – one set designed to protect business interests, and the other set that protects the interest of the consumer. Although it may seem currently that business (especially Big Business) holds all the cards, the fact is that the law takes a dim view of deceptive advertising practices. The first set of laws – that which protects business – has also been much more subject to change throughout history. Three times in U.S. history – the “Gilded Age” of the 1880’s and 1890’s, the “Roaring” 1920’s, and the current period of deregulation that began around 1980 – Federal law regarding corporate business has been tilted far in the direction of favoring business and management. At other times – most recently during the Theodore Roosevelt Administration (1900 – 1908) and again between 1935 through the late 1970’s – the laws were tilted the other way, favoring labor and consumers. If public sentiment is any indication and if Congress responds to public

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pressure, laws may tilt yet again – though when this may happen and to what degree is anyone’s guess.

The point here is that corporate, tax and business law is in an almost constant state of flux. This is one reason it’s a good idea to consult with professionals prior to forming a business entity.

Laws and regulations pertaining to advertising and marketing practices also change and evolve frequently – especially in response to technology. However, in most cases these laws have always favored the protection of the consumer, and continue to do so.

There was a time in the U.S. when receiving a corporate charter obligated the entity in question to serve the public good in some way in exchange for asset protection and immunity from liability. Although this is not currently a requirement, many smaller corporations being formed today are voluntarily adding a component of “social responsibility” to their operations. This may be as simple as providing some type of free service to the community, supporting the local community by favoring local and domestic industries in business-to-business transactions, engaging in fair and sustainable trade practices, investing in employees, and more.

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While such practices may cut into your short-term profit margins, they are investments that will pay off quite handsomely in the long run, creating a solid, stable business that will provide a good livelihood for you and your family for decades. You'll enjoy greater loyalty from a wider client base and a community – online and off – who will lend you consistent support and strengthen your business.

In conclusion, despite the seeming complexity of laws, rules and regulations, building a successful, long-term business requires little more than following a few rules of thumb:

- Play fair.
- Stand behind your product or service.
- Support those who support you.
- Under-promise and over-deliver.

That way, even if you miss dotting the occasional "i" or crossing the periodic "t," you'll weather the worst of storms – and enjoy smooth sailing when conditions are right.

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