

STARTING A NEW BUSINESS: A SIMPLE GUIDE TO FINANCIAL, TAX AND ACCOUNTING CONSIDERATIONS

Available from:
RMARK Financial Services & Custom Payroll Associates, Inc.
816 Office Park Circle
Lewisville, Texas 75057

RMARK Financial Services
www.rmark.com
214-222-0316

Custom Payroll Associates, Inc.
www.custompayroll.com
972-353-0000

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Introduction:

This book is the distillation of well over fifty years of business experience. My partner, Robert Shahan and I, both grew up in family-owned and operated businesses.

Each of us is a licensed CPA in Texas. Robert is a former IRS agent and I spent many years in industry before going into private practice in 1991.

We both enjoy being in business for ourselves. We don't do work for Fortune 500 companies. Instead, we work with the backbone of this country - small business. It is what we like to do.

Nothing we do or say here is intended to replace solid advice from local professional advisors where you plan to do business. There is no way to capture every local and state variation in an ebook like this and we will not try.

What we want to do is give you an overview of business based on our experience, some tips to avoid avoidable problems, questions to pose to your specific advisors and a general outline of areas that need to be addressed.

We both feel you need a good CPA and a good attorney to guide you through some of the bureaucratic details. But it is your business. Attorneys and CPAs are trained in certain areas and you should use them only as advisors. The decisions are yours and yours alone. They cannot be delegated to your advisors or employees.

Good luck on your new business. It can be a great ride and a lot of fun.

CHAPTER 1

SELECTING A LEGAL ENTITY

One of the first major decisions you will have to make as you start your new business is the form of legal entity it will take. To a large degree, this decision may be dictated by the way you have organized your operations and whether you intend to work on your own or in conjunction with others.

The form of entity you choose can have a significant impact on the way you are protected under the law and the way you are affected by income tax rules and regulations. There are five basic forms of business organizations. Each has its own benefits and drawbacks and is treated differently for legal and tax purposes.

Sole Proprietorship

A sole proprietorship is typically a business owned and operated by one individual, or very often by a husband and wife. A sole proprietorship is not considered to be a legal entity under the law but rather is an extension of the individual who owns it. The owner has possession of the business assets and is directly responsible for the debts and other liabilities incurred by the business. The income or loss of a sole proprietorship is combined with the other earnings of an individual for income tax purposes.

A sole proprietorship is perhaps the easiest form of business to own and operate because it does not require any specific legal organization except, of course, the normal industry requirements such as licenses or permits. A sole proprietorship typically does not have any rules or operating regulations under which it must function. The business decisions are solely the result of the owner's abilities.

If you are going to operate a sole proprietorship, or any entity whatsoever, under a name other than your own, you need to file a fictitious name statement or **DBA** (Doing Business As). This allows anyone doing business with you to find the legal entity behind the trade name you are using. Normally, you will file this at the county clerk's office in the county where you are doing business and with the Secretary of State in your state. It is usually very inexpensive to file such a statement.

Partnerships

Partnerships can take two legal forms - general or limited. In a general partnership, two or more individuals join together to run the business enterprise. A partnership must usually file a DBA to operate a business under the partnership name. Each of the individual partners has ownership of the partnership assets and responsibility for the partnership liabilities, as well as authority in running the business. The authority of the partners, and the way in which profits or losses are to be shared, can be modified by the partnership agreement. The responsibility for liabilities can also be modified by agreement among the partners, but partnership creditors typically have recourse to the personal assets of each of the partners for settlement of partnership debts.

A limited partnership is comprised of one or more general partners who are personally liable for partnership debts and one or more limited partners who contribute capital and share in the profits or losses of the business. The limited partners do not take a part in running the business and are not liable for the debts of the partnership. The general partner in many cases can also be a corporation to eliminate any personal liability.

The rights, responsibilities, and obligations of both the limited and

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general partners are typically detailed in a partnership agreement. It is a good idea to have such an agreement for any partnership whether limited or general.

A partnership is a legal entity recognized under the law and as such it has rights and responsibilities in and of itself. A partnership can sign contracts, obtain trade credit, and borrow money. When a partnership is small most creditors require a personal guarantee of the general partners for credit.

A partnership is also required to file federal and state (where applicable) income tax returns. A partnership typically does not pay income tax. The information from the partnership Form 1065 tax return is combined with the personal income of the partners to determine combined personal and business tax liability on each partner's IRS Form 1040.

A partnership will likely be required to file their information with the state they are formed and operate in.

Corporation

A corporation is a separate legal entity that exists under the authority granted by state law. A corporation has substantially all of the legal rights of an individual and is responsible for its own debts. It must also file income tax returns and pay taxes on income it derives from its operations. Typically, the owners of a corporation who are "shareholders" are protected from the liabilities of the business. However, when a corporation is small, creditors often require personal guarantees of the principal owners before extending credit. The legal protection afforded the owners of a corporation can far outweigh the additional expense of starting and administering a corporation. There can be additional tax savings for a corporation over a sole proprietorship.

A corporation must obtain permission from the secretary of state to use or do business under a fictitious name. A corporation must also adopt and file articles of incorporation and by-laws that govern its rights and obligations to its shareholders, directors and officers. These are normally filed with the secretary of state's office in the state capital and the county clerk's office where you do business. Your county clerk's office should have all the necessary forms and is the place to start. This can be done in person, by mail or by a third party. You will also have to file with each state you have a nexus in. So, even if you choose a state that is easy to create a corporation in and has favorable tax laws for your corporation, you will still have to file in the state you actually do business in.

Corporations must file annual income tax returns with the IRS. States in which the corporation does business may require annual filing. The elections made in a corporation's initial tax returns can have a significant impact on how the business is taxed in the future.

Incorporating a business allows a number of other advantages such as the ease of bringing in additional capital through the sale of equity and allowing an individual to sell or transfer their interest in the business. It also provides for business continuity when the original owners choose to retire or sell their interest.

Should you decide to incorporate your business venture, you should seek the advice of competent legal counsel or business-oriented accountants.

S Corporations

An S corporation is treated like a regular corporation with one exception. For federal income tax purposes, an S corporation will pay no federal tax. State corporate income tax may still have to be reported and paid. Income

or net loss from the S corporation's federal tax returns is combined with the other income of the stockholder on his or her personal federal tax return. There are special rules governing the deductibility of S corporation losses and certain deductions.

S corporation status is attained by timely filing of an IRS Form 2553. The decision to elect "S" status is not always an easy one. Careful consultation should be obtained prior to incorporation for new businesses or before filing the election for existing corporations.

Limited Liability Company

A limited liability corporation (LLC) is a new form of business organization that may combine the liability protection of a corporation with the favorable tax treatment of a partnership. The laws vary somewhat from state to state, so consult with competent legal counsel and business-oriented CPAs in the state(s) you will operate your business.

An LLC is an incorporated business organization that generally protects all owners against individual liability for the organization's liability and obligations, and against vicarious liability for the negligence and malfeasance of others involved in the business. Management may be flexibly structured to allow members to apportion management authority in the manner they determine the most appropriate. Partnership classification is assured under some state statutes and may be attained through proper structuring in others.

Most LLCs will have limitations on the transferability of the interest of its members and the ability of members to carry on the business after any member ceases to be involved in the LLC through death, retirement, withdrawal or expulsion. Under the more flexible state statutes, these limitations may be reduced or eliminated through careful drafting of the articles of organization.

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Creating an LLC is as simple as forming a corporation. The organization must file Articles of Organization with the secretary of state. These are similar to the Articles of Incorporation used to form corporations. The filing fees are much the same.

An operating agreement defines the rights and obligations of the members, including how profits, losses, and distributions will be shared. Members are not personally liable for the debts and obligations of the LLC. The only individual liabilities the members have are for: (1) the amounts the members have agreed to contribute to the LLC; (2) under some statutes, amounts distributed to the members; (3) any negligence or malfeasance the member individually commits or that the member supervises. This generally means that members are not liable for the contracts and general liabilities of the LLC or for any mistakes or improper actions of others in the name of the LLC.

One of the greatest advantages of forming an LLC is its tax structure. If properly structured, LLCs provide the benefit of one level of taxation; therefore, as with partnerships, any income generated by the company is passed through to the tax return of the owner. Owners do not avoid personal taxes, but corporate taxes are avoided.

Combinations

Under some circumstances it may be advantageous to use several forms of business simultaneously. One currently popular form is to use an LLP with an S corporation as the one percent general partner. The S corporation can be set up as a Nevada or Delaware corporation if appropriate, which is usually not. This can reduce corporate taxes (though not personal flow-through taxes) to almost zero, and still provide legal liability protection for the owners.

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Form of Business Menu

Structure	Ownership Rules	Tax treatment	Liability	Pros & Cons
Sole Proprietorship	One Owner	Income reported on personal return	Unlimited personal liability	Easy to set up but leaves your personal finances at risk - few business deductions
S corporation	Up to 75 Shareholders w/ one class of stock	Pass through federal entity	Limited	Easy to set up but may later limit financing options
C corporation	Unlimited shareholders - no limits on classes of stock or voting arrangements	Dividend income taxed at the corporate and shareholder levels; losses and deductions stay at corporate level	Limited	Can be costly from a tax perspective but investor friendly
Limited Liability Company	Unlimited number of members - flexible membership arrangements	Pass through federal entity	Limited	Has advantages but makes investors leery - cost of switching forms from S or C corp status generally prohibitive
Partnership	Two or more owners	Pass through federal tax entity, flexibility of profit and loss allocations among partners	Personal assets of any operating partner at risk from business creditors	Allows lots of room to play with tax benefits - general partnership personal liability can be scary
Limited Liability Partnership	Two or more owners	Pass through federal tax entity, flexibility about profit and loss allocations among partners	Limited	Has advantages over traditional partnership; easy for partnership to switch but has not gained acceptance in all states

Chapter 2

REGISTERING WITH THE TAX AUTHORITIES

A significant task for the new business owner is assuring that the business is properly complying with the extensive tax and information filing requirements imposed by various governmental agencies. Stiff penalties are commonly assessed if the required forms and returns are not properly prepared and timely filed. There are several forms required to be filed when the business is started. While this chapter is not intended to be an all-inclusive list of the filing requirements, it summarizes some of the more prominent requirements common to most businesses. Professionals with experience in your business should be consulted to assure that any industry-specific filings are properly handled.

Internal Revenue Service

All tax forms filed with the Internal Revenue Service require the use of a Federal Employer Identification Number (FEIN). This number is obtained by filing a Form SS-4 with the IRS. An example of Form SS-4 is in the Exhibit Section.

There is no deadline for filing Form SS-4. However, to avoid substantial confusion, file your Form SS-4 early. If an income tax form is filed without a FEIN, the IRS will assign one. It is not uncommon for one business to be assigned more than one FEIN, which can result in notices for delinquent tax returns that have been filed using a second FEIN.

Most filings with the IRS come under the headings of income and payroll taxes. Payroll tax requirements are detailed in Chapter Four. Income tax filing requirements and tax planning are discussed in Chapter Six.

State Unemployment Agency

In every state there is state unemployment agency. It can be identified by various names. The American Payroll Association lists every state unemployment agency and has a link to each of their Internet sites. When you submit an SS-4 to the IRS they automatically notify the state unemployment agency that you have applied for an FEIN. The state unemployment agency should send you a package of information on state unemployment taxes and forms to obtain a state unemployment ID number that may be different from your FEIN. Normally, the filing and deposits are quarterly but may be more often depending on the amount of the deposit and the state you are in. More and more states are going to electronic filing even, for very small businesses.

Sales and Use Tax

You will need to obtain a Sales and Use Tax Permit if you sell any taxable products or services. To find your state's sales tax agency go to your browser and type "Sales Tax" and the name of your state. You will have to need a permit to collect and remit sales tax. Many times there is no fee for obtaining a permit. You will then have to file reports, possibly as often as monthly, depending on your volume of taxable sales collected.

Use tax is normally the same rate as sales tax. It is imposed on any purchase of goods or services you did not pay sales tax on but is eligible for state tax. For instance, you own a convenience store and you buy Windex[®] for resell and occasionally get a bottle to clean your own windows. You paid no sales tax on the Windex when you bought it because you bought it for resale. If you then consume it in your business, you are the ultimate consumer and sales tax should have been paid. Since you didn't pay sales tax on the Windex, you now

owe use tax on it at the same rate you would have paid sales tax. Another common situation of use tax is when you buy products from out of state and are not charged sales tax by the seller. If the purchase is taxable in your state, you owe use tax.

Business License

To operate a business you may need to obtain a business license. Applications can typically be obtained at the city hall where your business is located. At the time of filing the application, a fee must be paid that can range from nothing to \$25,000 depending on the city and the size of the business. The license is usually issued immediately and must be posted in plain sight at your place of business. The license, with the related fee, may normally be renewed annually.

Tax Calendar

The following summarizes some of the more significant filing dates for a corporation using a calendar year-end. Many of these requirements also apply to partnerships and sole proprietorships. Naturally, if a year-end other than December 31st is used (see Chapter Five) some of these dates will vary.

JANUARY 15TH

- File and pay fourth estimated tax payment

JANUARY 31ST

- Send out IRS Form W-2 for previous year
- Pay any undeposited federal unemployment tax and file IRS Form 940.
- On IRS Form 941, report wages and tax related to employees' wages of previous quarter (income, FICA, Medicare) - pay any un-deposited withheld tax
- Pay previous quarter's state unemployment tax and file a quarterly report with the state revenue agency

FEBRUARY 28TH

- Form W-3, report wage information to the Social Security Administration - include copies of all W-2s - make no payment

MARCH 15TH

- Pay and file corporate income tax (Form 1120 or Form 1120S)
- File for six-month corporate tax extension with Form 7004 - pay estimated tax
- Deadline to file Form 2553 for S corp. election for this calendar year

APRIL 15TH

- Pay and file personal income tax Form 1040
- File automatic four month extension and pay estimated taxes (1040)
- File first estimated tax payment

APRIL 30TH

- On IRS Form 941, report wages and tax related to employees' wages of previous quarter (income, FICA, Medicare) - pay any un-deposited withheld tax
- Deposit federal unemployment tax for previous quarter if more than \$100
- Pay the previous quarter's state unemployment tax and file "Employers Quarterly Report"

MAY 15TH

- Pay and file the state franchise tax with the comptroller. Alternative: file for a six-month extension but estimated tax due now

JUNE 15TH

- File second estimated tax payment

JULY 31ST

- On IRS Form 941, report wages and tax related to employees' wages of previous quarter (income, FICA, Medicare) - pay any un-deposited withheld tax
- Deposit federal unemployment tax for previous quarter if more than \$100
- Pay previous quarter's state unemployment tax and file quarterly report with the state revenue agency

AUGUST 15TH

- Pay and file extended personal income tax Form 1040 - previously extended
- File second extension (1040)

SEPTEMBER 15TH

- Pay and file corporate income tax (1120/1102S) - previously extended
- Pay third estimated tax payment

OCTOBER 15TH

- Pay and file personal income tax (1040/1041) - those extended twice

OCTOBER 31ST

- On IRS Form 941, report wages and tax related to employees' wages of previous quarter (income, FICA, Medicare) - pay any un-deposited withheld tax
- Deposit federal unemployment tax for previous quarter if more than \$100
- Pay previous quarter's state unemployment tax and file quarterly report with the state revenue agency

There are numerous other tax filing deadlines if you deal in certain regulated industries such as utilities or petroleum.

CHAPTER 3

ACCOUNTING AND BOOKKEEPING

Most operators of a new and growing business have a flair for the environment in which the business operates. They may be a great salesperson, an outstanding mechanic, carpenter, lawyer, or inventor. Unfortunately, most people don't like to keep the books. As a business owner, you must remember that your company's books and financial statements represent a score sheet that tells how you are progressing. They also act as an early warning system that lets you know when and why the business may be going amiss. Financial statements and the underlying records will provide the basis for many decisions made by outsiders such as banks, landlords, potential investors and trade creditors, not to mention taxing authorities and other governing bodies. The necessity for good, well-organized financial records cannot be over-emphasized. One of the greatest mistakes made by owners of small businesses is not keeping good financial records and making improper or poor business decisions based on inadequate information.

Quality financial information does not necessarily translate into complicated bookkeeping or accounting systems. Far too often owners of businesses become overwhelmed by their accounting system to the point where it is of no use to them. An accounting or bookkeeping system is like any tool used in your business; it should be sophisticated enough to provide the information you need to run your business and simple enough for you to run it (or supervise the bookkeeper). Questions you should ask in developing an accounting and financial reporting system include:

- Who will be the users of the financial information?
- What questions do I need answered to manage the business?
- What questions should be answered for government or regulatory taxing authorities?

As your business grows, you should work closely with your CPA to ensure that your accounting system is providing you with appropriate information.

Chart of Accounts

The basic road map into any accounting system is the chart of accounts. It is this chart that helps establish the information captured by your accounting system and what information will subsequently be readily retrievable by the system. This tool, like the rest of the accounting systems, needs to be dynamic and should grow as the size and needs of your business changes.

To help establish a good working chart of accounts you need to answer some questions, in conjunction with your accountant, as to how your business will operate, and what is important to you. Some of these considerations might be:

- Will your business have inventory to account for? If so, will it be purchased in final form or will there be production costs?
- Are fixed assets a significant portion of your business?
- Will you sell only one product or service or will there be several types of business?
- Will you have accounts receivable from customers that you will need to track?

- Are you going to sell in only one location or will you do business in several locations?
- Are the products you sell subject to sales tax?
- Do you need to track costs by department?
- What type of government controls or regulatory reporting are you subject to?

Each one of these questions can have several answers and probably will generate more questions. Each answer will have an impact on how the chart of accounts is structured. It may seem that developing a chart of accounts is not particularly high on your list of things to do as you start a new business; but, the amount of time and money that a well-organized accounting system may save you can be significant. It will also allow you to generate needed information for various decisions you will have to make. An example of a basic chart of accounts follows this section.

Cash or Accrual Accounting

One of the decisions to be made as you start a business is whether to keep your records on a cash or accrual basis of accounting. The cash basis of accounting has the advantage of simplicity and almost everyone understands it. Under the cash basis of accounting, you record sales when you receive the money and account for expenses when you pay the bills. The increase in the money in “the cigar box” at the end of the month is how much you made.

Unfortunately as we all know, the business world is not always so easy. Sales are made to customers and you sometimes must extend credit. Your business will incur liabilities that are due even though you may not have received

the invoice or have the cash available to pay them.

Most users of financial statements such as bankers and investors are accustomed to accrual-based statements and expect to see them. Once you become familiar with them, they provide a much better measuring device for your business operations than cash-based statements.

Whether you use the cash or accrual basis, it is possible to keep books for income tax purposes on a different basis than for financial statements. It may be more advantageous (less tax) for you to do so. Your accountant can advise you on the advantages and feasibility of doing this in your particular circumstances.

Accounting Records and Record-Keeping

Another question for business owners must answer is “Who will keep the books of the business?” Will you do it yourself, will the receptionist or a secretary double as a part-time bookkeeper, will you have a bookkeeper that comes in periodically or will the volume of activity be such that a full-time bookkeeper will be required?

Very often the owners of a business decide to keep the books themselves and underestimate the commitment they have made to other phases of the operation and the time required to maintain a good set of financial records. As a consequence, the record keeping is often low priority and must be caught up later. This approach, though rarely planned, can require a substantial expenditure of time and money. While it is important for the owners of a business to maintain control and stay involved in the financial operations of the enterprise, this can be achieved by maintaining close control over the check signing function and scrutinizing certain records. Your company’s CPA can help

develop a good program of record keeping duties for you, your employees and any outside bookkeepers you may engage.

A Word About Computers

The computer is probably the single most valuable invention for bookkeeping and accounting since the advent of double entry bookkeeping a thousand years ago.

Your CPA should know both your business and computers so he or she can take much of the confusion out of the selection process by assisting you in the purchase and installation of your computer and software.

There are a number of very good, easy to use accounting software systems that are commercially available. Quickbooks® may be the most common but by no means the only or the best one available. No computer program will solve the problems of inaccurate or poor quality financial records. All it will do is generate bad information faster. This is one of the reasons that the computer has also probably caused more headaches for the owners of modern businesses than any other single factor. If you want to use a computer-based accounting package, either in your own business or through your CPA, it is imperative that you generate accurate information to be entered into the system.

The real value of the computer becomes apparent once it is running smoothly in your business. Your accountant can then function in the capacity for which he was trained - not as a "number cruncher" but as your business advisor, consultant, and strategist. Both of you can focus on analyzing your business to make it more profitable rather than producing bulky reports.

Internal Control

What is internal control? It is the system of checks and balances within a business enterprise that helps to ensure the company's assets are properly safeguarded and that the financial information produced by the company is accurate and reliable. When you're operating as a "one man shop," or at least handling all of the company's financial transactions, maintaining good internal accounting control is relatively straightforward.

However, when your company grows to the size where you must delegate some of the functions it becomes more difficult to ensure that all the transactions are being accounted for properly.

No matter the size of your business, you should always be able to answer "yes" to the following questions:

1. When my company provides goods or services to our customers, am I sure that the sale is recorded and the revenue is recorded in accounts receivable or the cash is collected?
2. When my company expends cash, am I sure we received goods or services?

The methods used to ensure that these two questions can be answered affirmatively will vary widely. The solution in your particular instance may be as simple as numbering the sales tickets and being sure all tickets are accounted for or reviewing all invoices and timecards before signing company checks. These are fundamentals in a well-run business. As the company grows, you will need to consider concepts such as segregation of authority as well as employee fidelity bonds or controlled access storerooms. These are essential stepping stones to maintaining good control in your business.

No matter what the size of your enterprise, you should consider controlling your business and safeguarding hard-earned assets as a priority from the outset. Your CPA is trained in internal control techniques and will be invaluable in setting them up. As you grow, you will find that your financing provider will rely on your internal control as a measure of how much your records can be trusted. If you reach the level where you need a formal outside audit by a public accounting firm, internal control will become an integral part of such an audit.

The following "Chart of Accounts" is only an example, used to illustrate a typical breakdown for financial statement purposes.

Illustrative Chart of Accounts

Current Assets:

- 1000 Cash
- 1070 Accounts Receivable
- 1075 Allowance for Uncollectibles
- 1080 Inventory
- 1140 Prepaid Rent
- 1150 Prepaid Expenses

Fixed Assets:

- 1510 Equipment
- 1520 Furniture and Fixtures
- 1530 Automobile
- 1540 Leasehold Improvements
- 1590 Accumulated Depreciation

Intangible Assets:

- 1810 Goodwill
- 1820 Organizational Costs
- 1890 Accumulated Amortization
- 1940 Deposits

Current Liabilities:

- 2100 Accounts Payable
- 2120 Interest Payable
- 2130 Salaries Payable
- 2140 Income Tax Payable
- 2150 Sales Tax Payable
- 2160 Federal Withholding and FICA Tax Payable
- 2170 State Withholding Tax Payable
- 2180 Federal Unemployment Tax Payable
- 2190 State Unemployment Tax Payable
- 2200 Advances from Customers

Long-Term Liabilities:

- 2400 Notes payable
- 2410 Mortgage Payable
- 2420 Credit Line Payable
- 2600 Shareholder Loans Payable

Stockholder's Equity:

3010 Capital Stock
3040 Additional Paid In Capital
3090 Retained Earnings

Revenue:

4000 Sales
4100 Returns and Allowances

Cost of Goods Sold:

5100 Purchases
5110 Freight
5120 Direct Labor

Expenses:

6000 Wages Employees
6010 Wages Officers
6020 Contract Labor
6070 SUTA Expense
6080 FUTA Expense
6090 Employer FICA
6120 Advertising
6130 Auto Expense
6210 Bank Charges
6400 Dues and Subscriptions
6450 Employee Benefits
6510 Entertainment Expense
6700 Insurance
7100 Office Expense
7140 Professional Fees
7150 Postage
7250 Rent
7260 Repairs and Maintenance
7360 Supplies
7470 Taxes – Other
7480 Telephone
7500 Travel
7600 Utilities

Other Revenue and Expenses:

8010 Interest Income
8030 Other Income
8520 Interest Expense
8550 Depreciation and Amortization
9000 Taxes – Income

CHAPTER 4

PAYROLL TAXES

Regardless of your business form, if you are going to have employees then you will have to contend with payroll taxes. The brief summary that follows will give you some guidance in the rules and regulations of the various taxing authorities.

Available Publications

Circular E, Publication 15, Employer's Tax Guide, covers payroll tax reporting and deposit requirements and can be obtained through the local office of the Internal Revenue Service or by browsing the Internet.

Tax Deposit Requirements

Federal income tax withheld and FICA taxes (employer and employee portion) must be deposited on a schedule according to how large your tax deposits were for the previous lookback period of July 1 through June 30.

Monthly Depositor. An employer who reported employment taxes of \$50,000 or less during the lookback period generally must make only monthly deposits for the entire calendar year. The deposit for a given month must be made on or before the 15th day of the following month.

Semi-Weekly Wed/Fri Depositor. Employers who reported taxes (employment and other federal taxes combined) of more than \$50,000 during the lookback period is a semi-weekly depositor for the entire year. Such employers must make deposits on or before Wednesday or Friday, depending on the timing of their payrolls. Specifically, employment taxes from payments to employees made on Wednesday, Thursday or Friday must be deposited on or before the following Wednesday. Taxes from

Saturday, Sunday, Monday or Tuesday payments to employees must be deposited by the following Friday.

Nonbanking Days. Semi-weekly depositors will always have at least three banking days to make a deposit. If any of the three weekdays following the close of a semi-weekly period is a bank holiday, the employer will have an additional banking day to make the deposit. For example, if Monday is a bank holiday, deposits from the prior year Wednesday through Friday period can be made by the following Thursday rather than by the regular Wednesday deposit day.

One Day Depositor. If a monthly or semi-weekly depositor accumulates employment taxes of \$100,000 or more during a deposit period (monthly or semi-weekly), taxes must be deposited by the next banking day. This rule overrides the normal rules for determining deposit dates discussed above. A monthly depositor who must make a one-day deposit under this rule immediately becomes a semi-weekly depositor for the rest of the calendar year and the following year.

Federal Unemployment Taxes (FUTA)

To determine your quarterly liability for FUTA, multiply that part of the first \$7,000 of each employee's annual wages paid during the quarter by .008. If the resultant liability for all employees for the quarter is \$100 or less, there is no requirement to deposit it immediately; you merely add it to your liability for the following quarter.

If your liability for any calendar quarter (plus any undeposited taxes for an earlier quarter) is more than \$100, you are required to deposit the taxes with a federal tax deposit coupon at an authorized financial institution or via EFTPS by the end of the following month.

If the tax reported on your annual federal unemployment tax return, Form 940, less deposits for the year:

- Is more than \$100, you must deposit all of the tax by January 31st, or,
- Is less than \$100, you may pay the taxes when you file Form 940.

EFTPS

Under The Electronic Federal Tax Payment System (EFTPS) if your total deposits of social security, Medicare, railroad retirement and income taxes withheld were more than \$50,000 in your lookback period described above you must make electronic deposits of all depository tax liabilities. Failure to do so will subject you to a penalty of 10 percent of the taxes due.

State Unemployment Taxes (SUTA)

Depending on your state of residence, additional unemployment taxes may be due to a state unemployment agency. You will normally pay a percentage of each employee's wages to a limit. The limit varies from state to state. The percentage for a new employer is higher than an existing employer with no claims. Your SUTA rate will go up and down based on your experience - that is, the number of claims paid to former employees. A good plan for hiring and terminating employees is very important. You can pay over \$500 per year per employee or less than \$25 per year per employee depending on how employees are terminated and how many unemployment claims are filed.

Supplemental Wages

If supplemental wages – such as bonuses, commissions, overtime pay – are included in the same payment with regular wages, tax to be withheld is determined as if the total of the

supplemental and regular wages were a single payment for the regular payroll period.

If supplemental wages are not paid with the same payment as the regular wages, the employer may:

- Withhold at a flat rate (see Table for federal) and a fixed percentage for most states (see Table for details). Obviously, states with no state income tax will have no supplemental wage withholding.
- Combine the supplemental wage with the last regular wage, determine the tax on the total wage and subtract the amounts already withheld on the regular wage payment.

Fringe Benefits

Gross income does not include fringe benefits that qualify for exclusion, as described in the categories listed below. Fringe benefits that qualify for the exclusion are exempt from income tax and social security tax withholding (FICA and payment of federal unemployment tax (FUTA). Conversely, benefits that do not qualify are subject to those taxes.

No-additional-cost service. This is a service provided to an employee that is excludable if the service is offered for sale to the public in the ordinary course of business and the employer does not incur substantial additional cost. For example, employers who furnish airline travel or hotel rooms to employees working in these businesses in such a way that the non-employee customers are not displaced and they incur no substantial additional cost in providing those services to the employees, may exclude cost from the employee's gross income.

Qualified employee discount. Any employee discount is an excludable qualified employee discount if: (1) in the case of property it does not exceed the gross-profit percentage of the price at that the property is being offered to customers; (2) in the case of service it does not exceed 20 percent of the price at which the service is being offered.

Working condition fringe. Any employer-provided property or service is an excludable benefit to the extent that they are deductible as ordinary and necessary business expenses had the employee paid for them. Under certain conditions, the fair market value of a qualified automobile demonstration used by a full time auto salesperson is an excludable working condition fringe.

De minimis fringe. Property or services not otherwise tax-free are excludable if their value is so small as to make accounting unreasonable or administratively impractical. An operation of any eating facility for employees is an excludable de minimis fringe if it is located on or near the employer's business premises and the revenue derived normally equals or exceeds the direct operating costs of the facility.

Qualified Moving Expenses Reimbursement. An employee may exclude from gross income an amount received from an employer for payment of qualified moving expenses.

Transportation Fringe Benefits. Beginning in 1995, an employee may exclude from gross income certain maximum amounts received from an employer as reimbursements for transit passes, vanpooling expenses, and qualified parking expenses.

New Hire Reporting

Mandatory new hire reporting is in place in all states. This reporting is

designed to feed a national database for tracking down parents who are not making their child support payments. See the article with your state requirements at "[Payroll Articles By State](#)".

Other Tax Requirements

Whenever a wage payment is made, the employer must provide the employee with a statement of the gross wages and specific deductions (if any). Use the Form W-4 submitted by the employee and the tax tables provided in the employer's tax guides to determine the correct income tax to withhold. If the employee fails to submit a Form W-4, the employer must withhold at the rate applicable to a single person who has no withholding exemptions.

An employer must also complete a Form I-9 on each employee and obtain the necessary citizenship or other employment eligibility status verification.

When making a reimbursement or payment of moving expenses to or for an employee, the employer must complete and furnish the employee with a Form 4782 for each move.

The employer must also furnish a Form W-2 to each employee showing remuneration and withheld taxes for each calendar year. Flat rate expense account allowance, disability insurance paid by the employer and moving expense reimbursements are among the items to be included as other compensation on a Form W-2. Upon request, a Form W-2 must be furnished to a terminated employee within 30 days after the request or the final wage payment whichever is later. All other Form W-2s should be given to employees by January 31st of the following year.

The payroll tax requirements and the work related to compliance are quite cumbersome and complicated. Once a business employs more than a few people, we recommend that a qualified payroll service be used because it has generally been our experience that the cost of the service far outweighs the personnel and management time required to operate the payroll system in house.

Tax Rates

The following charts contain tax rates and the taxable wage basis for employers and employees. The limits and maximum contributions for 2007 given are per employee.

FICA

Employee Rate	6.20%
On wages of	\$97,500.00
Employer Rate	6.20%
On wages of	\$97,500.00

Medicare

Employee Rate	1.45%
On wages of	unlimited
Employer Rate	1.45%
On wages of	unlimited

Federal Unemployment

Employer Rate (after credit for paid SUI)	0.8%
On wages of	\$7,000.00

CHAPTER 5

SELECTING A YEAR-END

If the new business is a sole proprietorship or a partnership, the company will usually be required to use a calendar year-end. However, if the business is incorporated, the corporation is often allowed to select a fiscal year-end using a month-end other than December. Tax law mandates that most S corporations and many personal service corporations use a December 31 year-end.

Which Month to Choose

The selection of a year-end involves several considerations. The most important factor is the ease by which data is accumulated. For this purpose, most companies prefer to use a quarter-end as the last day of the fiscal year (e.g.; March 31st, June 30th, September 30th, or December 31st). Many companies not using a quarter-end date find it complicates several government filings and can be confusing to shareholders and others when disclosing quarterly data.

A second consideration involves the nature and seasonal fluctuations of the business. As a general rule, the year-end causes a disruption to the normal course of business, especially if a physical inventory is required. It is usually better to have this disruption occur during the off-season. Also, since the periods just before and just after year-end often involve an additional time commitment by the key officers, a year-end that does not conflict with normal vacation schedules is preferable.

There are also tax reasons to select a year-end other than December 31st. If the company has, for example, a June 30th year-end, it is possible for the corporation to pay bonuses in June and

obtain a tax deduction. The employee then has six months to decide whether to pay tax currently on the income or attempt to shelter it.

Proper planning in selecting a year-end can also defer the payment of taxes at the corporate level. Suppose the company incorporated in July and operated at break-even through the next April but expected May and June to be big income months. By selecting a March or April year-end, the company can delay for ten months the payment of taxes on the May and June income. Since cash is often scarce for a start-up company, this deferral can be of significant benefit.

How to Make the Election

The election of a year-end is made on the first tax return of the corporation. Even though the corporate by-laws disclose the fiscal year and the request for Federal Identification Number (Form SS-4) asks for the year-end, a final election is not made until the tax return is filed. There is not a separate form for making the election. The corporation merely states the fiscal year on page one of Form 1120. There are two important requirements for making the election. First, it must be made on a timely filed (including extensions) return. If the first return is not timely filed the year-end of the corporation is, by default, December 31st. Secondly, the first year can not be longer than twelve months. For example, if a company is incorporated on June 25th, and wants to select a June year-end, it must file a return for the five-day period, June 25th through June 30th. Otherwise, the first return would be for twelve months and five days, which is not allowed.

Changing the Year-End

Once a year-end is selected it may be changed under certain conditions

without the prior approval of the IRS. Conversely, if the conditions are not met it can only be changed if permission is obtained from the IRS. In considering a request for change of year-end, the Internal Revenue Service will look closely at the business or economic reasons for the change. The absence of a tax avoidance motive is generally a requirement.

Certain corporate events will require a change of year-end. For example, if the company's stock is acquired by another corporation the acquired corporation will be required to use the same year-end as the parent company.

CHAPTER 6

INCOME TAXES

Eventually, you will have to deal with income taxes. The income tax laws are extensive and can be confusing for an individual starting a business. This chapter does not cover all the tax ramifications of a new business; however, it provides some guidance on complying with the laws. A qualified CPA or tax attorney should be consulted when you are dealing with income taxes. Income taxes have a direct result and a potentially significant impact on the cash flow of your business.

Income Tax Forms

Each type of legal entity is required to file a different type of income tax form.

Corporation. A corporation is considered a taxable entity and is required to file a Federal Form 1120, normally a state corporation income tax return.

Partnership. A partnership is not a taxable entity. It is treated as a conduit through which taxable income is passed to the individual partners for inclusion in their respective tax returns. The partnership may be required to file Federal Form 1065 and in some states a state tax return. No tax is due with these forms. However, included with the forms is a Schedule K-1 that lists the various items of income and credits to be included on the individual partner's return.

S corporation. An S corporation is a type of corporation that enjoys special treatment under the tax laws. The government taxes this type of entity in the same manner as a partnership with certain exceptions. The tax forms required are Federal Form 1120S and normally a state corporation income tax return.

Sole Proprietorship. A sole proprietorship is considered to be a component of the individual's personal tax situation. The tax form required is the Schedule-C which is included with the owner's Form 1040. In addition, if the business has net taxable income, then a Schedule SE must be prepared to determine the amount of self-employment tax that is due. Many states follow these same rules with their own state income tax returns

Limited Liability Company. This is a newer form of business organization and if properly structured, is treated as a partnership or a corporation for federal income tax purposes. These variations in treatment depend on exactly how it was formed, what its actual structure is and how it chooses to be treated at its first taxable period end. Check with your CPA for details. For state income tax purposes, the state determines the income tax treatment.

Estimated Tax Payments

In addition to the regular tax forms, the law requires that if an estimate of the tax is not properly prepaid on a quarterly basis, a non-deductible underpayment penalty will be levied. Since an estimate is based on forecasting the future, and liable to human error, the tax laws provide two safe-harbors to avoid the penalty for underpayment. If your payments for each quarter equal the lesser of 100 percent of the prior year's tax or 90 percent of the current year's tax, then the penalty can be avoided. In some cases you may have to pay 110 percent of the prior year federal tax liability to avoid the penalty. Some states may also require estimated payments of state income tax.

Estimates are filed using the following forms:

Corporate

Federal tax deposit Form 8109 deposited with your bank or EFTPS deposit if appropriate.

Individual

Federal Form 1040 Schedule ES.

Due Dates and Forms

The due dates of the various federal forms are:

Corporate Federal Form

Form 1120 is due the 15th day of the 3rd month after the end of the tax year. The Federal tax deposit Form 8109 or EFTPS payment is due the 15th day of the 4th, 6th, 9th, and 12th months of the tax year.

Partnership

Federal Form 1065 is due the 15th day of the 4th month after the end of the tax year (April 15th for most partnerships).

S Corporation

Federal Form 1120S is due the 15th day of the 3rd month after the end of the tax year. Federal tax deposit Form 8109 or EFTPS is due the 15th day of the 4th, 6th, 9th, and 12th months of the tax year.

Sole Proprietorship

Form 1040 is due April 15th. Estimated tax payment forms (1040-ES) are due quarterly on April 15th, June 15th, September 15th, and January 15th.

Limited Liability Company

This designation may be classified as a partnership or corporation for federal

income tax purposes. Filing dates also vary by state.

Extensions

The business owner may request an extension of time to file the tax returns. However, these extensions do not extend the time for paying the tax. Therefore, even if you have filed an extension if you did not pay all the tax due, even if you could not determine the amount by the filing date, there will be penalties for late payment and interest. None the less it is almost always better to file the extension or return even if you can't pay the tax when you file rather than waiting until you can pay the tax. There are penalties for not filing some returns on time.

First Corporate Return

The first tax return a corporation files is very important. As part of that return, elections are made that will dictate the way the corporation is taxed for many years to come. Some of the more significant elections that may need consideration are outlined below:

- Election to capitalize and amortize costs incurred to organize the business. These can be legal, accounting or similar fees paid to commence operations. Such costs are not normally considered expenses of the corporation and are not deductible unless this election is made.
- Election to accrue vacation pay earned but not taken by employees at the end of the tax year. Without this election, vacation pay is not deductible until the year it is taken.

The elections discussed above are only a few of those that may need to be considered in an initial return. A qualified tax practitioner can help plan how best to utilize elections to take advantage of some of the following provisions of the federal tax laws including:

- Net-operating loss carryovers
- Research and development tax credits
- Business energy tax credits

Tax Planning

Proper tax planning is essential in order to make the most of the income tax laws. You will probably need to develop a relationship with a qualified professional who has experience with the taxation of your type of business. Tax planning is not a one-time shot right before the return is due. Tax planning is a year-round endeavor requiring communication on both sides – you and your CPA. Proper planning ensures that there are no surprises when the return is filed.

State Taxes

If your company will be doing business in more than one state, it is essential that you familiarize yourself with the tax laws and filing requirements of those states. Each state has its own rules and regulations. If you are not in compliance, you may be barred from doing business in that state.

Conclusion

Income tax laws are quite complicated. The money you may save by attempting to tackle your own taxes, particularly as they relate to a business, can be greatly overshadowed by the expense you may incur if you make a mistake. This axiom takes on greater significance when the return is for a

corporation – especially the first return. However, a far greater consideration than potential mistakes is missing savings opportunities that may be available to you and your business.

CHAPTER 7

CASH PLANNING AND FORECASTING

CASH IS KING! The lifeblood of any business is its ability to collect cash and pay bills as well as pay its employees and owners. Far too often small businesses are profitable, but they do not have enough operating capital to meet their current needs. Consequently, they may be forced to sell out to a stronger competitor, sell a portion of the company to investors at an undesirable price or close the doors and put the company out of business. None of these alternatives are typically what the owner intended when starting the business.

The ability to forecast cash resources and uses is an art and is by no means a well-defined science. None of us has a crystal ball. A cash forecast, whether prepared by the management of a company or an outside consultant, can be no more than a guess as to when the customers will pay and when your business will pay its obligations. Theoretically, the more effort that is put into cash forecasting the better the educated guess will be, resulting in a fairly accurate picture of future business operations.

Starting the Analysis

One of the most significant factors to be considered in your cash flow forecast is the volume of sales generated in the next several months as well as the rest of the period you intend to forecast. Your sales forecast must be as fine-tuned as possible. It is typically unrealistic to assume that there is a million-dollar market for your product in your area and you will be able to capture a specified percent of it. A sales forecast needs to be based upon specific facts. These might include your sales history or the history of similar

businesses you have owned or operated or the competition.

When you begin your forecast, ask yourself what other actions can I control such as adding new product lines, deleting unprofitable operations, adding a new salesperson, or terminating one that is not producing to quota? In preparing a forecast, you must also take into consideration items such as the seasonality of your business, the relative state of the economy and the period over which you forecast.

Obviously, your ability to forecast sales for the next month is better than it is for three to five years from now. The amount of detail necessary for a cash forecast is really a matter of preference. It can be based on per-unit sales extended out by the sales price of each type of unit or an average sales volume per day, week or month of your type of business in its current environment.

Cash Collections

Once you have determined a reasonable level of sales and you are comfortable with the forecast you have made, you must address questions such as: what percentage of my sales are received in cash and what portion are credit sales for which I will have to carry accounts receivable? For those that are receivable-based, how soon is the cash collected? Do I have to wait for customers to pay me or do third parties such as Visa or MasterCard take the customer's account and convert it to cash for me with an appropriate discount?

If you are relying on customer payments for collection of receivables you must determine what portion of the receivables will be collected in thirty days, sixty days, ninety days and thereafter and what portion, if any, may never be collected. To assume that 100 percent of your sales will ultimately

be converted to cash is probably unrealistic, especially considering the economic environment and the tight cash situations that may face some of your customers.

Other sources of cash may be available in addition to sales. Do you expect to bring in a partner or other investors or can you borrow money from a bank? When will you receive the cash and how much will you get? Part of your cash flow analysis may be to determine how much investment money or borrowings will be required to operate your business.

Once you are comfortable with the cash receipt side of your business and the timing of the collections of funds from your sales and other sources, it is necessary to consider the expenses and other cash needs of your business operation.

Disbursements

Certainly if your business entails sales of inventory you will have to purchase the merchandise from others or purchase the component parts and pay employees to assemble it. This may require a significant outlay of cash before the first dollar of sales is generated and received. You should consider how often and in what amount your employees must be paid and when their payroll taxes must be deposited.

Additionally, you need to know the credit trade terms your vendors are willing to advance to you. Do you have to pay for inventory items on a COD basis or can you pay for them thirty or forty-five days after receipt?

What expenses must be paid to allow you to convert purchased merchandise to salable inventory? If your production requires utilities to run machines or supplies that are required such as dispensable chemicals or packing

materials that must be purchased prior to the sale of the inventory you should factor the timing of payment.

In addition to the cost of manufacturing, you should consider whether your productive capacity allows you to generate enough inventory to support the level of sales you are predicting. If the volume of sales you forecast is above and beyond your ability to produce today, what changes in your operating environment must be made to meet the production levels? Will you need additional employees? If so, how much will they cost? Do you have to acquire additional machinery for your shop operations? What is the cost of the machinery and when will you have to pay for it?

Once you have determined the cost of operating your production or service facilities, you need to consider what other expenses you must pay to keep the doors of your business open. You typically will have to pay rent for your office or manufacturing facility. You must consider how much the monthly payment is and when it has to be paid. Ask yourself if there will be other cash requirements such as a deposit on first and last month's rent. If you are opening a new business, you must consider what your cash requirements are to make your facility ready for your specific needs and purposes. Will you have to buy or rent furniture? Will you need to make tenant improvements or pay deposits for utilities and other services?

You also need to consider many of the overhead items and costs to open a new business that will hopefully be one time expenses. This may be attorney's fees for drafting partnership agreements or incorporating your business, the cost to obtain business licenses, authorization from the taxing authorities, setting up an accounting system, stationary costs and costs of signs or logos.

It may seem like the list of costs and expenses to be incurred is endless. It may even discourage you from moving forward with your business endeavor. However, it is imperative to make the list as detailed as possible to ensure that you have sufficient funds to make your operation ready for business prior to running out of cash. The more detailed the list and the more sufficient information you can provide, the less chance there is of unpleasant surprises as you move down the stream to opening your business.

In addition to determining the amount and volume of necessary expenses and cash outlays it is critical to determine the timing of such payments.

As we have discussed in other chapters, there may be a variety of financing alternatives available to you. Most of the start-up costs can be delayed or deferred until you can generate the cash from your operation to help pay them. This needs to be carefully analyzed and factored into your cash flow analysis. However, a good rule of thumb is to assume that you are going to have to pay your expenses sooner than you think and that you will collect your cash slower than you anticipate. If you work with this attitude, any surprises should be favorable ones.

Cash flow projections can be very slow, time consuming and tedious. It is often very tempting to hire someone else to prepare the projections for you. There are a variety of individuals who can help you do this, but the critical factor is that they only help. You as the owner and operator of the business are the only one truly qualified to develop your cash flow projections. You know what it takes to open and operate your business. Certainly a trained professional can offer guidance and ask pointed questions to be sure you are considering all of the necessary and hidden costs of operating a business. However, the more effort

you put into developing the cash flow projections the more accurate they will tend to be. This exercise may also help you to pinpoint areas of potential cash savings you had not otherwise considered.

We have included a worksheet following this chapter that may assist you in developing a cash flow analysis. While this worksheet does not include all the items that should be considered in preparing your cash flow analysis, it should help raise many of the questions you need to ask yourself before deciding how much cash will be required to establish and operate your business. It will also help establish the period of time that must elapse before you can expect to pay back the lender or return profits to your investors.

PROJECTED STATEMENT OF CASH FLOW
(for one year)

	<u>Projected Quarter Ending</u>			
	1 st	2 nd	3 rd	4 th
Net income				
Add (deduct) items not requiring cash:				
Depreciation				
Net Cash Provided				
Increase (decrease) in cash:				
Accounts receivable				
Inventory				
Property and equipment				
Accounts payable				
Accrued income taxes				
Preferred stock				
Increase (decrease) in cash				
Net change in cash				
Cash beginning of period				
Cash end of period				

CHAPTER 8

OBTAINING CREDIT AND FINANCING FOR YOUR BUSINESS

If you are not independently wealthy, and perhaps even if you are, eventually you will probably need to obtain some outside capital for your business. In some instances, you may need to obtain capital for the initial expenses prior to opening your business or for expansion or working capital during the off season.

Generally, business financing can take two forms - debt or equity. Debt, of course, means borrowing money. The loans may come from family, friends, banks, other financial institutions or professional investors. Equity relates to selling an ownership interest in your business. Such a sale can take many forms such as the admitting of a partner; or, if you are in a corporation, issuing additional common stock, options or warrants to investors. It is typically a prudent idea to consult with your attorney as there are many significant legal ramifications to such a step.

How Do I Get the Money?

Regardless of the type of financing you need and are able to obtain for your business, the process of obtaining it is somewhat similar. There are several questions that must be answered during the course of raising money for your business. The ability to answer these questions is critical to your success in obtaining financing as well as overall success of the business. Remember, in raising capital you have to sell the ability of your business to potential investors in much the same way as you sell your product to your customers.

How much cash do I need? To answer this question you will have to do

some serious cash flow planning that will require estimates of future sales, the related costs and how quickly you must pay your vendors. You will also have to factor into your planning an idea of when you can repay the loan. However, if you raise cash through equity you probably don't need to pay it back, but your co-owners will want to know how the value of the business will grow and how they will benefit through dividends or selling their shares.

What will you do with the money?

One of the most important questions you will have to answer for a potential investor is how the money will be spent. Will you use it for equipment or to hire additional employees or perhaps for research and development? Again, part of the answer on how you spend the money is how it will benefit the company.

What experience do you have in running your business?

One of the primary reasons for business failure is lack of experience and management. You will need to convince your investors that you have the knowledge, experience and ability to manage your business and their money at the level at which you expect to operate.

What is the climate for your type of business and your geographic location?

Few investors will want to put money into your business if you haven't done sufficient "homework" to determine that you have a reasonable chance of success. If your business is based on existing economic or legal conditions that are subject to change in the near future your risk is substantially increased. Even if your business has great potential, if the local economy is sluggish to the point that it can't support your venture, you need to plan for this before moving ahead.

Once you have developed concrete answers to these and other pertinent questions you can begin looking for financing. One of the first steps is to

determine whether to raise funds through debt or equity. There are positive and negative aspects to each type of capital. The cost to your company for each type of funding is different - as is the way they are treated for income tax purposes. The interest on borrowed money is deductible by a business for income tax purposes and reduces the effective cost to your company. Dividends, which you might pay on the same investment in stock, would typically not be tax deductible by your company. In selling stock there usually is no firm commitment by your company to pay the money back, but your stockholder will want and generally will have a legal right to have a voice in the management of your company. When you have made the decision as to the type of financing you think is appropriate based on your desires and needs, it is probably a good idea to consult with your accountant regarding alternative types of debt or equity financing available.

Financing Alternatives

Whether you determine that debt or equity financing is the best choice for your company, there are a number of alternative types of financing available. Depending upon the nature of your business, the financing may be a combination of debt and equity and may be tailored to fit the specific needs of your company.

In conclusion, we will only mention a few of the more conventional methods for a young company to obtain capital though the possibilities are many. A good business-oriented accountant can discuss these and other alternatives in greater detail.

Debt Financing Sources

Banks. The most common source of funds is a bank. That is why they are in business. Banks typically lend to small businesses on a secured basis using equipment, inventory or accounts receivable. The more liquid and readily salable the assets you have to offer as security, the more acceptable they are likely to be to a banker. Loans from a bank may take several forms such as:

- A line of credit that renews annually and allows you to borrow up to a predetermined maximum as you need it and pay it back as funds from sales and receivables are collected.
- A short-term demand note that is payable in full on a specified date.
- A term loan for the purchase of a specific asset such as a computer or a machine.

As your relationship with your banker becomes better and your business becomes established, you may consider a long-term (3 to 5 years) loan that will be payable in monthly installments.

Lease financing. In today's business environment it is quite common to acquire equipment through lease agreements. Leasing packages come in a variety of types through many sources. Leasing companies typically will accept a somewhat higher degree of credit risk because they are looking to the value of the equipment for collateral if your business cannot make the agreed upon payments. For this reason, leasing companies generally prefer to finance new equipment of a general-purpose nature that can be resold if necessary. Leases often run for a period of three to five years and because of the risk that leasing

companies are willing to take, they are somewhat more expensive than commercial bank loans.

Trade credit. A very important source of financing for your company may be from the vendors and suppliers with whom you do business. Many suppliers will originally ask for cash on delivery; or in some instances, they want payment before starting on your order, depending on the nature of your purchase. Most suppliers will quickly establish trade credit with you once you have gained their confidence by continuing to do business with them and paying as requested. Establishing good relationships with trade creditors is essential because it allows you to use the goods and services in your operations and sell your product to your customers - in some instances before you pay for them. The trade credit you build today will be relied upon by other vendors as you attempt to establish yourself with them in the future. Trade credit terms will vary depending on the type of purchase you make, the supplier's industry and the industry you are in.

Equity Financing Sources

Equity financing usually means selling a portion of your business. This can be accomplished in a number of ways including the sale of common or preferred stock or stock warrants. Equity sales are usually carefully tailored to meet the needs of both the company and the investor.

Venture capital companies. A venture capital company or fund is typically a company that is in the business of taking risks. A venture capital fund is often backed by a group of investors who may be individuals or corporations. The investors are often represented by a management group that evaluates potential investments and manages the existing investment portfolio.

The price of venture capital financing is usually very high when compared to borrowing money from a bank, but it must be remembered that venture capitalists are dealing with much higher risk situations than commercial banks will finance. This cost of venture capital is measured in terms of the portion of your company you must sell to obtain the level of financing you require. A venture capital firm sometimes requires a 300 to 500 percentage return on its investment over a four to five year investment period. While this may seem like an enormously high return, a venture capitalist is in the risk business and the return on a good investment must help offset those companies that do not meet their projections or fail altogether. To determine the price of such financing, a venture capitalist will start with the amount of financing you require and calculate what they must receive at the time the investment will be sold to allow them to achieve the necessary rate of return.

Based upon the operating projections you provide, discounted based on their experience, they will estimate what your company might be worth at the time the investment will be liquidated. This might be at the point of a public offering or a sale to a corporate investor. The last step for a venture capital company in determining pricing is to calculate what percentage of the company they must own to realize the return desired. At this point, the "horse trading" generally begins. As a general rule you will want to retain as much of the ownership of the company as you can. The venture capitalist wants enough ownership to achieve the investment goals and have some control over how the money is spent. This will often be achieved by voting power and representation on the board of directors. At the same time a venture capitalist wants to be sure there is sufficient reward in the company for you and your management team to be motivated and

achieve the projections in your business plan.

An individual or group of individuals often manages a venture capital company with a strong background in business and management. They can often provide depth of experience and management assistance in areas where your management team may be weak. A venture capital group can very often provide contacts and valuable introductions in your industry. Remember, a venture capital investor becomes a member of your team.

Private individuals. Very often, individuals who are successful in their own right and have accumulated substantial wealth may be looked to for investment in your business venture. Such individuals may believe that the success of your business may enhance their own business as well as help increase their personal wealth. These individuals, like a venture capital company, very often want to participate in the management activities of your firm and help guide your progress through representation on the board of directors. The business acumen and contacts of these individuals can often be a valuable asset of your business. An individual investor can often react to opportunity much quicker than a venture capital firm and typically has only their own interests to serve as opposed to a financial backer or group of investors.

Individual investors can be more flexible and often have personal, financial and tax motivations to consider. Where do you find a private individual or so-called "angel"? Networking with successful family, friends and acquaintances is an excellent place to begin. You may also discover networking groups in your area.

CHAPTER 9

INSURANCE

Business insurance, like many types of expenditures, is one of those items that business owners typically do not like to pay. You must remember that sufficient insurance can be as critical to the success of your business as a good product or service. Without proper insurance you could lose all of the money, time and effort you put into your company. The types and amounts of coverage you purchase must be evaluated on a cost-benefit basis like any other commodity. Your accountant and insurance agent can help you review the amount of coverage you may wish to purchase for various purposes. Usually, you will want to insure against risks that could have significant detrimental impact on your business. This normally would include such items as fire, storm damage, theft, general and product liability.

Depending on the nature and size of your business, it is often a good idea to self-insure for all or a portion of certain losses. Self-insurance can be accomplished by not buying coverage for incidental risks or increasing the deductions on policies you do buy. Often, raising the deductible can have a very favorable impact on policy premiums. The administrative cost to the insurance company to process small claims is quite high. Consequently, the rates typically go down substantially if they are relieved of this expense by insuring for losses in excess of a sizable deductible amount. An insurance broker can provide you with comparative costs for various types of coverage with varying degrees of deductible amounts.

Required Policies

Very little insurance coverage is mandatory. The only insurance coverage typically required by law is worker's compensation, which covers

injuries to employees while on the job and is mandatory in all states except Texas. One alternative to workers compensation insurance may be an ERISA based accident policy that will cover the employee for any accident at any time. Your insurance agent can explain the required coverage, the rating systems and help you purchase a policy.

You must also be aware that the terms of your building, office lease and mortgage or loan covenants may require you to carry certain kinds of insurance coverage in specified minimum amounts. If you have leased equipment or have borrowed money from a bank or other lenders, there will usually be insurance requirements in the agreements relating to these transactions. There are many other types of policies you may wish to consider. The specific coverage provided by each and the related costs can be explained in depth by a qualified insurance broker.

Some common types of insurance coverage are listed below:

Business Interruption. This coverage, as the name implies, covers the loss of revenues your business would generate if you were forced to shut down for reasons beyond your control. While this is obviously valuable insurance, the policy premium must be carefully considered relative to the potential profits your business might lose during a short shutdown of operations.

Employee Fidelity Bond. This type of insurance typically covers the risk of loss from theft by employees. If your business deals in large amounts of cash, negotiable securities or similar types of assets, you may be well advised to consider this coverage. Certain industries are required to carry this insurance by regulatory authorities.

Umbrella Coverage. This type of insurance covers losses above and beyond the limits of other policies that you carry. Umbrella policies usually pertain to liability of various sorts and are usually valuable if your business or you have a net worth, requiring protection in the event of a catastrophic loss.

Insurance is like any other product - before purchasing, you should consult with more than one broker as to your needs for protection. You should discuss insurance needs with acquaintances in the same or related business as yours. Before buying coverage you should check out the reputation of the company that is underwriting the policy. Insurance companies are usually regulated by the state insurance board and are licensed to do business in the state. Companies are rated by the A.M. Best Company and other services. These ratings are available through your insurance broker or the public library.

Business Owners Policy

This is a type of policy that is available in many states to some business owners, normally service-type companies. It normally provides one million dollars in general liability. The property damage coverage included in this policy covers loss due to fire, storm, vandalism, glass and associated items. Separate from this insurance you can obtain a portion of coverage for loss of earnings and other risks. Since all the coverage is incorporated in a single policy you are able to achieve an overall-underwriting discount. Again, be sure to check with an insurance professional on exactly what a policy for you will cover and cost.

Health Insurance

Even small companies can buy group health insurance. You as a business owner still need to protect yourself and your family against the costs of a

catastrophic illness or injury; and, it can be difficult to obtain good employees without offering health insurance. By using a group policy to help recruit and keep quality personnel you may also receive a break from what a private policy would cost you alone. There are plans that allow for a higher deductible and lower premium for the owners and a more standard deductible for employees. Your insurance agent or CPA should be able to help you make the appropriate choices for your situation. Don't forget Health Savings Accounts. These are a great way to increase your pre-tax retirement savings if you have already maximized your other pre-tax investment options like your IRA, 401K, and the like.

Home Based Business

Another recent development is business insurance for a home-based business. Many companies that sell homeowner policies are reluctant to offer a rider to cover a business at home. There are now companies actively seeking that segment of the market. If your agent can not provide coverage for your home-based business seek another independent agent who can help you with at least that phase of your coverage.

Vehicle

If you buy a vehicle in your business you will need to obtain commercial coverage for it. Almost always commercial coverage is going to be more expensive than buying personal insurance for the same vehicle. This needs to be part of your total cost decision when buying or leasing a vehicle. Your CPA can help lay out the decision of purchase or lease, personal or commercial, taking into account all the costs and risks. You also need to be aware of the various discounts available. There are discounts for driver's education, for location, for multiple vehicles, for high deductibles and many others. All of these

discounts can help reduce your cost if you can take advantage of them.

Chapter 10

Labor Law

You will encounter mandated responsibilities in the labor law area generally more than any one part of your business. There are multiple federal, state and local agencies that will control your interaction with your employees. At times they will be inconsistent and no matter what you do somebody is going to say it is wrong.

Perhaps the most basic of all payroll and employment laws is the Fair Labor Standards Act of 1938 (FLSA)), also known as the Federal Wage & Hour Law.

The FLSA does the following:

- Sets the minimum wage and overtime rates employees must receive for their work
- Requires record keeping by employers
- Places restrictions on the types of work children can do and the hours they can work
- Mandates equal pay for equal work

Almost as important is what the FLSA does not do. The FLSA does not:

- Require employers to provide paid vacations, sick days, jury duty leave, holidays, lunch breaks, or coffee breaks
- Regulate how often employees must be paid or when they must be paid after termination of employment (either voluntarily or involuntarily)

Restrict the hours that employees over 16 years of age may be required to work.

Another federal law or regulation may govern these areas, but in most instances they are handled by the individual states.

FLSA only affects your business if you are in interstate commerce. That is a technical distinction. The Department of Labor who oversees FLSA enforcement takes the specific and overt attitude that everyone is in interstate commerce. They make an assumption that if wages and gross revenues exceed five hundred thousand dollars you are automatically involved in interstate commerce. They go so far as to say if a waiter takes a credit card slip to the cashier and the credit card company is out-of-state, that waiter is involved in interstate commerce. These attitudes can be challenged, but it is seldom worth the time or expense.

State wage and hour laws are all over the map. This article list all of the state wage and hour agencies. You can get a synopsis of your state laws from the appropriate site.

Other applications of labor law that may apply to your business include but are not limited to:

Civil Rights Acts of 1964 and 1991

Age Discrimination in Employment Act

Americans with Disability Act

Immigration Reform and Control Act of 1986

Family and Medical Leave Act
Uniformed Services Employment and Reemployment Rights Act of 1994

OSHA

Sexual Harassment

Because of the complexity of payroll tax law and employment law, we recommend not only using a payroll service bureau but also having the number of a good labor law attorney in your address book. Five minutes spent on a thoughtful question with a labor law attorney may save years of expensive litigation.

CHAPTER 11

SELECTING PROFESSIONAL ADVISORS

Starting your own business obviously entails a multitude of decisions - decisions that can seem overwhelming without the right players on your team. In order to succeed you need to equip yourself with every tool at your disposal.

One of the most cost-effective tools you can utilize is the expertise of a specialist. The right CPA and attorney can eliminate a host of problems and potentially costly errors you might make as you build the financial foundation of your business.

As any coach can tell you, having a first rate quarterback (you) won't guarantee a winning team without a first rate line of defense. The right CPA and attorney **are** your best defense. Their expertise can help save you money, that in turn can be used to increase profits.

When enlisting the expertise of a CPA and attorney you want a specialist suited to meet your specific needs. You want a specialist who will listen to you. More importantly, you need someone you can and will listen to as they devise strategies to help you succeed.

Make sure they are appropriate for your size business. Make sure they are familiar with your industry or general area of business. Make sure you understand how they bill and how much. Make sure there is good chemistry. You won't call someone you don't really like when you need to.

You want to succeed – and you can. By taking the time to make key decisions and enlisting the right players on your team – you will succeed!

Several other free sources of expert advice can be found at

SCORE

Small Business Development Centers

US Chamber of Commerce

Or your local chamber of commerce and possibly your state has an economic development department.

CONCLUSION

You now have a handy reference guide to starting a business. With it, you should be able to successfully handle many of the problems encountered in starting and running a business. Always remember to seek professional advice in areas you are not confident. The benefit will far outweigh the cost. Good luck! We wish you success and welcome you to the wonderful world of free enterprise.