**KNOW YOUR LEGAL RIGHTS**

**Legal Considerations Before Starting a Small Business**

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*Know Your Legal Rights* is a bi-monthly column distributed by the State Bar of Wisconsin. It is written by members of theState Bar of Wisconsin’s Lawyer Referral and Information Service (LRIS), which connects Wisconsin residents with lawyers throughout the state. Learn more at [*LRIS.org*](https://www.wisbar.org/forPublic/INeedaLawyer/Pages/i-need-a-lawyer.aspx)

As the U.S. economy transitions to slower growth, some entrepreneurial Wisconsinites who were laid off may decide to start their own business. It’s an exciting opportunity. However, without a detailed plan you may find yourself in legal trouble.

The first step to avoiding legal challenges is by creating a business plan. Creating this plan will serve as your small business’s roadmap. It forces you to think about the following:

* the product or service you are offering,
* pricing,
* marketing,
* competition, and
* cash-flow needs.

Additionally, hiring a lawyer is crucial in helping you determine the kind of business entity you want to create. Moreover, creating a business plan will help the lawyer guide you in creating your business entity, and it will help potential investors and banks when you consider opening a business account.

**Form the Proper Business Entity**

For tax and liability purposes, it is essential that you choose and form the appropriate business entity for your business. The appropriate business entity will determine and impact your liability exposure and tax payments. For instance, a small business with a proprietorship (“sole proprietorship”) are one and the same—and the sole proprietor is personally liable for the debts or obligations of the business.

For tax purposes, a sole proprietor reports net income or net loss from the business on his or her personal federal income tax return. Conversely, a Limited Liability Company (LLC) member or a corporation shareholder is not personally liable for the debts and obligations of the LLC or the corporation.

The following are the most common business entity structures that you must choose from:

* **Sole proprietorship**: a proprietorship is a small business owned by a single person (a sole proprietor) who has not filed the paperwork with the State of Wisconsin Department of Financial Institutions (DFI) to operate the business in some other legal form. The defining feature of a sole proprietorship is that there is no legal distinction between the owner and the business. Specifically, because the business and the sole proprietor are one and the same, a sole proprietor is personally liable for the debts or obligations of the business.
* **Partnership**: an agreement between two or more people where the owners will manage and operate the business in return for a split of the profits. For example, each partner in a four-person partnership would be allocated 25 percent of the partnership’s profits, unless there is a partnership agreement allocating profits differently. This outcome may be the one desired by the four partners if they all contributed an equal amount of money to the partnership. Note, if the partners contributed unequal amounts, the profits are not likely to be shared equally.
* **C-Corporation**: any type of corporation where the owner and the business pay separate taxes. For instance, the corporation pays tax on its income—meaning that it is not passed through its shareholders. This can benefit your tax liability, especially with the 2017 Tax Cuts and Jobs Act.
* **S-Corporation**: any type of corporation that does not pay tax on income; rather, it is passed through its shareholders based on the number of shares they own.
* **LLC**: an LLC is a private business that is formed in a way that makes a legal distinction between the business and the owner. A single member LLC is typically taxed like a sole proprietorship. The Internal Revenue Code treats multi-member LLCs like a partnership.

**Register the Business Name**

You must register your business with the Wisconsin Department of Financial Institutions (DFI). To register your business name with the government, you must search the DFI database to see whether the name you have in mind for your business is available, file the name, pay the filing fees, and obtain an Employer Identification Number.

**To Reduce Stress, Hire a Lawyer**

Although starting a business is exciting, it can be stressful. To reduce the stress, hire a competent lawyer that can deal with the legal issues while you focus your energy on starting and running your business.

*Lanre J. Abiola founded the Milwaukee-based law firm Prestige Law Office, LLC, in 2022. He focuses on business law, estate planning, immigration law, and insurance claims disputes. He is a member of the State Bar of Wisconsin Lawyer Referral and Information Service, which connects Wisconsin residents with lawyers throughout the state. Learn more at* [wislaw.org](http://www.wislaw.org).