

## Employment Law Compliance for Start-Ups

Before you press "go" to launch your next business idea, as a founder and entrepreneur of a start-up company you should address an important (if uninspiring) step: employment law compliance. Complacency now can turn into an expensive distraction later, with the potential to create surprise liabilities and maybe even scuttle future deals. This alert flags core employment law issues every start-up should tackle now so they don't snowball later.

### I. Onboarding Compliance Checklist

Before work can begin, employers must check an ever-growing number of compliance boxes:

- **Register to Do Business:** Register your company in each state where you have employees (e.g., the local departments of tax, labor, state, etc.).
- **Workers' Compensation and Unemployment Insurance:** Obtain both in each state where you have employees.
- **New Hire Reporting:** Report new hires to the state (required by federal law).
- **Form I-9:** Verify employment eligibility within three business days.
- **Payroll Forms:** Obtain W-4s and state tax withholding forms, direct deposit forms, etc.
- **Notices and Posters:** Provide all required federal, state, and local notices at hire and post them in the workplace.
- **Background Checks:** If used, comply with federal, state, and local requirements.
- **Employee Handbook:** Prepare a handbook covering core policies and obtain acknowledgments from new hires.
- **Training:** Provide anti-harassment and other trainings, where required.
- **Statutory Leave:** Determine statutory leave and benefit requirements (including insurance requirements).
- **Discretionary Benefits:** Decide what benefits to offer, such as health insurance, retirement/401(k), and parental leave.

### II. Key Initial Worker Compliance Decisions

#### Worker Classifications

**Employee vs. Contractor.** Misclassifying employees as independent contractors creates legal exposure for back wages, overtime, penalties, unpaid withholding and payroll taxes, benefits, and lawsuits. Whether a worker is an employee or contractor depends on legal tests, not preferences. Legal tests typically fall into two buckets:

- **Common law right to control test.** Examines factors like degree of control over work, whether the worker uses their own tools, opportunity for profit or loss, and whether the worker serves multiple clients.
- **ABC Test.** The employer must establish that the worker (A) is free from control and direction, (B) performs work outside the usual course of the company's business, and (C) is customarily engaged in an independent trade or business.

The "reality on the ground"—not the words in a contract—controls, and employers bear nearly all risk for misclassifications.

**Exempt vs. Non-Exempt.** Whether an employee is "exempt" from overtime depends on federal and state law. To qualify, the employee must meet three requirements:

- **Salary Basis:** Paid a predetermined amount that does not vary based on hours worked.
- **Minimum Salary Level:** Earns at least the applicable threshold (e.g., \$1,275/week in New York City).
- **Exempt Duties:** Performs primarily exempt duties as defined by the regulations.

Non-exempt employees must be paid at least minimum wage for all hours worked and overtime at 1.5x their regular rate for hours over 40 per week (under federal law, some states require more than a 1.5x regular rate of pay in certain situations).

### **Multi-State and Remote Work Compliance**

The jurisdiction where work is performed generally determines compliance obligations. Hiring a remote employee in another state can unexpectedly trigger new compliance requirements in that other state, such as:

- Registering to do business and withhold state and local taxes
- Obtaining workers' compensation coverage
- Registering for state unemployment insurance (and other mandatory insurance / leave benefits)
- Complying with that state's wage-and-hour laws
- Providing state-mandated notices and posters

The burden of multi-state compliance is one of the factors that should be considered when deciding whether to hire remote workers. Companies should also track where current employees work (including on hybrid remote work days) to avoid surprises down the road.

### **Compliance Solutions: Go It Alone or Use a PEO**

Some start-ups handle these compliance obligations in-house while others partner with a Professional Employer Organization (PEO) to manage payroll and HR complexity. A PEO enters into a co-employment arrangement, becoming the employer of record for payroll, benefits, and certain compliance functions while the client company retains day-to-day supervision over the worker. The standardized processes and procedures of a PEO may help facilitate compliance in general, but in some situations may result in a trade-off in terms of flexibility for customized or bespoke processes (where that is needed by the company).

## **III. Protect Yourself from Unfair Competition**

### **Intellectual Property**

Start-ups should require every employee and contractor to sign a Proprietary Information and Invention Assignment Agreement (PIIA) at or before their start date, covering assignment of work product, cooperation in securing intellectual property (IP) rights, and return of materials upon separation. Some states limit the allowable scope of work product and IP assignment or may require specific notices or disclosures.

### **Confidentiality**

Using clear confidentiality provisions that define confidential information and establish need-to-know access can be helpful for protecting a start-up's proprietary data, trade secrets, or client lists. Be mindful, however, of required carveouts under the Defend Trade Secrets Act and state laws, such as New York's limits on confidentiality agreements covering discrimination, harassment, and retaliation claims.

## Non-Competes and Non-Solicits

Non-competes can help protect a company's investment in training employees, safeguard proprietary business methods, and prevent competitors from gaining an unfair advantage through departing employees. However, in some states, non-competes are heavily restricted or outright banned. In highly regulated states, laws often include technical requirements like advance notice and salary thresholds for the imposition of a non-compete clause. Even in states that do not regulate non-competes by statute, courts enforce them only if reasonably tailored in scope, geography, and duration. Customer/client non-solicits can be useful in protecting established business relationships and preventing departing employees from diverting clients to a competitor (though they are increasingly treated like non-competes for enforceability purposes). Finally, employee non-solicitation provisions can protect start-ups from "talent poaching" and generally trigger less scrutiny than other types of restrictive covenants.

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## Conclusion

Employment law compliance is not glamorous, but it is essential. The good news is that most issues are manageable with the right vendors, clear policies, and early legal guidance.

Patterson Belknap has a multi-disciplinary team of lawyers who are focused on the legal needs of founders and entrepreneurs. A description of the full range of our services and attorney contacts can be found [here](#). Please visit the [Founder Focus Resource Center](#) for more content on a broad range of topics of interest to founders and their professional advisors.

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