

Business Start-Up Guide

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SECTION 1 - INTRODUCTION

Many people starting a business are excited by the prospect of being their own boss and controlling their own destiny, but they often forget the administrative side of starting a new business. Once this realization hits them it is often a case of panic when they realize all the things they should have done and now must do.

We have assumed you already have your product, your business plan, financing, business name and are ready to go.

The guide is not inclusive of all the information necessary to get started. It is a helpful guide to doing so. Examples of information not included due to their complex or specific requirements to certain types of businesses are: the need to pay self-employment taxes and/or estimated taxes, limitations surrounding certain expenses such as entertainment and auto and the requirements for documenting those expenses and various types of accounting software. We strongly recommend you contact our office for a complimentary planning session or with any specific questions.

SECTION 2 - SELECTING A BUSINESS STRUCTURE

What business structure best fits your needs? Here are your choices and a brief description of each:

1. Sole proprietorships
2. Partnerships
3. Corporations
4. S Corporations
5. LLC (Limited Liability Company)

Sole Proprietorship

A sole proprietorship is someone that owns an unincorporated business by himself or herself. It is the simplest form of business ownership requiring the least amount of accounting, however, if you have employees the requirements for tax filings are the same as for an incorporated business. Sole proprietorships are used when the owner is the only "employee" of the business and an informal set of accounting records will suffice although not recommended. Sole proprietorships offer no liability protection for the owner so carrying the proper type and amount of insurance is extremely important.

A sole proprietor files his or her reportable income from the business on Schedule C of their Form 1040.

Partnerships

A partnership is the relationship existing between two or more persons for the purpose of carrying on a trade or business. A partner may contribute money, property or skills to the partnership with the expectation of earning a profit in the endeavor. A partnership must maintain a complete set of accounting records including capital accounts for each partner. Partnerships are used when the legal liability protection of a corporation or S corporation are not of paramount importance and are often used by doctors, lawyers, accountants and other "professionals". General partnerships, as is the case with sole proprietorships, offer no liability protection and again the proper type and amount of insurance is extremely important. Limited Liability Partnerships are another form of partnerships available.

A partnership files its annual income tax return on Form 1065. The income from the partnership is allocated to the individual partner, in accordance with the partnership agreement, on Form K-1 for inclusion on their personal Form 1040.

Under most State law there is no need to have a formal partnership agreement in order to have a partnership for tax purposes, however we strongly recommend an agreement be in place prior to entering this type of business structure.

SECTION 2 - SELECTING A BUSINESS STRUCTURE (Continued)

Corporations

A corporation is an entity that issues stock to its' shareholders (think IBM, Ford) in exchange for money, property or services. A corporation may be a "regular" corporation or an "S" corporation. Corporations have the requirement of maintaining the most complex set of accounting records. Shareholders in corporations, for the most part, have unlimited liability protection. Corporations are most often used when a product is being manufactured, constructed or distributed and legal liability may be of concern.

Regular Corporations

A regular corporation, often referred to as a "C" corporation, is recognized for legal and tax purposes as a separate entity and as such pays income taxes at its own level unlike a sole proprietorship or partnership where the income "flows thru" to the owner or partner and is taxed at the individual level. Since the income of the C corporation is taxed at its own level there is double taxation when the corporation distributes its' income to the shareholders in the form of dividends.

A C corporation files its' income tax return on Form 1120.

S Corporations

An S corporation, like a "C" corporation, is recognized for legal and tax purposes as a separate entity but does not pay income taxes at its own level. Like a sole proprietorship or partnership where the income "flows thru" to the owner or partner, an S corporation is taxed at the individual shareholder level.

There are very specific requirements that must be met to "qualify" as an S corporation. The requirements include, but are not limited to, it being a domestic corporation, allowed shareholders (type, nationality and number) and classes of stock.

An S corporation files its' income tax return on Form 1120S.

LLC (Limited Liability Company)

An LLC is a business structure that is governed by State, not Federal, statute. Accordingly, it is important to determine your State's LLC rules and regulations. An LLC has many possible variations and therefore its accounting and tax requirements may mirror those of a sole proprietorship, a partnership or a corporation (regular or S corporation) depending upon certain elections made. An LLC provides limited personal liability for the debts and actions of the LLC (although an action brought for malpractice is not limited to the LLC level but pierces the limited liability veil down to the LLC owner or member). Many other features of an LLC may also be similar to those of a partnership or corporation.

SECTION 2 - SELECTING A BUSINESS STRUCTURE (Continued)

LLC (Limited Liability Company) (Continued)

Owners of an LLC are referred to as members, although many use the term partner erroneously.

A single owner LLC, for tax purposes, is treated as a "disregarded entity", the tax accounting rules and regulations mirror those of a sole proprietorship, and the taxable income of the business is reported on Schedule C of the individual owner's Form 1040.

An LLC with two or more members is treated as a partnership, unless it elects to be treated as a corporation, must follow the tax accounting rules and regulations for a partnership.

An LLC may elect to be treated as either a C corporation or an S corporation and depending on the election made it will be required to follow the particular tax accounting rules and regulations associated with that particular corporate return.

An LLC is the fastest growing form of business, and its use depends upon a number of factors including, but not limited to, liability protection, an ease of business and reporting requirements.

SECTION 3 - OBTAINING REQUIRED TAX INFORMATION

Once you have gone through the process of determining your business structure you must start the process of getting that structure into operation. This will require the filing of numerous documents with various Federal and State authorities.

First, you must make the proper State filings (remember to check your state's rules and regulations) before going on to the Federal requirements. This will require registering your sole proprietorship, partnership, corporation or LLC with the Secretary of State's office. You may need incorporation papers or LLC Articles of Organization. Normally a sole proprietorship or partnership does not need to file specific paperwork with the Secretary of State for organization.

Second, you must obtain the necessary permits and registration numbers. For the State of Connecticut this requires a Form REG-1, Business Taxes Registration Application for all taxes payable or to be remitted to the State other than unemployment compensation taxes. You will also need to file a Form UC-1A, Employer Status Report for Unemployment Compensation. These forms may be filed online at www.ct.gov/tsc.

Third, be aware that the State of Connecticut requires an Annual Report for all businesses regardless of their organizational structure.

The Federal government only requires one registration number for all Federal reporting purposes. The registration number may be obtained by filing a Form SS-4 Application for Employer Identification Number. This may be applied for by telephone, fax or online at www.irs.gov.

SECTION 4 - BUSINESS TAXES

Depending on the business structure you have chosen you may be responsible for some or all of the following taxes:

Federal

1. Income tax
2. Self-employment tax
3. Estimated taxes
4. Social Security and Medicare taxes
5. Federal Unemployment Tax

State

1. Income tax
2. Estimated taxes
3. State Unemployment Tax
4. Sales Tax

In addition to the above, if you have employees, you will be responsible for the withholding and forwarding to the appropriate Federal or State authority, the required Income Tax withholding and Social Security and Medicare tax withholding.

SECTION 5 - OTHER ANCILLARY STEPS

Depending upon the type of business, some or all of the following may be necessary steps. Additional information is included in this guide for certain of the items listed below.

1. Choose a business name and verify your right to use that name
2. See if the business name is available as a domain name (check at Register.com)
3. Register the business name and get a business certificate
4. Register your domain name even if you are not ready to use it
5. Choose a location for your business
6. Check zoning laws for your location
7. Get any required business licenses or permits
8. Register or reserve Federal or State trademarks
9. Register copyrights
10. Apply for patents for an invention
11. Place any required notices of your intent to do business in a given community
12. Get your business telephone numbers
13. Check into your insurance needs
14. Determine employee benefits (health insurance, retirement plans etc.)
15. Open your business bank account
16. Purchase equipment and supplies
17. Order inventory
18. Order signage
19. Get an email address or website
20. Prepare your sales literature
21. Obtain promotional items
22. Place any fixed advertising, such as Yellow Pages
23. Determine your social networking and marketing plans
24. Set up your accounting system
25. Determine your record retention
26. Get agreements for doing business with your partners or shareholders, such as buy-sale agreements, management agreements and compensation agreements.

INSURANCE NEEDS

Business insurance needs will vary with the type of business. For example, professionals should carry malpractice insurance whereas a manufacturer will carry product liability insurance. We have outlined the different areas of insurance coverage; however, you should contact a trained insurance professional to determine your actual needs.

Unemployment Insurance

Unemployment insurance, many consider this an additional tax at both the Federal and State levels, is required by law and is provided by the Federal and State governments.

Workers' Compensation Insurance

Workers' compensation insurance protects your employees if they suffer job related medical injuries. Insurance coverage is mandated on a State-by-State basis, so it is important to discuss your needs with your insurance agent especially if you are doing business in more than one State. Some States also require employers to provide separate short term disability insurance for their employees.

Property Insurance

Property insurance insures against the loss or damage to the business location and its contents. Property insurance can be specific or broad, a specific coverage example would be fire insurance, which obviously insures against fire damage but would not insure for storm related damage. A policy covering a multitude of risks is usually called a casualty insurance policy, this type of policy lumps property and casualty together.

Liability Insurance

Liability insurance insures against legal liability imposed against your business because of malpractice or negligence.

Commercial Auto

Personal automobile insurance does not protect vehicles used in your business; you need a separate commercial auto policy for your business automobiles.

Business Interruption Insurance

Business interruption insurance insures against loss or damage to the cash flow and profit of a business because of the interruption. An example would be a fire that makes it impossible for the business to continue operations until the damage is corrected.

INSURANCE NEEDS (Continued)

Health Insurance

Historically health insurance has been provided by businesses to be competitive with other businesses. The landscape of the health care insurance will now change with the passage of Federal legislation and health insurance will become a requirement for most employers and workers. Employers providing this coverage under current law should check into tax elections that allow the employee contribution to be made in pre-tax dollars by the employee.

Life and Disability

As with health insurance, life and disability insurance are commonly provided to employees as part of their fringe benefit package. As previously noted, some States require the employer to provide disability insurance for their employees.

Key Man Coverage

Key man insurance coverage may take the form of a life insurance policy and/or disability insurance policy on a key employee with the business as the beneficiary of such policies. Many businesses believe this coverage is necessary to provide the business with funds should a key employee die or become disabled utilizing the funds to attract an experienced replacement.

Surety Bonds

Surety bonds involve three parties, the principal who has primary responsibility to perform the obligation, the surety who is the individual or company with the secondary responsibility of the obligation should the principal fail to perform and the obligee, who is the person to whom the obligation of performance is owed. Surety bonds are commonly used in the world of finance and construction.

Travel Insurance

Travel insurance can save travel related costs should the travel plans need to be canceled. Many believe if a flight needs to be cancelled due to health or weather or some other reason, that a refund will be received for the expended costs. This is not always the case. Travel insurance coverage comes in many forms, trip cancellation, medical, emergency evacuation, accidental death and luggage and personal belongings are examples.

INSURANCE NEEDS (Continued)

Specialized Policies

Types of specialized insurance are:

International Operations

If your company does business overseas most traditional policies will only cover claims brought in the United States. An International Liability policy will cover you for liability, health, workers compensation and property insurance in the foreign country you are doing business in.

Valuable Papers Insurance

Most professional businesses such as lawyers and accountants handle and produce documents critical to the operations of their own, as well as their clients, businesses. Valuable papers insurance protects against the loss of these papers by providing funds to re-create the paperwork.

Scripted Policies

There are always the types of operations or physical objects that do not fall under normal coverage. Scripted policies are designed to protect these types of assets.

Maritime Operations

If you operate water vessels that dock at United States harbors you will need to have Maritime Operations coverage. This coverage is a special form of workers' compensation coverage required under the Jones Act and the Longshoremen's Act.

Railroad Operations

Common insurance policies exclude coverage for any operations taking place in or around railroad tracks. Railroad Operation coverage fills this insurance gap if you are operating around railroad tracks.

Kidnap and Ransom Insurance

If your personnel travel, especially overseas, this coverage may be necessary to aid and reimburse the business in the case of a kidnapping.

ACCOUNTING SYSTEMS

Unfortunately, many people begin their new business without thought about their accounting, tax and reporting needs. We are providing guidance on this; however, we cannot emphasize enough the need for any new business to immediately engage a corporate attorney and a certified public accountant to guide them through the maze of business requirements.

We have previously discussed the requirements to obtain the necessary business identification numbers and licenses. One of the requirements at the time of organization of the business is to select a fiscal year for the operation of a business. Current tax law has placed limits on the fiscal year end dates for many forms of business. For example, a business operating as a sole-proprietorship must have its fiscal year end correspond with the tax filing date for the individual taxpayer, this is almost always a December date.

Similar to sole-proprietorships, partnerships must also select a fiscal year end that corresponds to the income tax filing date of the majority of its partners. Again, in most cases this will result in a fiscal year at the end of December.

S Corporations, under current Federal law, may select a fiscal year end that ends with the months of September, October, November, or December.

C Corporations are the only business entity that may select a fiscal year end ending with any calendar month.

It is important to note that in the first year of business the fiscal year end cannot exceed the month prior to the month of organization, one year out. For example, a partnership starting its operations in March must end its first year as of December, so its first “year” of operation will only comprise the ten-month period of March to December. A C Corporation starting its operations in March may select any month end up to and including February of the following year.

RECORD RETENTION

Record retention depends upon many factors, Federal and State tax and civil law, contracts, business preference and other factors. We have provided, in the Addendum section of this Guide, a recommended retention schedule that is useful for most businesses.

BUSINESS AGREEMENTS

One of the most neglected areas of starting a new business is the failure to put in place the necessary business agreements for such areas as, but not limited to, removal/withdrawal of a partner or shareholder (buy-sell agreement), individual responsibilities of the partners/shareholders (management agreement) and who makes what and how and why (compensation agreements).

Everyone starting a new business, with a spouse, parent, sibling, and friend or outside investor enters starry-eyed. Like a new marriage you assume it will go on happily forever and, unfortunately, like many marriages, it can end in divorce. Understand one thing, when you start a new business, you will spend more hours with your partners/shareholders than you will spend with your spouse. People do not get along forever due to changes in priorities, health or a multitude of other reasons. Therefore, like a Pre-Marital Agreement it is extremely important to put the necessary “rules and regulations” in place at the beginning of the enterprise in order to save it should disagreements or other matters cause the removal/withdrawal of a partner/shareholder. Doing so will, hopefully, reduce or eliminate any of the associated emotional trauma and pain. As earlier stated, having a corporate attorney and certified public accountant familiar with new businesses on board at the beginning will be of tremendous help.

Buy-Sell Agreements

Buy sell agreements should be put in place should it be necessary to acquire the interest of a partner/shareholder due to death, disability or requested withdrawal from the business. It is usually accompanied by a predetermined formula or procedure where the parties agree to purchase/sell the interest to the business entity or the remaining partners/shareholders. Funds to accomplish this are often provided by insurance policies although a number of businesses often “go naked” and expect to be able to fund the agreement from current or future operations.

Management Agreements

Nothing can destroy a business faster than an argument over who is in charge of what. Accordingly, well-drafted management agreements can save the day. For example, in a partnership it would define who is responsible for the day to day management of the partnership and what are the limits of that authority. It would put into place the requirements of the position and the steps necessary to remove or replace the managing partner.

BUSINESS AGREEMENTS (Continued)

Compensation Agreements

Money is the root of all evil. Failure to define how compensation is determined is the failure of many businesses. Putting into place a well-defined compensation arrangement covering such things as base salary, bonuses for defined reasons such as sales goals, productivity, fee generation and the like will save the day when one of the partner/shareholders or in most cases the spouse of a partner/shareholder questions why their compensation is not equal to or in excess of another partner/shareholder.

SECTION 6 - CONCLUSION

We hope this guide is useful to you as a new entrepreneur and wish you well with your endeavors. Additional assistance may be found at the Internal Revenue website - www.irs.gov and the State of Connecticut websites - www.sots.ct.gov (Secretary of State) and www.ct.gov/drs/site/default.asp (Department of Revenue Services).