

Outline of Considerations in Starting a New Business





At Lewis & Knopf we have over 40 years of working with various new business start-ups. From this, we have compiled the attached “Outline of Considerations in Starting a New Business”.

We find that the most common reasons for new businesses failing are:

- 1) Having inadequate capital
- 2) Poor planning and
- 3) Being unaware of federal, state and local tax requirements.

Sometimes this is a result of not knowing the questions to ask or the procedures to follow in starting a new business. Because we, at Lewis & Knopf, work with many different businesses in various stages of growth, we know what works and what does not. Running a business successfully is a tall order. It takes knowledge, skill, hard work and more than a little luck.

It is our hope that the “Outline of Considerations in Starting a New Business” will provide you with some of the questions to ask and procedures to follow to get your new business off to the right start. Our experienced professionals are available to assist you.

LEWIS & KNOPF, P.C.
CERTIFIED PUBLIC ACCOUNTANTS



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Developing a Business Plan

Every business should have a business plan, which is a projection of the expected future performance of the business and how this will be achieved.

I. Study and Evaluate the Market

- A. Sales potential
- B. Labor availability
- C. Labor union strength in the area
- D. Location availability
- E. Environmental and toxic waste consideration

II. Establish a financial plan (a projection of where you are headed in the next 5 years)

- A. Prepare an income and expense forecast in conjunction with cash flow requirements.
 - 1. Financial model considerations
 - a. Identify which expenses are a function of sales
 - b. Identify which expenses have no identifiable relationship to sales
 - c. Identify which expenses are a function of other variables
 - d. Keep the financial model as simple as possible
 - e. Allow the model to be influenced by external variables (i.e. industry statistics, local economic indicators, etc.)
 - f. Use realistic assumptions based on company's operational plan
 - g. Consider preparing forecasts at various volume levels
 - h. Consider alternatives to react to situations that may arise, either favorable or unfavorable
 - i. Consider needs for expansion if necessary

III. Establish an Operational Plan

- A. Define your company's goals as to profits, growth, share of market, and time allowances to achieve goals
- B. Decide on personnel requirements including the quality, training, and quantity needed
- C. Decide on an accounting system format while being sure to establish a system with good internal control yet being functional enough to allow extraction of timely financial data needed to properly manage the company
- D. Establish objectives for all personnel (fix responsibilities)
- E. Establish job descriptions for all personnel
- F. All goals, policies and objectives should be in writing to allow management to control and achieve their overall plan
- G. The business plan should be updated periodically to keep in line with current performance of the business

- IV. Common Causes of Failure
- A. Inadequate accounting system
 - B. Poor location
 - C. Lack of marketing skills

 - D. Lack of capital budgeting
 - E. Lack of management skills or tools
 - F. Excessive inventory
 - G. Fraud
 - H. Disaster

Evaluating the Five Entity Choices

A business can operate as one of five different entities. When deciding which entity to use, a business owner must weigh the advantages and the disadvantages.

- I. Sole Proprietorship
- A. Easiest form to operate
 - B. Saves both legal fees and accounting fees for organizational documents and for tax return preparation
 - C. Tax credits and other special tax items retain their character on the owner's return
 - D. Certain fringe benefits available to corporate shareholder-employees are not available to sole proprietors
 - 1. Not eligible for group term life insurance
 - 2. Limitation on deductible medical insurance payments
 - E. Transfer of partial ownership ordinarily requires a change in business form
 - F. Minor children of the sole proprietor do not qualify for Social Security coverage
 - G. A sole proprietorship seems most appropriate for small, individual undertakings which will not have significant capital requirements

II. Partnership

- A. Must involve two or more entities
- B. Tax credits and other special tax items retain their character on the partner's personal return
- C. Retains most of the tax characteristics of a sole proprietorship
- D. Ordinarily the form of entity chosen when a group of people join together to participate in a business activity
- E. Has a great deal of flexibility in allocation of income and losses, however, allocations must have economic substance
- F. May file Form 1128 requesting permission to adopt a tax year other than a calendar year (Rev. Proc. 72-51)
- G. Partnership income is only taxed at the individual level
- H. Eliminates the possibility of personal holding company (Section 541) taxes or the tax on unreasonable accumulation of earnings (Section 531)

III. Limited Liability Company

- A. Limits owners liability on company debts and obligations
- B. Owners are called members
- C. Requires Articles of Organization
- D. No restrictions as to who can be owners
- E. Must involve 1 or more members
- F. Retains the same tax characteristics as a partnership
- G. May not use the cash method of accounting if a C corporation is one of its members
- H. May be taxed as single member LLC – Sole proprietorship or
- I. May be taxed as a partnership, C corporation or S corporation

IV. Corporation

- A. Limited liability
- B. Ownership interests are easily transferred
- C. Conventional organizational hierarchy
- D. Owners may remain anonymous
- E. Most attractive deferred compensation plans available
- F. Stockholder-employees may participate in group benefits
- G. Low income tax rates
- H. May adopt a fiscal tax year for more advantageous tax planning
- I. Organizational costs are higher
- J. Taxation at the corporate level and stockholder level (double taxation)
- K. Passive income may result in personal holding company taxes
- L. Excessive accumulated earnings may result in Section 531 taxes
- M. Tax credits and other special character items do not flow through to the stockholders
- N. Must pay state annual report fee
- O. Losses provide no tax benefit to the shareholders unless the stock qualifies under Section 1244
- P. A corporation may elect to be treated as an S Chapter Corporation

V. S Chapter Corporation

- A. Limited liability
- B. Ownership interests are easily transferred
- C. Conventional organizational hierarchy
- D. Owners may remain anonymous
- E. Profits and losses are taxed at individual level with losses limited to stockholder's "at risk" basis
- F. Tax credits and other special tax items flow through to the stockholders
- G. Must be on a calendar year with very few exceptions
- H. Organizational costs are higher
- I. Passive income may result in S Chapter Election being revoked
- J. Stockholder-employees may participate in group benefits subject to limitation
- K. Must pay state annual report fee
- L. Requires an additional timely filed election on Form 2553

Forming a Business Entity

Once you have decided which one of the five entities to use, the following documents should be completed and filed:

A. Sole Proprietorship

- 1. Certificate of Persons Conducting Business Under Assumed Name
- 2. SS-4 Application for Employer Identification Number
- 3. C-3400 Michigan Application for Registration for Sales, Use, Income and Single Business Taxes
- 4. MESC 1009 Registration Report to Determine Liability
- 5. Specific Industry Taxes and Licenses Applications

B. Partnership and Limited Liability Company

- 1. Certificate of Persons Conducting Business Under Assumed Name
- 2. SS-4 Application for Employer Identification Number
- 3. C-3400 Michigan Application for Registration for Sales, Use, Income and Single Business Taxes
- 4. MESC 1009 Registration Report to Determine Liability
- 5. Specific Industry Taxes and Licenses Applications
- 6. Partnership Agreement



C. Corporation

1. Certificate of Persons Conducting Business Under Assumed Name
2. SS-4 Application for Employer Identification Number
3. C-3400 Michigan Application for Registration for Sales, Use, Income and Single Business Taxes
4. MESC 1009 Registration Report to Determine Liability
5. Specific Industry Taxes and Licenses Applications
6. Articles of Incorporation
7. Application of Reservation of Corporation Name
8. Share Certificates
9. Corporate By-Laws
10. Organizational Minutes of Incorporators
11. Minutes of First Meeting
12. Section 1244 Stock Election (optional)

D. S Chapter Corporation

The same documents as listed above (Item C, 1-12) for Corporation should be filed in addition to:

1. Form 2553 Election by Small Business Corporation

The business owner must also consider:

A. Insurance

- | | |
|-------------------------|-----------------------|
| 1. Workers Compensation | 5. Life |
| 2. Package Liability | 6. Disability |
| 3. Umbrella | 7. Bond |
| 4. Fleet | 8. Health and Welfare |

B. Financial Planning

1. Income and Expense Budget
2. Cash Flow Projection
3. Financial and Operational Policies

Accounting

I. Accounting Method

There are two general types of accounting methods that businesses may adopt.

A. Cash Method

Money received for services and expenses paid during the accounting period are used to measure net income or loss.

B. Accrual Method

Income earned and expenses incurred during the accounting period are used to measure net income or loss.

II. Accounting Records

Maintenance of clear, concise and timely accounting records is a necessity for any successful business.

A. Journals of Original Entry (The first step in recording a business transaction)

- Sales Journal
- Cash Receipts Journal
- Check Register
- Accounts Payable/Purchases Journal
- Payroll Journal
- General Journal

B. General Ledger

Summarizes information from journals of original entry in account order:

- Assets
- Liabilities
- Equity
- Income
- Expense

C. Subsidiary Ledgers

Supports detail from journals of original entry:

- Accounts Receivable
- Accounts Payable
- Plant and Equipment



D. Financial Statements

Present information from the General Ledger in a basic format consisting of:

- Balance Sheet
- Income Statement
- Statement of Retained Earnings or Equity
- Statement of Cash Flows

These enable the business owner to compare performance between periods.

III. Accounting Systems

An accounting system may be maintained by using:

- (1) A Manual System or
- (2) A Standard Pegboard/One-Write System or
- (3) Computer System Utilizing
 - Standard Software
 - Customized Software

Tax Return Requirements

A business must report to federal, state and possibly local governments. The two most common taxes paid by a business are the payroll taxes withheld from employees and income taxes paid by the business.

I. Payroll Taxes

All entities with employees must file the following forms:

A. Form 941

Employers Quarterly Federal Tax Return Payroll tax deposits must be made at various times during the quarter depending on the undeposited liability. Please refer to the instructions for Form 941 to obtain the deposit requirements. Form 941 is due on the last day of the month after the end of the quarter.

B. Forms W3 and W2

Each employee must be given an individual W2 by January 31 following the close of the calendar year. The total of the W2's issued is stated in summary form, on Form W3, which is due at the Social Security Administration by February 28 following the close of the calendar year.

C. Form MESC 1020

Employers Quarterly Contribution Report, and Form MESC 1017 Employer's Wage Detail Report for Michigan unemployment must be received by the Michigan Employment Security Commission by the 25th day of the month after the end of the quarter.

D. Form 940

Employers Annual Federal Unemployment Tax Return Deposits must be made quarterly if the undeposited liability is \$100 or more. The annual Form 940 is due on the following January 31 after the close of the calendar year.

E. City Withholding

Must be filed monthly or quarterly depending on the amount of the liability. An annual reconciliation, city W3, must be filed by the following January 31 after the close of the calendar year.

F. Form C-3200 Michigan Withholding

Must be filed monthly, quarterly or annually depending on the amount of the liability. An annual reconciliation return is due by February 28 following the close of the calendar year.

II. Income Taxes

Each of the four operating entities must file a different income tax return with federal, state and city governments (if applicable).

A. Sole Proprietorship

1. Form 1040 U. S. Individual Income Tax Return including Schedule C – Profit or Loss From Business or Profession
2. Form MI 1040 Michigan Individual Income Tax Return
3. Form C-8000 Single Business Tax Annual Return
4. City Individual Income Tax Return (where applicable)
5. Specific Industry Taxes and Returns

B. Partnership

1. Form 1065 U.S. Partnership Return of Income
2. Form C-8000 Single Business Tax Annual Return
3. City Partnership Return of Income (where applicable)
4. Specific Industry Taxes and Returns

C. Corporation

1. Form 1120 U.S. Corporation Income Tax Return
2. Form C-8000 Single Business Tax Annual Return
3. City Corporation Income Tax Return (where applicable)
4. Specific Industry Taxes and Returns

D. S Chapter Corporation

1. Form 1120S U.S. Income Tax Return for an S Corporation
2. Form C-8000 Single Business Tax Annual Return
3. City Corporation Income Tax Return (where applicable)
4. Specific Industry Taxes and Returns



III. Other Taxes

A. Corporations (including S Chapter)

1. Form C & S 2500 Michigan Annual Report

B. All Entities

1. Form C-3200 Sales and Use Tax Return – The publication “Business Guide to Understanding Michigan’s Sales and Use Taxes” is available from the Michigan Department of Treasury.

Personnel

Hiring and retaining the best-qualified and most productive personnel is crucial to the success of every business.

I. Hiring

For each employee the following documents should be maintained:

- A. Employment Applications
- B. Federal, State and Local Withholding Tax Authorization (W-4)
- C. Immigration Department Form (I-9)
- D. Employee Personnel File
- E. Employee Earnings Records
- F. “COBRA” Notification (If Required)
- G. Benefit Plans (If Applicable)

II. Administration of Personnel

- A. Personnel manual; a written copy of company policies and procedures should be given to each employee
- B. Performance evaluations should be conducted periodically to review employee performance
- C. Disciplinary Actions
- D. Promotion
- E. Termination



III. Do's and Don'ts in the Hiring Process

The process of selecting the best-qualified applicant for any position should begin long before you interview anyone.

First of all, you need to know specifically what job duties your new staff member will perform and what skills are needed to do these tasks. You are risking future problems if you hire anyone simply because there appears to be a surplus of work for your current staff or you're replacing without having a clear understanding of his/her job duties. Take the time to outline clearly what is to be expected of a new employee.

Once such an outline is complete, then it's a simple matter to formulate questions to be asked during an interview. Any question related to a candidate's ability to perform specific tasks is not illegal.

However, a word of caution. Be cautious that in framing a question you don't exclude creative answers or require answers that might tend to eliminate more women and minorities from consideration. For instance, if there is a need to fill a job vacancy in which the employee occasionally is required to handle bags weighing up to 50 pounds, the answer to the question "How would you (the applicant) handle moving material weighing up to 50 pounds when no fork-lift was available?" would give you a better indication of an employee's initiative than would the question "Can you handle material weighing up to 50 pounds?" Since the employer's goal is to select the applicant who is the most capable, questions should be asked in such a manner that "test" his/her ability to adapt to new and novel situations.

Any question which would elicit information about a person's ethnic background, race, marital status, age (other than if a candidate is over 18 years of age), religion, or height and weight is illegal. Women applicants can't be asked about their child care arrangements, although all candidates can be asked about their attendance histories. All applicants can be asked if they have any physical limitations which would prohibit them from doing the available work.

Your application form also should be free of questions which would provide you with any information about an applicant's race, sex, national origin, religion, age (other than the above exception), height, weight, marital status, or handicap. The best applications request only information on the applicant's education, previous employment and references.

Pre-employment drug tests may be used to screen applicants. It is legal to cite current drug use as a reason for not hiring. If an applicant has successfully been treated for a previous substance abuse problem, however, it is illegal to use their past record to turn them down. An employer may not use the possibility of a future problem to determine who to hire. Alcoholics and other drug addicts are sometimes considered handicapped and may not be discriminated against.

By following the above minimal requirements, most employers will avoid the more obvious violations of civil rights laws. However, if you need additional information or have any questions, please call the Flint office of the Michigan Department of Civil Rights for assistance.



IV. Minimum Wage

New amendments to the Fair Labor Standards Act increased minimum wage on July 24, 2009 to \$7.25 per hour. Overtime and child labor provisions apply. (Contact the Department of Labor Wage and Hour Division for additional information.)

V. Independent Contractors

Independent contractors are in business for themselves, performing services rather than selling goods. They are not eligible for any employee benefits, and an employer does not have to pay any payroll taxes or worker's compensation insurance on their behalf. The key factor that determines whether a worker is an independent contractor is WHO HAS THE RIGHT TO CONTROL THE WORKER AS TO HOW WORK IS ACCOMPLISHED. A business must file a Form 1099 and accompanying 1096 for each independent contractor paid \$600 or more within a calendar year. SEVERE PENALTIES MAY BE LEVIED IF AN INDIVIDUAL IS MISCLASSIFIED AS AN INDEPENDENT CONTRACTOR.

Risk Management

Some types of insurance coverage are required by law. Others are required by necessity to prevent the destruction of your business in the event of a catastrophic claim.

I. Standard business insurance coverage consists of:

Commercial Liability
Commercial Property
Workers' Compensation
Commercial Auto

II. Additional optional coverage may be purchased such as:

Inland Marine	Goods in Transit
Business Interruption	Product Liability
Commercial Umbrella	Disability Insurance
Commercial Crime	Life Insurance –
Errors and Omissions	Key Man, Group Term, Split Dollar
Labor Reimbursement	

III. Risk management also includes loss control programs that minimize the severity and frequency of losses. This will help control insurance costs. A professional insurance and risk management firm will provide guidance in this area. Regardless of the form of business entity, adequate insurance coverage should be maintained for all risks.

Office Organization

An efficiently run office leads to an efficient and successful business.

I. Furnishings and Equipment

A business owner must consider whether to lease or purchase.

- Furniture
- Copier
- File Cabinets
- Typewriter
- Computer
- Calculators

II. Forms and Supplies

Standard or customized forms may be obtained from local office supply stores or print shops.

You should include:

- Sales Invoices
- Checks
- Purchase orders
- Stationery and Envelopes
- Filing Supplies/System

III. Delegation and separation of duties enables efficient operation and safeguarding of assets.

Areas to include would be:

- Sales
- Purchasing
- Accounting



INSERT RECORDS RETENTION, PAGE 16



Summary of Items to be Completed in Connection with Formation of Corporation

- I. Corporation Documents Prepared by Attorney, Where Applicable
 - A. Preparation and filing of Articles of Incorporation
 - B. Execution of building lease
 - C. Preparation of miscellaneous agreements relative to incorporation, including the following:
 - 1. Employment agreements
 - 2. Stock buy/sell agreement
 - D. Preparation of Bill of Sale and Promissory Note, if necessary, transferring assets and/or funds to corporation (Form 8594)
 - E. Preparation of corporate minute book:
 - 1. Minutes of Meeting of Incorporator
 - 2. Waiver of Notice of First Meeting of Board of Directors
 - 3. Minutes of First Meeting of Board of Directors
 - 4. Section 1244 Plan

- II. Services to be Provided by Accountant
 - A. Application for Employer Identification Number
 - B. Preparation of Sub-Chapter S election, if adopted
 - C. Determination of value of assets to be transferred to corporation, if any
 - D. Application for Michigan Employment Security Commission number
 - E. Preparation of Application for Registration with State of Michigan
 - F. Compliance with Michigan Income Tax Act
 - G. Compliance with Michigan Single Business Tax Act
 - H. Preparation of Michigan Annual Report annually

III. Responsibilities of Corporate Officers

- A. Open and maintain bank account in corporate name
- B. Order new check deposit stamps to show business is now corporation
- C. All printing should bear the corporate name
- D. All invoices should bear the corporate name
- E. Change listing in telephone directory to corporate name
- F. Signs (inside and outside) should be changed to show corporate name
- G. All contracts and agreements should be in name of corporation
- H. Liability insurance, Errors and Omissions insurance, if adopted, should cover both corporation and individuals
- I. All other insurance policies, including fire, public liability, Worker's Compensation insurance and all employees, including shareholder employees, if any, should be assigned to or issued in the name of the corporation.
- J. List utilities in name of corporation, if required under lease
- K. Transfer all business charge cards from individual to corporation
- L. Miscellaneous (where applicable)
 1. Acquire Food Service License, if applicable
 2. Acquire Federal Retail Liquor Stamp, if applicable
 3. Contact local Health Department, if applicable
 4. Acquire local business license, if applicable

IV. General Comment

The corporation is to be managed by the Board of Directors and its officers. All information required to keep minutes up to date should be furnished to attorney for corporation. The minutes must be prepared annually, which will include minutes of annual meeting of shareholder and minutes of annual meeting of Board of Directors, as well as minutes of special meetings of shareholders or special meetings of Board of Directors.

As part of the normal process associated with forming a corporation, certain steps should be taken.

1. Insurance

Notify your insurance companies that you have formed a corporation. Examples of such insurance companies include, but may not be limited to, the following: Workers' compensation, general public liability; and fire, property and office contents insurance.

2. Telephone

Telephone service should be listed in the name of the corporation. Accordingly, please contact your telephone company representative and indicate that the telephone service should now be listed in the name of the corporation.

3. Associations

All societies and associations to which you belong should be notified that you have formed a corporation.

4. Credit Cards

Credit cards should now be issued in the name of the corporation and should be used for all corporate purposes which include, but may not be limited to, the following: Travel and entertainment; acquisition of supplies and equipment; and payment of miscellaneous expenses normally associated with corporate purposes.

5. Personal Expenses

If at any time you personally expend any sum or sums for the benefit of the corporation, it is suggested that you issue a check to yourself for any such expenses incurred. For example, if you make a payment for, or on behalf of the corporation, you may merely deliver the receipt to the corporation and, in exchange, receive a check as payment in full for same. You are, however, requested to confer with your accountant regarding specific procedures to be used.

6. Stationery

All letterheads, envelopes, receipt forms and other paper supplies should be ordered in the name of the corporation or any assumed name adopted by the corporation.

7. Bank Accounts

A. Checking

It will be necessary for you to open a checking account for the corporation. Depending upon the preference of your accountant, you may wish to open two accounts. Specifically, one checking account may be used for the general income and expenses of the corporation, and the other checking account shall be for employment expenses.

B. Savings/Money Market Accounts

You may wish to open a savings or money market account, which shall be the depository of funds in excess of the working capital need of the corporation.

8. Checks

When you open your checking account, please be certain to order checks that have been approved by your accountant. In this regard, you may wish to special order a specific form of check, which will provide a space for a memorandum of the payment or space for wages and taxes withheld, etc.

9. Bookkeeping

Please confer with your accountant as to the specific form of bookkeeping procedure to be used.

10. Assets

If you have not already done so, prepare a list of all assets which shall be transferred by you to the corporation.



11. Motor Vehicle

Subject to the preference of your accountant, you may wish to either transfer your automobile to the corporation or have the corporation reimburse you for your use of the vehicle for and on behalf of the corporation.

12. Miscellaneous Insurance

You should review your present insurance coverage with your insurance representative. Specifically, you should review your life insurance, disability insurance, health insurance and accident insurance.

13. Shareholder Meetings

Shareholders control the policies of the corporation through their power to vote for directors and to vote for other corporate changes. At least once each year the corporation should provide a financial report of the corporation for the preceding fiscal year. The corporation's activities and financial report should be presented at the annual meeting of the shareholder(s) at which time there would be an election of the Board of Directors.

14. Director Meetings

The Board of Directors is charged with the duty and responsibility of managing the business and affairs of the corporation, determining corporate policies and selecting officers and agents who carry on the day-to-day operations of the corporation.

15. Michigan Annual Report

It is the duty of each corporation to file an annual report with the Michigan Department of Commerce – Corporation Division. The report must be filed no later than May 15 of each year. Failure to file the report timely will result in penalties being imposed and, further, may result in termination of the corporation.

16. Maintenance of Corporate Minute Book

Each corporation must keep minutes of proceedings of its shareholders' and directors' meetings. Your attorney will usually maintain the corporate minute book.