

Business Formation Considerations

Selecting a corporate structure for an Unconventional Learning Environment (ULE) is an important decision for education entrepreneurs. This decision will not only impact potential liability in the future, but it will also affect operations, management, and taxes. The information below is neither intended to be, nor is it a substitute for, legal advice from a local attorney. It is, however, designed to be a helpful overview of business formation considerations relevant to ULEs.



1. State Incorporation (Business Entities)

The Arkansas Secretary of State offers [guidance](#) for new businesses, including a “Doing Business in Arkansas” handbook to help guide entrepreneurs in making business formation decisions.

One of the advantages of a ULE forming a business entity is limiting the personal liability of organizational leadership. When a ULE forms as an entity under state law, the ULE is viewed as a distinct entity in the eyes of the law. This means that if a legal complaint is filed against the ULE, the personal liability of leadership of the ULE will be limited. If an ULE is not an entity formed under law, leadership are far more likely to have personal liability for damages that may occur during the operation of the ULE. (An ULE does not have to incorporate, it may be an LLC, in which case there are no directors, they are “members”)

It is important to note that ULEs are not required to be an entity formed under state law to offer educational services. For example, ULEs may operate as a sole proprietorship or an unincorporated association. However, in such cases, leaders will carry a higher risk of liability.

ULE's may also consider forming a private membership association where participants in the ULE join as members and receive contractual services offered by the association to simplify regulatory burdens. Before forming a private membership association, educational entrepreneurs should seek the advice of competent legal counsel to understand the risks and advantages to such an arrangement.

Prior to forming a business entity, ULEs should think about liability issues and plan out the goals of the corporation in order to decide the what type of entity the ULE should be.

In addition to forming a corporation with the state of Arkansas, ULE organizers should consider federal non-profit recognition.

Business Structures:

(AR Secretary of State)

- Sole Proprietorship
- Partnership
- General Partnership
- Limited Liability Partnership
- Limited Partnership
- Limited Liability Limited Partnership
- Corporation
- S Corporation
- Limited Liability Company
- [Nonprofit Corporation](#)
- Commercial Registered Agent
- Nonfiling/Nonqualifying Entity

2. Federal 501(c)(3) Nonprofit Recognition:

ULE's that have an educational, religious, literary, or charitable purpose (an exempt purpose) may receive an exemption from federal income tax if they are recognized by the Internal Revenue Service (IRS) as a nonprofit organization, which can reduce taxes and other expenses. A ULE that is a 501(c)(3) organization is also eligible to receive donations that are tax-exempt.

A 501(c)(3) organization cannot, however, be organized or operated for the benefit of private interests, and an entity's earnings may not inure to the benefits of any private owner or individual. This does not mean a 501(c)(3) organization cannot make a profit. But it does mean that the profits may not be used for the benefit of private interests or individuals. So seeking 501(c)(3) recognition is probably not the best option for entrepreneurs who are seeking to personally enjoy some profit for the services provided.

It is worth noting that although 501(c)(3) is the most commonly known federal tax exempt status, there are other types of organizations that qualify for exemption from federal income tax. The IRS provides helpful guidance on applying for federal tax-exempt status.

Failure to comply with federal non-profit requirements may result in the loss of non-profit status and additional tax liability. A 501(c)(3) organization is also prohibited from engaging in certain political and/or lobbying activities. Federal 501(c)(3) recognition does not eliminate or replace state-level incorporation requirements or taxes.

To accommodate the vast number of entities choosing to file for 501(c)(3) status with the IRS, the Arkansas Secretary of State provides a blank template with suggested IRS language as well as the traditional nonprofit articles of incorporation templates. If the nonprofit corporation intends to solicit charitable contributions, it must also register as a charitable entity with the Arkansas Secretary of State's office which can be done by going here: Charitable Entities.

While there are many benefits to federal 501(c)(3) recognition, there are also reasons some ULE's may choose not to apply. For example: It takes significant time and money to file and to maintain federal 501(c)(3) status as a nonprofit. It is also possible to be a nonprofit in the state of Arkansas without obtaining federal tax-exempt status. Depending on the goals of the ULE, it may or may not be worth the effort and expense.

3. Business Licensing

The state of Arkansas does not require a general business license. However, Arkansas Code Title 26 generally permits counties and municipalities to enact business license taxation. See ACA 26-77-102 generally. New businesses should research what kind of business licensing requirements may apply to the business areas relevant to their location and type of business or organization. For example, many localities require a general business license and if an ULE meets the definition of a childcare center, defined above, it may be required to apply for a state license in this area before operating and follow the various regulations related to fire safety codes and building safety.

There is not, however, a specific business license that is a prerequisite for providing instruction in an ULE.

To find your local government office, check the [Arkansas' Local Government Portal](#) for helpful resources and contact information. Local government websites may offer online business licensing. Otherwise, mailing an application to the city clerk or county recorder may be required.

4. State Tax Considerations

An ULE that is receiving income or making sales should consider the tax implications. The classification of a business entity for purposes of taxation may be a different classification than the corporate structure of the business entity. For example, the owner of a single-member LLC may simply pay business taxes as an individual by filing an additional form with their personal taxes.

Income Taxes

Arkansas nonprofit corporations can apply for state corporate tax exemption by sending the articles of incorporation, bylaws, and a completed version of [Form AR1023CT](#) to the Corporation Income Tax Section of the Arkansas Department of Finance and Administration. [Ark. Code § 26-51-303](#).

Sales Taxes

There is no general tax exemption for sales made to Arkansas nonprofit corporations. "The gross receipts or gross proceeds derived from sales of tangible personal property or services to churches or charitable organizations are not exempt from tax unless the items purchased are for resale by the church or charitable organization." To claim the sale-for-resale exemption, a church or charitable organization must have either: (1) a resale certificate or (2) a letter opinion issued by The Arkansas Department of Finance and Administration certifying that it is a church or charitable organization and that it intends to resell the items purchased. [Ark. Admin. Rules § 006.05.06-005-GR-39\(B\)](#).

Churches or charitable organizations are, however, exempt from tax on the gross receipts or proceeds from the sale of tangible personal property or services unless the organization is engaged in a business for profit or the organization is selling new tangible personal property and their sales compete with sales made by for-profit businesses. [Ark. Admin. Rules § 006.05.06-005-GR-39\(A\)](#).

Property Taxes

All buildings belonging to institutions of purely public charity, together with the land actually occupied by these institutions, not leased or otherwise used with a view to profit, and all moneys and credits appropriated solely to sustaining, and belonging exclusively to, these institutions are exempt from property taxation. [Ark. Code § 26-3-301](#).

5. Staffing Considerations

ULEs commonly hire teachers and tutors and utilize the services of volunteers. There are various legal issues to consider when working with paid or volunteer staff. The following sections summarize some important legal issues in this area of staffing.

Volunteers and the Fair Labor Standards Act

The FLSA generally prohibits individuals from volunteering in commercial activities run by a non-profit organization (such as a gift shop). Additionally, paid employees of a non-profit organization cannot volunteer to provide the same type of services to their non-profit organization that they are employed to provide.

The Department of Labor provides more information on the FLSA and volunteers that should be reviewed before relying on volunteer labor. To determine whether the FLSA applies to a particular ULE, refer to the Department of Labor's Coverage and Employment Status Advisor.

Employee vs. Independent Contractor

Many ULEs will pay teachers or tutors to assist with instruction. Are these staff members independent contractors or employees? This is a common question, and getting it right is critical as a misclassification could cost the ULE. Failure to appropriately classify staff can lead to significant tax liability and other regulatory issues that can lead to the demise of an ULE. The Internal Revenue Service (IRS) provides a helpful Worker Classification 101 and helpful guidance, entitled: Independent Contractor (Self-Employed) or Employee?

An ULE is legally obligated to withhold taxes (income, social security, and Medicare) from an employee's pay in addition to paying a portion of social security, Medicare, and unemployment taxes for the employee. For an independent contractor, by contrast, none of this tax withholding is required since the independent contractor is responsible for paying their own taxes as an independent business.

While there are obvious financial benefits to treating all teachers and tutors in an ULE as independent contractors, care should be exercised prior to reaching this conclusion.

A central factor in this analysis is control. If the ULE controls what will be done and how it will be done, the teacher or tutor will generally be considered an employee. The more control the ULE has over the teacher or tutor's work, the more likely they are rightly considered an employee. Another evidence of control is the right to discharge the teacher or tutor. In other words, if the teacher or tutor can be discharged at the will for any reason, they are more likely to be classified as an employee rather than an independent contractor.

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Another consideration for ULEs to be aware of is that minimum wage and overtime protections in the Fair Labor Standards Act (FLSA) apply to employees but not independent contractors. The Wage and Hour Division of the Department of Labor is responsible for determining whether an employee has been denied these benefits due to misclassification. Rules and resources from the Division may be consulted as well.

The Arkansas Code was amended in 2019 to codify the IRS' twenty-factor test for determining the employment status of an individual. This means that an employer charged with determining the employment status of an individual must use the following twenty factors when making a determination:

1. A person for whom a service is performed has the right to require compliance with instructions, including without limitation when, where, and how a worker is to work;
2. A worker is required to receive training, including without limitation through:
 - a. Working with an experienced employee;
 - b. Corresponding with the person for whom a service is performed;
 - c. Attending meetings; or
 - d. Other training methods;
3. A worker's services are integrated into the business operation of the person for whom a service is performed and are provided in a way that shows the worker's services are subject to the direction and control of the person for whom a service is performed;
4. A worker's services are required to be performed personally, indicating an interest in the methods used and the results;
5. A person for whom a service is performed hires, supervises, or pays assistants;
6. A continuing relationship exists between a worker performing services and a person for whom a service is performed;
7. A worker performing a service has hours set by the person for whom a service is performed;
8. A worker is required to devote substantially full time to the business of the person for whom a service is performed, indicating the person for whom a service is performed has control over the amount of time the worker spends working and by implication restricts the worker from obtaining other gainful work;
9.
 - a. The work is performed on the premises of the person for whom a service is performed, or the person for whom a service is performed has control over where the work takes place.
 - b. A person for whom a service is performed has control over where the work takes place if the person has the right to:
 - i. Compel the worker to travel a designated route;
 - ii. Compel the worker to canvass a territory within a certain time; or
 - iii. Require that the work be done at a specific place, especially if the work could be performed elsewhere;
10. A worker is required to perform services in the order or sequence set by the person for whom a service is performed or the person for whom a service is performed retains the right to set the order or sequence;
11. A worker is required to submit regular oral or written reports to the person for whom a service is performed;
12. A worker is paid by the hour, week, or month except when he or she is paid by the hour, week, or month only as a convenient way of paying a lump sum agreed upon as the cost of a job;
13. A person for whom a service is performed pays the worker's business or traveling expenses;
14. A person for whom a service is performed provides significant tools and materials to the worker performing services;
15. A worker invests in the facilities used in performing the services;
16. A worker realizes a profit or suffers a loss as a result of the services performed that is in addition to the profit or loss ordinarily realized by an employee;
17. A worker performs more than de minimis services for more than one (1) person or firm at the same time, unless the persons or firms are part of the same service arrangement;
18. A worker makes his or her services available to the general public on a regular and consistent basis;
19. A person for whom a service is performed retains the right to discharge the worker; and
20. A worker has the right to terminate the relationship with the person for whom a service is performed at any time he or she wishes without incurring liability.

(Ark. Code § 11-1-204)

6. Insurance Needs

Each ULE is unique, so individual group insurance needs will vary depending on the nature of the ULE. While nonpublic schools are not required to purchase insurance, the following insurance options will help ULEs to ensure they are adequately protected:

- Directors and Officers Insurance: covers legal costs for board members or executives in the case of personal liability.
- General Liability Insurance: covers legal fees and settlements in the event of a lawsuit.
- Property insurance: covers any buildings, equipment, or other property in the event of a fire, natural disaster, theft, and other kinds of unforeseen events that cause damage to property.
- Data Breach and Cyber Liability Insurance: covers costs of litigation and settlement if there is a cyber security or other data breach.
- Worker's compensation: covers employees who get hurt on the job.
- Umbrella insurance: provides supplemental coverage for situations where other kind of insurance are insufficient to cover damages or costs.
- Abuse or Molestation Coverage: provides payment for related costs outside general policy limits. When operating an education environment, having an insurance rider that covers potential abuse or molestation should be a consideration. Not all carriers provide this so an edupreneur should inquire whether this coverage is available from any particular carrier.

An ULE that has three or more employees must generally have worker's compensation insurance. Every employer must "secure compensation to its employees" for compensable injuries "arising out of and in the course of employment without regard to fault as the cause of injury." Ark. Code § 11-9-401.

Though, there are some limitations. The definition of "employment" is limited to where "three (3) or more employees are regularly employed by the same employer." And it excludes a person performing services for a nonprofit religious, charitable, or relief organization. Ark. Code §11-9-102. Frequently Asked Questions on worker's compensation can be reviewed here.

Visit the Arkansas Insurance Department for official state information or to find a licensed insurance agent or a licensed insurance company.

Please note that the yes. every kid. foundation. Edupreneur Support Program does not offer legal advice. Our focus is to provide encouragement, insight, and information on navigating regulations and statutes impacting your work.