

**HOW TO FORM, STRUCTURE, AND  
REPORT A NEW BUSINESS**

*“This booklet contains important information an entrepreneur needs to know about starting, structuring and reporting tax and other information to regulatory agencies”.*

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*We See More Than Numbers....*

*We See Opportunities and People*

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## I. INTRODUCTION

Most people don't think of accountants as businessmen or women, but they are. In addition to performing the well-known services of preparing income tax returns and financial statements and advising individuals and businesses on a multitude of financial issues, they also run a business, i.e. an accounting business. And like any other business, an accounting firm employs staff, rents office space, pays business expenses such as payroll taxes, telephone and yes, even income taxes, and borrows money for expansion. It's even subject to downturns in the economy and must promote its business in order to grow. A new accounting firm also faces many of the same startup problems that other businesses face.

Our firm was no different. When Skody Scot & Company, CPAs, P.C. began operations in 1990, it encountered many of the same problems that most other startups encounter such as: **shortage of capital**, need for competent help, **shortage of capital**, need to get the word out, **shortage of capital**, search for adequate office space, **shortage of capital** and **FEAR** of the unknown.

Yet despite all the growing pains of building a service business from the ground up, our firm became successful, developed a good reputation and currently has a long list of loyal clients. This success didn't come easily. Developing an accounting business, **or any business**, requires a great amount of time and energy, not to mention a certain degree of good luck. It also requires something call **PLANNING**.

Remember President Clinton's 1992 campaign mantra - "**Its the economy stupid**". His staff felt that the economy was the single most important issue facing the nation and his election, and based on the results, they were correct.

With business, there is also one overriding, central theme to building a successful business - "**Its planning**". Unfortunately most business owners and managers of startups and existing enterprises incorrectly feel that planning isn't necessary. The two most frequent reasons given why it isn't important are - "I'm too small and busy to waste time on planning, I know what I need (i.e. more business or financing)" or "My business is not a big corporation with many departments, there's no need to spend time on planning".

These beliefs (or misbeliefs) couldn't be further from the truth. Small businesses, especially startups, require more planning than a large corporation because their resources are limited. And, when you have limited resources, you can't afford to make a mistake. Mistakes cost time and money. Making one or more can put a business, **out-of-business**, before it even gets out of the starting gate.

Therefore, every entrepreneur should set aside time for planning.

Planning should include:

- Projecting anticipated income and expenses for the next month and year
- Marketing the business on a limited budget
- Determining staffing needs and duties of each staff member
- And if a partnership, or a corporation with more than one active shareholder, deciding and agreeing on what role each owner will play

## II. GETTING STARTED

### A. CHOOSING A LEGAL ENTITY

#### 1. Types Of Legal Entities

After you make that fateful decision to start your own business, whether it's manufacturing, selling a product or providing a service, one of the first decisions you have to make is what business structure (or legal entity) you want to operate your business as. The form you choose will have significant implications, such as, how you are taxed by federal, state and local taxing authorities, your legal protections (i.e. liability and protection from lawsuits) and the number of individuals, if any, that can share in the profits or co-own the business.

The four basic forms of business organizations are:

- a) Sole Proprietorship
- b) Partnership
- c) Corporation
- d) Limited Liability Company (LLC)

## 2. Sole Proprietorship

A Sole Proprietorship is a business owned by one individual (owner), hence the word Sole. It is not a separate legal entity, but rather the business is just another asset an individual owns such as a car or a house. The owner is responsible, and legally liable, for all the liabilities (debt) of the business whether the business is successful or not.

Many businesses start as a Sole Proprietorship because it's the easiest to start and operate, or because the owner is unfamiliar with the other forms of business. With the exception of certain permits or licenses required by law for businesses in certain industries, a sole proprietorship files less forms than other entities. Although no separate set of books (accounting records) are required, all business expenses must be tracked and substantiated.

## 3. Partnership

A Partnership is an agreement by two or more individuals to carry on a business for profit. It is created by filing a registration statement stating the business name of the partnership (e.g. ABC Partnership), and the true (legal) name and addresses of all partners. There are two types of partnerships - **Limited** and **General**. Both are required to maintain a separate set of accounting records and must file its own federal and state income tax returns.

A General Partnership is comprised of two or more individuals who share in the ownership of all partnership assets and are equally liable for all partnership debt. The partners can decide what percentage of profit and losses each partner will be entitled to as well as each partner's ownership share. These percentages can be modified at any time.

A Limited Partnership is comprised of one or more general partners who are personally liable for the partnership debt **and** one or more limited partners. The limited partners share in the profits but do not share losses beyond their capital investment. A limited partner is not really a partner in the true sense of the word but rather an investor with no personal liability beyond their investment.

The benefit of a general partnership is - it is relatively easy to form and relatively easy to modify (i.e. modify the partnership agreement), which states the responsibilities and interest of each partner. The major drawback is that each partner is personally liable for the acts and debt of all other partners. This means if one partner goes on a spending spree, a creditor can sue another partner for the debt. In addition, a creditor can go after a partner's personal assets (e.g. stocks & bonds and other businesses) to pay for any unpaid liabilities of the partnership.

#### 4. Corporation

A Corporation is a separate legal person (entity) created and allowed under state law. It has an existence separate from its owners, known as shareholders. A Corporation must get approval from the Secretary of State to do business under a fictitious name (i.e. the name created by its incorporators). This name must be unique and different from any existing entity within the state. New York State for example, requests each applicant to supply three possible names for a newly created corporation. A Corporation must file "Articles of Incorporation" and "By-laws" which dictate and govern its rights and obligations to its shareholders, directors and officers. As a separate legal entity it must also maintain its own set of accounting records and file its own income tax returns.

A Corporation has many benefits over other business structures. The main benefit is that in almost all cases, shareholders are protected ("shielded") from business debt incurred by the Corporation. Unlike a Sole Proprietorship or Partnership, a creditor of the Corporation cannot sue and hold a shareholder personally liable for the debt of the Corporation. However, a point not often mentioned is that although a shareholder is not liable for the corporation's debt, they are still liable for personal or professional acts. That is, even if doctors, lawyers or hairdressers incorporate, they are still liable for negligence (acts due to incompetence) or for illegal acts.

The federal and most state governments allow corporations to make special tax elections (see Section B 3). These elections allow corporations to be treated as if they are Partnerships, which has many beneficial tax ramifications (see section II B). In other cases, certain corporations are automatically classified as a particular type of corporation. A Professional Corporation is an example of a special type of corporation.

## 5. Limited Liability Company (or LLC)

Limited Liability Companies are also created by state law and have been growing in popularity over the last two decades as the primary business structure for small business. Instead of shareholders their owners are called “**Members**”, and like shareholders they are not personally liable for the LLC’s debts or obligations. Unlike either a Partnership or Corporation, a LLC has the ability to change the way it is taxed. That is to say, by amending certain documents, a LLC can be treated as either a Partnership or as a Corporation. Obviously this allows the Members a great degree of flexibility in running the business.

## B. TAX BENEFITS AND DRAWBACKS OF CERTAIN ENTITIES

### 1. Sole Proprietorships

The key tax benefit of a Sole Proprietorship is that, generally speaking, the profits of the business are taxed at the owner’s personal tax rate. There are no additional federal or state income taxes imposed on the profits of the business. A Sole Proprietor reports his or her business income or loss on either a **Schedule C, E or F** on their federal income tax return. This amount is also reported on most state income tax returns.

There is one exception to this rule if you operate your business in New York City. In New York City, a business that operates as a Sole Proprietorship must file a separate income tax return called an “Unincorporated Business Tax” return, and in many cases, pay additional taxes on the profits earned by the business.

One of the drawbacks of this form of business is the inability to deduct from taxes certain expenses allowed by other entities such as Corporations or LLCs.

### 2. Partnerships

Partnerships are taxed similarly to Sole Proprietorships. However, unlike a Sole Proprietorship where there is only one owner, a partnership will have two or more owners. Upon inception, the partners must decide what interest each partner will have in the partnership and what percentage of the profit or losses the partners will be entitled to each year. Then, each year, the profit and losses of the Partnership will “pass through” to each partner based on his or her respective partnership profit or loss percentage.

Although not subject to the double taxation of a regular corporation (see below), and similar to a Sole Proprietorship, a Partnership is restricted in what type of expenses the business can deduct. The Partnership must also file its own tax returns. The federal tax form is 1065.

### 3. Corporations

As mentioned earlier, one of the major benefits of a corporation is the protection its shareholders receive from the debts of the corporation. The Corporation can also deduct many expenses not available to other business forms such as shareholders fringe benefits. From a tax perspective, the major drawback of a regular corporation is the additional taxes the business must pay. This is generally known as “double taxation”. The reason it is double is because the corporation must pay federal corporate income taxes on the net profit of the business and then the individual shareholders must pay personal income taxes on money the corporation distributes to them during the year. Most states also tax the corporation twice. One way to avoid this double taxation is for the shareholders to pay themselves a bonus at year end. This will reduce the profit of the business and, accordingly the amount of corporate taxes owed. Unfortunately, it also increases the payroll taxes due. You should discuss this with your accountant before doing this.

In addition, corporate tax rates (ranging from **15%** to **35%** on the federal level) are generally higher than personal tax rates, at certain levels. This could be a drawback for certain types of businesses. What’s more, if the corporation is a “Professional Corporation” (Accounting, Legal, etc.), it is subject to a flat 35% on all corporate profits for federal tax purposes.

**Subchapter “S” Election** - One of the good things that Congress and most states have done for small business is allow a small corporation to elect to be treated as a partnership for tax purposes. That is, the entire income the corporation earns is “passed down” to each shareholder according to that shareholder’s interest (pro-rata ownership share). Use **Form 2553** to make the election to be treated as a Subchapter S corporation.

**IMPORTANT** -Shareholders pay personal income taxes on the “S” corporations entire net profit, not solely on the amount distributed (withdrawn) from the corporation. Also, a shareholder who works for the corporation cannot withdraw **ONLY** profits from the business as distributions. They must also declare themselves as an employee of the corporation and pay payroll taxes (discussed in another section) on the wages they declare. However, the regulations only require that a reasonable salary be taken. After that, the remainder withdrawn is not subject to payroll taxes.

**IMPORTANT** - In addition to making a federal election to be treated as a “S” corporation, most states that allow “S” corporation treatment require that you also file a state election.

Some of the drawbacks of being a “S” corporation are:

- Individual tax rates are sometimes even higher than corporate rates at certain personal income levels. This means that certain shareholders of successful small corporations could pay more federal and state income taxes by being a “S” corporation than by being a regular corporation
- Certain expenses (health insurance premiums and other benefits) paid by the “S” corporation to a shareholder owning **2%** or more of the stock, must be included in that shareholder’s income, and is subject to income taxes
- New York City doesn’t have a similar “S” election, hence a “S” corporation doing business in New York City must pay New York City corporate taxes on the earnings of the corporation

#### 4. Limited Liability Companies (LLC)

A business operating as a LLC is taxed very similarly to a “S” Corporation, that is, profits are not taxed at the corporate level but only once at the individual level. However, the LLC is not subject to the restrictions placed on “S” corporations such as a limit on the number of shareholders allowed.

## C. INITIAL FILINGS AND APPLICATIONS

### 1. Obtain A License

To operate a business, most states and localities require that you obtain a business license. Applications can be obtained from the city government where your business is located (in New York City contact the Department of Consumer Affairs). The application fees range from **\$25** to several thousand dollars depending on the type of business you are in. It usually must be renewed annually. The business will receive a license in the mail and this license should be posted in plain sight in the place of business.

### 2. Using A Fictitious Name

If you operate a corporation under another name from its legal name, or a business under a fictitious name, most states require that an application to operate under another name be filed with the state where the business is located. This certificate is called a DBA or "Doing Business As" certificate.

### 3. Employer Identification Number

All corporations and all other businesses that hire employees must apply for an Employer Identification Number (EIN #). This number is obtained by filing a Form SS4 with the Internal Revenue Service. This number is similar to an individual's social security number and must be used on all income and payroll tax returns and all other legal correspondences with tax agencies.

### 4. Bank Account

Partnerships and Corporations are required to maintain a separate set of accounting records. A Sole Proprietor should also maintain a separate set of accounting records for his or her business, although not legally required to. As such, one of the first things an owner, partner or shareholder should do after deciding which legal form the business will take is open a business bank account. If the business is a corporation, the bank will require an EIN number prior to opening the account.

### III. PAYROLL, INCOME TAX AND OTHER FILINGS

#### A. PAYROLL TAXES

Regardless of what form of business you operate under, if you have employees, you are required to pay a variety of employment related taxes that are collectively called "Payroll Taxes". Unlike some other requirements, compliance with payroll tax rules are strictly enforced. Penalties for noncompliance can be very steep, and owners, partners and even corporate shareholders are held personally liable for nonpayment of all required payroll taxes, even in the case of bankruptcy.

A summary of these payroll tax rules and payroll taxes are as follows. It should be noted that there are many exceptions to these general rules for collecting and remitting payroll taxes. You should consult your tax advisor for the specific requirements of your business.

1. **Form I-9** - All employers must verify that each new employee is legally eligible to work in the United States. As such, each employee should complete the US Citizen and Immigration Services **Form I-9**, Employment Eligibility Verification Form. You can get this form from an INS office or by calling 1-800-375-5283.
2. **Form W-4** - Employers should ask each new employee to complete Form W-4, Employee Withholding Certificate. Although not usually required to be filed with the Internal Revenue Service, beginning in 1996, this form is required to be filed with the New York State Department of Taxation. This form is used to tell the employer information about his/her employee such as their social security number (SS#), address, filing status and number of dependents.
3. **Form 941** - Employers must withhold income taxes, Social Security and Medicare taxes, from wages paid to employees, but not amounts paid to independent contractors (see below). Employers must also pay Social Security and Medicare taxes in an amount equal to the employees' share. Both the employer's and employees' portion of Social Security tax are based on a rate of **6.2%** (or **12.4%** combined), of the employees wages, up to a maximum of **\$102,000** (in 2008) per employee. The maximum amount will be adjusted each year.

The Medicare rate is **1.45%** (**2.9%** combined), on all of the employee wages. Both the amount withheld from the employee (income taxes, Social Security and Medicare taxes) and the employers portion of Social Security and Medicare taxes must be paid to the Internal Revenue Service on either a monthly basis (for most small businesses) or on a semiweekly basis, and reported to the IRS on Form 941, on a quarterly basis. Today most employers are required to make these payments electronically through the Electronic Funds Transfer system.

4. **Form NYS-45** - New York State also requires that employers withhold New York State and New York City income taxes from their employees. And similar to the IRS, NYS requires employers to file a quarterly report of income withheld and wages paid.
  
5. **Federal (FUTA) And State Unemployment (SUI) Taxes** - Employers are required to pay federal and state unemployment taxes. Currently, the federal rate is **6.2%** for the first **\$7,000** paid each employee as wages, during the calendar year. The employer gets a credit against FUTA tax for contributions paid into State unemployment funds. The credit can't exceed **5.4%** of the first **\$8,500** of wages for a net rate of **.8%**. In New York, unemployment taxes are reported on form NYS-45 and can range from **1.025%** to **9.425%** and varies depending on an employer's history of employees filing for unemployment benefits.
  
6. **Other Employment Related Expenses** - In addition to the above taxes, employers are required to maintain State Disability and Workers Compensation policies. The cost of those policies vary depending on the number of employees covered and the type of business your are in.
  
7. **Other Payroll Tax Requirements**
  - **Form W-2** - Employers are required to furnish a W-2 form to each employee each year showing the total wages paid, total wages taxable and all taxes withheld from their wages. A copy of all W-2s along with a summary W-3 form must be filed with the Social Security Administration each year.

7. **Other Payroll Tax Requirements (continued)**

- **Form 1099** - The Internal Revenue Service requires that a Form 1099 information return be filed for all payments over \$600 made to individuals (other than employees), for personal services. An example of this would be payments made to outside contractors.

8. **Other Information** - Employers can prepare their own payroll tax returns and make all necessary payroll tax payments on their own. However, due to the numerous payroll tax rules and steep penalties for noncompliance of these rules, they might consider paying an expert to comply with these rules. Most accountants will provide this service as well as many payroll tax service companies. The cost to have a payroll service perform this function is relatively inexpensive and should be seriously considered. If you plan on doing your own payroll tax reporting you should get Publication 15 (Circular E) from the Internal Revenue Service. This publication contains all the information you need to comply with these federal rules.

**B. INCOME TAXES**

**1. BUSINESS INCOME TAX RETURNS**

The following is a list of the various federal income tax returns that must be filed by different business entities and their related due dates:

- **Sole Proprietors** - Depending on whether the business is a farm, rental property or other business, income and expenses are reported on an individual Form **1040** and the appropriate schedule (i.e. **C, E** or **F**). Form 1040 is due on April 15<sup>th</sup>.
- **Partnerships (and some non-single member LLCs)** - Form **1065** on the 15<sup>th</sup> day of the fourth month after the end of the tax year, which for most partnerships is April 15<sup>th</sup>.
- **Corporations (and some non-single member LLCs)** - Form **1120** (or **1120S** for a Subchapter “S” corporation) on the 15<sup>th</sup> day of the third month after the end of the tax year, which for most corporations is March 15<sup>th</sup>. Taxes are not sent to the IRS but rather deposited at a commercial bank along with a federal tax deposit coupon (Form 8109).

- **Extensions** - All tax entities can apply for an extension to postpone filing their tax returns to a later date. These extensions **Do Not** postpone the payment of necessary taxes, just the filing of the return. Therefore, an estimate of taxes due must be made and payment of these taxes must accompany the extension.
  - **Individuals - Form 4868** - The filing of Form **1040** can be extended once for six months on **Form 4868** until October 15<sup>th</sup>.
  - **Partnerships & LLCs - Form 7004** - The filing of Form **1065** can be extended once for six months on **Form 7004**) until October 15<sup>th</sup>.
  - **Corporations - Form 7004** - The filing of Forms **1120** and **1120S** can be extended for six months on Form **7004**.
- **Estimates** - All businesses, regardless of their type of structure, must file estimated taxes during the year. See Section D for estimated due dates.

### C. OTHER TAX FILINGS

In addition to filing payroll tax returns and income tax returns, some businesses must file other tax returns. For example, most states impose sales tax on the sale of a variety of goods and services and require the businesses involved to collect and remit the sales tax collected.

New York City also imposes a tax, called “Commercial Rent Tax”, on rent paid in the borough of Manhattan, below 96<sup>st</sup> Street, over a minimum amount.

Also, certain regulated industries such as utilities, petroleum and banking are required to make additional filings.

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**D. TAX CALENDAR**

<b>* DATE(S)</b>	<b>RETURNS</b>
January 15 January 31	Estimated Individual Income Tax Payment Annual Federal Unemployment Tax Quarterly Payroll Taxes
February 28	Annual Year-End Wage & Tax Statements
March 15 March 20	Corporate Income Tax Quarterly New York State Sales Tax Quarterly New York City Commercial Rent Tax
April 15  April 30	Estimated Individual/Corp. Income Tax Payment Individual & Partnership Income Tax Quarterly Payroll Tax
June 15 June 20	Estimated Individual/Corp. Income Tax Payment Annual New York State Sales Tax Annual New York City Commercial Rent Tax
July 31	Quarterly Payroll Tax
September 15 September 20	Estimated Individual/Corp. Income Tax Payment Quarterly New York State Sales Tax Quarterly New York City Commercial Rent Tax
October 31	Quarterly Payroll Tax
December 15 December 20	Estimated Corporate Income Tax Payment Quarterly New York State Sales Tax Quarterly New York City Commercial Rent Tax

\* NOTE – WHEN DATE FALLS ON A SATURDAY, SUNDAY OR HOLIDAY,  
THE DUE DATE BECOMES THE FOLLOWING WORK DAY

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#### IV. BOOKKEEPING, ACCOUNTING AND COMPUTERIZATION

##### A. BOOKKEEPING (MAINTAINING YOUR BOOKS)

Unlike a large corporation, with many departments and employees who handle different Company functions, small business owners usually handle most functions themselves. In addition to managing the day-to-day operations of the business, many small business owners wear many other hats such as Receptionist, Secretary, Salesperson, Purchase Agent, Billing and Collection Clerk, Personnel Recruiter, Supervisor and Bookkeeper. And unless you enjoy working with numbers, you'll be like most other business owners who dislike maintaining their accounting books. Unfortunately, this function is very important in running every business, large or small. It's important in order to pay - employees salaries, sales taxes, payroll taxes and all other business expenses on time. It is necessary to know how much money is owed to you by customers, clients or patients. Up-to-date bookkeeping is also important in knowing how your business is doing and planning for the future. Lastly, It is important in getting credit from suppliers and obtaining financing from lenders and financial institutions.

The following are basic elements of a simple bookkeeping system:

##### 1. General Ledger

The heart of any bookkeeping system is the General Ledger. For most small businesses, the General Ledger is nothing more than a book that tracks all business cash receipts and cash disbursements. This book has a separate page for every major asset the business owns (e.g. Cash, Office Equipment), every major type of liability the business owes (e.g. Credit Card debt, Bank Loans), every major classification of revenue the business earns (e.g. Product Sales, Rental Income) and every major classification of expenses the business incurs (e.g. Office Expense, Telephone, Salaries). Each page is called an account and a list of all the accounts is called "**A Chart of Accounts**". In its simplest form, the General Ledger tracks every financial transaction that occurs during the year.

**2. Chart Of Accounts**

The following is a sample chart of accounts used by a general service business corporation. The accounts are broken up into five major categories: Assets, Liabilities, Shareholders Equity, Revenue and Expenses.

<u>Account #</u>	<u>Account Name</u>
<b>Assets</b>	
101	Petty cash
102	Cash - checking
103	Accounts receivable
104	Prepaid expenses
105	Loans and exchanges
115	Office equipment
116	Furniture and fixtures
117	Machinery and equipment
118	Leasehold improvements
119	Accumulated depreciation
121	Security deposits
122	Other
<b>Liabilities</b>	
201	Accounts payable
202	Accrued expenses
203	Payroll taxes payable
204	Due to shareholders
205	Customer deposits payable
215	Credit cards payable
216	Loans payable
221	Security deposits payable
222	Other liabilities
<b>Shareholders' Equity</b>	
251	Common stock
252	Retained earnings
<b>Revenue</b>	
301	Sales
302	Sales returns
303	Interest income
304	Other income

## How To Form, Structure and Report a New Business

### Expenses

401	Office salaries
402	Officer salaries
403	Payroll taxes
404	Employee benefits
405	Accounting
406	Advertising and promotion
407	Bank charges
408	Commissions
409	Contributions
410	Depreciation
411	Dues, books and subscriptions
412	Equipment rentals
413	Insurance
414	Interest
415	Leasing
416	License and permits
417	Meal and entertainment
418	Miscellaneous
419	Office expense
420	Office supplies
421	Outside services
422	Postage and delivery
423	Professional fees
424	Rent
425	Repairs and maintenance
426	Supplies
427	Taxes - payroll
428	Taxes - federal
429	Taxes - state
430	Taxes - city
431	Taxes - other
432	Telephone
433	Travel
434	Utilities
499	Unidentified

### 3. Tracking Invoices And Bills

**Invoices** - Each invoice sent to customers, clients or patients should have a unique number assigned to it. This will help you keep track of every invoice sent and help match collections against these invoices. A copy of each invoice should be kept in a folder or binder.

**Bills** - Every bill received from a supplier or other vendor should be kept in a folder or binder. The folders can be kept in alphabetical order by vendor name or in chronological order by the date the bill is paid. The word **PAID**, along with the check number and date paid, should be written on each bill prior to filing it away.

**Bank Statements** - Bank statements should be reconciled to the check book and general ledger each month to ensure that you have properly recorded all cash receipts and disbursements.

### B. FINANCIAL STATEMENTS

Financial statements are reports that summarize the financial activities and current position of a business at a particular point in time (usually at the end of a year). Financial statements are required by banks and other lending institutions as well as large vendors who sell to a business on credit. The two most basic financial statements are the **Income Statement** and **Balance Sheet**. The General Ledger provides the information for these statements. An Income Statement summarizes all revenue earned or received and all expenses incurred or paid for a specified period (e.g. January 1 through December 31). A Balance Sheet is a statement that shows the total of the assets the business owns, the liabilities the business owes and the difference between the two (i.e. the Owners or Shareholders Equity), at a specific point in time (e.g. December 31<sup>st</sup>). An example of these two statements is as follows:

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**BEST SERVICE COMPANY  
INCOME STATEMENT  
FOR THE YEAR ENDED DECEMBER 31, 20XX**

**Revenue:**

Sales \$400,000

**Expenses:**

Salaries	\$150,000	
Payroll taxes	15,000	
Employee benefits	20,000	
Advertising	40,000	
Depreciation	9,000	
Dues, books and subscriptions	5,000	
Office supplies & expenses	15,000	
Postage & delivery	4,000	
Professional fees	15,000	
Rent	50,000	
Supplies	28,000	
Telephone & Communications	12,000	
Utilities	<u>9,000</u>	
		<u>363,000</u>
Net income		<u>\$ 28,000</u>

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**BEST SERVICE COMPANY  
BALANCE SHEET  
DECEMBER 31, 20XX**

**Assets**

Cash	\$ 41,000
Prepaid expenses	5,100
Accounts receivable	27,500
Property and equipment	20,600
Less: Accumulated depreciation	( 17,600)
Other assets	<u>4,750</u>
Total assets	<u>\$ 81,350</u>

**Liabilities**

Accounts payable	\$ 19,000
Accrued expenses	7,250
Bank loans payable	10,000
Loans payable to shareholders	<u>18,000</u>
Total liabilities	<u>54,250</u>

**Shareholders Equity**

Common stock	1,000
Retained earnings	<u>26,100</u>
Total shareholders equity	<u>27,100</u>
Total liabilities and shareholders equity	<u>\$ 81,350</u>

**C. COMPUTERIZATION**

In today's high-tech environment, no business can survive without using a computer. This is never more true than for a small business. As a matter of fact, it could be said that computers and other cutting edge technology, has been the great equalizer when it comes to small businesses competing against larger corporations. Now, a small business can process volumes of data, produce quality reports and design high quality visual products, at an affordable cost that was unheard of only a few years ago.

### 1. Basic System

Today a small business can purchase a basic computer system for under **\$1,000** that includes a flat panel monitor, a CD/DVD drive and sound card and speakers. A high quality inkjet or laserjet printer is also a necessity and relatively inexpensive to buy.

Most new systems now come with software that will satisfy the basic needs of most businesses. This includes a word processor, spreadsheet and some sort of graphics program. Other programs that many businesses find useful are: database, presentation, drawing and accounting.

### 2. Accounting

It used to be that accounting programs were very expensive, only performed basic accounting functions, or was so difficult to learn that only an experienced computer consultant or accountant could setup and operate these programs. Thankfully, times have changed and software costs, including accounting programs, have plummeted in price and ease of use. What's more, they have become so powerful that accounting programs are now being used by almost every business that owns a computer. Today an average low-cost accounting program costs about under **\$500** and is as powerful as high-end programs were a decade ago. Two of the most popular programs are QuickBooks and Peachtree. These programs perform most accounting functions such as printing customer invoices and tracking accounts receivable, printing checks and tracking accounts payable, maintaining a full general ledger and even reconciling your bank statement to your books. Even the manuals have been written in easy to understand English. Although not necessary, it is advisable to consult an accounting professional to help set up the program and provide some basic guidance on its use.

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## V. OBTAINING BUSINESS FINANCING

### A. Types Of Financing

Unless you are independently wealthy or have very rich relatives (relatives that you talk to and who like you), at some point, if not at the very beginning, every business will require additional capital (cash) for growth. A business obtains financing in two ways - through equity, debt or a combination of both.

- **Equity** relates to selling an ownership interest in your business to another person or business. A sale can take many forms depending on your particular business structure. For example, if your business is a partnership you can admit more partners or if it is a corporation, you can issue shares to an investor.
- **Debt** means borrowing money. Money can be borrowed from yourself, from a friend (or former friend after you borrow it), a relative, a bank, a financing company or even a creditor.

### B. Borrowing Money

As mentioned before, creditors, banks and other lending institutions require a business to submit financial statements in order to borrow money. Obviously, they want to know that the business is making money and will be able to repay its loans. They also want to see that the business is growing. That is why they usually ask for two or three years worth of financial information. In addition to requiring financial statements most banks and financial institutions require other documents such as a business plan, personal financial statements and income tax returns.

One mistake that many people make when applying for a business loan is not being prepared. The usual scenario is a business owner goes into a bank and says he or she needs money to build their business and the bank should give them the money because they have a great business and they promise to repay the loan soon. Unfortunately, even if what they say is true, a majority of business loan requests are turned down. As mentioned before, one way to improve your odds is to be prepared. This includes having a **Business Plan** that spells out at a minimum, what the business does, the owners of the business, specifically why the business needs the money and how the business plans on using and repaying these funds.

## VI. AGREEMENTS, INSURANCE, AND TAX PLANNING

### A. Agreements

Although too large in scope to cover in this booklet, it is important to mention the necessity of having some basic agreements. At the very least, agreements are important because they capture in writing the wishes of two or more individuals and remove the element of memory from any agreement. A list of some of the more common agreements in business are as follows:

- Employee Contracts
- Shareholders Agreements
- Buy/Sell Agreements
- Outside Contractor Agreements
- Loan Repayment Agreements
- Sales Contracts & Leases

If funds are limited, an agreement can be made informally without an attorney. These agreements might not be conclusive enough to stand up in court but they will at least document the intent of the parties to the agreement. For increased protection, especially in today's litigious (sue crazy) world, you might want to have more formal agreements drafted by a qualified attorney.

### B. Insurance

With the exception of workers compensation, state disability and state unemployment insurance, most insurance is not mandatory. Although not mandatory by any regulatory agency, some insurance coverage is required by other organizations you do business with. For example, most landlords require fire and casualty insurance and some banks require insurance on inventory that was put up as collateral on a business loan. However, depending on the business, not having certain insurance is like playing Russian Roulette. One day you have a thriving business, the next day after a fire you have nothing but ashes and memories. Other types of insurance include: Liability, Umbrella Coverage, Business Interruption and Buy/Sell Life Insurance. Consult an Insurance Broker for more information.

### C. Tax Planning And Other Tips

The best way to avoid taxes is to plan for them and consult with a tax professional. As covered in some detail earlier, choosing a particular business structure can have a significant impact on the taxes you pay. Other areas that should be considered that effect the amount of taxes a business pays are briefly listed below:

- **Switching from one form of business to another** can have tax implications. For example, converting from a regular corporation to an “S” Corporation can prevent a business from using prior year losses to offset current year profit.
- **Late filing or payment of taxes** can cause the business to pay penalties and interest. In certain cases such as with payroll taxes, even one day late can produce the imposition of costly penalties.
- **Misclassification of employees as outside contractors** can have a serious impact on a business operations and its finances. If a federal or state agency determines that payments made to an individual are wages and not payments to an “independent”, outside contractor, your business can be liable for a wide assortment of taxes and penalties, including recalculated payroll taxes and non-withheld and unpaid income taxes.
- **Impact of selling a partnership interest or shares in a corporation or liquidating the business.** Many times a partner or corporate shareholder wants to sell his or her interest in the business or close the business altogether. You should be aware that the sale or distribution may have taxable consequences.
- **Buying business assets** -Most business assets purchased cannot be deducted as an expense in the year purchased but must be deducted (i.e. depreciated) over a several year period. For example office computers are generally depreciated over five years and office furniture and fixtures over seven years. However, there is a special provision in the tax law (Section 179) that allows most business assets to be expensed in the year purchased, up to a fixed amount. The total allowed depends on many factors, including the tax ceiling and special allowances (e.g. due to a natural disaster) in effect at the time.

- **Selling non-inventory business assets** can also have a tax impact. If a business sells an asset for more than it lists on the books (i.e. its cost minus the amount depreciated) the business will have to pay capital gains tax. However, if a business replaces an asset with a similar asset (called a “like-kind exchange”) the business can postpone paying these taxes.

There are many other ways to reduce taxes through planning. You should consult your tax advisor for more information.

### VII. CONCLUSION

By the time you have read this entire booklet you might be saying to yourself, what person in his or her right mind would go through all of this and more to own their own business. The answer is most business owners or entrepreneurs are not entirely sane. It takes a little craziness to take on the responsibilities of running a business. The stress of making payroll and planning for a future without a crystal ball is sometimes overwhelming. But as any successful business owner will tell you, the rewards are worth it. Our country was built on the success of small business. Most large businesses today began as a small business. One only has to look at Apple, Microsoft, Walmart, Amazon or Google to know that success is not a fairy tale.

We hope this booklet was informative and has answered some of your questions. If you would like more information about the topics covered, or help with any other tax or accounting related question, feel free to call **Laurence Scot** at **(212) 967-1100**.