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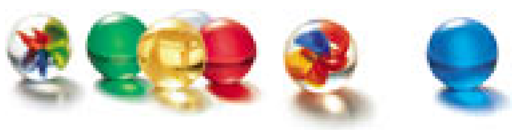

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DIFFERENT FORMS OF BUSINESS ORGANIZATION

PLAN: Select a "Sole proprietorship" form of business organization initially: when you are the sole owner of the business, and you anticipate that the business will operate at a loss or near break-even (zero profit).

1. Only one-owner businesses can operate as a Sole Proprietorship, therefore the owner will file a Schedule "C" (information only) tax form, along with their personal income tax return (Form 1040).

Note: If your business has more than one owner, you will want to select the corporation form of business organization (either an "S" corporation or a "C" corporation).

2. Under this form of organization, any business profit (or loss) is shown on the bottom line of Schedule "C" (a tax form showing the business' "Sales" (less) "Expenses"), and flows through to the owner's personal income tax return (Form 1040).

Profit is taxed at the owner's personal income tax rate.

Losses offset other income shown on the owner's personal income tax return (Form 1040) such as: interest, dividends, W-2 wages, other business income, short-term capital gains, net rental income, and farm income.

Note: Although your expectation is that your business will generate a profit, it' s nice to know that if your business does generate a loss (hopefully just a paper tax loss, and not an actual out-of-pocket dollar loss), this loss can be used to reduce other taxable income.

3. Whenever the sole proprietorship generates a profit, the owner is liable for "Self-Employment" Tax (at 15.3% of all Sole Proprietorship profit up to $61,200, and 2.95% on all profit in excess of $61,200). Self Employment Tax due is calculated on Schedule "SE".

Note: It's this liability for Self-Employment Tax that represents the major tax disadvantage for the Sole Proprietorship form of business organization.

4. The owner pays himself or herself by writing a "Draw" check out of the business' checking account.

Note 1: Since the Sole Proprietorship is prohibited from paying the owner W-2 wages, the only way the owner can be compensated is by receiving a Draw Check.

Note 2: This draw check is a "Non-taxable Event"--meaning that whether or not the owner receives a draw check, the owner will still be liable for taxes due on the entire profit of the Sole Proprietorship, even if the profit dollars are kept in the business' checking account. As a sole proprietor "you are the business and the business is you." Transfers of cash from the "business" to your personal funds are similar to moving dollars from your right pocket to your left pocket.

5. Although the owner cannot be paid W-2 wages by the Sole Proprietorship, the owner can have the

business pay his or her spouse W-2 wages, if the spouse is active in the business.

Note 1: These W-2 wages are subject to Social Security (FICA) and Federal Income Tax Withholding plus the Employer' s matching portion of the Social Security (FICA) tax due.

Note 2: This only applies when both spouses actively work in the business, and it's a sole proprietorship.

If you are "married filing jointly," put the business in the name of the spouse who is the *highest* wage earner. This spouse is more likely to "max out" on a portion of Social Security (Self-Employment) taxes.

If you are "married filing separately" you should follow the following guidelines:

If the business is anticipated to make a profit, put the business in the name of the *lowest* wage earner--this spouse may be in a lower tax bracket (for example, 15%, as opposed to 28%).
If the business is anticipated to generate a loss, put the business in the name of the *highest* wage earner--so that this business loss can offset potentially higher tax bracket income (for example, 28%, as opposed to 15%).

PLAN: You May Want to Select an "S" Corporation Form of Business Organization When Your Business is Anticipated to Make a Profit.

1. You can elect to be an "S" Corporation even if your business only has one owner, or, if more than one owner, up to a maximum of 75 shareholders. An "S" Corporation is a separate legal entity where the individual shareholders (owners) elect to be personally responsible for the income taxes due on the pro-rata share of any corporate profits. "S" Corporation shareholders, by making this election, also receive the benefit of any tax losses generated by the corporation--all profits and losses of an "S" Corporation flow through to its owner(s)' personal income tax return(s). (Remember, an "S" Corporation is a separate legal entity, but not a separate taxable entity.) The owner(s)' pro-rata share of the corporate profit or loss is reported on a *Schedule K-1*. If there is only one owner, all profit or loss is shown on only one *Schedule* K-l--theirs.
2. Under this form of organization, corporate business profit or loss is shown at the bottom of "Form 1120-S"--an information only business tax form showing the business' "Sales" (less) "Expenses", and flows through to the owner(s)' personal income tax remms (Form 1040). Just as in the instance of the Sole Proprietorship:

□. Profit is taxed at the owner(s)' personal income tax rate(s).
□. Losses offset their other income shown on the owner(s)' personal income tax return (Form 1040) such as: interest, dividends, W-2 wages, other business income, short-term capital gains, net rental income, and farm income.

Note: The goal is that your business, even initially, will not actually lose money but will at worst, experience "Paper Losses" that are created by non-cash business expenses (such as vehicle mileage, depreciation, and Section "179" asset expensing).

3. **The big distinguishing tax advantage of an "S" Corporation** (over a Sole Proprietorship) is that

"S" Corporation profits (after shareholder(s)' salaries) **are exempt from self-employment** taxes. The profit of an "S" Corporation is considered a Return on Investment (ROI) to its owner(s), not earned income, and therefore is not subject to Self-Employment tax.

4. The owner(s) can compensate themselves in two distinct ways: (a) W-2 Wages, and/or (b) Distribution of Profit.

a. W-2 Wages: Any owner(s) of an "S" Corporation, and/or their respective spouse(s) can receive W-2 wages from the business; in fact, any owner(s) who actively work in the business are obliged to pay themselves W-2 wages for the fair market value of the work they perform for the business. This amount can be estimated by paying the owner(s) an amount that the business would have to pay someone else to do the task(s) the owner(s) performs for the business.

Note: These W-2 wages are subject to Social Security (FICA) and Federal Income Tax withholding, plus the employer's matching portion of Social Security Tax (FICA).

b. Distribution of Profit: Owner(s) can also compensate themselves by issuing Distribution of Profit check(s), made payable to the owner(s), written out of the business' checking account.

Note: This Distribution check(s) is considered a "Non Taxable Event"--meaning that whether or not the owner(s) receives a Distribution of Profit check, the owner(sO will be liable for taxes due on each owner(s)' pro-rata share of the entire profit of the "S" Corporation--even if the profit dollars are kept in the business' checking account.

All corporations are "C" Corporations initially. You, as the owner, must file an IRS Form 2553 electing to have your business become an "S" Corporation.

Note 1: Your business is not allowed to become an "S" Corporation if it has more than 35 stockholders, who are U.S. citizens,

and

Note 2: This Form 2553 must be filed within 2 months and 15 days of either:

(1) the date of incorporation, or

(2) the beginning of the corporation's current fiscal tax year.

PLAN: Select a "C" Corporation Form of Business Organization When You Have Both a Strong Desire and Opportunity to "Grow" the Business (Increase Sales) by Keeping Dollars in the Business, and are Liable for Higher Personal Income Tax Rates as the Business' Owner(s).

1. Any number (one or more) of individuals can be the owner(s) of a "C" Corporation. The owner(s) can take compensation out of a "C" Corporation in the form of W-2 wages, paid to themselves and/or their spouse.
2. Owners may wish to keep the dollars of profit in the business to "Grow" the business' sales. This type of growth may require additional funding, particularly in one or more of the following areas: cash flow reserves, accounts receivables, inventory, and equipment. Dollars that are kept in a "C" Corporation are taxed at "C" (regular) Corporation rates.