

Student name: \_\_\_\_\_ Date: \_\_\_\_\_

## Describe types of business formats.

### Objectives:

- A. List and describe five types of business taxes.
- B. Describe five most common business formats.
- C. Compare and contrast the advantages and disadvantages of various business formats.

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### MODULE 11A: INFORMATION SHEET

*TO THE STUDENT: Read and study the following information sheet and then complete the student activities at the end of this module.*

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#### Introduction

You are finally realizing your life long dream and opening your own business. How will you set up your business organization? There are many formats. The following information will focus on the five most common. They are: *Sole Proprietorship, Partnership, Corporation, Limited Liability Company, and Franchise*. Each has different tax consequences, advantages, and disadvantages. As the business grows, changing the business format may also be beneficial.

When deciding how to organize your business, you should consider the following:

- The business might be sold.
- The business might be passed to heirs.
- The business might merge with another company.
- Family-operated businesses owners can have disagreements, spouses can divorce, etc.

The business format you choose will affect:

- Federal income taxes.
- Liability to creditors.
- Legal and/or personal relationships among the owners.
- Legal life and/or transferal of the business.

## Business Taxes

The *format* of your business will determine *what* taxes you must pay and *how* you pay them. There are five general kinds of business taxes:

Income Tax - All businesses, except partnerships, must file an annual income tax return. Partnerships file an information return. Federal income tax is a pay-as-you-go tax. You must pay the tax as you earn or receive income during the year. If you do not pay your tax through withholding, or do not pay enough tax that way, you might have to make payments (usually quarterly) of estimated tax during the year.

Self-Employment Tax - This is the Social Security and Medicare Tax (FICA) for individuals who work for themselves. Your payments of Self-Employment Tax contribute to your coverage under the Social Security System. This is also an estimated tax, payable quarterly.

Employment Tax - You are responsible for deducting the following taxes from your employees' paychecks and submitting them to the appropriate government offices:

- Personal Income Tax - federal, state, city, local
- Social Security and Medicare Tax (FICA)
- Unemployment Insurance Tax - federal, state if applicable

As the employer, you are responsible for matching Social Security and Medicare (FICA) taxes, paying the majority of Unemployment Insurance Tax, and all of Workers' Compensation.

Excise Tax - You need to pay these taxes if you do any of the following:

- Manufacture or sell certain products.
- Use various kinds of equipment, facilities, or products.
- Operate certain kinds of businesses.

Some examples are businesses that deal with the environment; communications; fuel; sale of heavy trucks, cars, and trailers; lottery; guns; tobacco products; and alcohol products.

Sales Tax - States usually raise money from a sales tax on the sale of goods (but generally not services). The sales tax is a percentage of the cost of the item sold and is included in the amount paid. The business collects the tax, paid by the consumer, and sends it to the government on a quarterly basis.

## Types of business formats

**Sole Proprietorship** - Many small businesses are sole proprietorships. One person supplies the capital, owns all the assets of the business, and assumes all the responsibility for operating the business. The owner has total control and makes all the decisions regarding the operation of the business. All the earnings belong to the owner. You cannot have multiple owners.

A sole proprietorship can be owner/operated or it can have employees. The owner is not an employee, however, so they cannot be covered by any of the company's insurance plans or participate in pension or profit sharing. The owner also has legal responsibility for any decisions made by the employees.

A sole proprietorship commonly operates under the name of the owner, but it can have another name. It must then be registered within the county in which it will operate.

A sole proprietorship is very simple for tax purposes as it is easy to start and operate. It's inexpensive as an attorney and/or accountant is not necessary to set it up.

The owner doesn't draw a salary for tax purposes. What is report for income OR loss at the end of the tax year belongs to the owner. A sole proprietorship is taxed on all income from the business at an individual tax rate. Business income and allowable expenses are reflected on a personal income tax return. There is no double taxation, as the business is not treated as a separate taxable entity like a corporation.

A separate checking account for the business is opened to keep track of finances and all revenue and expenses. The owner is personally responsibility for losses to the business. For example: If the business can't pay for supplies, suppliers can sue you individually. Creditors can go after business and personal assets, including your house and bank account. And the reverse as personal creditors can make claims against business assets. You can protect some personal assets from business risk by owning the assets jointly with a spouse or transferring ownership of the assets to your spouse or children. Business insurance may be purchased (i.e.: general liability, malpractice, product liability) to cover some risks of running the business so personal liability may be lessened. (i.e.: customer injured on premises or from products sold).

The owner can transfer the business by selling all or some of the assets of the business. The business can be sold or discontinued with minimal tax consequences. As the business isn't separate from the owner, if the owner dies, so does the business, unless it's been willed to someone else. Transfer can be time-consuming and costly.

**Partnership** - A partnership requires 2 or more people who agree to provide capital and share responsibilities and costs for operating the business. A

partnership can be adapted to changing business needs, as additional partners can be easily added. Like a sole proprietorship, a partnership is relatively easy to start and operate. Start-up costs are relatively inexpensive.

Each partner is personally liable for debts of the business. They get all the profits, and have unlimited personal liability for business losses. Take great care in choosing a partner! The acts of one partner bind the entire partnership and put all the assets at risk.

Always prepare a *Partnership Agreement* to prevent operating problems. There are legal fees when drawing up an agreement. The agreement should include such things as:

- Contributions - amount of equity invested by each partner.
- Division of profits, property, and responsibility of loss.
- Management and Control - partner responsibility and duty.
- Duration of partnership.
- Provisions for changes in the partnership - dissolution of partnership, death or incapacitation of a partner, admission of a new partner, withdrawal of a partner (1<sup>st</sup> Right of Refusal for remaining partners).
- Restrictions of authority and expenditures.
- Dispute settlement clause.

There is no double taxation of a partnership. There's no federal income tax on the business, just on personal income.

The owners and business are one and the same. If the partnership dissolves, so does the business. Unless otherwise specified, the partnership (and therefore the business) dissolves upon the death of one of the partners.

There are two types of partnership. A *General Partnership* is when all partners have an equal share in the business. It's easier to start, however, there must be total consent of the partners for decision-making. Interests may not be sold or transferred unless all the partners agree. With a *Limited Partnership*, one or more partners may have limited liability, limited contributions, profits and/or losses limited to that amount, yet no management authority. But one or more partners must have unlimited liability, and can, therefore, manage the business.

**Corporation** - This is one of the best-known and most widely used business forms. The government views a corporation as a *separate legal entity* from its owners. Therefore, a corporation provides liability protection for its owners or *shareholders*. A corporation is liable for its own debts and can only be held liable for its assets (which is the amount the owners have invested in the corporation's stock). Shareholders are not responsible for debts of corporation.

The corporation is subject to federal and state taxation. Corporate income tax is taxed at the corporate level. If dividends are distributed to shareholders, it is taxed again at the individual level. A small business that's incorporated may avoid this double taxation by paying a salary to the employee shareholder. Earnings can be used for future investment in the company or paid to shareholders in the form of a cash or stock dividend.

A corporation has a perpetual life. This means it goes on even if the owner(s) sell the business or die.

Forming a corporation is more complicated and costly than forming other types of businesses. Articles of incorporation must be filed with the office of secretary of state in the state in which the corporation is organized. This is not necessarily the state in which the corporation will do business. However, the certificate of incorporation must be recorded in the states in which you do do business. The corporation must have its own name. It must be unique and not used by another corporation.

A corporation is owned by its shareholders or stockholders. Although a corporation usually has many owners, it's possible for one person to create and own 100% of a corporation. It is easy to transfer ownership or add owners to the corporation. A corporation must have at least one stockholder and/or director and/or officer. Only shareholders can approve amendments to the articles of incorporation, mergers with other companies, and decisions to dissolve the corporation. Shareholders elect directors who oversee the operation of the business and make major corporate decisions (shareholders can elect themselves as directors if they wish). Directors appoint officers of the corporation who are responsible for day-to-day business operations.

It's important that the corporation observe all the formalities of being a corporation such as; issuing stock certificates to its shareholders, holding annual meetings and recording minutes of the meeting in the corporate register, and electing directors or ratifying the status of existing directors. This is enforced to provide evidence that the corporation is real, not a sham. These formalities are dictated by law and must be followed to maintain corporate status.

Ownership of a corporation can be transferred by sale of all or a portion of the shares. Owners can be added by selling authorized stock from the corporation or by having the current owners sell some of their stock. Small businesses that are corporations are often owned by a small group of shareholders that all work in the business.

**Limited Liability Company** - The LLC is a new type of business entity that has only recently become available in all 50 states. As it is so new, there is little precedent available should legal issues arise. It is a hybrid that combines of the advantages of a partnership and a corporation. The business is not taxed. Income,

losses, deductions, and tax credits flow through the LLC to the individual members. At the same time the members are shielded from being personally liable for the acts of the LLC.

Members of an LLC can be individuals, partnerships, or corporations, and membership is unlimited. Each member of an LLC can also manage the business, or a management group can be hired to do so.

To form an LLC, articles of organization must be filed with the office of the secretary of state. It's similar to a partnership agreement. It guides the conduct of the business. An LLC is generally treated as a partnership for federal tax purposes. Since the individual members are treated as partners, they may be subject to self-employment taxes. If the business hires employees, a Federal Employer ID number will need to be obtained and payroll taxes will have to be paid. The name of a company operating as an LLC must have it designated in its name.

LLCs are usually more costly to set up and operate than a sole proprietorship, partnership, and some forms of corporations. But, it can have unlimited members. Most states restrict one member LLCs to avoid all sole proprietorships applying for LLC designation.

**Franchising** - A franchise is a legal and commercial relationship between two parties. A *franchisor* owns the right to a name or *trademark* and sells the right to use that name or trademark to the *franchisee*. An ongoing relationship will exist between the two parties. The franchisor provides a full range of services such as site selection, training, product supply, marketing assistance, and financing. The franchisee sells goods or services that must meet the franchisor's quality standards.

The *franchise agreement* governs the method for conducting business between the two parties. Many industries rely on franchised businesses to distribute their products or services, such as automobiles, real estate, and fast foods. This is usually the fastest method to expand a business.

Don't be pressured into a franchise that's not right for you. Some franchises can be poorly managed and be financially weak. Carefully investigate your options, read *Disclosure Statements* (information about the company's business), visit current franchisees, check with the Better Business Bureau or Chamber of Commerce. A key issue to inquire is how does the franchise protect franchisee territories? Is the franchisor planning to sell additional franchises so close to you that the competition negatively impacts on your business? How do they control their expansion?

Purchasing a franchise can provide you with easy access to an established product or service or make it easier to introduce a new product or service. Well-organized

franchises will have many business decisions already made for you such as; site selection (where the business will be located), methods of marketing and advertising, and operating and control procedures. Good franchises will provide pre-opening training for you and your staff and continuing quality control inspections of your facilities and products/services. And because your business will be part of a much larger company, you will have access to *purchasing power* (the ability to buy product and supplies at a quantity and volume discount). Buying a franchise can reduce many of the risks of opening a business. The success rate for franchisee-owned businesses is better than for other start-up businesses.

However, conforming to pre-determined business standards isn't for everyone. You can't manage totally independently and your establishment must meet franchise standards of construction and appearance. And many times unwanted products may be sent to you to sell even though your *demographic market* (your customers) will not buy them.

Although generally a safer business venture than a sole proprietorship or partnership, buying a franchise can be one of the most costly. There is usually an initial fee (like a deposit), and then you pay a percent of revenue on a yearly basis. There can be other fees as well such as; advertising fees, fees for access to a reservation or computer network, and sign-rental fees. These additional fees can total 5-10% of gross sales annually.

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**MODULE 11A: STUDENT ACTIVITIES**

**TO THE STUDENT:** After reading and studying the information sheet, complete the following questions.

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**Activity 1:** List the 3 most important *advantages* and 3 biggest *disadvantages* about each business format.

Format Type	Advantages	Disadvantages
Sole Proprietorship		
Partnership		
Corporation		
Limited Liability Co.		
Franchise		





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**MODULE 11A: STANDARDS ADDRESSED IN THIS MODULE**

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**Pennsylvania’s Academic Standards for Reading, Writing, Speaking and Listening (RWSL)****1.1.11. Learning to Read Independently**

- E. Establish a reading vocabulary by identifying and correctly using new words acquired through the study of their relationships to other words. Use a dictionary or related reference.

**1.5.11. Quality of Writing**

- F. Edit writing using the conventions of language.
- Spell all words correctly.
  - Use capital letters correctly.
  - Punctuate correctly (periods, exclamation points, question marks, commas, quotation marks, apostrophes, colons, semicolons, parentheses, hyphens, brackets, ellipses).
  - Use nouns, pronouns, verbs, adjectives, adverbs, conjunctions, prepositions and interjections properly.
  - Use complete sentences (simple, compound, complex, declarative, interrogative, exclamatory and imperative).

Student name: \_\_\_\_\_ Date: \_\_\_\_\_

## Describe the opportunities of entrepreneurship.

### Objectives:

- A. Explain the importance of small businesses to the economy.
- B. List and describe two ways jobs are created.
- C. List advantages and disadvantages of owning your own business.
- D. Describe three ways to start a business.
- E. Identify the four basic types of businesses.
- F. Describe the characteristics of and list examples of service businesses.
- G. Explain resources provided by the Small Business Administration.

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### MODULE 11B: INFORMATION SHEET

*TO THE STUDENT:* Read and study the following information sheet and then complete the student activities at the end of this module.

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### Introduction

Have you ever thought of owning your own business? What kinds of products or services would you sell? Where would you locate your business? Who would be your target market? Can you name people in your community who own their own businesses? They may be florists, landscapers, cosmetologists, childcare providers, or pizza shop owners. These people are entrepreneurs. An *entrepreneur* is a person who owns and operates his or her own business.

Starting a business has always been part of the American Dream. Entrepreneurs and their small businesses play an important role in the economy. Small businesses create jobs through *growth* and *expansion*, whereas large companies tend to create jobs through replacement and expansion. *Replacement* is where jobs become available through termination, retirement, death, promotion, resignation, etc. The small business sector has helped the U.S. have a higher standard of living. When people are working, they have more money to spend or save. Spending creates demands for more goods and services, many of which are provided by small companies. Small businesses then must hire more people to meet the increased demand. Small businesses can provide specialized products and services that large companies do not.

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They also create competition for each other and large companies, which helps to keep prices down and the quality of the products and services high.

### Advantages/Benefits of owning a business

- Exciting
- Rewarding/Satisfying
- Challenging
- Set your own schedule
- Try new ideas
- Do the job better than others
- Independent – you're the boss
- Freedom to make decisions
- Community recognition
- Financially rewarding if successful
- Builds self-esteem

### Disadvantages/Negatives of owning a business

- High failure rate
- Personal financial risk
- Work many hours
- Can be lonely
- Staffing problems
- Emotional strain – multiple problems to solve
- Must do all jobs – bookkeeping, managing, sales, secretary, custodian, etc.

### Types of businesses to start

There are three ways to start your own business; creating your own business from scratch (called a *start-up*), purchasing an *existing business*, or buying a *franchise*. Each of these formats has its positives and negatives if we compare them with regards to *cost*, *success rate*, and *creative freedom*. A start-up can be the least expensive way to start a business and it may provide you with total creative freedom in running it, however, its success rate is the lowest of the three. Purchasing an existing business increases your chances of business success; therefore, the cost of buying it will tend to be higher. You still have some creative freedom, however, making dramatic changes in the business could chase existing customers away. Purchasing a franchise can ensure financial success, however, there is a price to pay for that security. And franchise owners tend to have the least amount of freedom when it comes to running the business.

People may start many different kinds of businesses during their lifetime, but all of them will fall into one of four basic categories. Some types are easier and less expensive to start than others, such as cutting hair versus producing television, however, each type of business has different accounting, marketing, and promotional needs. A **manufacturer** makes a product. A **wholesaler** (middleman) buys large quantities of product from a manufacturer and distributes it in smaller quantities to retailers. They provide storage and transportation services as well. **Retailers** sell products to the end user. A **service** provider sells their time, skills, and expertise. This tends to be the easiest and least expensive entry into starting your own business.

As our economy is moving more and more towards a service economy, you should have a good understanding of the nature of a service business. Its major characteristics are as follows:

Intangible – a service is something you can't touch; it's something you experience.

Inseparable – production and consumption of the service happen together; the consumer is part of the production process. This puts great pressure on the service provider. (Think about sitting in your dentist's chair and hearing your dentist exclaim, "oops!" How would you feel?)

Perishable – services are created on demand and priced to sell; you can't create an inventory of services for later use. If you have a 100-room hotel and only sell 90 rooms one night, you can't sell 110 rooms the next night to make up for it.

Labor-intensive – service businesses depend on the interaction between employees and consumers, as well as the performance of physical tasks.

### Types of service businesses

Healthcare	Education	Communications
Entertainment	Law	Government
Accounting	Utilities	Transportation
Technology	Personal Care	Real Estate
Food Service and Lodging	Finance	Banking

## Getting started

To increase your chance for success, take the time up front to research and plan your business idea and to evaluate your business and personal goals. A great resource for any budding entrepreneur is the Small Business Administration - [www.sba.gov](http://www.sba.gov). The SBA can do the following:

- Provide financial, technical, and management assistance to help start, run, and expand a business
- Guide you through the legal steps to follow in setting up and operating your business
- Assist in developing a business plan – lending institutions require one
- Help you register with proper federal, state, local agencies
- Provide workshops, seminars, and courses on starting, running, improving, and expanding your business
- Guide you through the process of applying for business loans
- Provide you with a free start-up kit – "Is Entrepreneurship Right For You?"

The following is the Business Start-up Checklist from the SBA start-up kit. It provides a thorough overview of the steps necessary to ensure business success:

- Select legal organization (proprietorship, partnership, LLC or Corporation)
- Register trade name or filed Certificate of Incorporation.
- If you have a partner, do you have a partnership agreement?
- Check local zoning ordinances regarding zoning, licenses, etc.
- Secure local business certificate (if needed).
- Estimate monthly personal expenses.
- Estimate projected monthly cash flow.
- Set up bookkeeping system.
- Set up other records keeping systems.
- Open a business checking account.
- Secure business stationary, including business cards.
- Register with State Division of Revenue.
- Register with Internal Revenue Service (IRS).
- Secure professional resources (accountant, attorney, insurance agent, banker, consultant, etc.).
- Secure business insurance coverage.
- If hiring employee(s) understand employer responsibilities for W-4; I-9; employment application; job description, fringe benefit package.
- Have an employee handbook and have had it reviewed by legal counsel or other personnel professional.

- Estimate cost of advertising, fixtures, decorating, inventory, fees, working capital, etc.
- Estimate cash needed to start your business.
- If you will accept checks, have you written check acceptance procedures and safeguards?
- If extending credit, have in place written formal credit procedures.
- Prepare a marketing plan, with specific goals and objectives.
- Prepare a business plan, including written projections of cash flow.
- If using independent contractors, will require references, insurance and issue IRS 1099.
- If you have an employee compensation package, have you made provisions for State Unemployment & Disability and Worker's Compensation?
- If purchasing or leasing equipment, do you understand the savings and/or difficulties with each method.
- When purchasing used equipment, know to check for liens for unpaid sales tax; know to require bill of sale from seller containing an affidavit that seller has full right to sell and transfer equipment and that said equipment is free and clear of any and all liens, mortgages, debts, or other encumbrances or claims. Check with county to determine any UCC filings or chattel mortgages.
- Secure copyrights, trademarks or patents where applicable.
- Consider alternative plans to financing.
- Understand bank's requirements for business loans.

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**MODULE 11B: STUDENT ACTIVITIES**

*TO THE STUDENT:* After reading and studying the information sheet, complete the following questions.

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**Activity 1: Answer the following questions:**

1. Describe two ways entrepreneurs and their small businesses provide a positive impact on the economy:
2. Jobs are created through *growth* and *replacement*. Give two examples of how companies create jobs through replacement.
3. What are two advantages or benefits of owning your own business?
4. What are two disadvantages or negatives of owning your own business?
5. Compare and contrast a start-up, an existing business, and a franchise with respect to cost, success rate, and creativity:
6. What is the difference between a retail business and a service business? Give an example of each.
7. List and describe two characteristics of a service business:



8. List three ways the Small Business Administration can help entrepreneurs get their businesses started:

**Activity 2: Interview an entrepreneur** in your community to get their responses to the following questions. This person can be your employer, a parent, a family friend, etc. This can be a present or former business owner. This can be done in person or over the phone.

Entrepreneur's name:

\_\_\_\_\_  
Name of business:

\_\_\_\_\_  
Location of business:

- \_\_\_\_\_  
1. What products or services do you sell?
2. Who are your customers?
3. Explain why you decided to work in this type of business.
4. How long have you been in business?

5. What was your main reason for wanting to start your own business?
  
6. Why did you choose to locate your business in its present location?
  
7. Under what type of business format (sole proprietorship, partnership, corporation, etc.) do you operate your business?
  
8. Why did you choose that type of business format?
  
9. How many hours do you work weekly? \_\_\_\_\_
  
10. What is the biggest challenge of owning your own business?
  
11. What do you see as the greatest benefit of having your own business?
  
12. What do you dislike most about being your own boss?
  
13. If you were starting over today, what would you do differently?

14. What do you feel are the most important characteristics for an entrepreneur to have?

15. What advice would you offer to someone who is considering starting his or her own business?

Student Response – After learning about starting your own business and interviewing this entrepreneur, what is your opinion about starting your own business?

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**MODULE 11B: STANDARDS ADDRESSED IN THIS MODULE**

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**Pennsylvania’s Academic Standards for Career Education and Work**

**13.1.11. Career Awareness and Preparation**

- A. Analyze career options based on individual interests, abilities, aptitudes, achievements, and goals.

**13.4.11 Entrepreneurship**

- A. Analyze entrepreneurship as it relates to personal career goals and corporate opportunities.

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  - Use nouns, pronouns, verbs, adjectives, adverbs, conjunctions, prepositions and interjections properly.
  - Use complete sentences (simple, compound, complex, declarative, interrogative, exclamatory and imperative).

**1.6.11 Speaking and Listening**

- A. Listen to others.
- Ask clarifying questions.
  - Synthesize information, ideas and opinions to determine relevancy.
  - Take notes.