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Starting a business often feels like a dream where you're running but you never seem to get anywhere. You want to land the customers, generate revenue, and worry about the details later. Yet one of the most common – and costly – mistakes new business owners make is treating a startup as a series of task checkboxes instead of a foundational decision.

News flash! How you set up your business affects everything down the road: personal liability, taxes, control of the company, and even how disputes play out.

Why can't I just start?

Whether you realize it or not, starting a business in your own name without forming a legal entity means you're a sole proprietor. No paperwork is required, which is exactly why so many people end up in a sole proprietorship unintentionally.

At first glance, it seems simple. You can accept payments, sign contracts, and get to work. But legally, there's no separation between you and the business. You *are* the business.

Risks of operating without a legal entity

Lack of separation creates real exposure.

If the business takes on debt, *you* owe it. If a customer sues, it's *your* bank account, *your* car, or even *your* home, in some cases, on the chopping block. Insurance helps, but it doesn't replace the protection that comes from forming the right legal structure from the start.

There are also practical downsides. Banks, landlords, and investors view unformed businesses as less credible. You may have trouble opening accounts, securing financing, or negotiating contracts. And from a tax perspective, you lose out on planning opportunities that can reduce your overall liability.

Just as important, operating informally makes it harder to bring in partners, sell part of the business, or transition it later. You're building something that may be difficult to scale or stop.

Consider this scenario

You're a contractor who starts taking on small jobs. At first, you're just earning some side income through cash payments, a few invoices, and nothing formal. Over time, the work grows. You hire a helper, take on larger projects, and sign agreements with clients.

Then something goes wrong. A dispute arises over a project, and the client files a claim for damages. Only at that point do you realize there's no legal separation between your business and your personal finances. The claim isn't just against the business; it's against *you* personally.

This is more common than most people think. Many business owners don't realize they've been operating as a business until a problem forces the issue.

Why forming matters

Forming a legal entity like an LLC or corporation is about more than paperwork. Done correctly, it creates a structure that:

- Separates personal assets from business liabilities
- Signals professionalism to customers, banks, and partners
- Opens the door to tax planning strategies
- Makes it easier to add partners or investors
- Provides a framework for ownership, management, and succession

These benefits only exist if the formation is handled properly and followed through on.

How should I form a business?

At a high level, forming a business involves several key steps:

- **Choose a name.** Ensure it's available in your state and doesn't conflict with existing businesses.
- **Choose the type of entity.** This decision has legal and tax consequences. An LLC, for example, offers flexibility, while a corporation may be better suited for certain growth or investment goals.
- **File formation documents with the state.** This is the step on which many online services focus. It's important, but it's only one piece of the puzzle.
- **Obtain an EIN.** This is the business's federal tax identification number, required for hiring employees and opening bank accounts.
- **Prepare governing documents.** For LLCs, this means an operating agreement. For corporations, this means bylaws and shareholder agreements. These documents define ownership, decision-making, and what happens if something goes wrong.
- **Open separate bank accounts.** Mixing personal and business finances can undermine liability protection and create accounting problems.

- **Follow formalities.** Keep records, document major decisions, and treat the business as a separate entity in practice, not just on paper.

The ‘cheap and easy’ trap

Many business owners are drawn online to quick, low-cost formation options. These services can be useful tools, but they often give the impression that once the state approves your filing, you’re done.

You’re not.

The filing creates the entity but doesn’t define how it operates. Without proper governing documents and follow-through, you may end up with unclear ownership rights, management disputes, or gaps in liability protection.

In other words, you’ve paid for the shell of a business without building the structure you need inside it.

Formation isn’t finished just because the state says ‘Approved’

Many problems start here. Business owners assume the hard part is over once they receive confirmation from the state. That’s only the beginning. The real work is making sure the business is set up to function properly:

- Are ownership percentages clearly defined?
- Is there a plan for decision-making?
- What happens if an owner leaves, becomes disabled, or wants to sell?
- Are finances properly separated and documented?

Ignoring these questions doesn’t make them go away. It just postpones them until they become urgent and expensive.

Practical takeaway

If you’re starting a business — or already operating without a formal structure — take the time to do this right. That doesn’t mean overcomplicating things, but it does mean understanding the consequences of your choices.

A properly formed business is about more than compliance. It’s about protecting what you’re building, developing resilience for the future, and avoiding problems that are much harder to fix later than they are to prevent.
