

GET THE SCOOP ON...

Protecting your product ■ Getting on the IRS's good side ■ Incorporating pros and cons ■ License and permit prerequisites

Getting Up and Running

For many people, the paperwork required to start a business will be fairly minimal. However, taking steps up front to protect the fruits of your labor will save you time, money, and worry later on.

Considering how best to safeguard your business's intellectual property and what type of business structure to adopt are critical aspects of starting a new business. If patents, copyrights, or trademarks are involved, you can count on lots of forms being part of your start-up activities. Ensuring that your business has the right to use the name you have carefully selected, to market any products or services you have developed, and to operate using sound financial management practices is critical for longevity.

Not following proper procedures at the outset can cost you thousands of dollars in penalties and fines, not to mention potential lawsuits, if you're careless. Consider your start-up legal fees as an investment in protecting the intellectual property of your business. I've identified the most important

Chapter 5

procedures and government requirements you'll need to be aware of and have summarized them here.

Mission statement

Although the government doesn't require a mission statement, developing one is a smart first step for new business owners. While you're immersed in paperwork, forms, and legal documents, a mission statement can remind you of why you're doing this; it keeps you focused on the big picture. It will also help when you seek out advice on what form of business structure you should adopt.

Some of the elements of your mission statement might include

- The ultimate purpose of the business—what you want customers to gain from their association with you.
- Who your company aims to serve (such as businesses or individuals, adults or children, less fortunate or upper income, etc.).
- The benefits of the products and services you'll be selling.
- What clients should expect from you in terms of service, responsiveness, and professionalism.
- How you expect to be treated by customers, suppliers, and partners.
- How prominent you intend the company to become in your industry. Some owners want their companies to remain well-kept secrets in order to keep competitors in the dark, while others strive to be vocal industry leaders.



Watch Out!

Keep your mission statement brief and focused. Explain your company's overarching goal in 25 words or less, such as, "Helping families reduce their debt," or, "Partnering with medical centers to develop state-of-the-art transplant technology."

- What you want the company to become known for, also known as its Unique Selling Proposition (USP).
- How important monetary success, such as profitability, is to the company.
- Operating principles you will follow in your efforts to achieve client objectives, including ethical issues or response times, for example.
- Your financial goal, either in terms of annual company revenue or your own target salary.
- Your exit strategy—whether you intend to sell the business once you reach a certain sales level, hand it down to the next generation, or go public.

Developing and establishing your organization's guiding principles will help you in many ways as you grow—in your marketing to clients, in attracting and retaining the right employees, and in determining which growth opportunities should be pursued. Your mission will help to establish the corporate culture for your company by setting standards and expectations for employees, as well as defining priorities.

Once your organization's mission has been set, your focus should be on protecting corporate assets.

Patents, copyrights, and trademarks

A company's intellectual property is often its most valuable asset. As the world economy shifts from industrial- to information-based, ownership of ideas is at the core. Patent, copyright, and trademark documentation helps to determine who is the rightful owner of inventions, concepts, brands, and artistic creations. Copyright or trademarks can also dramatically increase the marketability of a business. So protecting intellectual property rights can significantly increase the potential value of a business. And whoever files first has a clear advantage.



Moneysaver

The U.S. Patent and Trademark Office assists businesses in protecting their investments and in promoting their goods and services. They can be reached at (866) 767-3848, or visit their Web site at www.uspto.gov.

Patents

Patents are the worldwide standard for assigning ownership of an invention or process. Before filing a patent application, an inventor should first confirm that a patent is not currently held by someone else for the same product or process. To qualify for patenting, an invention must be new, proven to work, and tangible; intangible ideas are not patentable.

Patent searches can be done online at the U.S. Patent and Trademark database (www.uspto.gov). Another more costly yet less time-consuming option is to work with an attorney who specializes in patent filings. Costs range anywhere from \$2,000 to \$6,000 for a typical search-and-filing process.

Keep in mind, however, that having a patented product does not guarantee business success. At the same time, a patented product or process is not necessary to establish a thriving company. Legal documents such as patents and trademarks merely help to protect your ownership rights.

Copyrights

Where patents protect tangible ideas or products, copyrights protect the ownership of creative ideas and products, such as



Bright Idea

As soon as you have confirmed that your idea can be patented, proceed to file the paperwork. Even if you have no immediate plans to manufacture or market your product, you will retain the right to do so within the next 17 years without competition. You can also license or sell the idea, once you've patented it. The only downside is that your exclusive rights begin to run out as soon as you file.

fine artwork, music, and books. The creator of such works has the right to prevent others from using, copying, or distributing his or her works without permission.

Copyrights are easier to secure than patents but much harder to enforce, unfortunately. The U.S. Copyright Office of the Library of Congress issues and administers copyrights that are registered with their office.

To apply for a copyright, complete an application and send it along with a check for \$30 and a complete copy of whatever work you are seeking to copyright. You can download an application at the U.S. Copyright Office Web site at www.copyright.gov.

Be sure to complete and file the appropriate application for the copyright, depending on whether it's for music, art, or written work.

Trademarks

In some cases, a company's identity or brand name is its most valuable asset. A well-known brand name connotes a certain level of quality or prestige that many consumers have come to trust and associate with a particular company. To allow someone to tamper with that brand image could be extremely damaging and costly to a company—which is where trademarks come in.

Trademarks protect both product and service names and their associated symbols for an initial period of 20 years. During that time, no one else may use that symbol or name without the company's approval. By definition, trademarks identify the source or owner of the mark.



Bright Idea

One cheap and popular way to establish yourself as the true creator of a work of art, written work, or concept is to document it, place those pieces of paper in an envelope, and mail it to yourself. If your authority is ever challenged, you can present the unopened, date-stamped envelope as proof of when you came up with the idea. Attorneys caution, however, that this approach is weak and the best way to protect yourself is to file the appropriate paperwork.



Bright Idea

Once you've settled on a company name, check to see if the URL is available. Being able to direct customers to a Web site URL that matches the corporate moniker is important. If the URL for your first choice is taken, you may want to consider alternate names for your business. Check URL, or Web domain names, at www.directnic.com, where you can also register them for a nominal fee.

Name search

Selecting a company's name is one of the most important decisions you will make as you start your business. A business's name will help identify what the company does, as well as establish its image. Discount Duds, for example, presents a very different image than Van Wert Clothiers.

Begin the process of generating potential names by brainstorming with managers, consultants, and friends. Consider the ambiance you plan for the company, the level of service and pricing strategy you have defined, as well as synonyms or phrases frequently associated with your product or service.

The strongest and most protectable trademarks are those that consist of words or phrases that have been newly created or coined, rather than a collection of several common words. Made-up words are considered the most distinctive trademarks and are more easily protected than generic or common terms.

Once you have settled on a name, the next step is to confirm that no one else in your service area is already using it. "Service area" is a key issue; if you intend to operate only in your local



Watch Out!

Keep careful watch over your own corporate name and brand to be sure no one else appropriates it or creates a look-alike entity to leverage your good name. Brand names are big business! In 2002, Interbrand Corp. estimated the value of some of the world's biggest brands in the billions of dollars—Coca-Cola was worth \$69.6 billion, Microsoft \$64.1 billion, and IBM \$51.2 billion.



Bright Idea

To learn whether a company name has already been trademarked, visit www.tmcenter.com.

area, you may only need to check local records. However, if you will be operating nationally or internationally, it is best to conduct a national or international name search to ensure that you won't encounter problems down the road. If another company has already registered a business name as its own, by trademark or incorporation, you cannot use it without their permission.

The process of running a name search through your attorney's office can cost anywhere from \$500 on up, depending on the geographic area being searched. An international search will cost several thousand dollars. Weigh that against the potential loss of business if you are prevented from exporting your company's name to other countries.

Although you'll want to complete the search before expanding into a new area, it's not necessary to make the investment now, when cash may be tight. Reevaluate the need to register your company name in other areas every six months, as your business grows and matures.

Corporate structure

Selection of your business's corporate structure affects how you track revenue, pay employees, and complete government paperwork. Your options currently range from operating as a sole proprietorship, a partnership, a corporation, a limited liability company, a limited liability partnership, or a professional corporation. Most importantly, a separate corporate entity shifts liability for financial obligations or lawsuits from the business owner to the business itself. This is the major reason many business owners incorporate—to shield themselves from corporate liabilities.

Be aware, however, that individuals and businesses can choose to sue whomever they please, so despite the fact that you've incorporated, you can still be named personally in any lawsuit. Incorporating generally helps protect personal assets, such as a house or car, in such instances.

Sole proprietorship

Many companies start out as one-person operations. These solo businesses are often run as sole proprietorships, which are taxed at individual rates rather than corporate tax rates. As the IRS sees it, any income generated for the business is passed through directly to the business owner.

To establish a sole proprietorship, you need to complete a Doing Business As (DBA) certificate, available at a legal stationery shop, search courthouse records to confirm that no other business has already registered the same name, and pay the requisite fee, typically under \$50.

If you have a partner in the business, you can also file a DBA for a partnership. The main difference with a partnership, however, is that each partner is equally responsible for the acts and omissions of the other. So if your partner chooses to buy a building for your new business, you are both responsible for the mortgage payments.

Corporation

Incorporating enables you to separate your business obligations from your personal obligations. Once your business is officially incorporated, you become an employee. Any revenue earned is



Moneysaver

Once your revenues as a sole proprietorship reach a certain level, your company has a greater chance of being audited. Statistics show that sole proprietorships with revenues above \$50,000 are audited more frequently than those below that amount. Some companies elect to incorporate when their revenues approach \$50,000.

**Watch Out!**

Employers are required to complete an I-9 form when an employee is hired, documenting that the individual is a U.S. citizen or resident alien with two forms of ID. Employees must also complete a W-4 form, authorizing their employer to withhold their taxes.

paid to the company, not to you personally. Taxes are also paid monthly, not quarterly or annually as they are with sole proprietorships, on salaries and wages paid to employees—like you, the owner.

The major advantage is that if the company is ever sued, you may be able to shield some of your personal property.

Another advantage—to your clients—is that if you operate as a freelancer or independent consultant, for example, your corporate clients do not need to issue 1099 forms at the end of each year summarizing what they paid you. It's also clearer to the government that you are not an employee—a situation some companies are concerned about proving. Being able to tell clients that you operate a corporation, in some cases, may give you an edge when competing for business.

Although the actual process of incorporating can be handled in minutes, consulting your attorney and accountant before initiating anything will also save you time and money. Doing so will ensure that you've selected the appropriate form of incorporation, that you've elected appropriate officers, and that the paperwork is all in order.

Keep in mind that incorporating in a state different from your home state, such as Delaware, frequently does not eliminate the annual franchise fee that home states charge all corporations operating in their borders. This franchise fee is also payable regardless of the size of your sales. If you incorporate before you actually plan to start operating, you will still be expected to cough up the annual fee (which is generally somewhere between



Bright Idea

Companies frequently incorporate in Delaware rather than their own home state because of its business-friendly courts. When lawsuits are filed, Delaware will rule in favor of the corporation more often than not—although favorable rulings are never guaranteed. However, any licenses or permits required by your home state still need to be obtained.

\$100 and \$400). Depending on the number of shareholders involved in the company, you may elect to file as a Subchapter S corporation or as a Subchapter C. Most smaller companies are Subchapter S corporations. Operating as a Subchapter S corporation allows you to avoid being “double taxed.” Instead of reporting profits on the corporate return, shareholders (including the business owner) are taxed on amounts received from the company. Allowing profits to be distributed to shareholders without taxation at the corporate level is called “pass through” tax treatment.

Limited liability companies

Both limited liability companies (LLC) and limited liability partnerships (LLP) have a general partner, who is personally liable for the actions of the organization, and limited partners, who are not liable. LLPs are frequently used in real estate transactions, where there are several silent partners not involved in the day-to-day decision-making. LLCs are becoming very popular among law and consulting firms, where the partners are active in daily operations; and they are less expensive and less complex to set up and manage than corporations.

Professional Corporations

If you’re starting a business in order to provide professional services, such as architecture design, legal services, medical or dental services, accounting guidance, or financial planning, among others, you should consider comparing the advantages and

disadvantages of a professional corporation—generally identified by a PC, PA, P. Corp., (Professional Corporation), or Inc., with those having either a Subchapter S or C. Find out first from your state whether your services are on their list of what are considered “professional services,” since that list varies by state. In some states, professional services are defined as those services that require a license.

Professional corporations (PC) are taxed like a C corporation, unless the owner(s) have elected to be taxed as an S corporation. PCs do not have the advantage of graduated corporate federal income tax rates and some states require that professional corporations pay a flat tax rate regardless of income level.

The advantages come into play mainly when a professional service provider, such as a doctor, operates within a larger organization and wants to set up his or her own entity. Even if a professional practice is set up as a corporation, with the accountants or doctors as employees, each member can elect to set up his or her own PC; the larger corporation then pays the doctor’s PC, and the PC pays the doctor (based on the doctor’s instructions). In addition to providing liability protection, having a professional corporation also opens tax planning avenues not available to individuals, such as being able to set up corporate retirement programs.

Reporting and paying taxes

The Internal Revenue Service (IRS) requires that Americans pay taxes on a wide variety of items, including:

- Salary and wages
- Owned property
- Sales
- Luxury items
- Capital gains on investments

As a business owner, you are responsible for paying a number of taxes, based on your annual sales and employees' wages, to both federal and state governments.

Earnings of sole proprietorships are taxed as part of the owner's personal income, rather than as a separate business. IRS Schedule C allows the sole proprietor to itemize all income and expenses for the year.

On the other hand, partnerships, corporations, and limited liability companies (LLC) file separate business and personal tax returns. Partnerships and LLCs file a tax return, with each partner also responsible for paying personal taxes on his or her share of the business's earnings. Corporations—Subchapter S, C, or professional—file a tax return for the organization while the owner pays taxes on any salary or dividends received from the company during the year.

Income

Employers are responsible for withholding a portion of each employee's salary or wages, according to his or her individual tax bracket. The company then pays that withholding figure to the government, by making a payment to its bank each month.

Failure to withhold and pay the required tax amounts on time each month will cost your company big bucks in fines and penalties.

Unemployment Taxes

In addition to income taxes, employees must pay a portion of their earnings to the state unemployment fund. Under the Federal Unemployment Tax Act (FUTA), employees pay 8% of



Watch Out!

Failing to pay monthly corporate withholding amounts is extremely costly. Making the deposit even one day late can result in fines of several hundred dollars. Avoid these penalties by paying your monthly tax withholding figures by the 15th of each month.

their wages up to the first \$7,000 earned. This means that employers must withhold this amount and pay the state accordingly.

Social Security

Employee and employer also split the social security tax, which is 12.4% of the first \$68,400 earned. An additional 1.45% of the employee's salary is paid to Medicare.

Insurance

Although some business owners decide to risk not having insurance to cover their business against loss, most successful entrepreneurs would agree that having no insurance is the most risky situation of all. Especially at the start of a business, when your financial risk is the greatest, insurance is crucial.

If you are leasing work space, be sure to read your lease closely as it may specify the type and minimum amount of insurance you are required to carry. The building owner or leasing

agent may require written proof from your insurance carrier annually that you have coverage in place.

The whole purpose of insurance is to reduce the risk of loss and keep a company up and running following a disaster. Of course, a disaster could be anything from an earthquake, to a fire, to an owner's serious illness, to one of your employees cleaning out your bank account and skipping town.

Worker's compensation, which provides for any employee who is injured on the job, is the only type of insurance required by law in every state. However, some states may also require

“Talk to both a reputable property and casualty insurance agency and an agency whose specialty is life and health insurance. Together they can evaluate your business premises and operations and advise you of potential risks and appropriate types and levels of insurance coverage.”

—William Seybold, ING

additional insurance beyond worker's compensation. In New York, for example, you are required to have disability insurance to provide for any employee who is injured off the job. Be sure you know your state's particular requirements.

Business owners can often be exempted, however, from certain types of insurance. Although it's not necessarily smart to restrict yourself from insurance protection, you can often save money by exempting yourself from coverage.

Other valuable types of insurance include

- **General liability:** Protects against a lawsuit that may result if someone is injured at your place of business.
- **Home-based business rider:** Many property insurance policies allow you to add a rider to protect any business-related equipment on-site. However, there are limitations you'll want to investigate before relying totally on your homeowners policy for protection in case of a loss.
- **Errors and omissions (E&O):** Protects against a lawsuit that alleges your advice was either damaging or incomplete. Lawyers and consultants typically buy this type of protection. E&O may also provide coverage for discrimination claims or negligent acts of corporate officers.
- **Business interruption:** Provides funds to compensate the company for some event that caused business to be lost.
- **Key man:** Enables the company to continue to operate even if one of the owners or senior managers becomes ill or dies.
- **Automotive:** Ensures that the company isn't penalized if an auto accident occurs at the hands of an employee while on the job.

Licenses and permits

Some service businesses require all individuals providing services to be licensed, such as hairstylists and cosmetologists, while companies are often required to have a business permit in order

to operate. The list of businesses and professions that must be licensed varies by state, as does the list of businesses needing a permit in order to operate.

Each state has an office that handles the processing of licenses and permits. To learn whether you are required to be licensed or have a permit, call your local SBA office or Chamber of Commerce.

Just the facts

- Writing a mission statement for your company helps your employees understand the purpose and top priorities for your business, making it easier for you to reach your goals.
- To protect your company's intellectual property, such as written work, product brand name, or innovative manufacturing processes, consult an attorney and complete all the necessary forms to register a patent, copyright, or trademark.
- Investigate which corporate structure makes sense for your business, based on the amount of revenue you expect to earn, whether you'll have partners or shareholders, as well as other issues your attorney or accountant bring up.
- Consult a tax accountant to be sure that you are withholding all the necessary taxes from your employees' paychecks and that you are paying the least amount required under the law.
- Business insurance is essential to ensure that your company continues to operate after disaster strikes.

