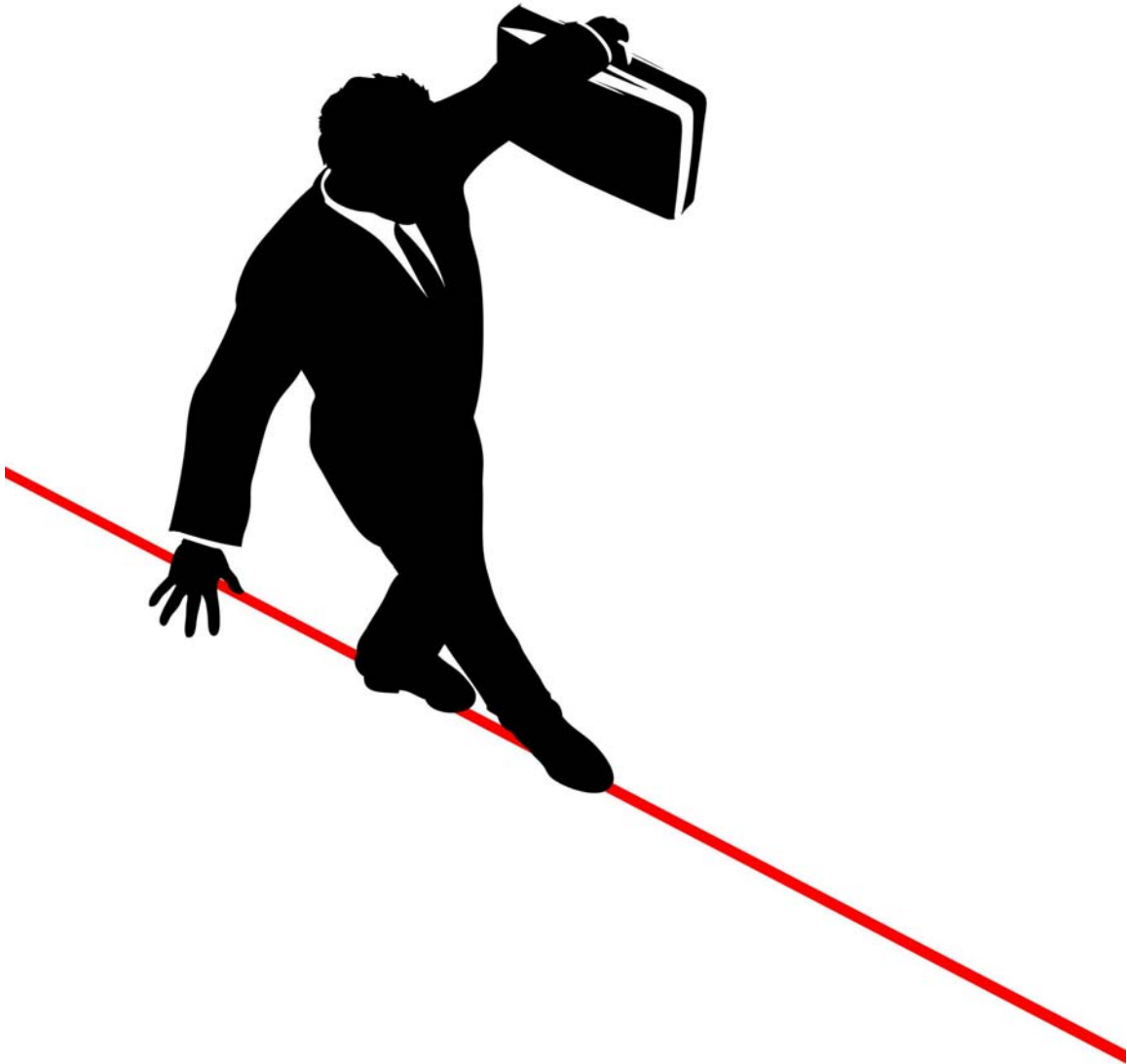


SPECIAL REPORT

“7 Deadly Legal Mistakes Made By Business Owners And How You Can Avoid Them...”



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DEADLY MISTAKE #1: BOTCHED BUSINESS ENTITY FORMATION

Personal Liability

Running a company as a sole proprietorship or a general partnership risks everything because these types of entities do not shield personal assets from business liabilities. From breach of contract lawsuits to personal injury claims, as an owner, you can be put on the hook to satisfy business claims.



In some instances, this means that a successful claimant can confiscate your personal bank accounts, autos, and even your house. It only takes one successful lawsuit with a big payout to ruin a business...and destroy your life in the process.

Shields

To reduce this risk, many entrepreneurs use corporations or limited liability companies to shield personal assets against most business risks. Yet even these shields are not enough if you co-own the company.

Equity Splits

Co-owners frequently split equity equally out of a sense of “fairness.”

If there are two owners, they’ll split the company ownership 50/50; three owners will divide the equity into thirds, etc.

Although this may seem fair, it is a recipe for disaster because no one ultimately calls the shots where there is a disagreement. Multi-owner businesses often implode when there is no one with a controlling equity interest who has the ultimate decision-making power.



When entering into a new business venture with others, you should try to get a controlling interest (e.g. at least 51% of the equity). Minority owners tend to end up with the short end of the stick when it comes to disputes.

If you can’t obtain a controlling *equity* interest, the next best thing is to obtain a controlling *voting* interest. For example, if Jack and Jill split stock equally in their corporation, Jill could insist that she have 51% of the voting rights even though they both own 50% of the stock.

Exit Plans



This method of dispute resolution brings up a related issue – setting up the exit plan at the time the entity is formed. Typically, co-owners will sign a buy-sell agreement that states how they will part ways in the future (such as one owner buying out the interest of the other owner) when certain events or conditions occur. Although this may seem pessimistic, it is actually the mature realistic way of addressing the eventual separation because you and the other owners are deciding how to part at a time when you view each other positively.

DEADLY MISTAKE #2: INFORMAL ENTITY OPERATION

The Fake Person

Part of running a company using a corporation or limited liability company as a shield means maintaining the formalities required for such a



business entity to exist under the law. This shield is based on a concept in the law that entity is a fictitious individual separate and distinct from you as an owner.

However, to keep this legal fiction in place does mean making everyone who does business with the company aware of the entity's existence and that you are acting on behalf of the company rather than personally when you do something.

Banking



Many entrepreneurs are tripped up by this by commingling business and personal income and expenses. Some even use only one bank account.

This is a recipe for disaster because the company is not your personal piggy bank to loot to pay for personal items.

Company income and expenses should be handled out of business bank (not your personal) accounts. If you need money from the business, it can be paid as a salary, an equity distribution, or even

borrowed in some circumstances as a documented loan. However, simply pulling money from the business account to pay for personal expenses jeopardizes the entity's shield of personal assets and can even trigger a costly government income tax audit for both the business and you.

Signatures

When signing anything on behalf of the company, you should do so using both your name *and* company title. This makes it clear that you are acting for the company rather than personally.



Electronic documents and e-mail have increased the risk that an owner will slip up and send out something without a proper signature. For example, if you send an email to a supplier but sign it just with your name and not your company title, you might become personally liable for what you wrote in the e-mail.

Company Operating Documents

Management of a corporation or limited liability company should be done consistent with a signed written document that explains how the business should be run. For *corporations*, this document is commonly known as a *shareholders agreement*. For *limited liability companies*, the document is called an *operating agreement*. In both cases, the document is a binding contract between you and the other owners explaining your respective rights and responsibilities. In a single shareholder corporation or single member limited liability company, it may in fact be an agreement only signed by you as the sole owner.



DEADLY MISTAKE #3: BAD HUMAN RESOURCES

Employee v. Independent Contractor

A common mistake business owners make is to treat independent contractors as employees. Government agencies are extremely skeptical of situations where someone is being handled like an employee but called an independent contractor because this tactic is used by employers to evade responsibility for withholding income taxes from paychecks plus contributions for worker's compensation, unemployment compensation, Social Security, etc.



Each government agency looks at a variety of factors to determine whether or not work-for-hire is really an employer-employee relationship.

Controlling the time and means for doing work suggests you have an employee. In contrast, letting one use their own tools, set their own hours, and own means for accomplishing a task by a certain deadline may establish an independent contractor relationship.

It is hard for you to deny employment exists where the agreement provides for a laborer to show up in your office 9 to 5, take scheduled breaks, be supervised by you while performing the work, receive compensation every couple of weeks on payday, etc. In contrast, if your business has a written agreement with another company where its owner has to complete a project within a certain time period using

its discretion on the best means to accomplish the goal of contract makes a strong case for work-for-hire instead of employment.

Prescreening



Whether you use independent contractors or employees, the failure to prescreen candidates is a frequent fatal flaw. Entrepreneurs caught up in growing business frequently fail to perform due diligence to ensure that the person being brought in to do something is both qualified and dependable.

It is far better for you to find out whether a person is up to the task before delegating than trying to clean up a mess after the fact. A bad fit leads to lawsuits, unemployment compensation claims, discrimination complaints, etc.

Scope of Work

Business owners frequently end up with disgruntled employees and independent contractors because work instructions are incomplete or misunderstood. Delegating work to others, you should include a clearly defined scope of work. For *employees*, it may be the job description created for the position that must be read and understood before employment begins. For *independent contractors*, the work-for-hire agreement should clearly explain the project, including any milestones.

Non-Disclosure and Non-Compete



To protect the company, make sure your employees and independent contractors sign non-disclosure and non-compete agreements. These can be separate contracts or included in a common document.

You will want to use these agreements to make it clear that confidential company information cannot be misused and that those doing your company's work can't turn around and compete against the business for a period of time in the geographic region where the company operates.

BAD MISTAKE #4: INVISIBLE CONTRACTS

"A gentleman's agreement is an agreement which is not an agreement, made between two people neither of whom are gentlemen, whereby each expects the other to be strictly bound without himself being bound at all." – Sir Harry Vaisey

Verbal Agreements



It isn't enough to seal a deal with a handshake. Memories are short and people tend to hear what they want to when discussing a deal. And if there's a dispute, what is remembered will not be the same as what was

agreed upon in conversation.

Character Matters

Prudent business owners insist on getting contracts reduced to writing and signed by someone having authority to do so. Yet it is important to remember that a dishonest or unreliable person will sign a contract without expecting to be held to it. For this reason, agreements should only be signed with those who are likely to perform. No matter how good a deal looks on paper, it isn't if the other party can't or won't perform.

BAD MISTAKE #5: INTELLECTUAL PROPERTY ABANDONMENT



Business owners who don't fence in their intellectual property frequently lose it to competitors. This means registering your company's copyrights, trademarks, and obtaining patents as needed, and enforcing those rights against those who infringe against them. Many entrepreneurs get caught up in the excitement of their business plans and talk to others about what should be kept private. Note that ideas by themselves can't be protected. Don't give away your business' intellectual property assets to competitors by speaking instead of being silent.

BAD MISTAKE #6: PROPERTY PITFALLS

Buying v. Leasing

Your company can land in bankruptcy court by going into debt to buy commercial real estate or locking into a long-term lease with



unrealistic expectations of growth needed to make the payments.

It rarely makes sense for a growing company to buy instead of leasing the space needed to operate. And

when it comes to leasing, your business can falter if you mistake *want* for *need*.

Fancy offices in a prime location loaded with expensive furniture and equipment is a sure path to ruining your company. In fact, in the early years, most companies can get by perfectly fine operating from the owner's home, or from a virtual or executive office space on short-term leases.

Standard Terms

Many "standard" terms in a lease are in fact negotiable. If a particular landlord balks at your stance, a competitor will be more amenable to meeting your company's needs as a tenant.

Never take the term "standard" at face value. On the other hand, if your company wants to lease from an unsophisticated investor, having

your business lawyer draft up a tenant-friendly “standard” commercial lease for use in the deal can sometimes get you concessions that would never have otherwise been obtained.

Personal Guarantees



When buying or leasing commercial real estate for your company, you may encounter landlord demands to personally guarantee the deal in case your company goes belly up and can't meet the payments.

If at all possible, you should avoid making personal guarantees so that personal assets aren't risked. If a guarantee can't be eliminated, every effort should be made to negotiate a cap on your personal liability. For example, your personal guarantee might be reduced from the balance an unpaid lease term to a month's worth of rent or a small flat fee instead.

BAD MISTAKE #7: TAX EVASION

One of the most common reasons that businesses fold involuntarily is that taxes accrue but are not paid timely. There are a variety of reasons this happens but often it is a matter of cash flow management and mistaking your company's sales revenue for after-tax income that can be spent.

Tax Avoidance v. Tax Evasion

Lawfully minimizing your company's tax burden (tax avoidance) is perfectly okay. In contrast, not paying taxes that are owed (tax evasion) is illegal.



Tax evasion can lead to tax liens and seizure of both your business and personal assets to satisfy unpaid taxes. This is one of the few areas¹ that a business entity will not shield you as an owner from personal liability.

Because of the risk to your personal wealth in addition to your company's survival, it is essential that you promptly pay what is owed rather than ducking the issue and hoping not to get caught.

¹ Environmental contamination is another legal issue where a business entity rarely shields your personal assets.

Scheduling

You should work with your company's business attorney and accountant to ensure you are minimizing what is owed in taxes but



promptly paying those taxes as they come due. Setting aside a portion of gross profits in a separate account to pay taxes is a common technique to ensure you have sufficient funds to keep the government happy. It doesn't matter how profitable your business is if the end result is

confiscation of all your assets when taxes aren't paid.

YOUR NEXT STEP...



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