

CHECKLIST FOR THE BUSINESS START-UP

Frequently, when the decision to start a business moves from an idea to reality, everything seems to demand immediate attention. Important steps may be overlooked. Completing the essential steps included in the checklist will increase the efficiency and organization of a new business.

PERSONAL ASSESSMENT

- Have motivation and energy, willingness to put in long hours with an unpredictable financial return.
- Possess business experience, background and training for the operation.
- Have leadership and organizational abilities, willingness to assume decision-making responsibilities.
- Have interest in working with many different types of people.

PLANNING

- Determine and define the products or service to be provided.
- Develop a business plan.
- Develop a financial plan.
- Develop a marketing and/or promotional plan.

ESTABLISHMENT

- Secure financing.
- Contact the necessary federal, state and local agencies for regulatory information and permit and license applications.
- Review federal, state and local tax laws.
- Obtain management assistance from resource organizations such as Small Business Administration (SBA), or Service Corps of Retired Executives (SCORE).
- Get necessary professional advice and assistance from attorneys and accountants.
- Complete all forms and pay all fees.

IMPLEMENTATION

- Register the business name.
- Obtain adequate insurance coverage.
- Open a separate bank account for the business.
- Hire and train employees.
- Initiate marketing plan.

REGISTRATION FORMS AND REQUIREMENTS

INCORPORATION IN THE STATE OF MARYLAND

Who Must File – Any profit or not-for-profit business wishing to incorporate in the State of Maryland must file Articles of Incorporation. There is a minimum \$100 filing fee.

Where to file:

State Department of Assessments & Taxation
Corporate Charter Division
301 West Preston Street
Baltimore, MD 21201
(301) 225-1340

Note: Do not commence business as a corporation until you receive a written notice of the Department's acceptance of your articles.

COMBINED REGISTRATION APPLICATION – STATE

Who Must File – A business must file a Combined Registration Application with the State of Maryland, Comptroller of the Treasury. This form registers the business with the State and will result in the State providing forms for filing sales and use tax, State withholding tax, State Unemployment Insurance and sales tax license.

Where to file:

State of Maryland
Central Registration
Comptroller of the Treasury
301 West Preston Street, Room 404
Baltimore, MD 21201-2383

You can get an application from any office of a Clerk of the Circuit Court, or call Central Registration in Baltimore 1-800-492-1751.

SS-4 – FEDERAL

Who Must File – Every employer who has not previously obtained an identification number and who pays wages to one or more employees, or is required to have an identification number for use on any return, statement or other document, even if not an employer, must file form SS-4.

Note: If you have become the new owner of an existing, non-corporate business, you CANNOT use the EIN of the previous owner.

When to File – Those who pay wages must file on or before the seventh day after the date on which business begins. Others must file in sufficient time for the identification number to be included in a return, statement or other document.

Where to File:

Internal Revenue Service
Philadelphia, PA 19255

Form SS-4 can be obtained by calling:

Internal Revenue Service
Frederick Office
(301) 663-8578

FICTITIOUS NAME STATEMENT (DBA)

Sole proprietors and general partnerships must file for a trade name or DBA (Doing Business As) with the State Department of Assessments. You must pay an \$11 filing fee plus \$1 for each owner. Further information can be obtained by phoning (410) 225-1340.

For a profit or non-profit corporation, Articles of Incorporation must be filed with the State Department of Assessments & Taxation. A corporate name, if available, can be reserved for a period of 30 days. The reservation fee is \$7.

BUSINESS LICENSES

Some businesses and occupations are required to be licensed by the State. For additional information on licensing, contact the Clerk of the Circuit Court in the county where your business is located. In Frederick County, contact:

Clerk of the Circuit Court
Frederick County Court House
Frederick, MD 21701

SALES TAX

Anyone who engages in the retail sale of tangible personal property from a Maryland location needs a sales tax license. The Maryland sales tax is five percent of retail sales receipts. An application for a license is made on the Combined Registration Application. If you do business in other states or Washington, D.C., you may also be required to pay sales tax on those sales.

PROPERTY TAXES

Property taxes in Maryland are levied by local governments. Tax rates vary by locality. An annual personal property tax return is required to be filed with the State by April 15th. Personal property includes items such as furniture, fixtures and other office equipment.

WORKERS' COMPENSATION

All employers who pay at least \$250 per quarter in payroll are required to have workers' compensation insurance for all their employees. You may obtain this coverage from a private insurance company, by becoming self-insured, or by contacting the Maryland Injured Workers' Insurance Fund in Towson at (410) 494-2000.

PAYROLL — FEDERAL

FTD FORM 8109 – FEDERAL TAX DEPOSIT COUPON – WITHHELD INCOME AND FICA TAXES

How to Make Deposits – In general, you must deposit withheld income tax, and employer and employee FICA taxes, with an authorized financial institution or a Federal Reserve bank or branch. Include a Federal Tax Deposit Coupon (FTD) Form 8109 with each deposit.

When Your Deposits Are Due – The amount of tax you owe determines the frequency of deposits. You owe these taxes when you pay the wages (or make the payments from which the taxes are withheld), not when your payroll period ends. You will be a monthly or semiweekly depositor, based on a “look-back” period from July to June. If you deposited more than \$50,000 in payroll tax liabilities, you are a semi-weekly depositor; if you reported \$50,000 or less, you are a monthly depositor.

Monthly Depositors – All withholding taxes collected during a calendar month must be deposited by the 15th day of the following month. NOTE: New employers will be monthly depositors for the first year.

Semiweekly Depositors – Withholding taxes accumulated on Wednesday, Thursday and/or Friday must be deposited by the following Wednesday. Amounts accumulated on Saturday, Sunday, Monday and/or Tuesday are due the following Friday.

Two special exceptions:

\$500 Rule – No deposits are required for employers who accumulate less than \$500 of tax liability during a quarter. Pay taxes when filing the return at the end of the quarter.

\$100,000 Rule – If the total accumulated tax reaches \$100,000 or more on any day during a deposit period, it must be deposited by the next banking day.

IRS will send you an FTD Coupon Form 8109 Booklet. Use these coupons to make your payroll tax deposits. If you do not receive a supply of coupons or need more than the number sent, you can order more by calling or writing to the Internal Revenue Service.

FTD FORM 8109 – FEDERAL TAX DEPOSIT OF UNEMPLOYMENT TAXES

How to Make Deposits – In general, you must deposit federal unemployment taxes with an authorized financial institution or a Federal Reserve bank or branch, the same as above. Use the same coupon and complete the information regarding type of tax on the coupon submitted.

When Your Deposits are Due –

Less than \$100 at the end of any quarter – If your total undeposited taxes are less than \$100, you may carry the taxes over to the following quarter.

\$100 or more at the end of a quarter – If at the end of any quarter your total undeposited taxes for the quarter are \$100 or more, you must deposit the taxes within 30 days after the end of the quarter.

To calculate the amount of taxes you owe, multiply wages paid up to \$7,000 per employee by 0.8% (.008).

FORM 941 – EMPLOYER’S QUARTERLY FEDERAL TAX RETURN

Form 941 is used to report:

Income tax you withheld from wages, tips, pensions, annuities, supplemental unemployment compensation benefits, certain gambling winnings, and third party payment of sick pay.

Taxes under the Federal Insurance Contribution Act (FICA).

Who Must File – Employers who withhold income tax, FICA taxes, or both must file Form 941 quarterly.

When To File – File starting with the first quarter in which you are required to withhold income tax, or in which you pay wages subject to FICA tax.

Due Dates for Returns

<u>Payroll Period</u>	<u>Due Date</u>
January/February/March	April 30
April/May/June	July 31
July/August/September	October 31
October/November/December	January 31

Where To File:

Internal Revenue Service Center
Philadelphia, PA 19255

After you file your first return, the IRS will send you a form every three months. If you don’t have a form, get one from an IRS office well in advance of the due date.

FORM 940 – EMPLOYER’S ANNUAL FEDERAL UNEMPLOYMENT (FUTA) TAX RETURN

Use Form 940 for the annual reporting of tax under FUTA.

Who Must File – In general, every employer who paid wages of \$1,500 or more in any calendar quarter during the year or had one or more employees for some part of a day in 20 different weeks must file. Include all regular, temporary, and part-time employees.

Where To File:

Internal Revenue Service
Philadelphia, PA 19255

Due Date - January 31

FORM W-2 WAGE AND TAX STATEMENT

All employers must prepare Forms W-2.

Prepare a Form W-2 for each of your employees to whom you paid wages subject to income tax or Social Security (FICA) tax.

By January 31, give copies of W-2 to each person who was your employee during the year.

File Forms W-2 with accompanying W-3 (Social Security Administration copy) by February 28.

Where To File – See Form W-3.

Filers of at least 250 W-2 Forms must use magnetic media. There is a penalty for not filing on magnetic media unless you obtain a hardship waiver (Form 8508).

FORM W-3 – TRANSMITTAL OF INCOME AND TAX STATEMENTS – ANNUAL

Employers and other payers must file Form W-3 with copy A of Forms W-2.

Where To File:

Social Security Administration
Wilkes-Barre Data Operations Center
1150 E. Mountain Drive
Wilkes-Barre, PA 18769

FORM W-4 – EMPLOYEE WITHHOLDING ALLOWANCE CERTIFICATE

All employees are required to complete and sign this form and the employer is required to retain the completed form.

FORM I-9 – EMPLOYMENT ELIGIBILITY

The employer must verify specific employee documents to confirm eligibility to work in the United States. Employer and employee must sign the form and the employer must retain it.

PAYROLL — STATE

DEED/OUI 15 EMPLOYER’S QUARTERLY CONTRIBUTION REPORT

This form is used to report quarterly payments for state unemployment taxes and is used to report the wages paid during the quarter by individual.

When To File – The forms are due January 31, April 30, July 31, and October 31 of each year, together with payment due, if any. The report must be filed even if no wages were paid.

Where To File:

State of Maryland
Dept. of Economic & Employment Development
Office of Unemployment Insurance
P.O. Box 17291
Baltimore, MD 21203-7291

FORM MW-506 - STATE WITHHOLDING TAX

Form MW-506 is used to file the withheld Maryland taxes.

When To File – You will usually file by the 15th day of the following month. The state will notify you of your status as a monthly or quarterly depositor.

Where To File:

Comptroller of the Treasury
Revenue Administration Division
Remittance Processing Center
110 Carroll Street
Annapolis, MD 21411-0001

FORM MW-508 - ANNUAL RETURN FOR WITHHOLDING TAXES

Form MW-508 is used to reconcile the total amount of Maryland’s withholding taxes as reported on your Forms MW-506 with the amounts reported on Forms W-2.

When To File – February 28

Where To File:

Comptroller of the Treasury
Revenue Administration Division
Annapolis, MD 21411-0001

FORM 1099 - INFORMATION RETURN

Every person engaged in a trade or business and making “payments in the course of a trade or business” must file Information Return Forms 1099. Payments made to corporations are exempt from the reporting requirements.

“Payments in the course of a trade or business” include payments for services totaling \$600 or more to any person in a calendar year. Such payments are not subject to withholding tax and are not reported on withholding statement (W-2).

The return is required to be furnished to each person by January 31 of the year following the calendar year during which payment was made. A copy is also sent to the Internal Revenue Service for use in auditing the recipient’s tax return.

There are substantial penalties for failure to file information returns (\$50 per 1099, up to \$100,000 maximum, in most cases) and for failure to include the recipient’s identification number (\$50 per 1099).

Magnetic Media – If you file at least 50 information returns, you must file on magnetic media. There is a penalty for not doing so unless you obtain a waiver for undue hardship.

Form 1096 is the transmittal sheet to be sent to the IRS with each type of Form 1099.

CORPORATION INCOME TAX RETURN - FEDERAL

FORM 1120 - U. S. CORPORATION INCOME TAX RETURN

Domestic corporations, whether or not they have taxable income, must file Form 1120 by the 15th day of the 3rd month after fiscal year end (extensions of time to file are available, if requested on time.)

Payment of tax must be made to the bank with Form 8109.

FTD FORM 8109 - CORPORATION ESTIMATED TAX

A corporation must make an estimated federal tax payment on Form 8109 if it can expect income taxes to be \$500 or more.

FORM 1120S - U.S. INCOME TAX RETURN FOR AN S CORPORATION

S Corporations must file Form 1120S by the 15th day of the third month after fiscal year end. Extensions are available if requested on time. The taxable income passes through to the shareholders’ individual tax returns.

CORPORATION INCOME TAX - MARYLAND

MARYLAND FORM 500 - CORPORATION INCOME TAX RETURN

A corporation having Maryland income must file Form 500 by the 15th day of the third month after fiscal year end. Extensions are available if requested on time.

Where to File:

Comptroller of the Treasury
Revenue Administration Division
Annapolis, MD 21411-0001
(301) 974-3981

Estimated Payments – Corporations are required to make quarterly estimates on Form 500D or 500 DEP on or before the 15th day of the 4th, 6th, 9th and 12th months after the close of the tax year if income tax can be expected to exceed \$1000 for the year.

MARYLAND FORM 510 - PASS THROUGH ENTITY INCOME TAX RETURN

S Corporations having Maryland income must file Form 510 by the 15th day of the third month after fiscal year end. The taxable income passes through to the individual shareholders.

PARTNERSHIP TAX RETURNS – FEDERAL AND MARYLAND

FORM 1065 – U. S. PARTNERSHIP RETURN OF INCOME

Every partnership and limited liability company engaged in a trade or business or having income from sources within the United States must file Form 1065. The return is due by the 15th day of the fourth month after year end. Extensions are available by filing Form 8736. No tax is due with this return.

FORM 510 – PASS-THROUGH ENTITY INCOME TAX RETURN

All Maryland partnerships and limited liability companies must file

annually. The return is due on or before the 15th day of the fourth month after year end. Extensions are available by filing Form 510E.

PROPRIETORSHIP TAXES

The net income or loss of a proprietorship is reported as part of the income tax return (Form 1040 and MD 502) of the business owner. The income and expenses of the business are reported on Schedule C “Profit or Loss from a Business or Profession” and are taxable to the owner. The net income is subject to self employment tax.

CHARTS OF ACCOUNTS

Business transactions should be recorded (grouped) and totaled according to the following list (may be modified for different types of businesses).

CURRENT ASSETS

- 1000 CASH - CHECKING ACCOUNT
- 1050 CASH - SAVINGS ACCOUNT
- 1070 PETTY CASH
- 1100 ACCOUNTS RECEIVABLE
- 1120 NOTES RECEIVABLE
- 1130 ACCTS RECEIVABLE - OTHER
- 1140 LOANS RECEIVABLE - EMPLOYEES
- 1150 TRAVEL ALLOWANCE
- 1190 ALLOWANCE FOR DOUBTFUL ACCTS
- 1200 INVENTORY
- 1210 INVENTORY - RAW MATERIAL
- 1230 INVENTORY - WORK IN PROGRESS
- 1250 INVENTORY - FINISHED GOODS
- 1300 PREPAID EXPENSES
- 1320 PREPAID TAXES
- 1350 DEPOSITS

FIXED ASSETS

- 1400 LAND
- 1410 LAND IMPROVEMENTS
- 1420 BUILDINGS
- 1440 MACHINERY & EQUIPMENT
- 1460 AUTOS & TRUCKS
- 1480 FURNITURE & FIXTURES
- 1490 LEASEHOLD IMPROVEMENTS
- 1500 ACCUMULATED DEPRECIATION

OTHER ASSETS

- 1600 OTHER ASSETS

CURRENT LIABILITIES

- 2000 ACCOUNTS PAYABLE
- 2100 SALARY & WAGES PAYABLE
- 2110 COMMISSIONS PAYABLE
- 2200 ACCRUED LIABILITIES
- 2300 PAYROLL TAXES PAYABLE
- 2400 SALES TAX PAYABLE
- 2450 PROPERTY TAX PAYABLE
- 2500 STATE TAX PAYABLE
- 2510 FEDERAL TAX PAYABLE
- 2600 NOTES PAYABLE

LONG TERM LIABILITIES

- 2700 NOTES PAYABLE - LONG TERM
- 2750 MORTGAGES PAYABLE

STOCKHOLDERS' EQUITY

- 3000 COMMON STOCK

- 3010 TREASURY STOCK
- 3050 PAID IN SURPLUS
- 3100 RETAINED EARNINGS

REVENUE

- 4000 SALES
- 4500 RETURNS & ALLOWANCES

COST OF SALES

- 5000 DIRECT LABOR
- 5100 SUBCONTRACTS
- 5500 PURCHASES
- 5900 INVENTORY ADJUSTMENT

ADMINISTRATIVE EXPENSES

- 6050 SALARY - OFFICE
- 6070 SALARY - SALES
- 6090 SALARY - EXECUTIVE
- 6100 CONTRACT LABOR & COMMISSIONS
- 6150 VACATION PAY
- 6200 PRODUCTION SUPPLIES
- 6220 OFFICE SUPPLIES
- 6230 SMALL TOOLS & EQUIPMENT
- 6240 DUES & SUBSCRIPTIONS
- 6250 FREIGHT & POSTAGE
- 6260 RENT
- 6270 EQUIPMENT RENTAL
- 6300 REPAIRS & MAINTENANCE
- 6350 OUTSIDE SERVICES
- 6370 AUTO & TRUCK RENTAL
- 6390 UTILITIES
- 6400 TELEPHONE
- 6420 LAUNDRY
- 6450 DEPRECIATION
- 6460 AMORTIZATION
- 6500 INSURANCE
- 6520 PROPERTY TAXES
- 6530 PAYROLL TAXES
- 6550 MISCELLANEOUS TAXES & LICENSES
- 6600 ADVERTISING
- 6620 ENTERTAINMENT & PROMOTION
- 6640 TRAVEL & LODGING
- 6650 MEALS
- 6700 MISCELLANEOUS
- 6710 CONTRIBUTIONS
- 6750 INTEREST
- 6770 BAD DEBTS
- 6800 CASH SHORT (OVER)
- 7000 PROVISION FOR INCOME TAX

OTHER INCOME

- 8001 INTEREST INCOME
- 8005 MISCELLANEOUS INCOME

MONTHLY RECONCILIATIONS

CASH

Balance at beginning of month	\$
+ Net amount received (Cash Receipts)	+
- Net amount of checks (Cash Disbursements)	- _____
Balance at end of month	\$

Balance at end of month to be reconciled to checkbook and to bank statement as of last day of each month.

ACCOUNTS RECEIVABLE

Balance at beginning of month	\$
+ Accounts Receivable billed (Sales Record)	+
- Accts. Receivable collections (Cash Receipts)	- _____
Balance at end of month	\$

Balance at end of month to be reconciled to balances owing at month end per accounts receivable ledgers.

ACCOUNTS PAYABLE

Balance at beginning of month	\$
+ Accounts Payable credit (Invoice Ledger)	+
- Accounts Payable paid (Cash Disbursements)	- _____
Balance at end of month	\$

The unpaid bills in the "to be paid" file and other bills due should be totaled and the amount reconciled to the total above.

MONTHLY RECONCILIATIONS

The following checklist will help you analyze your financial statements on a monthly basis.

- Determine net profit or loss and how this compares with your budget.
- Make monthly and year-to-date comparisons of income and expense. Some items such as administrative salaries should be compared on an actual basis; others should be compared on a percentage basis.
- Circle income or expense items that have changed substantially, and check your records to determine why they have changed.
- Determine if seasonal fluctuations such as holidays or weather would materially change the statements.
- Determine any trends. You may want to graph your income and expenses in order to help you determine these trends.
- Compare your Income Statement to your Daily and Weekly Control Sheet.
- Determine whether you are making enough profit to pay all your bills.
- Adjust net profit for expenses not properly stated, such as reasonable salary compensation for a working owner or a reasonable rental factor if the building is owned and not leased.

- If an inventory has been taken, consider adjusting the financial statements for any large variance in stock.
- Determine that accounts payable and receivable listed on the Balance Sheet are correct.
- If material or labor costs are higher, determine whether an increase is attributed to usage or prices.

CASH DISBURSEMENT PROCEDURES

Following improper procedures in paying bills could create problems for daily business management or Internal Revenue Service audits. These few simple suggestions may help you.

- Every check should have some written document to support it – an invoice, petty cash voucher, payroll summary or check request will suffice. If such support is not available, write a memo stating what the check is for.
- Each of these supporting documents should be signed or initialed by you or someone you have authorized to do so. The signature should indicate that the goods or services have been received, the terms and price are correct, and no error has been made in computing the amount to be paid. When cash discounts are offered, make sure they are computed and deducted correctly.
- When each check is written, the supporting document should be marked "Paid" and should include the date and check number. If the checks are prepared for your signature by an employee, you should see the supporting document before you sign the check. If you do not use voucher (multiple copy) checks, it is generally recommended that you purchase a "Paid" stamp, which has an imprint where you may enter the date and check number. This stamp should be used with red ink so paid invoices are easily identified.
- After payment has been made, this supporting material should be filed in a paid bills file. The paid bills file should be kept in alphabetical order by payee for each accounting year (fiscal or calendar). Start a new file at the beginning of each calendar or fiscal year.
- It is recommended that paid bills be kept for seven years

TRAVEL AND ENTERTAINMENT DEDUCTIONS

No area of the tax law includes more tax opportunities – or more tax traps - than deductions for travel, transportation and entertainment expenses. The rules are complex and often difficult to understand. In addition, this is one of the IRS' favorite targets when conducting audits.

TRAVEL

Local – Local business travel is travel for business purposes which begins and ends at home on the same day. Commuting, regardless of the trip's length, is NOT deductible. The cost of travel between job sites and business locations is deductible. The cost from home to the first site or from the last site to home is not deductible.

Away from Home – Expenses for business purposes are deductible. Deductible expenses include air and bus fares, meals and lodging, rental vehicles, transportation to and from airport and hotel, taxi, laundry and dry cleaning, and numerous others. Documentation of all expenses is critical; see the section on recordkeeping for specifics.

ENTERTAINMENT

You may deduct 50% of entertainment expenses if they are "ordinary and necessary" business expenses. A deduction is allowed if the taxpayer can show the expenses are "directly related to" or "associated with" the conduct of a trade or business. The thrust of the discussion must be documented.

FORMS OF DOING BUSINESS

SOLE PROPRIETORSHIP

In a sole proprietorship, the assets and liabilities of the business are owned directly and entirely by one individual. A sole proprietor considering incorporation should know that incorporating would mean he could no longer treat the business as his own, though he owns 100 percent of the stock. Many of the tax difficulties of a one-person corporation are due to the owner's inability or refusal to recognize that he cannot toy with the assets of the business. The net income of a proprietorship is taxed directly to the owner of the business. The sole proprietor is also at risk for the business's liabilities. Along with the business, he or she could lose personal assets such as a home, car or savings.

PARTNERSHIPS

Partnerships include any unincorporated trade or business carried on by two or more persons who contribute capital or services to the venture and share in its profits and losses. In addition to the ordinary partnership, the term includes syndicates, groups, pools, and joint ventures. The net income of a partnership is taxed to the individual partners in accordance with their percentage share of the business. This income is taxed whether or not it is distributed to the partners.

LIMITED LIABILITY COMPANY

The limited liability company is the newest form of business entity. Its liability protection is similar to corporations and its flow-through losses are similar to partnerships and S corporations. The LLC offers an unlimited number of owners, but cannot offer fringe benefit and retirement packages available to corporate employees.

CORPORATION

A corporation is an entity created under business corporation state law which is taxed as a corporation under federal income tax law. The net income of a corporation is taxed directly to the corporation at corporate rates. A corporation can have one shareholder or many shareholders. Most business owners choose to operate as a corporation because of limited liability. Personal assets are protected from corporate liabilities and vice versa. Corporate income tax rates are also another attraction of corporations. Corporate rates range from 15% to 35%, based on taxable income. Individuals can use corporations to shelter income from tax, often by splitting income between a corporation and individual to avoid paying tax at the highest rates.

DECIDING WHETHER TO INCORPORATE

From a tax viewpoint, the corporation and the unincorporated entity have advantages and disadvantages. Determining whether tax factors dictate a corporate or noncorporate form is easier for a sole proprietorship than for a multimember partnership with differing personal interests. Rarely will all partners agree that incorporation is either inadvisable or advisable when evaluating their individual interests. Situations do exist where the federal tax structure clearly favors one form of business. Some instances are listed below.

- A corporation is better for an infant or expanding profitable business which needs capital.
- When most of a successful business' employees are owners, the corporation - with its liberal deferred compensation and fringe benefit plans - is better.
- When the owners of a multi-employee business personally need or want their earnings now, a noncorporate form is better - espe-

cially if the business provides employees with minimal deferred compensation and fringe benefit plans.

- When the business is going through a loss era (perhaps because it is a new business), a noncorporate form is better.

Small tax benefits alone do not justify the incorporation of a business, even though tax law facilitates incorporation. For example, if a business loaded with goodwill is incorporated tax free and liquidated two years later, the transaction could produce a substantial long-term capital gain on the original amount of goodwill, although it is simply restored to the original owner. It makes sense, therefore, to incorporate under these conditions:

- The objectives of the business and its owners will clearly be better achieved under corporate tax rules.
- There is a nontax reason (such as limited liability) which compels incorporation regardless of tax consequences.

LEGAL FORMS OF ORGANIZATION

The following short list compares the forms of business organization as they relate to human resources, funding, government regulations and revenue. Keep in mind that your initial organization decision can be changed. As your business grows and prospers, your financial and tax situations may warrant a change in your form of organization.

HUMAN RESOURCES

MANAGEMENT CONTROL

Proprietorship – One owner in total control

Partnership – Divided among two or more partners; decisions made by majority or prearranged agreement (limited partner cannot manage the business)

Corporation – Corporation acts as one person, but Board of Directors (influenced by votes of shareholders) hold legal, formal control; working control held by those who manage the business day-to-day

Limited Liability Company – Divided among partners unless limited by articles of organization

PERSONNEL AND EXPERTISE

Proprietorship – Depends primarily on owner's skills; often hard to obtain qualified employees

Partnership – Depends primarily on partners' skills; often hard to find suitable partners or employees

Corporation – Allows for flexible management; easier to secure quality employees with the necessary expertise

Limited Liability Company – Depends primarily on partners' skills; often hard to find suitable partners or employees

CONTINUITY/TRANSFERABILITY

Proprietorship – Ends on death of owner; free to sell or transfer

Partnership – Ends on death of partner (unless otherwise agreed in writing); transfer conditions vary with agreement

Corporation – Continues indefinitely; most flexible in terms of transfer of interest (i.e. ownership) from one shareholder to another

Limited Liability Company – Restricted transferability unless authorized by articles of organization or operation agreement. Death or bankruptcy of member causes dissolution (important for favorable tax treatment of LLC)

INITIAL FUNDING

REQUIREMENTS AND COSTS

Proprietorship – costs are lowest (filing fee required if business held under name other than owner's)

Partnership – costs low; general partnership agreement optional but recommended (limited partnership means that an agreement stating the liabilities and responsibilities of each partner is required)

Corporation – Costs are highest; legal forms, documents, professional fees required

Limited Liability Company – Costs are higher than a partnership, but less than a corporation; must file Articles of Organization with the state

ABILITY TO RAISE CAPITAL

Proprietorship – Limited - all equity (funding) must come from proprietor; loans based on credit-worthiness of owner

Partnership – Limited to resources of each of the partners and the ability of each to acquire loans and/or investors

Corporation – Greatest equity potential - can sell new stock; loans based on corporate financial strength and expertise thus providing larger borrowing base

Limited Liability Company – Limited to resources of each of the partners and the ability of each to acquire loans and/or investors

LOSSES/DEBTS

Proprietorship – Owner liable for all debts

Partnership – Partners liable for all debts (limited partner has restricted liability and involvement per partnership agreement)

Corporation – Corporation liable for debts (i.e., shareholders are liable only for amount invested; are liable for more only if personal guarantees were given)

Limited Liability Company – LLC is liable for debts (Shareholders are liable only for amount invested; liable for more only if personal guarantees were given)

GOVERNMENT REGULATION

Proprietorship – Little regulation; few records needed

Partnership – Subject to limited regulation; few records needed; articles of partnership should be drawn up

Corporation - Extensive recordkeeping required; must have Articles of Incorporation; by-laws and filing fees

Limited Liability Company - Must have Articles of Organization; filing fees

REVENUE

PROFITS

Proprietorship – All profits to owner

Partnership – Divided among partners

Corporation – Retained in corporation; shareholders receive dividends

Limited Liability Company – Divided among partners

GROWTH POTENTIAL

Proprietorship – Limited options - reinvest profits, obtain loans on owner's line-of-credit

Partnership – Limited options - reinvest profits, obtain loans on partners lines-of-credit

Corporation – Flexible - can reinvest profits (at discretion of Board of Directors); sell additional shares; obtain loans on corporate credit

Limited Liability Company – Limited options - reinvest profits, obtain loans on partners' lines-of-credit

EMPLOYEE VS. INDEPENDENT CONTRACTOR

Trying to determine whether you are dealing with an employee or an independent contractor can be pretty confusing. Even the courts often find that the traditional rule of thumb is not enough; other factors need to be considered. Under the common law test, an employee can be directed and controlled as to when, where and how the work should be done, as well as its tangible result. The employer need not exercise control; it is sufficient that he has the right to do so. The factors or elements that show control are listed below. Any single fact or a small group of facts is not conclusive evidence of the presence or absence of control as these common law factors are not always present in every case. Some factors do not apply to certain occupations, and the importance of each factor may vary with the occupation. Each factor is not always given equal weight. In each case, therefore, you must consider: that the factor exists; and how significant it is in determining whether a worker is an employee or an independent contractor.

SIGNPOSTS OF AN EMPLOYEE

- May be discharged.
- Receives hourly or salaried payment on a periodic basis.
- Permanent relationship is intended.
- Has regular, continuous, or stated tenure.
- Has employer-furnished tools, equipment, and/or place of work.
- Must do the job personally.
- Other employment is restricted.
- Training provided.
- Has set hours of work.

SIGNPOSTS OF AN INDEPENDENT CONTRACTOR

- Receives payment by the job.
- Number of transactions is single or limited.
- Relationship is brief in duration.
- The worker has a substantial investment in the work.
- The worker has an opportunity for profit or loss.
- Others may be employed to assist the worker.
- Services are offered to the general public.
- The person is involved in a recognized trade or calling.