

LAW

Three things all entrepreneurs must know



Tom Keuler

So you want to start a business and achieve that American dream. Be forewarned — that dream can turn into a nightmare.

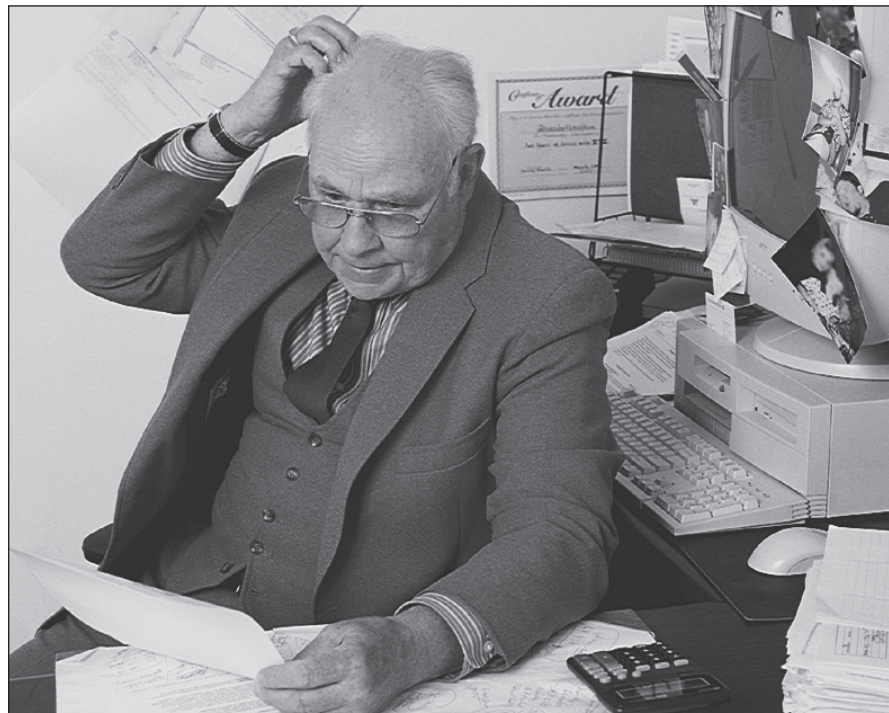
A business failure can mean the loss of your home and life savings. And the probability of failure is very real. According to The U.S. Census Bureau, the odds of failure are 50-50. But there are lines of defense you can use to minimize your losses.

Proprietorship or corporate entity?

The first step in starting a business is to choose a structure for your enterprise. Basically, you have two choices: a proprietorship or a corporate entity. Only one of these structures provides the first and perhaps best line of defense.

Without question, the proprietorship is the cheapest and easiest structure to use. With a proprietorship, you simply open up shop under a trade name. However, this choice gives you zero risk protection. Everything you do will be at your own personal risk. Worse yet, everything your employees do will also be at your risk. Just think what one dumb employee can cost you!

On the other hand, the corporate entity gives you an invaluable “corporate shield” that protects you from that dumb employee, and from the consequences of countless other risks of running a business. Yes, the corporate entity will cost you filing fees and some taxes, and will require you to submit annual reports and tax returns. But it’s well worth the



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Scratching your head over starting a business? You may want to see a professional business consultant to help you sort it all out.

cost and headache in the long run.

Once you choose the corporate entity, you must then determine what type of entity you want to use: the corporation or the limited liability company. Each entity is distinct from the other, and has its own advantages.

Most people are familiar with the corporation. It has shareholders (owners), a board of directors (policy makers) and officers (executives). The law will allow you to be all of these. To effectively use this structure, however, you must conduct your business through the corporation. If the corporation has full control of the business, the law will place all of the risk on the corporation, and not on you.

To set up a corporation, you file articles of incorporation with the Kentucky Secretary of State and pay a filing fee of about \$50. The secretary will provide you a filing form if you don’t have one. Once the articles are filed, you must hold an organizational meeting to elect directors and officers and to adopt a set of bylaws governing how the corporation will oper-

ate.

The lesser-known corporate entity is the limited liability company, or LLC. It is more simplistic and versatile than the corporation and has just two components: members (owners) and manager (chief executive officer). The law allows you to be all of these, too. And, as in the case of a corporation, to avoid personal risk you must make sure that the company has full control of the business.

To set up a LLC, you file articles of organization with the Kentucky Secretary of State and pay a filing fee of \$40. The secretary can also provide you a form for setting up the LLC. Once the articles are filed, you must set up an operating agreement that will establish the rules of operating the LLC.

Regardless of their differences, each entity gives you the same protection against risk. Unfortunately, there are people out there who are savvy to this protection and will seek to get around it by asking you to guarantee the obligations of the corporate entity. Once done, you become

personally liable for these obligations.

You should also know that the corporate shield is not bulletproof. You cannot use it to avoid liability for injury that you cause to others or to avoid personal liability for the entity’s failure to pay certain taxes, such as employee withholdings and sales taxes. The shield also won’t save you from liability for not providing your employees workers’ compensation coverage.

Professional consultant

The second line of defense is the professional consultant. Professional consultants include the commercial attorney and the CPA. These consultants can help you set up the corporate entity and advise you how to avoid the numerous legal and tax potholes that you may bump into down that road to success. More importantly, these consultants bring experience. Remember the adage, “experience is the best teacher”? These consultants have seen it all before. Use that experience.

Good ole’ common sense

The last line of defense is the most obvious: common sense. It is vitally important that you understand each risk you take on. If you need money — and you will — when you sign a bank note and give up a second mortgage on your home, you should understand that in the event the business goes bust, you will lose your home and still owe most if not all of what you owe on the loan. If the risk is more difficult to appreciate, use your common sense and go talk with a consultant.

Tom Keuler has been a partner in Paducah’s Denton & Keuler law firm for more than 30 years.

He represents many of the firm’s commercial, industrial and banking clients, and has been special counsel to the City of Paducah and counsel to the Municipal Code Commission in Frankfort.