



# Kit 1: Starting Your Business

These materials provide you additional information on the top 5 things to know when starting your business.

## 1. Entity Defined

A business entity refers to the formal structure of your business. You can think of the business entity as a separate person with its own set of rights and responsibilities. An entity has specific legal, administrative, and tax requirements as set by the state and federal government. Some examples of different entities include **sole proprietorship**, **limited liability companies**, or **corporation**. (To learn more about the difference between the types of available entities, please see the materials on “Choosing an Entity.”)

Sole Prop.	Partnership	LLC	Corporation
<ul style="list-style-type: none"><li>• Business owned by one person</li><li>• No liability protection</li></ul>	<ul style="list-style-type: none"><li>• Business equally owned by two or more people</li><li>• No liability protection</li></ul>	<ul style="list-style-type: none"><li>• Business owned by one or more people</li><li>• Individual owner(s) shielded from business liability</li></ul>	<ul style="list-style-type: none"><li>• Business owned by one or more person</li><li>• Individual owner(s) shielded from business liability</li></ul>

## 2. State of Entity Filing

### *What It Means*

To create a formal entity, you must file documents with the state your business will be associated with. Example: A Washington State entity will file with the Washington Secretary of State. The Washington Secretary of State has information and resources on creating a Washington corporation available on their website. Here’s a link to the Washington Secretary of State Corporations webpage: <https://www.sos.wa.gov/corps/>

### *Washington Entity*

If you are a small business and you live and operate in Washington, **you will likely want to create a Washington entity.**

### *Non-Washington*

Even if you live and run your business in Washington you have the option to file with another state, but this will add complexity to the process. If you do file with another state and operate in Washington you will need to do the following: **1)** file for a business license in the cities you operate in; **2)** Register with the Washington Secretary of State as a foreign entity; and **3)** follow any registration requirements of the state of creation. A foreign entity means that you are a non-Washington entity, but are doing business in Washington. Example: You file as a California LLC, then you will also need to file in Washington as a foreign business through the Washington Secretary of State.

(To see how to file for an LLC online or to file a business license, see the “How To” videos.)

### **3. Founder of Business**

The founders of the business are the individuals that **started the business** and are listed on the filing documentation. These are likely to be the same people who will be owners in the business.

If you are the only founder of your business then this part is easy and you will just list yourself. However, if there are multiple people who are founders of the business, you will need to create an Operating Agreement to establish ownership rights, roles and responsibilities. This will include agreeing on how the operational decisions are made and how the share of profit and losses will be divided among the owners. This process can get complicated, but it is important that everyone understands their rights as founders. Therefore, it is recommended to discuss your options with an attorney.

### **4. Ownership**

Knowing who owns your business is just as important as knowing who founded the business, but these groups may not be the same people. The owners may be the founders, but owners may also be brought in after the business is formed and in operation. An owner will have rights to share in the profits and losses of the business and make decisions on how the business operates. It is important to identify if the founders and owners have the same rights. You must also agree upon how the owners will operate the business and how responsibility will be divided between the owners.

Here is a list of items that should be discussed between the owners of the business. We recommend writing down what is agreed upon.

- 1) How to allocate ownership?
  - How much of the business will each person own?
- 2) How to run the day-to-day business?
  - Will everyone make decision together, will one person make all the decisions, or will different people be assigned to different areas?
- 3) What happens if an owner no longer wants to be a part of the business?
  - Will the business be shut down or will the other owners have the right to continue the business?

- 4) What changes in the business will require agreement of all of the owners?
- Do you want have to discuss and agree on everything, or only changes above a certain amount, or to decide if a new person is involved in the business?
- 5) How will the owners make financial decisions, including needing more money to run the business?
- Do you want to decide this as a group or will one person be responsible for these decisions?

*All of the owners should discuss these topics and agree upon how each process will be handled before officially forming the business. These agreements should be recorded in a written document that is a contract between the owners and the business. In a LLC or Partnership, this is done in the operating agreement. In a corporation, this is done in the shareholder agreement.*

## **5. Investors**

Investors include anyone who contributes **things of value** to your business. This can include friends, family and business partners. Before you start taking money from anyone, you should talk with an attorney. Money includes cash or property that currently has value or will have value in the future. When money is given to help start a business, it must be given within the regulations of the Securities and Exchange Commission. **Violations of SEC requirements can result in large fines and jail time.** It is always better to be safe than sorry; therefore, if anyone has given you anything of value to start or operate your business, then you may need to talk to an attorney about SEC filings and requirements.

## **6. Overview of Founders Owners and Investors**

Founders	Owners	Investors
<ul style="list-style-type: none"> <li>• A person who is a part of creating the entity <b>from the beginning.</b></li> <li>• May help with operations and/or get a share of profits and losses.</li> </ul>	<ul style="list-style-type: none"> <li>• Owners are people who may not have been there from the beginning, but who <b>have a stake in the profits and losses.</b></li> <li>• Unless agreed to otherwise, owners have <b>equal rights</b> to profits, losses and management decisions.</li> </ul>	<ul style="list-style-type: none"> <li>• Includes formal investors, family, friends, or any person who contributes to the business.</li> <li>• Contributions <b>are not just cash</b>, but also property, services or a share of the business.</li> </ul>

## **7. Wage Taxes**

Different types of entities have different taxation structures. The most common structure for small business is the Limited-Liability Corporation, which is commonly referred to as “LLC.” LLC’s are subject to pass-through taxation. This means that tax liability is “passed through” to the owner(s) who pay the taxes on the profits of the business. The owner of a LLC can choose for the LLC to be taxed through double taxation.

Common types of the taxation structures include:

- **Double Taxation:** Business paying taxes on profits and the owners paying taxes on their income. This is how corporations are typically taxed.
- **Pass-through Taxation:** The business does not pay taxes on the earning, but the owner does pay taxes. This is how S-Corps and LLCs and typically taxed.
- **Tax Optimization:** This allows the owner of an S-Corp to be paid a salary, which can result in a reduction of personal income taxes.

If any of these are a concern you should talk with an accountant and they can help you find the best option related to your tax needs.

## **8. Additional Help**

It is always recommended to talk with outside help, especially when there is more than one person involved in founding or owning your business. Additionally, investors and tax savings can present confusing issues to handle alone. **Therefore, if any of the above material raises any questions or caused you to stop and think hard for a few moments, then you should consult with an attorney and/or accountant.** Attorney costs can seem high when you are first getting started with your business, but it is better to pay more in the beginning to avoid even more costly problems later. Wayfind may be able to help you with free legal services or can give you a referral to other attorneys, if we can't help you.