

# Business Formation Issues: Protecting Yourself

**Disclaimer:** Nothing in this handout or presentation constitutes legal advice. This is general business advice from a business person. Consult with a lawyer, accountant, and insurance professional before making your decisions.

All business owners should take reasonable steps to protect themselves. The following afford key protections:

- Business legal structure
- Contracts and insurance

## Selecting a legal structure

Source: Much of the information in this section is adapted from the Colorado Business Resource Guide (<http://www.state.co.us/oed/guide/>).

The following table summarizes the key “practical matters” associated with each of type business legal structure. The table is not all inclusive and does not contain all of the advantages and disadvantages of each structure. It is an attempt to show the key required and recommended actions business owners should be aware of when making a decision about legal structure.

## Summary of Legal Entities and “Practical Matters”

Entity	Startup	Meetings/Filings	EIN/Taxes	Liability	Payroll
Sole proprietorship	<ul style="list-style-type: none"> <li>▪ No requirements</li> <li>▪ Trade name recommended</li> </ul>	Annual trade name renewal	<ul style="list-style-type: none"> <li>▪ If no employees, Employer Identification Number (EIN) not required</li> <li>▪ Schedule C on personal tax return</li> </ul>	Protection only through contracts and insurance	If no employees, none
Partnership	<ul style="list-style-type: none"> <li>▪ Partnership agreement strongly recommended</li> <li>▪ Trade name recommended</li> </ul>	Annual trade name renewal	<ul style="list-style-type: none"> <li>▪ EIN required</li> <li>▪ Partnership tax return required (federal and state; no additional tax liability)</li> <li>▪ Schedule C on personal tax return</li> </ul>	Protection only through contracts and insurance	If no employees, none
C corporation	<ul style="list-style-type: none"> <li>▪ Articles of incorporation</li> <li>▪ Bylaws</li> <li>▪ Issue stock</li> </ul>	<ul style="list-style-type: none"> <li>▪ Quarterly payroll reports and payments (federal and state)</li> <li>▪ Annual meeting of directors</li> <li>▪ Annual meeting of shareholders</li> <li>▪ Annual report to Secretary of State</li> </ul>	<ul style="list-style-type: none"> <li>▪ EIN required</li> <li>▪ Corporate tax return required (federal and state)</li> <li>▪ Possible double taxation</li> <li>▪ Some ways to reduce personal tax liability, but limited for small business</li> </ul>	Liability protection, but not absolute	Must set up payroll for all corporate officers, even if no other employees
S corporation	<ul style="list-style-type: none"> <li>▪ Articles of incorporation</li> <li>▪ Bylaws</li> <li>▪ Issue stock</li> </ul>	<ul style="list-style-type: none"> <li>▪ Quarterly payroll reports and payments (federal and state)</li> <li>▪ Annual meeting of directors</li> <li>▪ Annual meeting of shareholders</li> <li>▪ Annual report to Secretary of State</li> </ul>	<ul style="list-style-type: none"> <li>▪ EIN required</li> <li>▪ Corporate tax return required (federal and state; no additional tax liability)</li> <li>▪ Some ways to reduce personal tax liability, but limited for small business</li> </ul>	Liability protection, but not absolute	Must set up payroll for all corporate officers, even if no other employees
LLC	<ul style="list-style-type: none"> <li>▪ Articles of Organization</li> <li>▪ Operating Agreement (strongly recommended)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Annual meeting of members (owners)</li> <li>▪ Annual meeting of managers</li> <li>▪ Annual report to Secretary of State</li> </ul>	<ul style="list-style-type: none"> <li>▪ If no employees, EIN not required</li> <li>▪ Schedule C on personal tax return (single-member LLC)</li> </ul>	Liability protection, but not absolute	If no employees, none

# Contracts and insurance

Other than the legal structure you select for your business, you can protect yourself other ways:

- Contracts
- Business insurance

## Contracts

- Always have a contract with your clients and subcontractors.
- Have a lawyer review your base contract and change it as needed to fit situations.
- Contract may be a combination of a letter of agreement and standard terms and conditions.
- Key topics to include in a letter of agreement:
  - Statement of Purpose, Deliverables, Specifications, Your Responsibilities, Customer's Responsibilities, Schedule and Estimate, Fees and Payment, Approval Signatures
- Key topics to include in standard terms and conditions:
  - Fees and Expenses, Invoices and Payment, Customer Representative, Confidentiality, Project Modifications, Staffing, Access to Customer's Staff, Proprietary Materials, Canceling or Postponing a Project, Limit on Liability, Agreement and Acceptance
- Sample contracts:
  - [http://www.stcrmc.org/jobs\\_freelance/freefaq.htm#q10](http://www.stcrmc.org/jobs_freelance/freefaq.htm#q10)
  - [http://english.ttu.edu/gscic/Ch11/chapter\\_11.htm](http://english.ttu.edu/gscic/Ch11/chapter_11.htm)

## Business insurance

- General liability — exact coverage varies, but typically includes: business equipment (computers, laptops, etc.), damage you do to equipment at a client's site, injury to a client at your site.
  - Very important to proving you or a subcontractor is an independent contractor for workers' compensation cases.
  - Required by some client contracts.
  - Not very expensive (\$250 to \$500 a year).
  - May be available as a rider to your homeowner's insurance.
- Professional liability (errors and omissions) — Provides insurance for errors you make in what you create.
  - Very expensive.
  - Hard to find.
  - Not very common for technical writers.

- Workers' compensation — covers on-the-job injuries.
  - Not required if you are an owner, partner, shareholder, officer, or member of your legal entity and you have no employees.
  - If you have employees, you must have.
  - If you subcontract work to independent contractors, make sure of the following:
    - ♦ You have a signed contract with each subcontractor.
    - ♦ The contract says that the subcontractor has a trade name, separate business bank account, general liability insurance, and is responsible for all taxes. (Check with lawyer on wording to use.)
    - ♦ Have the subcontractor sign a waiver specifically stating subcontractor is responsible for any workers' compensation insurance. (Check with lawyer on wording)
- Consult with your lawyer and one or more independent insurance agents.

## Resources

- Consult your accountant and your lawyer about the pros and cons of each business entity.
- <http://www.irs.gov/businesses/index.html> — IRS business web site.
- [http://www.bwa.org/articles/business\\_entities.htm](http://www.bwa.org/articles/business_entities.htm) — Al Kemp's article about business entities.
- <http://www.state.co.us/oed/guide/> — Colorado Business Resource Guide.
- <http://www.gigalaw.com/articles/businesslaw.html> — Good article on business formation.
- <http://www.nolo.com> and click the Small Business link on the left — Good information on starting a business, including legal structures. Once in Small Business, the Independent Contractors link on the left has great information.
- <http://www.nwu.org/> — National Writers Union site has articles about contracts and other issues.
- <http://www.entrepreneur.com/mag/article/0,1539,291540,00.html> — Article about E&O insurance.

## Contact information

- Linda G. Gallagher
- [lindag@techcomplus.com](mailto:lindag@techcomplus.com)
- <http://www.techcomplus.com/>
- 303-450-9076