31 Starting a Business

Tab 31 Contents

Online Business Resources

www.sba.gov

The *U.S. Small Business Administration (SBA)* provides programs for businesses in the areas of technical assistance, training and counseling, financial assistance, assistance with government contracting, disaster assistance recovery, advocacy laws and regulations, civil rights compliance, and special interests, such as women, veterans, Native Americans, and young entrepreneurs.

The website provides links to information resources including advertising, finance, franchise opportunities, government contracting, information security, international trade, licenses and permits, federal and state compliance with labor laws.

www.score.org

The *Service Corps of Retired Executives (SCORE)* is dedicated to helping small businesses get off the ground, grow and achieve their goals. SCORE provides volunteer mentors, free confidential business counseling, free business tools, and inexpensive or free business workshops.

Various

There are a number of commercial products available to assist with setting up a business entity, creating a business plan, and other useful tools for start-up companies.

IRS Business Return Enforcement (Fiscal Year 2013)

	2013	2012	2011
Total Returns Examined	61,020	70,265	62,445
Returns filed in prior calendar year	9,938,483	9,950,784	9,869,358
Coverage	0.61%	0.71%	0.63%
Small Corporation Returns (assets under $10 million)			
Returns examined	17,604	21,164	19,697
Returns filed in prior calendar year	1,849,758	1,896,158	1,931,008
Coverage	0.95%	1.12%	1.02%
Large Corporation Returns (assets $10 million and higher)			
Returns examined	9,876	10,752	10,459
Returns filed in prior calendar year	62,347	60,489	59,291
Coverage	15.84%	17.78%	17.64%
S Corporation Returns—1120S			
Returns examined	18,670	21,658	18,519
Returns filed in prior calendar year	4,476,307	4,469,329	4,444,154
Coverage	0.42%	0.48%	0.42%
Partnership Returns—1065			
Returns examined	14,870	16,691	13,770
Returns filed in prior calendar year	3,550,071	3,524,808	3,434,905
Coverage	0.42%	0.47%	0.40%

Entity Classification Elections

Entity	Default Filing	Check the Box Options	Cannot Be Taxed as:
Individual	Sole proprietor, Sch. C (or Sch. E for rental)	Corporation	Partnership
Partnership	Partnership, Form 1065	Corporation	Sole proprietor
Corporation (formed as a corporation under state law)	C corporation, Form 1120; or S corporation, Form 1120S (with S election)	N/A	Sole proprietor; Partnership
LLC (single-member)	Sole proprietor, Sch. C (or Sch. E for rental), or disregarded entity if owned by a corporation or partnership.	Corporation	Partnership
LLC (multiple-owner)	Partnership, Form 1065	Corporation	Sole proprietor

Websites

www.archive.org.................. Internet Archive Wayback Machine
www.bizstats.com................ Business/Industry Statistics
www.bls.gov........................ U.S. Bureau of Labor Statistics
www.entrepreneur.com........ Entrepreneur Magazine
www.franchise.org............... International Franchise Association
www.sba.gov....................... U.S. Small Business Administration
www.score.org .... SCORE

Business Entity Comparison Chart

Entity	Organization and Ownership	Taxation of Profits and Losses
Sole proprietor, single-member LLC, and husband/wife business (See Tab 5) • Schedule C, Form 1040, *Profit or Loss From Business* • Schedule F, Form 1040, *Profit or Loss From Farming* • Schedule SE, Form 1040, *Self-Employment Tax* • IRS Pub. 334, *Tax Guide for Small Business*	• One individual carrying on an unincorporated trade or business. • A qualified joint venture whose only members are spouses may elect not to be taxed as a partnership and file as two sole proprietorships. An LLC may not make this election. See *Spousal business,* page 5-6. • Easiest business to organize with minimal legal restrictions. • The entity does not exist apart from the owner. Business starts and ends based on engaging in and ending engagement in business. • The owner has complete freedom over business decisions and is entitled to 100% of the profits. The owner is limited by his or her own ability to raise capital and obtain financing. Outside investors cannot be part owners. • Transfer of ownership consists of selling the business assets. • A single-member LLC is taxed as a sole proprietorship unless the election is made to be taxed as a corporation.	• The owner is self-employed and pays SE tax on net profits. • Net profits are subject to income tax in the year earned and cannot be deferred by retaining profits. • Losses offset other income in year incurred, such as W-2 wages, interest, dividends, and capital gains. ***Exceptions:*** Losses cannot be used to offset income from activities subject to passive loss, at-risk loss, and hobby loss rules.
Partnership (See Tab 20) • Form 1065, *U.S. Return of Partnership Income* • IRS Pub. 541, *Partnerships* • Tab 20, Partnerships/LLCs, *Deluxe Edition/ Small Business Edition* • IRC Subchapter K, §701 through §777	• Two or more owners conducting an unincorporated trade or business. • Easy to organize with minimal legal restrictions. • Multi-member LLCs are taxed as partnerships, unless the election to be taxed as a corporation is made. • No limitations on the number of partners or partner entities. • More flexibility than a corporation in dividing up profits, losses, ownership of capital, and making special allocations to partners. • Contributing property in exchange for a partnership interest is generally a tax-free event and there is generally no tax when liquidating a partnership interest in exchange for property (unless the liquidation is in cash only). • Getting out of a partnership may be more complicated than starting one. A partnership agreement can restrict selling or transferring of a partnership interest. • A partnership can terminate if too much ownership is exchanged or liquidated in one year. • State law may limit an LLC's life.	• The partnership pays no income tax. Profits pass through to partners for individual payment of tax. • Tax to partners cannot be deferred by retaining business earnings. • Pass-through items retain the same character to the partner as they had to the partnership. • A general partner's distributive share of profits is subject to SE tax. Limited partners share of profits not subject to SE tax unless in the form of guaranteed payments. • Payment for partner services to the partnership is not W-2 income, but may be guaranteed payments, profits, or special allocations. • Losses flow through to partners and can be used to offset other income such as W-2 wages, interest, dividends, and capital gains. ***Exceptions:*** Losses cannot be used to offset income from activities subject to passive loss, at-risk loss, and hobby loss rules.
S corporation (See Tab 19) • Form 1120S, *U.S. Income Tax Return for an S Corporation* • Tab 19, S Corporations, *Deluxe Edition/ Small Business Edition* • IRC Subchapter S, §1361 through §1379	• A corporation that elects to be taxed as an S corporation by filing Form 2553, *Election by a Small Business Corporation.* • Ownership is through owning shares of stock. Limited to 100 shareholders. (Spouses and their estates and all members of a family, as defined in IRC section 1361(c)(1)(B), and their estates can be treated as one shareholder for this test.) • Stock is limited to one class of stock with equal rights to distributions and liquidation proceeds. • Shareholders are limited to individuals, estates, certain trusts, and certain charities. Corporations and certain partnerships are ineligible to own stock. See *S Corporation Qualifications,* Tab 19, *Deluxe Edition/Small Business Edition,* for exceptions. • Other ownership and organization issues are the same as a C corporation.	• An S corporation generally pays no tax. Profits flow through to the shareholders. • Pass-through items retain the same character to the shareholder as they had to the corporation. • Distributions are not subject to SE tax. • Shareholders who perform services are paid as employees and income is reported on a W-2. • Losses flow through to shareholders and may be used to offset other income, subject to passive, at-risk, and hobby loss exception rules.
C corporation (See Tab 18) • Form 1120, *U.S. Corporation Income Tax Return* • IRS Pub. 542, *Corporations* • Tab 18, Corporations, *Deluxe Edition/ Small Business Edition* • IRC Subchapter C, §301 through §385	• A legal association carrying on a trade or business organized under state law. • Ownership is through owning shares of stock, and there is no limit on number of shareholders, or type of taxpayer or entity. • Forming a corporation may require complex and expensive legal procedures. Corporations must hold board meetings, shareholder meetings, and keep corporate minutes. Corporations are subject to federal and state regulations. • The life of a corporation is perpetual. Transfers of ownership can be as easy as selling or inheriting stock. • Liquidating a corporation is usually a taxable event, and contributions in exchange for stock may be taxable. • Raising additional capital can be as easy as issuing new shares of stock.	• Shareholders who perform services are paid as W-2 employees subject to payroll taxes and reporting rules. • Reasonable wages must be paid and not inflated to reduce corporate tax liability. • Net profits are subject to tax at the corporate rates. Profits distributed as dividends are taxed again on the shareholder's tax return. Tax to the shareholders can be deferred by retaining earnings for business purposes. • Losses do not pass through to shareholders. Business losses must be carried over to a year with profits. Capital losses must be carried over to a year with capital gains. At-risk limitations, hobby loss, and passive loss rules do not apply.

Business Entity Comparison Chart

Entity	Accounting and Recordkeeping	Fringe Benefits	Liability
Sole proprietor, single-member LLC, and husband/wife business (See Tab 5) • Schedule C, Form 1040, *Profit or Loss From Business* • Schedule F, Form 1040, *Profit or Loss From Farming* • Schedule SE, Form 1040, *Self-Employment Tax* • IRS Pub. 334, *Tax Guide for Small Business*	• Accounting is less involved than partnerships and corporations. Double-entry bookkeeping is not required as no balance sheet is needed when filing Schedule C or F. • Cannot file as a fiscal year business unless owner files Form 1040 under the fiscal year rules.	Excludable fringe benefits are generally not allowed for owner. ***Exceptions:*** Health insurance if spouse is an employee of the sole proprietorship, and the owner is covered as a family member of the employee-spouse. Also eligible for dependent care assistance fringe benefits, de minimis fringe benefits, and working condition fringe benefits.	Owner is personally liable for all debts and lawsuits against the business. ***Exception:*** If organized as an LLC under state law, liability is usually limited to owner's investment and his or her own malpractice.
Partnership (See Tab 20) • Form 1065, *U.S. Return of Partnership Income* • IRS Pub. 541, *Partnerships* • Tab 20, Partnerships/LLCs, *Deluxe Edition/Small Business Edition* • IRC Subchapter K, §701 through §777	• Small partnerships are not required to provide a balance sheet and can use the same bookkeeping system as a sole proprietor. Larger partnerships must provide a balance sheet with the return, which requires double-entry bookkeeping. • A partnership must generally use the same tax year as its partners, but can use a fiscal year if there is a business purpose or an IRC section 444 election was made. See *IRC Section 444 Election,* page 8-24. • Complex books and records are needed when a partner exchanges property, other than cash, for a partnership interest or for special allocations and basis elections.	Partners are eligible for some excludable fringe benefits. Taxable benefits are reported as guaranteed payments or an adjustment to a partner's distributable share of profits.	A general partner is personally liable for all debts and lawsuits brought against the partnership. ***Exception:*** If the partner is a limited partner, or the business is organized as an LLC under state law, liability is generally limited to the partner's investment, plus his or her own malpractice.
S corporation (See Tab 19) • Form 1120S, *U.S. Income Tax Return for an S Corporation* • Tab 19, S Corporations, *Deluxe Edition/Small Business Edition* • IRC Subchapter S, §1361 through §1379	• Double-entry bookkeeping may be required depending on income and other factors affecting the need for a balance sheet on the return. • Must use a calendar year unless it establishes a business purpose for using a fiscal year, or it makes an IRC section 444 election. See *IRC Section 444 Election,* page 8-24.	Shareholder/employees are eligible for some excludable fringe benefits. Benefits added to taxable wages on W-2 of more than 2% shareholders include accident and health plans, up to $50,000 of group health insurance, and meals and lodging furnished for the employer's convenience.	A shareholder's liability is limited to the amount invested, plus his or her own malpractice.
C corporation (See Tab 18) • Form 1120, *U.S. Corporation Income Tax Return* • IRS Pub. 542, *Corporations* • Tab 18, Corporations, *Deluxe Edition/Small Business Edition* • IRC Subchapter C, §301 through §385	• Double-entry bookkeeping may be required depending on income and other factors affecting the need for a balance sheet on the return. • No restriction on use of a fiscal year. ***Exception:*** A personal service corporation (PSC) must use a calendar year unless it establishes a business purpose for using a fiscal year or makes an IRC section 444 election. See *IRC Section 444 Election,* page 8-24. • Required to use accrual method of accounting if average annual gross receipts exceed $5 million.	Shareholder/employees eligible for excludable fringe benefits, generally to the same extent as any other employee, with exceptions under the non-discrimination rules. Benefits can include health insurance and reimbursement, education, life insurance, etc.	A shareholder's liability is limited to the amount invested, plus his or her own malpractice.

Business Plans

Cross References

- IRS Pub. 583, *Starting a Business and Keeping Records*
- Small Business Administration, www.sba.gov
- Service Corps of Retired Executives (SCORE), www.score.org

Related Topics

- Employer Identification Number, page 5-1, *1040 Edition/ Deluxe Edition*
- Start-Up Costs, page 8-18, *1040 Edition/Deluxe Edition*
- Buy-Sell Agreements, Tab 22
- Payroll and Labor Laws, Tab 23

The Purpose of a Business Plan

A business plan is a written document created to detail all aspects of a business on a comprehensive level. The process of writing a business plan requires significant research into each of the topics discussed, which can assist the writer in discovering potential problems before they occur. In some cases, the process of researching and writing a business plan will uncover a level of issues which will lead the writer to choose not to go into business.

A business plan helps to define short- and long-term goals for the business and the methods for measuring the level of success in reaching them.

Many banks and investors require a written business plan before lending to or investing in a business. Also, by carefully examining each aspect of a business at its beginning, a business can be structured to create the maximum level of tax advantage for the owners.

Layout

The layout of a business plan is detailed in the table of contents. Refer to the sample below.

Table of Contents

1) Executive Summary	6) Management and Organization
2) Mission, Vision, and Description	7) Personal Financial Statement
3) Products and Services	8) Start-Up Costs and Capitalization
4) Marketing Plan	9) Financial Plan
5) Operational Plan	

Business Entity Pros and Cons

	Sole Proprietorship	Single Member LLC	Multimember LLC	General Partnership	Limited Liability Partnership	C Corporation	S Corporation
Pros	• No formal creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • No double taxation of profits. • Husband and wife business may be eligible to file as Qualified Joint Venture.	• Simple creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • Liability protection for member, except for malpractice. • No double taxation of profits.	• Limited liability for all members, except for malpractice. • Unlimited number of members. • Separate entity from members, allowing for greater flexibility in operations. • Ownership is in the form of membership interest and can be transferred more easily than ownership in a single member LLC. • No double taxation of profits.	• Easy to create. • No limit on partner number or type. • Can be used to hold investments in other businesses and consolidate multiple lines of business. • Flexible allocation of profit, loss, and distributions. • Favorable tax treatment when liquidated. • No double taxation of profits.	• Liability protection for limited partners. • Separate entity from partners. • Ownership can be transferred within the rules of the partnership agreement. • Limited partners' liability is limited to their investment in the business. • Limited partners pay self-employment tax on guaranteed payments only. • No double taxation of profits.	• No liability for non-active stockholders. • No restrictions on ownership. • Ownership can be transferred through the sale of stock. • Separate entity from stockholders. • Fringe benefits for owner-officers. • Can have ownership interest in any other business entity. • Perpetual existence. • Raising capital can be achieved by issuing stock.	• Liability protection similar to that of C corporations. • No double taxation of profits. • Ownership is easily transferred through the sale of stock. • Separate entity from stockholders. • Self-employment tax is not assessed on the entire profit of the business. • Losses can offset shareholders' other taxable income.
Cons	• No liability protection except through insurance. • Self-employment tax is assessed on entire profit of the business. • Transfer of ownership through sale of assets and can be complex. • Owner cannot raise equity financing. • Limited access to fringe benefits for owners.	• Self-employment tax is assessed on entire profit of the business. • Transfer of ownership through sale of assets and can be complex. • Owner may be required to give personal repayment guarantee to obtain financing. • Failure to follow statutory requirements may result in loss of LLC status. • Limited access to fringe benefits for owners. • Laws regulating LLCs vary widely among states.	• Requires a separate tax return. • Laws regulating LLCs vary widely among states. • Failure to follow statutory requirements can result in loss of LLC status.	• Requires a separate tax return. • Unlimited liability for all partners. • Difficult to dissolve or change ownership without substantial planning. • Requires tracking of basis for partners, both inside and outside the partnership. • Individual partner's share of income is subject to self-employment taxes.	• Must have one general partner with unlimited liability. • Limited liability status for damages can be lost for a variety of administrative reasons. • Restrictions on partners based on entity type. • Requires a separate tax return. • Requires tracking of basis for partners, both inside and outside the partnership.	• Double taxation of profits. • Complex and expensive to create and maintain. • Require regular board of directors' meetings and minutes. • Requires a separate tax return.	• Complex and expensive to create and maintain. • Requires a separate tax return. • Requires regular board of directors' meetings and minutes. • Requires tracking of basis for stockholders. • Ownership is limited to specific types of entities. • Deductibility of fringe benefits for owner-employees is limited.
Likely Businesses	• Seasonal or part-time businesses. • Businesses with little liability. • Home based businesses. • Businesses intended to operate for the owner's life only.	• Businesses with potential liability in operations. • Businesses intended to operate for the owner's life only.	• Businesses requiring equity capital. • Businesses with potential liability in operations. • Businesses intended to exist beyond the lives of the members. • Businesses expecting changes in ownership over time.	• Two established businesses who wish to work as one. • Partners wishing to consolidate multiple entities into one entity.	• Businesses with partners not actively involved in business. • Businesses with equity capital needs. • Businesses with exposure to liability.	• Businesses with ownership in multiple other entities. • Businesses with significant exposure to liability. • Businesses intended to exist eternally.	• Businesses with significant exposure to liability.

Executive Summary

The executive summary is a summary of the entire plan. It should be written when all other sections of a business plan are complete and should be less than one page in length. The executive summary should include enough detail to allow a user to read the summary and gain a basic understanding of the business.

Mission, Vision, and Description

Mission statement. The mission statement should be less than 30 words and describe why a business exists, as well as its fundamental purpose at present.

Vision. The vision statement defines the intended future state of an organization. It sets a high, long-term goal which is used to guide decisions of management and ownership.

Description. The description section defines the following.

Elements of a Description

Item	Description
Goals and Objectives	Goals are benchmarks a business reaches by attaining objectives, which are used to guide efforts toward the goal.
Business Philosophy	The philosophy of a business describes what is most important to the owners and should include company values and competencies.
Target Market	A brief description explaining to whom a business sells or provides service.
Industry	An outline of the industry in which a business will operate, as well as any current or anticipated future changes.
Legal Entity	A description of the legal entity chosen and reason for use.

Products and Services

Provide a detailed description of the products and services the business will offer. Include pricing, unique features, and the required level of quality. Create an appendix for any photos, technical specifications, drawings, or brochures.

Marketing Plan

Market research. The marketing plan is developed by conducting (or having conducted) market research to define the clientele of a business and how to best market products and services. By defining and understanding the intended clientele and its view of the products and services to be offered, a business can then focus on its image and promotions.

Industry research. Industry research defines the industry and geographical market in which a business will operate. It identifies barriers to entry — elements which make starting and operating a business difficult, as well as how a business plans to overcome them. Barriers to entry can exist in the level of competition, state of the market, and in the cost and complexity of developing products and services.

Competitive analysis. Analyzing the potential competition can help a business establish a price for its product(s) and/or service(s). It can also help identify what makes the products(s) and/or service(s) unique compared to the competition.

Features and benefits. The product or service description in the marketing plan should address both the features and benefits of the product or service. A feature is a characteristic which makes the product or service unique, while a benefit describes the value it can provide to the customer or client.

Sales forecast. The sales forecast is the final element in a marketing plan. It forecasts over a 12-month period the quantities of each product or service expected to be sold. It is the base from which the financial plan will develop. Create two sales forecasts, one "best guess," which is an owner's realistic sales expectations, and one "worst case," which is the lowest amount of sales the business will achieve. Keep documentation of all assumptions made in the development of the forecast. This section is relied upon heavily when applying for financing or renewing existing debt obligations.

Operational Plan

The operational plan details the day-to-day operations of a business. Sections include the following items (if applicable).

Operational Plan Sections

Production	• Production techniques and costs. • Quality control processes. • Customer service processes. • Inventory control methods. • Product development methods.
Location	• Size and type of space, zoning, and utility requirements. • Required access for customers, clients, suppliers, and shipping. • Estimated costs per month based on research. • Business hours.
Legal Environment	• Required licenses, bonds, and permits. • Health, workplace, or environmental regulations. • Safety regulations, such as OSHA. • Industry or profession specific regulations. • Insurance coverage. • Trademarks, patents, and copyrights.
Personnel	• Number, type, and sourcing of required employees. • Quality of existing staff, if any. • Pay structures, job descriptions, and divisions of labor. • Training and development methods.
Inventory	• Types of inventory to be held. • Planned inventory investment amount. • Seasonal buildups of inventory, if required. • Lead time for ordering.
Suppliers	• Key suppliers, including name and address, types and amounts of inventory provided, credit and delivery policies, and history, if any.
Credit Policies	• Determine if credit will be offered to customers and clients. • Establish payment terms and early payment discounts. • Detail a process for determining customer credit-worthiness. • Create a plan for resolving slow or non-payment on customer accounts.
Managing Payables	• Create a table listing all vendors and their payment terms. • Establish a priority ranking for each vendor based on level of importance to operations.

Management and Organization

Key employees. The term key employee has a broader meaning in a business plan than in the income tax code. Here, it refers to a person or persons who will manage the business on a daily basis. Include in the list the key employees' talent, experience, and distinctive competencies brought to the business. Incorporate job descriptions of key employees, as well as resumes of the owners and key employees if using a business plan to seek financing.

Management continuation plan. Management continuation planning involves determining how a business will continue should one or more of the key employees be lost or become unable to fulfill his or her duties. Cross-training members of a management team is the most effective way to plan for a sudden unavailability or departure. The plan should specify the exact procedures for transferring duties when required, including arrangements with vendors, banks, employees, and owners.

If only one person is capable of running daily operations, provisions should be made for locating, training, and paying a manager from outside the organization, or for the wind down of operations.

Organizational chart. If a business has three or more employees, it is best to create an organizational chart outlining which employees report to which managers and the duties of all employees.

Personal Financial Statement

A personal financial statement (PFS) is a balance sheet for each owner on an individual basis. It includes values and detail of all assets owned, as well as amounts and terms for all debt obligations. When applying for financing, most banks will require a personal guarantee, assuring if the business is unable to pay back the debt, the individual owners will do so. Having a PFS from all owners establishes that sufficient net assets exist to repay the loan. If the owner has not created a PFS in the past, significant documentation, as well as estimates, will be required. The *Personal Financial Statement Worksheet,* next column, can be used to assemble a basic PFS.

Personal Financial Statement Summary

Assets	*Amount*	*Liabilities*	*Amount*
Cash accounts	$	Credit cards, lines of credit	$
Securities—stocks/ bonds/mutual funds	$	Loans	$
Life insurance—cash value	$	Loan on life insurance	$
Personal assets (autos, jewelry, etc.)	$	Taxes payable	$
Retirement funds	$	Mortgages	$
Real estate	$	Other debts	$
Other assets	$	Other liabilities (specify)	$
Total Assets	$	*Total Liabilities*	$
Net Worth:	$		

Net worth. Net worth is the value of all assets, less all liabilities. It is the most useful measure of financial resources.

Personal assets. Personal assets are all physical assets owned by an individual which are not real estate or business-use property. They include, but are not limited to, cars, trucks, boats, furniture, jewelry, art, clothing, and electronics. Most of the time the value of personal assets is an estimate as many individuals do not have a cumulative total and full appraisals are prohibitively expensive.

Personal Financial Statement Worksheet

Assets

Checking, Savings, CD and Money Market Accounts

Name of Bank or Institution	*Balance*	*Interest Rate (if any)*	*Maturity Date (if any)*
	$	%	
	$	%	
	$	%	
Total:	$		

Securities: Stocks, Bonds and Mutual Funds

Name of Security	*Current Value*	*Number of Shares*	*Date Acquired*
	$		
	$		
	$		
Total:	$		

Real Estate

Description/ Location	*Market Value*	*Purchase Date*	*Original Cost*
	$		$
	$		$
	$		$
Total:	$		

Liabilities

Credit Card and Line of Credit

Name of Card/Creditor	*Current Balance*	*Monthly Payment*	*Interest Rate*	*Credit Limit*
	$	$	%	$
	$	$	%	$
	$	$	%	$
Total:	$			

Loans

Property Description	*Current Balance*	*Monthly Payment*	*Interest Rate*	*Name of Lien Holder*
	$	$	%	
	$	$	%	
	$	$	%	
Total:	$			

Mortgages on Real Estate

Property Name/ Description	*Current Balance*	*Monthly Payment*	*Interest Rate*	*Name of Lien Holder*
	$	$	%	
	$	$	%	
	$	$	%	
Total:	$			

Life Insurance Held

Insurance Company	*Cash Surrender Value*	*Face Amount*	*Date Opened*	*Beneficiaries*	*Loan on Life Insurance*	*Owner*
	$	$			$	
	$	$			$	
Total:	$				$	

Start-Up Costs and Capitalization

Start-up costs. Start-up costs are incurred before the start of operations. Typical expenses include the costs of organization, professional consulting, capital equipment acquisition, and leasing a space. Researching these costs to develop realistic estimates, in addition to the information in the financial plan, will allow a business to seek the proper amount of capital. See *Start-Up Costs,* page 8-18, *1040 Edition/Deluxe Edition.*

Capital. Cash from the owners or investors is the most common source of capital when beginning a new entity. Business loans are also common and can be secured through private banks or the Small Business Administration (SBA). Compare differences among entities for capital contributions and loans in *C Corporations,* Tab 18, *S Corporations,* Tab 19, and *Partnerships and LLCs,* Tab 20.

SBA loans. The SBA is a federal agency which guarantees certain loans and lines of credit made by banks to small businesses. Loans and lines are available for working capital, asset purchase, and debt refinancing needs. See *Financing—Small Business Administration,* page 31-13.

Debt covenants. Debt covenants are requirements placed on businesses borrowing money and those guaranteeing a debt. In most cases, violating debt covenants will place a debt into technical default, even if required payments are being made on time. Technical default may trigger accelerated payments, increased interest rates, or immediate repayment of an entire debt. Assets used to secure a debt which falls into technical default may be repossessed to satisfy the debt obligation.

Example: Dina starts a business making and selling purses. She takes out a loan for production costs, using the value of her stock portfolio to guarantee repayment. As a debt covenant, the bank requires the portfolio to maintain a minimum value. Subsequently, the value of her portfolio decreases substantially below the minimum value, and the bank demands immediate repayment of the loan.

Financial Plan

Forecasting cash flow. Cash flow is made up of the streams of cash into and out of a business. For new businesses, cash flow, more than profit, is the best indicator of whether a business will survive. It determines whether a business will be able to pay its expenses and debts as they come due.

Projecting cash flow for the first 12 months of a new business will help the owners to determine:

- The amount of cash a business will collect from sales,
- The amounts of cash a business will pay out for expenses and capital equipment, and
- The need for additional cash to pay operating expenses.

When completing a cash flow forecast, it is best to use pragmatic estimates of cash to be received from sales. A "Contingencies" item is used to allow for unforeseen expenses, or for expenses which are higher than expected.

Using a separate contingency item, rather than simply adding a percentage to all anticipated expenses, will allow a business to better measure the actual performance against expectations. A suggested contingency allowance is 20% of all other anticipated expenses. See the *Projected Cash Flow (12 Months)* worksheet, page 31-8.

✎ **Author's Comment:** Cash flow is the most important financial element to manage in a small business. Slow collections from clients, unmanageable overhead and debt loads, as well as lack of ability to borrow, have led to the failure of many small businesses. Managing cash is a daily process in large companies, and small business would be wise to follow suit.

Forecasting Profit and Loss

12-month forecasted profit and loss statement. A 12-month forecasted profit and loss statement details the level of profitability and items which contribute to it. This statement will differ from the forecasted cash flow statement, depending on the accounting method of a business.

For cash-basis businesses, the primary difference between the forecasted profit and loss statement and the forecasted cash flow statement is payments which are not currently deductible expenses, such as capital asset purchases and the principal portion of loan payments. In addition, capital contributions or distributions by owners will not be included. All other expenses, as well as income, are included in the period they are paid or received.

The difference for accrual basis businesses, in addition to those for cash basis businesses, is the use of accounts receivable, accounts payable, and prepaid expenses.

Monthly Sales Forecast

Company Name:

Fiscal Year Begins:

Month:			
Product or service units sold		Product or service units sold	
Sale price per unit		Sale price per unit	
Item 1 Total:		**Item 5 Total:**	
Product or service units sold		Product or service units sold	
Sale price per unit		Sale price per unit	
Item 2 Total:		**Item 6 Total:**	
Product or service units sold		Product or service units sold	
Sale price per unit		Sale price per unit	
Item 3 Total:		**Item 7 Total:**	
Product or service units sold		**Monthly Totals—All Categories:**	
Sale price per unit			
Item 4 Total:			

Instructions: Fill in numbers for each product or service to be sold. Multiply the units sold by the sale price per unit to get total sales per item per month.

Accounts receivable and payable. Accounts receivable is used to record invoices not yet paid by clients but recorded as income when earned. Similarly, accounts payable is used to record amounts not yet paid to vendors that have been included in expenses when incurred. These rules cause some income and expenses to be recognized without the associated cash flows.

Prepaid expenses. Prepaid expenses are amounts paid in advance of the due date, or paid in one lump sum. When paid, the expenses are recorded as an asset on the balance sheet and expensed each period as the benefit is received.

Example: Tantini, Inc. pays its yearly insurance premium of $1,200 in one payment on January 1. The $1,200 is recorded as a prepaid expense and $100 is expensed each month as insurance expense.

Using the forecasted profit and loss. The forecasted profit and loss is used to determine sales or client requirements to aid in the building of a business and enable a business to measure success in these areas against specific goals. When used in conjunction with the marketing plan and product or service pricing, the forecasted profit and loss assists in determining how much of each product or service must be sold during a given month to achieve profitability. The statement is often requested when applying for new financing or renewing existing debt obligations.

Fixed and variable costs. All costs in a business fit into one of these two classifications, but never both. Fixed costs are costs a business will incur regardless of the level of sales or service. Variable costs are costs which change as the volume of sales changes and are usually expressed as a percentage of sales.

Examples of Fixed vs. Variable Costs

Fixed Costs		*Variable Costs*	
• Salaries	• Rent	• Raw Materials	• Finished Goods
• Insurance	• Interest	• Inventory	• Direct (Production) Labor

Example: CAS, Inc. manufactures sunglasses. For each pair it sells, the frame costs $2.50, the lenses cost $1.25, and the labor to produce the pair is $3. Each pair sells for $20. CAS' variable cost percentage is as follows:

Total cost per pair	$ 6.75
Sale price per pair	$20.00
Variable cost percentage	$6.75/$20.00 = 33.75%

Breakeven analysis. A breakeven analysis will determine the level of sales at which a company will cover all its fixed and variable costs. This level is referred to as the breakeven point and can be expressed in either sales revenue or units of sale, and for service-based businesses, in hours billed.

Example: Tantini, Inc. produces children's plastic cups. The company's fixed costs are $3,000 per month, and the cost to produce each cup is $4. The cups are sold for $10 each. Tantini's breakeven point is as follows:

Sale price per cup	$ 10
Less: production costs per cup	$ 4
Gross profit per cup	$ 6
Fixed costs per month	$3,000
Unit breakeven point	$3,000/$6 = 500 cups
Revenue breakeven point	($3,000/$6) × $10 = $5,000

Projected balance sheet. A projected balance sheet uses forecasted financial statements to project what a company will own and what it will owe at the end of the projection period.

Targeting a Business Plan to a Specific Audience

Audience or Objective	*Items to Emphasize*
Applying for Bank Financing	Sales Forecast, Forecasted Financial Statements, Breakeven Analysis, Personal Financial Statement(s), Managers and Key Employees.
Attracting Equity Investors	Products and Services, Marketing Plan, Operation Plan, Sales Forecasts, Managers and Key Employees.
Hobby-Loss Defense	Financial Plan, Operational Plan, Marketing Plan, Managers and Key Employees.
Securing Vendors	Products and Services, Marketing Plan, Mission, Vision and Description, Managers and Key Employees.

Projected Cash Flow (12 Months)

		Pre Start-Up Estimate	*Month*
Cash In			
1) **Initial cash position**	1)	______	______
2) Cash sales	2)	______	______
3) Collections from sales made on credit	3)	______	______
4) Loan or line of credit proceeds	4)	______	______
5) **Total cash receipts** (add lines 2–4)	5)	______	______
6) **Total cash available** (add lines 1 and 5)	6)	______	______
Cash Paid Out			
7) Accounting and legal	7)	______	______
8) Advertising	8)	______	______
9) Auto expenses	9)	______	______
10) Contractors and consultants	10)	______	______
11) Deposits and retainers	11)	______	______
12) Gross payroll	12)	______	______
13) Insurance	13)	______	______
14) Interest	14)	______	______
15) Inventory purchases	15)	______	______
16) Miscellaneous	16)	______	______
17) Office supplies	17)	______	______
18) Payroll taxes and fees	18)	______	______
19) Postage and delivery	19)	______	______
20) Raw material purchases	20)	______	______
21) Real estate taxes	21)	______	______
22) Rent	22)	______	______
23) Repairs and maintenance	23)	______	______
24) Sales taxes	24)	______	______
25) Telephone	25)	______	______
26) Utilities	26)	______	______
27) **Total expenses** (add lines 7–26)	27)	______	______
28) Loan principal payment	28)	______	______
29) Capital asset purchases	29)	______	______
30) Other start-up costs	30)	______	______
31) Contingencies	31)	______	______
32) Owners' withdrawals	32)	______	______
33) **Total cash paid out** (add lines 27–32)	33)	______	______
34) **Ending cash position** (line 6 minus line 33)	34)	______	______

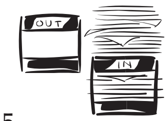
Use of Budgets in Ongoing Operations

Annual budget. Development of an annual budget generally takes place late in the year prior to the year of the budget and is broken down by month. Financial statements from recently completed periods are used to develop estimates for the budget. Using the budget, costs can be reduced, resources properly allocated, and new goals for the year can be set.

Budget variance. Budget variance is the difference between budget expectations and actual results. Actual results should be compared to the budget at the end of each month or quarter to adjust sales and spending to accomplish the budget objectives.

Internal Control, Accounting Procedures, and Insurance

Cross References
• Small Business Administration, www.sba.gov

Related Topics


• Insurance, page 8-6, *1040 Edition/Deluxe Edition*
• Buy-Sell Agreements, Tab 22
• Minimum Income Probes—IRS Audit, page 32-5

Internal Control
Control procedures. Internal control procedures are designed to safeguard the assets of a business. Without them, dishonest employees or owners can misappropriate assets in the form of cash, property, or supplies with little effort.

Separation of Duties. Duties which, if conducted by the same individual, would allow for simple concealment of theft should be kept separate. The following duties should be performed by different people.
• Receiving, recording, and depositing customer payments.
• Sourcing, approving, ordering, and receiving supplies or merchandise.
• Inputting, approving for payment, and paying vendor bills and payroll.
• Balancing and inputting transactions into bank accounts.
• Counting cash and merchandise on hand at the beginning and end of the day.

Small businesses generally lack sufficient staff to properly separate all duties which should be separated. In this case, increased involvement of owners and management in daily operations of a business can assist in detecting misappropriation of assets by an employee, manager, or owner.

Mandatory vacations. Many schemes to steal from a business require constant, manual intervention by the person perpetrating the scheme. By having and enforcing a mandatory vacation policy, the time a perpetrator spends away from work may allow a scheme to be uncovered in the course of daily operations. Mandatory vacations should be a minimum of two weeks, during which time the vacationing person has no access to a business or its records.

Environment of detection. If an employee or owner believes embezzlement will be discovered in the normal course of business, it is much less likely one would choose to embezzle. Creating an environment of detection is the process of alerting all employees and owners that systems are in place to detect embezzlement and theft, and that such acts will be prosecuted if perpetrated. This can be accomplished through training, one-on-one conversations, and the establishment of a hotline employees and owners can use to report suspected theft.

Awareness of others. Being observant of changes in the spending habits or behavior of employees or owners can be a simple, low cost way to detect embezzlement. If a manager notices an employee has recently purchased an expensive new car, has begun taking exotic vacations, or wearing designer clothing, and knows the employee's income cannot support the new lifestyle, additional scrutiny may be warranted. The same can be true among business partners.

Background checks. Background checks during the hiring process allow a business to determine whether a prospective employee has any criminal history. Many background checks also include credit histories to uncover any financial conditions which may make an employee more likely to steal from a business.

Accounting Procedures
Schedule of procedures. Whether a business does bookkeeping and accounting internally, or has it completed by a professional, the following schedule should be followed.

Accounting Procedure Schedule

Daily	*Monthly*	*Quarterly*	*Annually*
Count and record cash on hand.	Reconcile business deposit and credit accounts.	Compile a quarterly and year-to-date profit and loss.	Compile an annual profit and loss and balance sheet.
Record sales and returns in accounting system.	Reconcile long term liabilities, record depreciation.	Compare completed financial statements to budget.	Renew loans and lines of credit as required.
Deposit payments received.	Compile profit and loss and balance sheet.	Calculate and pay any required estimated tax payments.	Complete required tax returns.
Back up accounting data.	Review financial statements with ownership and senior management.	Review debt covenants to compliance.	Create the budget for the next business year.

Insurance
Types of insurance. Insurance is available to businesses which will cover most situations where a company has liability exposure. Insurance is particularly important in sole proprietorships and general partnerships as these entity types offer no liability protection on their own.

Liability insurance generally covers damages to compensate the injured party, known as compensatory damages. Policies also may cover general damages which have not been otherwise classified, as well as the costs of defense in a liability lawsuit. Punitive damages awarded to punish an intentional act by a business are generally not covered by any policy.

Insurance Policy Types

Type of Policy	*Coverage*
Product Liability	Protects against claims made by customers injured by the products of a business.
Professional Liability	Covers damages arising from errors and omissions arising from the performance of services by a business.
Employee Dishonesty	Covers financial losses due to employee(s) theft of money, property or securities of the employer.
General Liability	Covers general liabilities arising in the normal course of business.
Liability Umbrella	Covers the portion of damages awarded which are beyond the coverage limits of other liability policies.
Property and Casualty (P&C)	P&C insurance covers the property of a business against theft or destruction, including that which is caused by sudden, unexpected events. Some level of liability protection for the property covered is also generally included.

SWOT Analysis
SWOT analysis. SWOT stands for "Strengths, Weaknesses, Opportunities and Threats." It is a strategic analysis tool which is used to adjust operations in light of changing business conditions, both inside and outside an organization. A SWOT analysis ascertains the ability of a business to achieve a certain objective by quickly identifying all factors affecting success.

Strengths. Strengths are areas within a business which give it an advantage in meeting the objective. Processes, people, structure, and reputation are all examples of strengths. Once strengths are identified, the next step is to determine how to best capitalize upon them to move toward meeting the objective.

Weaknesses. Weaknesses are areas existing inside an organization that need improvement for the objective to be met. Shortage of staff, lack of facilities, and lack of sufficient capital are examples of a weakness. Once identified, a plan should be implemented to improve each weakness.

Opportunities. Opportunities exist outside an organization and are out of its control. Advances in technology, changes in government regulation, and condition of the economy are examples of opportunities. Once identified, opportunities should be leveraged to a business' advantage.

Threats. Threats are factors existing outside a business and beyond its control, which could impede the progress of a business toward the objective. Political changes, increased competition, and decreased demand are examples of threats. Once threats are identified, steps should be taken to mitigate their effects.

Starting a Business Checklist

Skip any item which does not apply to the business.	✓ *Done*
1) Develop a business concept	_______
2) Select and retain accountants and attorneys	_______
3) Select a business entity	_______
4) Determine ownership structure	_______
5) Complete a business plan including marketing, finance, management, and operational sections	_______
6) Obtain initial start-up capital	_______
7) File for organization with state	_______
8) Hold first board of directors meeting	_______
9) Apply for a federal employer identification number (EIN) by submitting Form SS-4. See *Employer Identification Number* (*EIN*), page 5-1	_______
10) Apply for S corporation status by filing Form 2553	_______
11) Develop website and a plan for use of technology	_______
12) Establish accounting procedures and choose accounting software or a third-party bookkeeping and accounting company	_______
13) Input all transactions from the beginning of business development into accounting software	_______
14) Apply for business financing and solicit investors	_______
15) Open business bank accounts	_______
16) Apply for required permits or licenses	_______
17) Select an insurance agent	_______
18) Purchase insurance	_______
19) Select a commercial real estate agent	_______
20) Locate and obtain office or production space	_______
21) Acquire furniture and equipment	_______
22) Complete any needed build-out of space	_______
23) Select a payroll processing company	_______
24) Select an employee benefits company	_______
25) Hire staff and complete training	_______
26) Commence marketing	_______
27) Order initial inventory and begin production	_______
28) Conduct a grand opening	_______

Top Ten Reasons Businesses Fail

Failure rates. Data from the SBA indicates three in 10 new businesses fail within the first two years, and only five in 10 businesses survive five or more years.

Reasons for failure. The ten most common reasons for failure are listed below.

1) Lack of experience. This can apply to either a business owner's lack of experience in what a business does or in running a business in general.
2) Insufficient capital. Many businesses take a year or more to begin funding daily operations through cash flow generated by sales or services provided. Sufficient capital must be in place to support a business through this period.
3) Poor location.
4) Poor inventory management. Keeping too much inventory uses too much capital unnecessarily, while having too little inventory can lead to shortages and customer dissatisfaction.
5) Over-investment in fixed assets. Investing too much too quickly in long-lived assets also uses much needed capital in an unnecessary way.
6) Poor credit arrangements. Lacking access to sufficient, reasonably priced credit can create cash flow problems if sales decline or customers do not pay a business in a timely manner.
7) Personal use of business funds. Business funds should not be used for personal purposes. Such use can leave a business without sufficient cash or available credit to fund operations.
8) Low sales.
9) Competition. Not properly assessing competition can potentially leave a business in a position of needing to compete in a market where it cannot do so and survive.
10) Unexpected growth. Growth without sufficient planning for the consequences can lead a thriving business to failure.

Remitting taxes collected. Businesses required to collect sales tax must remit the amounts collected to the appropriate state and local agencies as required by law. Failure to do so can cause loss of a sales tax license, barring a business from selling its products. Collecting and not remitting tax can be prosecuted as a criminal offense under certain circumstances.

Succession Planning

Succession planning is the process of researching, defining and implementing a plan for the eventual departure of business leaders and owners. The length of time and complexity of the plan are directly related to the size and complexity of the business creating the plan.

Since the changes in culture and operations associated with a change in leadership or ownership occur gradually, having a succession plan in place makes a change a smooth process. The business is allowed to continue to operate without the distractions of managing the effects of a sudden departure.

Management succession planning. Management succession planning develops a pool of succession candidates who could take over the responsibilities of a current leader upon their expected departure.

A management succession plan is designed with the intention of it being implemented, making it different from the more contingency-based management continuation plan, discussed on page 31-5. There are four key steps in management succession planning.

1) ***Analysis.*** Analysis involves researching the expected challenges facing a business and the industry and market in which it operates over the expected length of the succession plan.

Through this research, a clear understanding can be developed of the skills and characteristics required of the succession candidates.

2) ***Development.*** Development of the succession candidates differs based on whether they exist inside or outside the business. For internal candidates, rotations through different roles the candidate will eventually manage are common and effective, as are increased levels of responsibility and higher levels of training. External candidates can be more difficult to develop for succession and generally must be brought into the business before development can begin.
3) ***Selection.*** The selection of a single succession candidate is done after the development step is completed, usually just before the current leader is due to leave the business. The selection process consists of reviewing each of the succession candidates and selecting the one with the highest probability of success based on the review.
4) ***Transition.*** The transition process begins when the current leader departs and can continue for up to a year, depending on the size and complexity of the business and the responsibilities being transitioned. In cases where the former leader left on good terms, they may be kept on in a consulting role to assist the new leader in taking over their former role.

Ownership succession planning. Ownership succession planning involves planning for the eventual departure of an owner from a business through retirement, death, or in some cases, removal by other owners. In cases involving some small businesses, ownership and management succession planning are closely linked. Generally, ownership succession is achieved through one of four methods.

1) ***Sale of business to an outside party.*** In this case, a business is sold as a whole to someone outside the business. In the case of sole proprietorships and single member LLCs, the sale is accomplished through the sale of business assets. In multimember LLCs and partnerships, the sale is generally accomplished through the sale of a member or partner's interest, and in C corporations and S corporations, generally through the sale of stock. A thorough business valuation should be conducted. See *Methods,* next column.
2) ***Sale of business to other owners.*** The sale of a business ownership interest to other current owners should be planned and executed through buy-sell or cross-purchase agreements. See *Business Financial Planning,* Tab 22.
3) ***Transition at death.*** Some business owners choose to pass ownership in a business to their heirs at death. This type of ownership succession involves planning for potential tax and estate consequences.
4) ***Employee stock ownership plan (ESOP).*** Businesses with employees can choose to establish an ESOP, which is a type of retirement plan. The business owner can then sell their ownership shares to a trust which holds the shares on behalf of the ESOP.

   This process allows owners to convert the equity owned in the business into cash and provides an additional retirement benefit for the employees. Special rules exist regarding the taxation of the sale of stock to the trust of the ESOP.

Business Valuation

A business valuation is the process of determining what a business is worth for a number of different purposes. Business valuations not only help set a reasonable sale price for the business, but also assist in determining how much money the business can borrow, as well as the level of complexity required in completing estate planning for the owners.

Business valuations are generally completed by a business broker, certified valuation analyst, or mergers and acquisitions specialists.

Methods. There are a number of methods for completing a business valuation. The best method to use will be based on the type and complexity of the business undergoing valuation, as well as the purpose of the valuation. The following lists a few common methods.

Adjusted book value. Based on information on the balance sheet, the calculation involves determining the fair market value of the assets and subtracting the liabilities of the business.

Capitalized adjusted earnings. This method involves determining the discretionary cash flow of the business over several prior periods of time and using factors surrounding risk and interest rates to determine the value of the business.

Discounted future earnings. This is an expanded version of the capitalized adjusted earnings method which takes into account the expected growth rates of the business over a number of future periods.

Hiring Practices

Cross References

- Equal Pay Act of 1963
- Title VII of the Civil Rights Act of 1964
- Age Discrimination Act of 1967
- Titles I and V of the Americans with Disabilities Act of 1990
- Civil Rights Act of 1991
- Family and Medical Leave Act of 1993

Related Topics

- Retirement and Employee Benefits, Tab 13, *1040 Edition/Deluxe Edition*
- Payroll and Labor Laws, Tab 23

Avoiding Improper Interview Questions

There are a number of federal laws which govern the hiring of employees. Planning should be undertaken to avoid job ads and interview questions which are improper or illegal. A rule of thumb is to only ask questions which directly relate to the interviewee's ability to perform the job and to create job requirements which avoid discrimination.

Examples of Improper and Proper Interview Questions

Improper	*Proper*	*To Avoid Possible*
How old are you?	Are you over age 18?	Age discrimination.
Is that your maiden name?	Have you gone by any other names in the past?	Discrimination based on marital status or sexual orientation.
Are you married?	Marital status is not relevant to employment.	Discrimination based on marital status or sexual orientation.
Are you a U.S. citizen?	Are you legally authorized to work in the U.S.?	Discrimination based on origin.
Which religious holidays do you observe?	Are you able to work the schedule required for the job?	Discrimination based on religious affiliation.
Do you have or plan to have children?	Are you available to work overtime or travel as needed?	Discrimination based on marital status or sexual orientation.
Do you have any disabilities?	Are you able to perform the specific duties of this position?	Discrimination based on physical or mental disability.

Equal Opportunity Employment Laws	
Law	*Coverage*
Equal Pay Act of 1963	Requires men and women be paid equally for substantially similar work.
Title VII of the Civil Rights Act of 1964	Prohibits employment discrimination based on race, color, sex, or religion.
Age Discrimination Act of 1967	Protects people over the age of 40 from age-based employment discrimination.
Titles I and V of the Americans with Disabilities Act of 1990	Prohibits employment discrimination against qualified individuals with disabilities in the private sector and in state and local governments.
Civil Rights Act of 1991	Provides for monetary damages in cases of intentional employment discrimination.
Rehabilitation Act of 1973	Prohibits employment discrimination against qualified individuals in the federal government.
Genetic Information Nondiscrimination Act of 2008	Prohibits employment discrimination based on genetic information.

Legal Considerations

Cross References

- Federal Trade Act of 1974
- U.S. Patent Act
- U.S. Copyright Act of 1976

Related Topics

- Legal Aspects of Corporations, page 18-2

Truth in Advertising

The Federal Trade Commission (FTC) is the federal agency charged with regulating print and broadcast advertising nationwide. All states also have laws regulating advertising on a local level. All advertising must comply with the following rules.

Truthful and non-deceptive. For an ad to be truthful and non-deceptive, the ad must not contain any information which would be likely to mislead a consumer and which is important to a consumer's decision to buy or use the product or service. The ad cannot omit any information which would mislead or impact a consumer's decision to buy or use the product or service based on the omission.

Reasonable basis for claims made. Any advertiser must have objective evidence to support claims made within an ad. Ads which contain health or safety claims must generally be supported by competent and reliable scientific evidence. Customer testimonials are not considered objective evidence.

Not unfair. An ad is considered unfair if it causes, or is likely to cause, substantial consumer injury which a consumer could not reasonably avoid, and the risk of consumer injury is not outweighed by the benefit provided.

Special situations. Specific rules are in place regarding advertising for:

- Consumer leases.
- Offers of credit.
- 900 telephone numbers.
- Products sold through mail-order or telephone sales.

For additional information on truth in advertising, visit the FTCs website at www.ftc.gov.

Patents, Trademarks, and Copyrights

Patents. Patents grant the owner of a patent the right to prevent others from making, using, offering for sale or selling an invention in the U.S., or importing the invention into the U.S. Patents are issued by the U.S. Patent and Trademark office and generally have a life of 20 years from the date of issue.

Once issued, a patent holder must enforce the patent rights without assistance from the government. Patents cover the following items.

- Utility patents may be granted to anyone who invents or discovers a new, useful process, machine, article of manufacture, composition of matter, or a new and useful improvement thereon.
- Design patents may be granted to anyone who invents a new, original, and ornamental design for an article of manufacture.
- Plant patents may be granted to anyone who invents or discovers and asexually reproduces any distinct and new variety of plant.

Trademarks. Trademarks are words, names, symbols, or devices used in the trade of goods which indicate the source of the goods and also distinguish them from other goods. Servicemarks are used in a similar way except servicemarks are used for services rather than goods. The terms "trademark" and "mark" are widely used to refer to both trademarks and servicemarks.

The rights granted by trademarks prevent others from using the same or confusingly similar marks, but do not prevent others from producing the same goods or services. Trademarks used in interstate or foreign commerce may be registered with the U.S. Patent and Trademark Office.

Copyrights. A copyright, or copyright protection, is used to protect authors of original works of authorship against unauthorized reproduction of their work. Copyrights need not be registered with the U.S. Copyright Office, though doing so will assist the owner of a copyright in enforcing any violations. Owners of a copyright are given the exclusive right to do and authorize others to do the following.

- Reproduce the work in copies.
- Prepare derivative works based upon the work (such as sequels).
- Distribute copies of the work by public sale, rental, lease, or lending.
- Display or perform the work publicly.
- Digitally transmit audio in the case of sound recordings.

Go to www.copyright.gov for additional detail on copyrights.

Contracts

All contracts must have certain terms and conditions to be valid and legally binding. Violating any of the terms and conditions below can result in a breach of contract, allowing the injured party to sue for damages.

Mutual consent. Mutual consent means both parties have a mutual understanding of what the contract covers.

Example: Howard offers to sell Louise a cow for $1,000, and Louise accepts the offer. If Howard believes he is offering to sell a piece of livestock, and Louise believes she is buying a collectible figurine of a cow, no mutual consent has been reached, and no contract is in place.

Offer and acceptance. An offer to buy or sell must be made and accepted in its original terms to be binding.

Note: A counter offer is a rejection of the original offer, not acceptance. A seller is not required to accept a counter offer or to sell a product or service under the conditions and terms of an original offer to sell. The same applies to offers to buy.

Example: Howard offers to sell Louise a cow for $1,000. Louise counter offers Howard $750 for the cow. Howard rejects the counter offer, and sells the cow to Morgan. Louise cannot sue to enforce the original offer to sell the cow to her for $1,000 because her counter offer was rejected.

Mutual consideration. Both parties to a contract must give up and receive something of value.

Example: Morgan buys a cow from Howard for $750. Morgan gives up $750 and receives a cow, and Howard gives up a cow and receives $750.

Performance or delivery. A contract must require the performance of tasks or delivery of value.

Example: The contract between Howard and Morgan for the cow requires Howard to deliver the cow and Morgan to deliver the payment. If Howard delivers the cow, he can sue to force Morgan to deliver the payment and vice versa.

Good faith. Both a buyer and a seller must act in good faith, not entering into a contract with intent to breach.

Example: If Howard enters into a contract to sell Morgan a live cow, with the intent of in fact delivering a collectible figurine, he has not acted in good faith.

No violation of public policy. Contract terms cannot violate public policy, such as federal, state, or local laws. An agreement for something that is illegal is not enforceable as a contract.

Example: If a cow Howard sells to Morgan is in fact stolen, and does not belong to Howard, the agreement violates the law against possessing and selling stolen property and is not enforceable as a contract.

Financing— Small Business Administration

Cross References

- Website: www.sba.gov
- Email: answerdesk@sba.gov
- Phone: 1-800-U-ASK-SBA (1-800-827-5722)
- Answer desk, TTY: 704-344-6640

Related Topics

- Interest Expense, page 4-9, *1040 Edition/Deluxe Edition*
- Loan Guarantees, Tab 19

The Small Business Administration (SBA) administers a variety of loan programs. The SBA sets the guidelines for the loans while commercial lenders, community development organizations, and microlending institutions make the loans to small businesses. The SBA backs those loans with a guaranty that will eliminate some of the risk to the lending partners.

7(a) Loan Program

The 7(a) loan serves as the SBAs primary business loan program to help qualified small businesses obtain financing. Financing under this program can be guaranteed for a variety of general business purposes.

Loan proceeds can be used for most sound business purposes including working capital, machinery and equipment, furniture and fixtures, land and buildings (including purchase, renovation and new construction), leasehold improvements, and debt refinancing (under special conditions). Loan maturity is up to seven years for working capital, up to 10 years for equipment, and generally up to 25 years for real estate.

The 7(a) loan program is geared toward start-up and existing small businesses and is delivered through commercial lending institutions.

Certified Development Company (CDC), 504 Loan Program

The SBA 504 Loan Program provides long-term, fixed-rate financing to small businesses to acquire real estate or machinery or equipment for expansion or modernization. Typically this will include:

- A loan secured from a private-sector lender with a senior lien covering up to 50% of the projected cost,
- A loan secured from a CDC (funded by a 100% SBA-guaranteed debenture) with a junior lien covering up to 40% of the total cost, and
- A contribution of at least 10% equity from the borrower.

A CDC loan is geared toward small businesses requiring "brick and mortar" financing and is delivered by certified development companies.

Microloan Program

A microloan program provides short-term loans of up to $50,000 to small businesses and not-for-profit childcare centers for working capital or the purchase of inventory, supplies, furniture, fixtures, machinery and/or equipment. Proceeds cannot be used to pay existing debts or to purchase real estate. The SBA makes or guarantees a loan to an intermediary, who in turn makes the microloan to the applicant. These organizations also provide management and technical assistance. The loans are not guaranteed by the SBA. The microloan program is available in selected locations in most states.

The microloan program is geared toward small businesses and not-for-profit childcare centers needing small-scale financing and technical assistance for start-up or expansion and is delivered through specially designated intermediary lenders (nonprofit organizations with experience in lending and technical assistance).

Disaster Loans

The SBA provides low-interest, long-term loans for physical and economic damage caused by a declared disaster. SBA disaster loans can be used to repair or replace items destroyed or damaged in a declared disaster area including real estate, personal property, machinery and equipment, inventory and business assets. Businesses of any size and most private nonprofit organizations may apply for physical disaster loans.

Businesses that have suffered substantial economic injury that are located in a declared disaster area may be eligible for an economic injury disaster loan. Businesses that qualify are small businesses, small agricultural cooperatives, and most private nonprofit organizations. Economic damage means the business is unable to meet its obligations and to pay its ordinary and necessary operating expenses. A business may qualify for both an economic injury disaster loan and a physical disaster loan.

State Secretaries of State Contact Information

State	Website	Phone Number	State	Website	Phone Number
Alabama	www.sos.state.al.us	1-334-242-7200	Montana	http://sos.mt.gov	1-406-444-2034
Alaska	www.commerce.state.ak.us/occ/	1-907-465-2550	Nebraska	www.sos.ne.gov	1-402-471-4079
Arizona	www.azsos.gov	1-602-542-6187	Nevada	http://nvsos.gov	1-775-684-5708
Arkansas	www.sos.arkansas.gov	1-888-233-0325	New Hampshire	http://sos.nh.gov	1-603-271-3246
California	www.sos.ca.gov	1-916-653-6814	New Jersey	www.state.nj.us/state	1-866-534-7789
Colorado	www.sos.state.co.us	1-303-894-2200	New Mexico	www.sos.state.nm.us	1-800-477-3632
Connecticut	www.ct.gov/sots	1-860-509-6200	New York	www.dos.ny.gov	1-518-473-2492
Delaware	http://sos.delaware.gov	1-302-739-3073	North Carolina	www.sosnc.com	1-919-807-2225
District of Columbia	http://os.dc.gov	1-202-727-6306	North Dakota	http://sos.nd.gov	1-800-352-0867
Florida	www.dos.myflorida.com	1-850-245-6500	Ohio	www.sos.state.oh.us	1-877-767-3453
Georgia	www.sos.ga.gov	1-404-656-2817	Oklahoma	www.sos.ok.gov	1-405-521-3912
Hawaii	http://cca.hawaii.gov/breg/	1-808-586-2744	Oregon	http://sos.oregon.gov	1-503-986-2200
Idaho	www.sos.idaho.gov	1-208-334-2301	Pennsylvania	www.dos.pa.gov	1-717-787-6458
Illinois	http://www.cyberdriveillinois.com/	1-800-252-8980	Rhode Island	www.sos.ri.gov	1-401-222-3040
Indiana	www.in.gov/sos	1-317-232-6531	South Carolina	www.scsos.com	1-803-734-2158
Iowa	www.sos.iowa.gov	1-515-281-5204	South Dakota	www.sdsos.gov	1-605-773-3537
Kansas	www.kssos.org	1-785-296-4564	Tennessee	www.sos.tn.gov	1-615-741-2286
Kentucky	www.sos.ky.gov	1-502-564-3490	Texas	www.sos.state.tx.us	1-512-463-5555
Louisiana	www.sos.la.gov	1-225-922-2880	Utah	http://corporations.utah.gov/	1-877-526-3994
Maine	http://maine.gov/sos	1-207-624-7736	Vermont	www.sec.state.vt.us	1-802-828-2363
Maryland	www.sos.state.md.us	1-410-974-5521	Virginia	www.commonwealth.virginia.gov/	1-804-786-2441
Massachusetts	www.sec.state.ma.us	1-800-392-6090	Washington	www.sos.wa.gov	1-360-902-4151
Michigan	www.michigan.gov/sos	1-888-767-6424	West Virginia	www.sos.wv.gov	1-866-767-8683
Minnesota	www.sos.state.mn.us	1-877-551-6767	Wisconsin	www.sos.state.wi.us	1-608-266-8888
Mississippi	www.sos.ms.gov	1-601-359-1633	Wyoming	http://soswy.state.wy.us	1-307-777-7378
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