The First Steps of a New Business

By Howard L. Stevenson, Esq.

Business is on the rise! According to recent data from the Minority and Women's Business Enterprise Division of the Indiana Department of Administration, black owned businesses in the nation have increased 45 percent more than the national rate for all businesses from 1997-2002, totaling a number of 1.2 million. We have also seen significant progress in Indiana. Black-owned businesses have increased by 27 percent.

While this is cause for excitement, we want to ensure that we don't fail to address the appropriate legal and financial issues of a new business in the midst of the frenzy. First and foremost, at the inception of any business, a business owner should avail himself of the representation of a lawyer and an accountant. To a certain extent, the foundation that is set in the beginning will determine the degree of success a business experiences and ultimately sustains in the future.

Immediately after the decision is made to start a new business, the next issue to decide is what type of business entity to establish. Today, there are several business entity options available for entrepreneurs. Like anything else, each of them has advantages and drawbacks. Based on the needs and goals of your business, a business lawyer can recommend the appropriate business entity to select.

One type of business entity that is commonly used by startups is a sole proprietorship. A sole proprietorship is an unincorporated business entity that is owned by one person. It is very easy to create and operate. Since the business and the individual are identical, there is no paperwork to be filed with the government to form it or special maintenance required to keep the business alive. As long as you continue to call yourself a business, you are one.

Another business entity is a general partnership. A general partnership is formed by two or more persons who carry on a business for profit. Each of those persons is individually responsible for the partnership. This means that each partner is personally liable for the partnership's debts and legal liabilities. In addition, each partner is jointly and severally liable for the acts of the other partner.

For tax purposes, all partners are considered self-employed and claim their share of the partnership's income on their individual tax returns (the partnership itself pays no taxes). General partnerships are also relatively easy and inexpensive to create and maintain. Although a partnership agreement is not legally required, it usually accompanies the formation of a general partnership. Partnership agreements generally cover topics like transferability of ownership of the business, duration, and management control.

I generally do not recommend anyone set up a sole proprietorship or general partnership because are also not protected from personal liability if they end up in a legal dispute with a client or another person in the course of conducting their business. Accordingly, if they are sued, they are sued in their individual capacity. In addition, they cannot take advantage of special business income tax rates since all income is considered individual income.

There are other entities such as a corporation, limited liability partnership (LLP) or limited liability company (LLC) that does offer an owner protection from liability. In the next issue, I will discuss in more detail the legal protections a business owner receives by selecting a corporation, LLP, or LLC as a business entity.

Howard concentrates his practice in the areas of business law, real estate, and civil litigation.