

# FAILURE IS NOT AN OPTION

Ten Common Pitfalls for Entrepreneurs

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### General Recommendations

1. "The E-Myth Revisited" by Michael Gerber.
2. Learn basic business law principles through classes or books. There will be exceptions to the general principles but knowing the basics can help you identify when to seek legal help.
3. Review available resources including:
  - <http://www.sos.state.tx.us/corp/related.shtml> - discusses licensing and other new business issues
  - [www.irs.gov](http://www.irs.gov) – IRS web site for tax information & audit guides
  - <http://www.inc.com/articles/2002/10/24780.html> – Striking Out on Your Own (Inc!)
  - <http://www.inc.com/articles/2000/01/14880.html> - 10 Common Mistakes of Prospective Franchisees
  - Trade associations
4. Hire professionals (Attorney and CPA) and find a good banker.
5. Read your legal documents and ask "what if" questions – it's the only way to make sure that you and your attorney are correctly reflecting your desires.

### THE "BIG TEN" – SOME OF THE MOST COMMON PROBLEMS

#### 1. Starting Business without a Limited Liability Entity

- Unlimited personal liability
- Missing "founders" who surface when a "value event" is about to occur

#### 2. Failing to Document Owners' Rights & Responsibilities

- Business divorce & impasse resolution
- Transfer restrictions and rights of first refusal
- Initial capital contributions & vesting
- Withdrawing owner's equity & purchase rights
- Additional capital contributions – obligations and penalties
- Deceased owner's equity
- Representation on the Board of Directors
- Drag-along right
- Co-sale right
- Permitted transfers for estate planning

#### 3. Taxes, Taxes and More Taxes

- Employment
- Income taxes
- Estimated taxes
- Sales & Use Taxes
- Other

#### **4. Failing to Obtain and Protect Intellectual Property**

- Employees and consultants may own the created intellectual property
- Copyright created in a “work for hire” arrangement is owned by the employer but, due to technical legal issues, an inventions assignment is the only assurance of title
- Employer may have a limited “shop right” to use a patentable idea created by an employee
- Trade secret protection policy should be adopted and maintained. Once trade secret protection is lost, there is no way to restore it.

#### **5. Employees / Employment taxes**

- Paperwork
- I-9, W-4, New Hire reporting
- Garnishment business for child support etc
- State hour & wage laws
- Quarterly/ annual filing
- Monthly remittance
- Failure to remit trust fund penalties

#### **6. Independent Contractors**

- Behavioral Control
- Financial Control
- Relationship of the parties
- SS-8

#### **7. Securities Laws Violations**

- Noncompliance gives each investor a “put” personally guaranteed by you
- Widespread misconception about the mythical “35 investor” rule

#### **8. Not properly licensing intellectual property used by the company**

- Strict software management to prevent infringement from employee downloads
- Statutory damages and injunctions are ruinous

#### **9. Litigation**

- Only 2% of the “winners” feel like they won
- Litigation fees can bankrupt and distract management’s business focus
- Kicking the sleeping tiger?

#### **10. Inadequate Paperwork**

- Paperwork = books, records & written agreements
- Keep organizational records current (one factor considered in “piercing the corporate veil” to impose personal liability on shareholders)
- Inability to track ownership deters investors and purchasers
- Unwritten agreement may be unenforceable under Statute of Frauds
- Use contracts for contract labor
- Use loan documents for shareholder loans