4 Key Mistakes Business Owners Make

Companies often start without a lawyer. They may or may not have incorporated—and if they have, they have done so themselves, or through a service like Legal Zoom. These services may have provided some answers, but haven' t told them what questions to ask. Here are 4 key mistakes that business owners make which risk their entire company:

1. Not Establishing a Business Entity

In this case the risk is to everything you own, not just your company. The reason that you create a business entity is to limit your liability to the assets of the company. Many people start out by thinking they may establish the entity later but it is critical to take this step immediately. The type of entity—S Corporation, C Corporation, Limited Liability Partnership, Limited Liability Company, Professional corporation, or a non-profit corporation does not matter. All of these limit the liability of the entity from being able to reach the owner's personal assets.

Sole proprietorships and general partnerships do not provide this protection. In these cases, if something does go wrong, a suit could lead to any other income or personal property being at risk.

I hear many reasons why people have not created an entity, from ignorance, laziness, or sometimes altruistic reasons. There are no good reasons to not have a business entity. The excuses that I hear the most are:

I only work part time at the business. In this case, having an entity is probably most important. If this is not your primary means of making money we want to be sure that we protect you or your family's other income while you start and grow this business.

It is the same as having an LLC. This often comes from someone that has mostly addressed tax issues. An LLC and a sole proprietorship or partnership both have pass-through taxation where the income is taxed as part of your personal income. This is where the similarities end.

I stand behind my work 100% - This is a lovely thought, but you will be in a better position to stand behind your business when your home is not at risk. Although an error on your part may require compensation to the injured, this is why we have company assets and insurance. Unfortunately, there are also unjust legal actions—so you want to make sure you are protected in these situations.

2. Not Understanding That the Business is A Separate Entity

The next issue is to understand what it means to have a business as separate entity from you personally. In addition to keeping your finances separate, and from signing on behalf of the company, your company has rules you must follow and you must keep good corporate "hygiene." If you are the only owner in the company it is sometimes easy to forget the structure and the separateness of the company.

If you have a partner or a board of directors, you need to be more cognizant of the decision rules. I have seen people lose the company they founded through board-of -director actions.

You are integral to your business. As owners we pour a lot into our companies but it is for your protection that we maintain the separation.

3. Need To Accept Contract Terms

As a new business we often forget that we have the right to set the terms that we need. Although in some cases, individuals can claim that they were pushed into a business contract, the law thinks that contracts you make are negotiated between two sophisticated parties. In some cases, it may be hard to negotiate a large company's contract, but you are still presumed to understand and have decided that the deal you made was worth the terms. A few terms that are often accepted as is even though there can be large repercussions are:

Delivery – although price per item is a key element of negotiation, sometimes the timing and logistics of delivery are not as well negotiated. Make sure you understand what it takes to provide your services or goods and negotiate the time and cost that you need.

Payment terms – again, price is always a key element of negotiations, but the payment terms need to facilitate your work. Make sure the terms allow you to cover costs, services and your time when you need it covered.

Choice of law – this is usually a small clause near the end of the contract. In general, all companies put the state of their headquarters. It is the state law that will be used in a dispute. The reason this is important is that if you live in Idaho, it is hard to find a lawyer that is barred in Florida except by going to Florida. If the office of the company that you are dealing with is in your state or a local state, ask to use the more local law.

Notice rules – within a contract there are multiple items that require notice to the other party, make sure you make it as simple as possible. The easiest way to get changes to notice is to allow for an easy means if it is acknowledged by the other party. This means that email works if it is acknowledged, but if you are not getting the response you need, you should go through the more complicated process.

Lastly, remember that breaches of the rules mean you can lose the contract and not get the goods, services or payments that you are counting on. For this reason, it is good to use your contract when possible to limit the number of variation of issues that are required in a contract.

4. Consultants vs. Employees

The last issue that I will address as a core fundamental is understanding the difference between consultants and employees. Often companies think it is easier to have consultants than employees so they source all their support to consultants. Unfortunately this is not a decision that you are allowed to make there are rules as to who is an employee and who is a consultant.

Employees are people who complete tasks that you assign in the way you direct with equipment that you provide. They often work full time for you. An employee is treated to some benefits, and you are required to withhold taxes and pay taxes for them. Benefit rules require that if you provide benefits for some, they are available to others. Labor laws require that if they are not exempt they receive overtime.

Consultants, on the other hand, perform a project for you under their own direction with their equipment. They often work for multiple clients. They do not get the benefit of tax withholding, benefits or labor laws. The issue is that if you misclassify them as consultants when they are really employees, they can claim all the benefits of an employee for as long as they had been working for you.