

Topics to consider before starting a business

Okay. You've decided to start a business. There are several things to consider in your planning stages. The topics discussed below offer an overview of several issues, including:

- Business entities
- Licenses and permits
- Business insurance needs
- New employee hiring
- Payroll tax returns
- Tips for Small Business Banking

For more detailed information regarding these topics, we suggest you contact federal and state agencies, the Small Business Administration (SBA), or local small business chapters.

Types of business entities: Advantages and disadvantages

From the least complicated business entities (sole proprietorship and partnership) to the more complicated structures of an S Corporation or C Corporation, the type of business formed will vary according to the type of business and the individual (s) setting it up. The following information lists some considerations for each of these business entities:

Sole proprietorship

Business is operated by a single person. The owner is not considered an employee, but is, in fact, a self-employed individual. The simplest form of business – an individual can start up a sole proprietorship with no legal formalities. Inexpensive.

Business license or permit may be required. Check with your state or local agency for ordinances. Amount of licensing differs from state to state. Sole proprietor and its owner are treated as a single entity from an income tax standpoint.

May be subject to unlimited personal liability. All of the assets and liabilities of the company are the assets and liabilities of the individual. Retirement programs such as a Keogh plan are available. Separate business and personal expense books are kept. Business income is reported on individuals' Form 1040, Schedule C.

General partnership

Business is operated by two or more people.

Partnership agreement should be drawn up.

Defined as a voluntary contract between two or more competent persons to place any part of their money, effects, labor, and skill in lawful commerce or business with the understanding there shall be proportional sharing of profits and losses between them.

May be required to obtain a business license or permit.

May be required to file a partnership certificate with a public office.

Partners are not considered employees of the company, but are self-employed individuals.

Personal and partnership assets may be at risk.

Not required to pay separate business income taxes. However, you must file an information return indicating amount of money earned or lost during the year by each partner. Each partner is then responsible for paying their share of personal income tax.

Limited partnership

A partnership that is made up of one or more general partners and one or more limited partners.

The big difference between a general partner and a limited partner is that the limited partner is not personally liable for debts of the partnership.

Limited partners can only lose the amount they paid as a capital contribution or received from the partnership after it becomes insolvent.

A limited partner may not participate in management of the business. If a limited partner does participate, he or she may incur personal liability with the same repercussions as a general partner. Serves as a means to raise money from limited partners without having to take in new partners as active members in the business or engage in the complexities of starting a corporation and issuing stock.

Regular corporation (C Corporation)

Considered a separate entity from those who own or operate it.

Created under state law to carry out some business or other authorized activity.

One person may own all the stock.

May be made up of only one employee, in which case the owner and their corporation are considered separate legal entities.

Has its own name and identity, and all assets and liabilities belong to the corporation.

Primary advantage of incorporating is that it limits personal liability and protects you from being personally liable for debts (e.g., bills for supplies/equipments and injuries to persons involved in business activities that are not adequately covered by standard insurance).

Tax must be paid on the income made in a corporation, and if income is distributed to shareholders as dividends, the shareholders must pay tax on what they receive as dividends.

S Corporation

The same limited liability of a corporate shareholder. However, business owners must pay income taxes in the same manner as a sole proprietor or a partner.

Business losses may be offset against other income, which may reduce or eliminate the business owner's tax burden. To do this, you must participate in the business.

The S corporation generally is not subject to taxation at the federal level. Therefore, the advantage of an S corporation is the ability to escape the corporate double taxation (once at the corporate level and again at the shareholder level on dividends paid).

Must file an informational tax return.

Shareholders are required to pay their share of income tax on the corporation's income, whether or not they received money.

Shareholders may claim their share of a loss suffered by the corporation.

Contact your tax advisor or the tax division of your state treasury department for information on how S corporations are taxed in your state.

Professional corporation

Certain occupations, e.g., physicians, attorneys, and accountants, may incorporate their practice through a professional corporation only. However, some professionals in some states may incorporate as a professional corporation or as a regular corporation.

All shareholders must be licensed.

To find out who is covered in your state, contact your state's corporation filing office.

Licenses and permits

Generally, the government requires licenses and permits to either raise money to levy a tax on doing business, or to protect public health and safety and to maintain building aesthetics. Licenses and/or permits may also be required regarding the location of your business, the amount of money spent on remodeling to meet building codes, and the business' zoning.

Because each state has its own licensing and permit requirements it is a good idea to determine which are applicable to your situation. Most often state agencies offer free or inexpensive publications designed specifically to answer questions on state requirements for your business.

Laws and ordinances are amended frequently, so check with the appropriate local and state government agencies to determine if licensing and permits are required and/or the type (s) of licenses and permits required.

Federal registrations and licenses. There are two tax registrations at the federal level of which you should be aware:

1. Employer identification number (EIN) application (Form SS-4) must be filed by every business.

Form SS-4 can be obtained through your IRS Office, Social Security Administration office, or from a Paychex sales associate.

File with the IRS center in your area.

Form SS-4 processing time usually takes four to five weeks.

In case you have not received your EIN by the time your first tax deposit is due, write "Applied For" and the date you applied in the space where your EIN should go on your return. Be sure to file on time.

You can also save time and apply for your EIN by calling 866-816-2065 (9 a.m. to 3 p.m. ET) with the complete information from your Form SS-4. You will receive your EIN immediately.

All returns or documents filed with the IRS must be accompanied by a taxpayer identification number or social security number (EIN or SSN). The EIN or SSN must also be on any returns or documents filed (Forms 1099) that report: dividends, royalties, interest, and amounts you paid in the course of your business for certain types of payments that total \$600 or more a year.

2. Electing to become an S corporation from a regular corporation.

Shareholders must sign and file Form 2553 (Election by a Small Business Corporation) with the IRS.

Your company must be a domestic corporation organized under federal or state law, have only one class of stock, and have no more than 35 shareholders.

Shareholders must be individuals, estates and certain trust; partnerships and corporations are excluded from holding shareholder status. Shareholders with non-alien status are restricted from shareholder status.

State Requirements. Because each state has its own licensing and permit requirements, it is a good idea to check with your state agency before proceeding. State agencies often offer free or inexpensive publications designed specifically to answer questions on state requirements for your business. New Business Kits, customized for each state, are also available through Paychex. Call 1-800-322-7292.

Insurance needs

Perhaps one of the most important aspects of your business is a well-planned insurance program. Find an insurance agent who specializes in your particular type of business, and spend time with them reviewing the different types of insurance coverage and the concerns of your particular insurance needs. Purchase the coverage that will match the needs you have defined. Remember, more does not necessarily mean better.

Types of insurance available include: Property, liability, product, vehicle, workers' compensation, disability and business interruption.

Property

A great majority of property insurance for small business is written in one of three different forms:

Basic Form

Covers losses due to fire, lightning, explosion, windstorm or hail, smoke, aircraft or vehicles (a loss or damage that is caused by a vehicle that is owned by your company is not covered), riot, vandalism, sprinkler leaks, sinkholes, and volcanoes.

Broad Form

Covers everything that is covered in Basic Form with some additional protections, including: breakage of glass that is part of a building or structure, falling objects, weight of snow or ice, and water damage.

Special Form

Covers all risk of physical loss except where the policy specifically excludes or limits the loss. This provides the most coverage.

Liability

General liability insurance provides protection against perils, including injuries incurred by your customers or guests. However, general liability insurance does not cover punitive damages, instances of intentional injury to a customer by an employee, or injuries caused by products that are defective or motor vehicles, or an employer's liability in the instance of a worker receiving injuries on the job.

Product

Product liability insurance is necessary if your business manufactures, distributes, or sells a product that could cause injury to a person.

Vehicle

If you intend to have your employees drive business-owned or employee-owned vehicles, you should carry vehicle insurance. Vehicle insurance will provide protection against any damages or injuries caused by the employee.

Worker's Compensation

Worker's compensation provides coverage to employees injured on the job. All businesses with employees are required to carry some form of workers' compensation in order to protect the employer against punitive damages. The amount of money that can be recovered by an employee is limited, recovering only for medical treatment and lost wages. However, in some serious cases, an employee may be rewarded for future earnings if impaired by the injury.

Each state has its own law that provides guidelines for employers to follow within their respective states.

Insurance rates are determined by the state in which your business resides, what type of work your employees are required to do, and the company's safety record. Workers' compensation does not cover independent contractors. However, if you label an employee incorrectly as an independent contractor and that person incurs an injury while performing work for your company, you may have to pay large sums to cover medical bills and lost wages that ordinarily would have been covered by workers' compensation.

Disability

Disability is used to offset lost wages if an employee cannot work due to an off-the-job illness or injury. This type of insurance also varies from state to state.

Business Interruption

If your business is destroyed by fire, earthquake, or tornado and you are covered by business interruption insurance, your lost income and any expenses incurred to keep your business going during rebuilding or repairing are covered.

New Employee Hiring

Obtaining certain information from each new employee hired is required. New employees must provide you with their social security number (SSN), a completed Form W-4 (Employee's Withholding Allowance Certificate), and a Form I-9 (Employment Eligibility Verification) completed by both you and the employee.

Employers are required by law to report information about any new employee to their appropriate state agency within 20 days of the employee's date of hire. State agencies use new-hire reports to locate parents and enforce child support payment orders. As part of our payroll service, Paychex handles all of the new-hire requirements by reporting all of a business' new employees to the correct agency when they're hired.

Payroll Tax Returns

Employment-related forms and records

Keep all employment-related forms and records for at least four years. They should be made available for IRS review if requested. Records should include: federal, state-specific, local, income tax withholding records, Social Security/Medicare employee tax information, and Federal Unemployment Tax records.

Federal

Form 940, Employer's Annual Federal Unemployment (FUTA) Return

Form 940 EZ, Employer's Annual Federal Unemployment (FUTA) Return
Form 941, Quarterly Tax Return
Attendance records
Accident reports and injury claims (workers' compensation)
ERISA retirement and pension records
FMLA records
Form I-9, Employment Eligibility Verification
Personnel file records, including W-4s

State-specific

State Return
State Unemployment Insurance

Local

If required in your area

Income Tax Withholding Records

Names, addresses, and social security numbers of each employee.
Total amount and date of each wage payment, and payment time period.
Each wage payment-withholding amount.
Each payment amount withheld and the exact date it was collected.
If taxable amount is less than total payment, reason must be given
Non-residential alien status, residence in Puerto Rico or the Virgin Islands, or residence or physical presence in foreign country statements that are provided by the employee.
If no income tax was withheld from payments for non-cash compensation made to retail commission salespeople, the following information is needed: date and fair market value of each payment.
Form W-4, Withholding Allowance Certificate, for each employee.
Agreements that may exist between you and the employee on Form W-4 regarding additional amounts of tax withheld on a voluntary basis.
Statements provided by employees regarding the reporting of tips in their work.
Employee requests to have tax withheld based on their cumulative wages and any notice if the request is revoked.
Forms W-5 for employees eligible for the Earned Income Credit who elect to receive payment in advance.

Social Security & Medicare employee tax information

Must Include:

Each wage payment amount that was subject to social security tax.
Each wage payment amount that was subject to Medicare tax.
If the total wage payment is not the same as the taxable amounts, a reason must be provided.

Federal Unemployment Tax records

Must include:

Total amount paid to each employee during a calendar year.
Amount paid into state unemployment fund.
Amount of tax and any other information required must be shown on the employments tax return.
A reason must be given if the amount of compensation that is subject to unemployment tax differs from the total compensation

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