

# **Selecting The Proper Organizational Structure: What Am I Going To Be When I Grow Up?**

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# **Selecting The Proper Organizational Structure: What Am I Going To Be When I Grow Up?**

## **Abstract**

A number of decisions confront entrepreneurs during the early stages of their venture's life cycle. These decisions or lack thereof, made at the onset and during the early stages of the business' life cycle, have a major impact on the eventual survival and growth of the business. This article illustrates how key management decisions, specifically focusing on the selection of the organizational structure (i.e. S versus C Corporation), can impact the survival and growth of the entrepreneurial venture. A matrix with both advantages and disadvantages is developed to help entrepreneurs determine the proper organizational structure for their business venture.

## **Introduction**

A number of decisions confront entrepreneurs during the early stages of their venture's life cycle. These decisions, or lack thereof, made at the onset of the business and during the early stages of the business' life cycle have a major impact on the survival, growth and eventually the succession issues for the business. This article serves to illustrate how key management decisions, specifically focusing on the selection of the organizational structure (i.e. S versus C Corporation), can impact the survival and growth of the entrepreneurial venture.

One of the most important decisions entrepreneurs need to make during the start-up phase of their business is "What is the correct structure for my business?" Currently, there are five different structures that can be used: Sole Proprietorship, Partnership, C Corporation, S Corporation and Limited Liability Co. Since each structure has advantages and disadvantages for both the business and the business owners, it is important, when making the decision, to consider the tax and financial ramifications, as well as the entrepreneur's long-term goals and objectives.

The entrepreneur's initial decision as to the structure of the business may have long-term ramifications for the growth and future survival of the business. Based on the short-term needs of the business, an entrepreneur may choose one type of organizational structure with the intent to change the structure as the business grows. In some cases, the transfer from one entity to another can cause unexpected tax liabilities, as can choosing the wrong organizational structure from the start (Lauzen, 1985). Therefore, the ideal situation is to have a clear understanding of the nature of each type of entity and to plan the structure to fit both the short and long term goals of the entrepreneur and the business.

This article begins with a review of the literature, specifically as it relates to the importance of small business to the U.S. workforce and gross national product. We will then show the importance of planning for the survival and continued growth of a small business, specifically as it relates to the entrepreneur's management and organization during the initial phase of the business. Next, we describe a matrix that includes the tax, financial and management issues pertaining to each organizational structure. In addition, a table is included that illustrates the advantages and disadvantages of each organizational structure. The matrix and the table can be useful tools for

entrepreneurs to become more knowledgeable and aware of the tax, financial and management issues that need to be considered when starting their business. In the final section three case studies are presented to demonstrate the problems that occurred when entrepreneurs made wrong decisions in the initial phase of organizing their business.

Unfortunately, there is no “one” right answer when determining the organizational structure to use when starting a business. Consequently, individualized planning must be done for each new business to determine the type of entity that will best meet both the entrepreneur’s and the business’ short and long term needs. As consultants, we have seen many businesses incur unnecessary expense because entrepreneurs did not understand the importance that making the “right” decision initially will have on the future of the business.

## **Literature Review**

According to the IRS's data, there are 22 million small businesses in the United States (Lader and Glover, 1996). The U.S. Small Business Administration (SBA) reports that small businesses, including the self-employed, account for 58 percent of the U.S. workforce and 40 percent of the gross national product (Lader and Glover, 1996). In addition, data from the U.S. Small Business Administrations' Office of Advocacy indicates that 98% of all businesses operating in the United States are small business (Lader and Glover, 1996). David Birch’s research also suggest that all new net U.S. jobs for the period 1976-1984 were created by small businesses (Birch, 1987).

With the large impact that small business has on our economy, it is unfortunate that a large number of small businesses do not survive. According to Dun & Bradstreet, an average of 62,000 businesses failed each year between 1989-1994 (Dun & Bradstreet, 1994). Researchers continue to search for factors that affect the success of an entrepreneurial business. In an annual survey conducted by Dun & Bradstreet, almost 90% of all small business closings are directly related to improper managerial functions (Dun & Bradstreet, 1994).

The empirical literature regarding variables affecting small business success can be categorized into two main groupings: external and internal variables. The external variables are government regulations, taxes and the economy, while the internal variables can be classified into two major sub groupings: (1) management functions (i.e., planning, organizing, etc.) and (2) the functional areas of management (i.e., marketing, finance and accounting). Most entrepreneurial failures are caused by the owners' incompetence or lack of expertise in the functional areas of management function and a lack of application of management functions, rather than as a result of external variable. (Kuehl and Lambing, 1987; Harmon, 1979; Peterson et. al., 1983; Hodgetts and Kuratko, 1986).

### **Planning**

Students of the London Business School identified, through their research, the management factors of operations, accounting and marketing/sales as the most prevalent factors contributing to business failures (Accountancy, 1987). Improper or lack of management expertise manifests itself in many ways, including problems with inventory controls, taxes, cash flow, finances, marketing and pricing structures (Kuehl and Lambing, 1987).

A number of researchers have shown that the lack of long-term business planning, especially in the business' first three to five years, has been one of the major causes associated with business failures (Arlow & Ackelsberg, 1991; King, 1985; Lauzen, 1985). For example, a survey of more than 1,000 small businesses found that a lack of management expertise caused business failure; the greatest need for management assistance was in long-term business planning (Peterson, 1984). Lailinen also studied ten small businesses that had failed in an attempt to understand the reasons for their failure. He found that lack of an initial business plan and attention to the selection of the proper organization structure were given as reasons for entrepreneurs' failure (1992).

Therefore, the research supports that key management functions, such as proper planing and organizing, can differentiate successful from unsuccessful entrepreneurial ventures. Table 1 illustrates the differences in the entrepreneurs' principle approach to managing their business. The chart is differentiated based on successful versus unsuccessful small businesses.

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**Insert Table 1 Here**

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Without the proper business planning, problems such as inadequate record keeping, unexpected expenditures and under capitalization become associated with small business failures (Posch, 1986). One of the first steps in the initial business plan is for the entrepreneur to choose the organizational form that will suit the objectives of the business and himself. The selection of the organizational structure will then determine the proper accounting method to be used, which will in turn provide the basis for organizing the business' financial data and management decisions in the future (Dalton, 1985).

## **Selecting The Proper Organizational Structure**

Before an organizational structure is chosen, entrepreneurs must consider the start-up cost, projected operating profits/losses (short/long term), the owner(s)' personal income tax rates, accounting period options, succession plans, management objectives, legal issues, financing needs, and fringe/retirement plans. Then it is possible to determine the best structure for the business.

### **Matrix**

A matrix (Table 2) was designed through an in-depth review of the five types of organizational structures to help entrepreneurs understand the differences between the various organizational structures (Brynaraski, 1992; Finn, 1994; Ganswindt, 1987; Horwood, 1994; Marino, 1994; Means and Coats, 1994; Tousey, 1991; TMI Tax Services 1994). The matrix is designed so an entrepreneur can compare the differences between the five types of structures within the categories of tax, insurance, pension planning, legal liability, financing and management issues. Following the matrix, table 3 includes a summary of the advantages and disadvantages for each type of structure.

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**Insert Table 2 Here**

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**Insert Table 3 Here**

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Since the personal income tax rates have decreased, a number of businesses are considering changing from a C Corporation to a S Corporation (Marino, 1994) In addition, other businesses are considering changing from a C Corporation to a Limited Liability Company (Brenman, 1994). However when changes are made in the organizational structure, the resulting tax consequences should be carefully considered. For example, when a business transfers from a C Corporation to a Limited Liability Company, it is considered a liquidation to the shareholder and unrealized gains are taxable to the individual and the corporation. Therefore, unique consequences occur within each structure and should be taken into consideration before changes are made.

In order to demonstrate some of the problems that can transpire when improper decisions are made at the start-up phase of the business, three real life cases are presented. In each of the cases, the entrepreneurs suffered financial losses due to their poor decisions.

## **Case Studies**

### **Case 1**

The first case study involves a small retail operation that began as a sole proprietorship. The golf pro shop provides services, rents carts and sells retail merchandise. With only a handful of employees, the sole proprietor has successfully managed the business for a number of years and kept the accounting and legal fees to a minimum. Due to the business' inventory, the owner, a sole proprietor, was required to file his business' tax return on an accrual basis. As a result of the filing requirements and increasing cost of inventory and equipment, the sole proprietor has not been able to withdraw all of the taxable profits from the business. Therefore, some of the business profits were retained in the business. Although the owner was forced to pay taxes on money that he left in the business, he was satisfied with the sole proprietorship because of its' freedom and simplicity.

Problems started when the entrepreneur decided to bring his son into the business and could therefore no longer remain a sole proprietor. After examining the various organizational structures that allow two owners, the entrepreneur decided to transfer his business to an S Corporation through a tax-free exchange. In order for the transaction to qualify for a tax-free exchange, all of the assets of the sole proprietorship had to be transferred into the S Corporation and the sole proprietor had to maintain 100% of the stock ownership. In order for the father and son to be equal owners, the father then had to gift his son 50% of his stock.

On the surface, the transaction appeared to solve the problem. But, since the assets had been taxed at the sole proprietorship level before the tax-free exchange, the transfer caused a considerable

amount of the father's assets to be tied up in the C Corporation. In addition, the value of the stock was inflated which used up more of the father's estate and gift tax exclusion when he gave 50% of the stock to his son. If the entrepreneur had used bank financing for the growth of the business, rather than the profits of the business, he could have prevented locking in a considerable amount of the entrepreneur's after-tax dollars in the new corporation. In addition, there would have been far less value in the stock that was gifted to the entrepreneur's son.

In retrospect, if the business had started as a S Corporation, rather than a sole proprietor, there would have been several advantages. First, when the father brought the son in the business, he could have easily began distributing a small amount of stock to him each year. Therefore, he would not have depleted his estate and gift tax deduction. Second, the entrepreneur could have continued to retain the business' profits until such time as he was ready to distribute it.

On the other hand, if the entrepreneur had initially chosen a C Corporation, his overall tax (both corporate and personal) would have been less. As explained previously, the entrepreneur changed the organization to an S Corporation, rather than a C Corporation, at the time that his son came into the business. Unfortunately, that decision created a number of negative ramifications. For example in order to enlarge the business, the son increased the inventory and capital equipment.. He used the profits from the business to fund the capital expenditures. So therefore all of the retained profits, which were used to increase the business, were taxed at the two shareholders' tax bracket (34%). Unfortunately there were two problems that resulted from the son's expansion decision and the father's decision to be an S Corporation. First, the shareholders' tax bracket was considerably higher than the C Corporation's tax bracket (15%). Second, the father was upset because he was not only reducing his income in order to bring his son into the business and for the expansion requirements, but he was also incurring additional tax liabilities.

In reviewing the second case study, it became apparent that the decision made by the founder when he began his business created, at the time he was ready to transfer the business to his son, financial difficulties. The entrepreneur might have rectified his initial decision, to be a sole proprietor, if he had chosen to use the bank, rather than his own assets, for financing the capitalization needs of the business. A different financing arrangement would have first helped to reduced the value of the stock for estate and gift tax purposes; and second, it would have prevented a large amount of the entrepreneur's after-tax income from being tied up indefinitely.

In retrospect, it is apparent that proper planning needed to be done to assure that the father would have enough income to cover both the increase expenditure for his son's salary, the new expansion objectives and the increased tax cost. If the problems are not addressed up front, serious issues may emanate that could damage the relationship between the father and son, as well as the business.

## **Case 2**

The second case is a small retail business that also started as a sole proprietor. For the first two years, the entrepreneur borrowed money for the business' operating losses, accounts receivable and

inventory. The sole proprietor's husband is a physician with a high taxable income, so the wife's business losses from the sole proprietorship were used to offset the physician's taxable income.

After two years, the retail business was beginning to show profits. The business owner projected over the next few years that the profits would continue to increase substantially. Consequently, the decision was made that the sole proprietorship would be converted in a tax-free exchange to a C Corporation. The rationale was that all of the business losses had been used to offset the physician's taxable income; and now that the business was profitable, the profits would be retained for future growth. The owner was projecting a substantial profit that would be used for debt reduction and an increase in inventory and accounts receivable. Therefore, it was decided that as a C Corporation, the entrepreneur would be able to take advantage of the lower corporate tax.

The plan was for the business' profits to be retained in the C Corporation for business growth and debt reduction. Therefore, all assets and liabilities were subsequently transferred into the new corporation. Since the entrepreneur borrowed all of the money for the capitalization of the business, the value of the stock at the time of the transfer was minimal. Although the shareholder continued to be personally liable for the business' loans, all of the loans were transferred into the business' name. The plan appeared to be the right decision, since the tax rate for the C Corporation (15%) was substantially less than the individual's tax rate (34%).

Unfortunately, the entrepreneur's profit projections for the next few years were incorrect. Instead of showing profits, the business began losing money. To keep the business going, the shareholder continued to borrow money in the corporation's name, with the shareholder and her husband continuing to be personally liable for the debt. In addition, they loaned money to the business when the bank financing was not available. Because the business was not an S Corporation or a sole proprietorship, the business' losses could no longer be used to offset the physician's taxable income.

The net operating loss of the business was locked into the C Corporation until such time as the business was profitable. After several years, the entrepreneur decided to sell the business. The individual who bought the business purchased the assets and the C Corporation was liquidated. Unfortunately the sale of the business did not result in enough money to pay off all of the business' bank and shareholder loans. The loss to the shareholder was \$50,000. Due to the nature of the loss, all of the tax losses were treated as capital losses, rather than as an ordinary write-off. If the entrepreneur had remained a sole proprietor, the losses would have been treated as ordinary losses.

In retrospect, if the entrepreneur had made a more realistic projection of the business profits, proper planning could have been done. The entrepreneur would have been better off remaining a sole proprietorship to take advantage of the business' losses. At the time of the tax-free transfer, if the bank loans had been treated as paid-in capital, rather than as a debt of the corporation, then the shareholders would have been able to take the tax losses as an ordinary write-off when the corporation liquidated. Unfortunately, the entrepreneur made an unreasonable projection of the business' profits and created costly tax consequences and additional legal and accounting fees.

In reviewing the second case, it is clear that the entrepreneur's unrealistic and inaccurate projections of the profits caused her advisor to suggest an improper business structure. Changing the

structure of the business subsequently increased the cost of operation due to increase in tax cost, legal and accounting fees. Furthermore, the entrepreneur's decision to transfer the sole proprietorship to a C Corporation before she was assured that her projections were realistic caused the individuals to lose money that they will never be able to recapture.

### **Case 3**

The third case involves a MD and a Ph.D. who went into private practice together. The physician is an ear specialist and the Ph. D. is an audiologist. Their objective was to provide their patients with all of the services required to treat ear problems.

Due to the differences in their individual practices, considerable legal and accounting issues were addressed before the two men opened their joint practice. The founders' long range goal was to eventually have five shareholders, four physicians and one Ph.D. After a considerable expenditure in legal and accounting fees (\$60,000), a complex contract was developed and two corporations were formed.

The two founders owned stock in both corporations. One of the corporations was a C Corporation and the other was an S Corporation. The medical practice, which was owned 60% by the physician and 40% by the audiologist, was conducted through the C Corporation. The S Corporation, in which each man owned 50% of the stock, was used to purchase all of the equipment needed for the medical practice. The S Corporation charged rent to the C Corporation for the use of the equipment. Although the two men were operating the medical practice under one entity, each man kept his books separately and overhead costs were allocated based on their individual gross receipts.

After the first year in practice, several problems emerged as a result of their initial decisions. Since the corporation was new and did not have sufficient capital, the bank required the shareholders to be personally liable for the corporation's debts. During the first year, the shareholders borrowed money for capital expenditures and operating expenses, including their salaries. But since the business was initially established as a C Corporation, the business' losses could not be taken on the shareholders' personal return. As a result, they were borrowing money, in which they were liable, and then paying it to themselves as salary. On the one hand, they were paying personal income tax on the money and yet, they were not able to take advantage of the corporate losses. Although the corporate losses could be carried forward, the shareholders were using up their line of credit that was needed for the business' initial start-up phase.

The S Corporation, on the other hand, was showing a taxable profit. The profits were a result of the C Corporation paying rent to the S Corporation based on the amount of the note payment. Since the principal payment of debt was in excess of the allowable depreciation, the S Corporation was showing a taxable profit that would be reflected as taxable income on the shareholders' personal taxes. As result of the two entities' structure, the shareholders were paying taxes on inflated rental income from the S Corporation, while the C Corporation was showing inflated losses that could not, at this time, be written off by the corporation or the shareholders.

To rectify some of the tax problems, the S Corporation needed to restructure the rent based on a fair market rental. The change in rent would reduce the S Corporation's profits and decrease the C Corporation's losses. In addition, the shareholders needed to reduce their salary that prevented them from paying tax on borrowed money. It became clear that the best long-term solution was for the S Corporation to be merged with the C Corporation. The consequences of their initial decision cost the shareholders a considerable amount of money in unnecessary administration and legal fees.

Unfortunately the merger did not solve all of their managerial problems. A year and a half later, another problem occurred. The physician wanted to hire another physician and offer him an option to purchase stock. Based on the current structure, the physician (who owned 60% of the corporation) would have to sell part of his stock because there was no financial incentive for the audiologist to sell any of his stock. The current corporate agreement required the profits to be distributed based on the services rendered by his receptive share of the practice, not based on his percentage of the ownership. Therefore, even if the audiologist sold a percentage of his stock, he would not receive any additional income if the new physician generated profits for the practice. On the other hand, if the physician brought in three new doctors by selling only his stock, the audiologist could end up owning 40% of the business and each of the physicians would own only 15%. This would result in the audiologist having more control than any one of the physicians. In addition, when the practice was sold, the audiologist would be entitled to a larger percentage of the sales price. Yet, the physicians would be generating a much larger percentage of the revenues and profits than the audiologist.

None of the potential partners, interviewed by the physician, were willing to "buy into" the existing corporate structure. The physician became very discontented because he was unable to meet his initial objective of having other physicians join him in the practice. Consequently, the physician wanted to separate the existing corporation into two corporations, one for the physician and one for the audiologist. Unfortunately, it was not possible to do this without causing tax, and therefore financial problems, to the physician.

Fortunately after a great deal of discussion, a new contract was designed that enabled each new physician brought into the practice to own 20% of the practice, the originating physician would own 30% and the audiologist would own 10%. The new contract also created a salary and bonus for the physician and the audiologist based on the profits from the whole corporation. The new structure reduced their accounting fees and provided a vehicle for the expansion of the practice that benefited both men in the long run. Unfortunately, the business had to remain a C Corporation until the loss carry forwards were used up; then it was changed to an S Corporation.

In summary, this case illustrates how poor planning from the beginning created long term problems for the business. First, the corporation incurred excessive legal and accounting fees and increased tax cost as a result of setting up two corporations when only one corporation was needed. Second, if the objective was to reduce taxes, the type of corporations that were chosen were diametrically opposite from what they should have been. Third, the contract was designed to pay salaries to the owners regardless of the profits, resulting in increase debt and interest cost to the corporation and an increase tax cost to the shareholders. Fourth, the increase cost then resulted in problems with cash flow that limited the growth potential of the business. Finally, the design and organizational structure created problems for the business when the shareholders wanted to expand

their business. From a systems perspective, the contract created a problem since the shareholders were ending up competing with one another, rather than working for the “whole” organization.

Fortunately, the shareholders were able to work out their differences before too much damage was done. Even though the shareholders lost money as a result of poor planning, they were able to rectify the problem with a new contract before their existing structure destroyed the business.

## Conclusion

The three case studies illustrate the need for entrepreneurs to examine their short and long-term objectives. In addition, the cases demonstrate how important it is for entrepreneurs to carefully think through their business plans before deciding on the type of organizational structure that will support their needs. As corroborated in the three case studies, the structure of the organization can either limit or provide a vehicle to meet the objectives of the entrepreneur and the business. In some cases the entrepreneur can rectify mistakes before they become a “permanent” problem. On the other hand, improper planning can cost the entrepreneur a great deal of money. In all of the cases, the entrepreneurs incurred unnecessary financial cost because of their initial decisions.

Therefore, it is important for entrepreneurs to understand the ramification of their decisions when selecting the type of organizational structure in which to operate their business. It is extremely important that the entrepreneur be aware that the structure needs to be in alignment with their short-term and long-term goals and objectives. Unfortunately, there are no “right or wrong” answers. Our matrix was designed to provide entrepreneurs with a method to compare and contrast each entity and to help them with their decision. As we have seen from the case studies, mistakes were made even with the help of advisors. The reason for the problems may have been poor communication between the entrepreneur and his or her advisor. We are not suggesting that entrepreneurs not seek advice from professionals. Rather, we believe entrepreneurs should be aware of the differences between each of the organizational entities and become an active participant with their advisors. If the entrepreneur has not clearly thought through the short and long term objectives for his or her business, then an advisor may make recommendations that are not right. In the end result, we believe that the more informed and aware entrepreneurs are the greater chance their decisions will meet their short-term and long-term objectives.

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**Table 1**  
**Classifying Successful vs. Unsuccessful Businesses:**  
**The Planning Principle of Management**

<b>Successful</b>	<b>Unsuccessful</b>
Time allocated for planning	Planning only done if time is available
Planning receives considerable attention	Primary attention is in day to day operations
Long and short term planning integrated into one consistent purpose	Planning effort is short term
Goals and objectives are developed	Goals and objectives are general and subjective
Goals and objectives are monitored	Ineffective or no monitoring system
Planning is used proactively	Planning only used to react to marketplace
Planning done by all employees	Planning only done by owner-manager

**Table 2: Matrix**

<b>Entity Type</b>	<b>Sole Proprietorship</b>	<b>Partnership</b>	<b>C Corporation</b>	<b>S Corporation</b>	<b>Limited Liability</b>
<b>IRS Form</b>	Schedule C, Form 1040	Form 1065	Form 1120	Form 1120S	Form 1065
<b>Description</b>	<ul style="list-style-type: none"> <li>• self employed</li> <li>• sole owner liable for all business debts</li> <li>• sole owner receives profits</li> </ul>	<ul style="list-style-type: none"> <li>• two or more people with a legal contract to operate a business</li> <li>• each partner makes separate contribution</li> <li>• earnings are passed on to the individuals</li> </ul>	<ul style="list-style-type: none"> <li>• has its own legal identity, rights and liabilities</li> <li>• continuity of life</li> <li>• central management</li> <li>• limited liability</li> <li>• ownership transfers with stock</li> </ul>	<ul style="list-style-type: none"> <li>• income or loss is passed through to the shareholders</li> <li>• limited liabilities</li> <li>• ownership transfers with stock</li> <li>• debts not part of stockholder's basis</li> </ul>	<ul style="list-style-type: none"> <li>• hybrid</li> <li>• combines pass through attributes of a partnership with limited liability characteristics of a corporation</li> <li>• entity must lack 2 of these characteristics ( free transferability, central management, continuity of life)</li> </ul>
<b>Income Tax Level</b>	Individual	Individual	Corporate	Individual	Individual
<b>Social Security</b>	Profits	Profits/Losses	Salary	Salary	Profits/Losses
<b>Personal Service</b>	No Problem	No Problem	Higher Rate	No Problem	No Problem
<b>Sale of Business</b>	<ul style="list-style-type: none"> <li>• individual- assets determined by type of underlying asset</li> </ul>	<ul style="list-style-type: none"> <li>• capital asset</li> <li>• capital gain or loss</li> </ul>	<ul style="list-style-type: none"> <li>• Sale of stock- treated capital gain or loss</li> </ul>	<ul style="list-style-type: none"> <li>• Sale of stock treated- capital gain or loss</li> </ul>	<ul style="list-style-type: none"> <li>• capital asset</li> <li>• sale results in capital gain or loss</li> </ul>
<b>Life Insurance</b>	Individual Pays	Individual Pays	Corporation Pays	Individual Pays	Individual Pays
<b>Disability Insurance</b>	Not deductible	Not deductible	Deductible	Not deductible	Not deductible

**Table 3**  
**Advantage and Disadvantages**

Advantages	Entity	Disadvantages
<ul style="list-style-type: none"> <li>• easiest to organize &amp; discontinue</li> <li>• owner free to make decisions</li> <li>• minimum legal restrictions</li> <li>• losses can offset other income</li> <li>• debts are part of the basis for deducting losses</li> </ul>	<b>Sole Proprietorship</b>	<ul style="list-style-type: none"> <li>• unlimited liability to the owner</li> <li>• limited ability to raise capital</li> <li>• skills limited to owner's abilities</li> <li>• income tax cannot be deferred by retaining profits</li> </ul>
<ul style="list-style-type: none"> <li>• combines skills and judgments of more than one person</li> <li>• has a legal status</li> <li>• each partner has a personal interest in the business</li> <li>• active partner- losses offset other income</li> <li>• bus debts are used for the basis for deducting losses</li> </ul>	<b>Partnership</b>	<ul style="list-style-type: none"> <li>• unlimited liability for the partners</li> <li>• authority for decisions is divided</li> <li>• income tax cannot be deferred by retaining profits</li> <li>• could cause recognition of unrealized gain at death of partner</li> </ul>
<ul style="list-style-type: none"> <li>• first \$100,00 taxed at lower tax bracket</li> <li>• insurance can be paid by Corp</li> <li>• under certain conditions, shareholders can borrow from pension/profit sharing plan</li> <li>• ease of transferring stock</li> </ul>	<b>C Corporation</b>	<ul style="list-style-type: none"> <li>• potential for double taxation</li> <li>• if personal service: highest tax rate</li> <li>• all profits, if paid as salary, subject to SS Tax</li> <li>• double taxation through dividends</li> </ul>
<ul style="list-style-type: none"> <li>• income may be shifted to other family members</li> <li>• double taxation of profits is avoided</li> <li>• limited liability</li> <li>• pass through of profits is not subject to SE tax</li> <li>• if shareholders are active, losses can offset other income</li> <li>• interest on borrowed money for stock is tax deductible</li> </ul>	<b>S Corporation</b>	<ul style="list-style-type: none"> <li>• fringe benefits restricted</li> <li>• shareholders pay tax on undistributed profits</li> <li>• less flexibility for choosing a tax year</li> <li>• cannot have more than 35 shareholders without election</li> <li>• cannot allocate loss/profit except based on own</li> </ul>
<ul style="list-style-type: none"> <li>• limited liability</li> <li>• can take part in management without personal liability</li> <li>• business debts are part of basis for deductions</li> <li>• special allocation can be made for allocating profits</li> <li>• avoids certain S restrictions</li> </ul>	<b>Limited Liability</b>	<ul style="list-style-type: none"> <li>• transferring ownership may be difficult</li> <li>• different state laws can cause problems</li> <li>• transferring from corp to LLC can cause tax problems</li> <li>• must have at least two owners</li> <li>• earnings subject to self-employment tax</li> <li>• income tax not deferred by retaining profits</li> </ul>