

**U.S. LEGAL & REGULATORY COMPLIANCE:
AN OVERVIEW OF THE CHALLENGES AND
BENEFITS FOR SMALL BUSINESSES**

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Abstract

From LED neon signs to plastic poster displays, “Open for business” is among the grand opening taglines small business owners use to attract consumers. While this may be a popular display, staying in business should indirectly become the focus element thereafter. Given the numerous government regulations small businesses are required to follow, both challenges and opportunities may arise in terms of compliance. The complexity of laws regulating business activities and the direct costs of staying up-to-date with constant regulatory changes are among the challenges small business owners face. Non-compliance continues to also have adverse effects for small businesses that do not adhere to regulations, including monetary penalties and resources used to regain compliance and to remain open for business.

Every year, there are new regulations that directly apply to small businesses whether in obtaining a business license or paying local, state, and federal taxes. Consequently, small entities should seek to understand the regulatory laws and implement a solid mechanism for effective compliance management. In addressing

the regulatory laws and implement a solid mechanism for effective compliance management. In addressing compliance problems, this study offers a practical approach to effective regulatory compliance management. Ultimately, the goal of compliance is not to drive away small businesses, rather to provide different opportunities in promoting safe business practices.

Regulatory compliance is composed of a set of guidelines, standards, and procedures that applies to the operations of a business organization.¹ Lawmakers authorize regulatory agencies to enact, enforce, and adjudicate the law through regulations and standards.² Regardless of industry variations, most, if not all small businesses are required to comply with local, state and/or federal government regulations. A lack of systematic review of the regulatory process does not negate the responsibilities that small businesses have to comply with the law. Hence, keeping abreast of the regulations governing a specific small business organization will help ensure compliance and reduce or eliminate the financial burdens resulting from noncompliance.

The Small Business Regulatory Enforcement Fairness

¹ *Stay Legally Compliant*, U.S. Small Business Administration, <https://www.sba.gov/business-guide/manage-your-business/stay-legally-compliant>, (last visited April 12, 2022).

² *Id.*

Act of 1996 (SBREFA)³ was enacted to provide small business entities a more comprehensive view of federal regulations and promote active participation in the regulatory process. At the time this legislation was enacted, mounting concerns within the small business sector signaled to lawmakers that federal regulations were overly complex in language, numerous, but also costly to implement. Under SBREFA, federal agencies are required to assist small businesses in complying with regulations and develop programs to address small business inquiries.⁴ Today, the Environmental Protection Agency (EPA), Occupational Safety and Health Administration (OSHA), Food and Drug Administration (FDA) are among the major U.S. Federal regulatory agencies. In the restaurant industry, for example, OSHA enforces regulations to protect the health of consumers and workers. In this way, restaurants must comply with the safety measures prescribed to remain in business. The EPA is responsible for safeguarding the environment and protecting human health. The EPA also works with local agencies to ensure construction businesses follow the right permits and authorizations for building sites.⁵ Although regulatory agencies are responsible for enforcement of applicable regulations

³ S.942 - 104th Congress (1995-1996): *Small Business Regulatory Enforcement Fairness Act of 1996*, s.942, 104th Cong. (1996), <https://www.congress.gov/bill/104th-congress/senate-bill/942/text>, (last visited April 12, 2022).

⁴ Id.

⁵ *Environmental Protection Agency*, USA.gov, <https://www.usa.gov/federal-agencies/environmental-protection-agency> (last visited April 12, 2022).

and statutory law, every small business entity has a shared responsibility to understand and comply with the regulations established.

Due to the evolving regulatory environment, complex terminology, compliance costs, and added regulations emerge as part of the challenges faced by small businesses. In addressing those challenges, a small business should not treat regulatory compliance only as a quick fix to mitigate business risk. Instead, a small business should conduct a thorough analysis of regulatory laws that relate to and that may impact its operations. Subsequently, internal procedures or a compliance management system can promote an understanding of current regulations and assist in avoiding the pitfalls of noncompliance. However, those procedures should not become a passive checklist of compliance obligations. This is an on-going process that requires an active interest in the laws that affect a given business industry.⁶

Small Business: The Definition and Context

As defined in the U.S. Code, Title 15 Chapter 14A § 632, businesses that are classified as “small” are independently owned and operated entities that are not dominant in their industries.⁷ To determine which

⁶ Mar Pérezts & Sébastien Picard, *Compliance or Comfort Zone ? The Work of Embedded Ethics in Performing Regulation*, 131 *Journal of Business Ethics* 833-852 (2015), <https://www.jstor.org/stable/24703644>, (last visited April 12 2022).

⁷ 15 U.S.C.A. § 632

businesses qualify for this classification, a set of criteria such as size standards are considered in the application process. The Small Business Association (SBA) is the federal agency responsible for size classifications, under the North American Industry Classification System (NAICS). In distinguishing small businesses from larger firms, the SBA look at the degree of competition in the market as well as entry barriers to assess their overall economic impact.⁸ Although this may vary from industry to industry, establishing size standards considers:

1. The average number of employees
2. The average annual receipts⁹

In calculating the number of employees, the SBA considers any person that is hired part-time, full time or another employment basis. Receipts are revenues that the business received or accrued from its operations averaged on an annual basis. Size standards are important in determining which businesses meet the requirements for federal contracting programs, loans, and other government benefits.¹⁰ Size standards are based on either average number of employees or annual receipts of a small business. For instance, the number of employees in a manufacturing and mining enterprise should not exceed 500, meanwhile the average revenue

⁸ Id.

⁹ *Size Standards*, U.S. Small Business Administration, <https://www.sba.gov/federal-contracting/contracting-guide/size-standards>, (last visited April 12, 2022).

¹⁰ *Small Businesses and Enforcement*, United States Environmental Protection Agency, <https://www.epa.gov/enforcement/small-businesses-and-enforcement>, (last visited April 12, 2022).

in the crop production industry enterprise should not exceed \$1.0 million. To determine eligibility for small business identification, business owners can review the NAICS code for their area of business and size standards, as outline by the Small Business Administration. *See*, Table 1.

Table 1. Examples of Small Business Size Standards by NAICS Industry¹¹

NAICS Code	NAICS U.S. industry title	Size standards in millions of dollars	Size standards in number of employees
Sector 11 - Agriculture, Forestry, Fishing and Hunting			
111110	Soybean Farming	\$1.0	
111120	Oilseed (except Soybean) Farming	\$1.0	
111130	Dry Pea and Bean Farming	\$1.0	
Sector 21 - Mining, Quarrying, and Oil and Gas Extraction			
211120	Crude Petroleum Extraction		1,250
211130	Natural Gas Extraction		1,250
Sector 22 - Utilities			
221111	Hydroelectric Power Generation		500
221112	Fossil Fuel Electric Power Generation		750
Sectors 31-33 - Manufacturing			
311811	Retail Bakeries		500
311812	Commercial Bakeries		1,000

¹¹ 13 C.F.R. § 121.201, *What size standards has SBA identified by North American Industry Classification System Codes?*, <https://www.ecfr.gov/current/title-13/section-121.201>, (last visited April 12, 2022).

Regulatory Compliance in Business Practices

Compliance when effectively enforced can yield various positive outcomes in business practices. Regulatory government agencies and small businesses are both major players in achieving enforcement results. For instance, the Internal Revenue Service (IRS) provides different guidelines to ensure that small businesses submit payroll taxes for employees and report their quarterly taxable earnings. With active implementation and participation from all the stakeholders, regulatory compliance helps:

- Ensure safe business practices between small businesses, employees, and consumers
- Maintain accountability and transparency in business transactions
- Promote fair dealings and ethical behaviors
- Help establish consumer trust and strong business reputation
- Protect small businesses against future liabilities and suits¹²

Compliance Challenges for Small Businesses

Complex regulatory processes can create challenges for new and existing small businesses. Often, business owners do not know where to access information relating to existing or new regulations or simply do not actively engage in the compliance system. When small

¹² Id.

businesses view compliance as a list of daunting obligations, there is more friction in the implementation phase, thus leading to undesirable regulatory outcomes such as penalties, fines, and other enforcement remedies. Local, state, and federal agencies are empowered to interpret federal law, to create regulations that have the effect of the law, and to investigate and adjudicate violations of the law. Thus, for small businesses, the first interaction with regulatory compliance matters will be with a governmental agency and the law within its jurisdiction. Small businesses face various compliance challenges including interpreting complex legal language, managing rising compliance costs, and staying current with an ever-changing regulatory environment.

A. Complex Legal Language

At the federal level, new regulations are published in the Code of Federal Regulations (C.F.R.),¹³ an official guide that contains regulations enacted by the federal government. This is a starting point for a small business to acquire a basic understanding of the legal terminology applicable to its industry. Complex legal language presents a challenge for small businesses in terms of its technicality. “Technicality is a function of the finesse of the distinctions a rule makes, the specialized terminology it employs, and the redefined substantive

¹³ <https://www.ecfr.gov/>

judgments it requires”.¹⁴ In attempting to understand the law and other various rules, small business owners often find the regulatory process advanced in technical terms and demanding expertise in the law or, at the very least, assistance from a legal professional.¹⁵ While any small business should have access to a legal professional, fees and costs increase compliance costs. Often, small business owners perceive regulations as lengthy documents with complex language. Typically, small businesses must stay abreast of different areas of the law, including employment law, environmental law, labor law, tax law and other pertinent laws that vary by industry. This increases the challenges of compliance because legal terms and provisions used in, for example, the healthcare-related industry are different from the automotive or manufacturing industries. However, there are some common legal terms that apply across industries including “liability”, “negligence”, “malfeasance”, “alternative dispute resolution”, to name a few.

Comparatively, administrative agencies educate small businesses on how to remain compliant. Many agencies provide educational resources both in print and digital versions. For example, the EPA hosts a website containing current information related to laws and regulations by business sector. The EPA offers other printed materials including manuals, policy statements, interpretive memoranda, and bulletins for further

¹⁴ Peter Schuck, *Legal Complexity: Some Causes, Consequences, and Cures*, Duke Law Journal, vol. 42, no. 1, 1992, pp. 4, <https://doi.org/10.2307/1372753>, (last visited April 12, 2022).

¹⁵ *Id.*

guidance on compliance.¹⁶ The SBA also helps small businesses comply with federal laws by assisting with compliance issues and responding to inquiries relating to federal regulations. In other instances, legal rulings require a more thorough understanding, thus small businesses must allocate additional resources to receive assistance from lawyers, industry experts, and accountants. The average costs of a small business lawyer can range from \$150 to \$1,000 per hour in larger cities including New York and San Francisco.¹⁷ Consequently, small businesses have increased regulatory cost burdens directly associated with compliance.

B. Compliance Costs

Both internal and external regulations impact the costs of compliance in different industries. Internal costs include recordkeeping, staff training, internal auditing, payroll compliance and other monitoring procedures. External expenses comprise of hiring consultants and auditors, adhering to tax compliance costs,¹⁸ as well as other

¹⁶ *EPA Guidance Documents*, <https://www.epa.gov/guidance>, (last visited April 12, 2022).

¹⁷ *How Much Does a Business Attorney Cost Per Year?* International Centre for Trade and Sustainable Development, <https://www.ictsd.org/business/how-much-does-a-business-attorney-cost-per-year/>, (last visited April 12, 2022).

¹⁸ Eichfelder, Sebastian, and Michael Schorn. *Tax Compliance Costs: A Business-Administration Perspective*, FinanzArchiv / Public Finance Analysis, vol. 68, no. 2, Mohr Siebeck GmbH & Co. KG, 2012, pp. 191–230, <http://www.jstor.org/stable/23272525>, (last visited April 12, 2022).

licenses or permits renewal requirements. Small businesses pay on average \$11,700 per year per employee in regulatory costs, and the “costs of regulation to smaller businesses with 50 employees or less are nearly 20% higher than they are for the average firm”.¹⁹ Compliance costs are likely to keep rising given the ongoing changes in the regulatory landscape. Sources for regulatory compliance costs are too numerous to list here, but one strategy to help manage compliance costs begins with a workable compliance management system.

C. Constant Regulatory Changes

Small business entities face immense pressures to keep abreast of new changes in laws, regulations, and policies. Every year, there are adjustments and/or changes made in terms of regulations. For example, the IRS may decide to adjust the tax bracket based on perceived economic activity. In addition, the Code of Federal Regulations expands and contracts as regulations are enacted, amended, or superseded. “Between fiscal year 2005 and fiscal year 2014, federal agencies published 36,457 final

¹⁹ Michael Hendrix, *Regulations Impact Small Business and the Heart of America's Economy*, U.S. Chamber of Commerce Foundation, March 14, 2017, <https://www.uschamberfoundation.org/blog/post/regulations-impact-small-business-and-heart-americas-economy>, (last visited April 12, 2022)

rules.”²⁰ This data shows the numerous rules that have an impact on the regulatory sector as it accumulates throughout the years.

In closing, small businesses are not entirely at the mercy of governmental regulations and the agencies that promulgate and administer them. The Administrative Procedure Act provides procedural rights to small businesses to make public comments on proposed rules prior to their final drafting and enactment. In addition, a small business has the right to contest alleged violations for which it is cited, and to have its “day in court” before an administrative law judge (“ALJ”). Should the business lose at the ALJ level, it may petition the agency’s commissioners or head. Once its administrative remedies are exhausted, a small business might also seek judicial review in the local, state, or federal court system.²¹

Compliance Management Approach

In navigating the regulatory environment, a good compliance management approach is essential. Management procedures cannot be vague, as such, strategic ongoing planning will be required. Small

²⁰ 2015 Report to Congress on the Benefits and Costs of Federal Regulations and Agency Compliance with the Unfunded Mandates Reform Act, Office of Management and Budget, https://obamawhitehouse.archives.gov/sites/default/files/omb/inforeg/2015_cb/2015-cost-benefit-report.pdf, (last visited April 12, 2022)

²¹ Nancy K Kubasek et al., *Dynamic Business Law*, 1042-1050 (5 ed. 2019).

businesses which do not possess the resources to implement a full compliance program can be proactive in their internal compliance procedures. For instance, they can implement recordkeeping tools geared towards tracking financial records. The SBA published a general guide on how small businesses can stay legally compliant.²² A brief summary includes:

1. Identify laws, regulations, and standards applicable to your business or industry
2. Know which local, state, or federal agencies enforce and oversee regulations pertaining to your business and location
3. Check for license, permits, and recertification requirements
4. Monitor internal and external compliance requirements for changes and new regulations

Conclusion

Upon being recognized as a “small” entity, business owners or management should research which governmental agencies create and oversee regulations in their specific industries. Regulatory or administrative agencies have those powers granted in the enabling statutes of legislative acts. Agencies have executive, legislative, and adjudicatory powers.²³ Upon being

²² *Stay Legally Compliant*, U.S. Small Business Administration, <https://www.sba.gov/business-guide/manage-your-business/stay-legally-compliant> (last visited February 24, 2022).

²³ Nancy K Kubasek et al., *Dynamic Business Law*, 1042-1050 (5 ed. 2019).

recognized as a “small” entity, business owners or management should research which governmental agencies create and oversee regulations in their specific industries. Regulatory or administrative agencies have those powers granted in the enabling statutes of legislative acts. Those regulations vary by industry and location, but small businesses have the responsibility to operate in accordance with local, state, and federal laws. Noncompliance with such regulations can result in paying penalties and fines. Failure of compliance can also lead to the revocation of a business license within a state.

Compliance may seem demanding and time consuming to some, but it has many positive benefits including accountability in business practices. Small businesses should have in place policies and procedures to stay current with proposed and enacted regulations. Consequently, the future of regulatory compliance depends on the contribution of all the stakeholders. To this end, small businesses can become agent of change in their implementation plans, further promoting business longevity and safe business practices. Government agencies and policymakers in turn have the responsibility to uphold an effective compliance framework and dynamic economy.