Business Entities Teaching Outline

I. Introduction

Business entities: ***Sole Proprietorship, Partnership, LLC, S-Corp, C-Corp.***

Utah registration via One Stop Business Registration (corporations.utah.gov). Domestic vs. foreign entity.

Consult tax pro/attorney. Legal/tax considerations drive choice.

II. ***Sole Proprietorship***

Definition: No legal distinction; owner = business. Automatic. No EIN needed. Schedule C/1040.

Advantages

- Simplicity (no formal filing unless DBA)
- Absolute control
- Limited regulation
- Easy tax prep (lowest burden)
- Easy ownership transfer

Disadvantages

- Unlimited personal liability (debts, employee actions)
- Increased responsibility (all decisions)
- Difficulty raising capital (banks reluctant)

III. ***Partnership***

Definition: Agreement between 2+ individuals. General, Limited, Joint Venture, Husband/Wife. Requires Partnership Agreement. File DBA if needed. Form 1065 K-1.

Advantages

- Simplicity/start-up funding ease

- Limited regulation
- Increased knowledge/shared commitment
- Key employee advancement
- Adaptability

Disadvantages

- Joint & individual liability (personal assets at risk)
- Dispute resolution difficult
- Profit sharing/contention risk
- Partner changes costly (asset valuation)

IV. ***Limited Liability Company (LLC)***

Definition: State-filed entity. Members not personally liable. Default sole prop or partnership tax treatment (Form 8832 to change). Form 1065/1120S possible. Operating agreement recommended.

Advantages

- Reduced record keeping vs. corps
- Flexible profit distribution
- Tax advantages (no entity-level tax; pass-through)
- Limited liability (varies by state)

Disadvantages

- Self-employment taxes on members
- Non-transferable (dissolves on member exit; new agreement needed)
- Harder to raise outside investment (no stock)

V. ***S Corporation***

Definition: C-Corp with Sub-S election (Form 2553). ≤100 shareholders (US citizens/permanent residents). One class of stock. Form 1120S. Reasonable salary required.

Advantages

- Liability protection
- Ownership transferability (stock sale)
- Tax benefits (avoids self-employment tax on profits; pass-through)
- Accounting discipline

Disadvantages

- Increased regulation (annual meetings, minutes, bylaws)
- Shareholder compensation rules (reasonable salary; audit risk)
- Accounting costs
- Regulatory/operational costs
- Ownership restrictions
- Cost to set up (attorney often needed)

VI. ***C Corporation***

Definition: Independent legal entity. Unlimited shareholders. Double taxation. Form 1120/1120-A. Board of Directors.

Advantages

- Strong liability protection (veil)
- Stock issuance for capital/employees
- Perceived stability
- Tax advantages (lower corporate rate on retained earnings)

Disadvantages

- Costs/complexity/setup
- Increased paperwork
- Business formality (annual meetings, minutes, reports)
- Double taxation (entity + dividends)

I. ***Tax Obligations***

- Federal Estimated Quarterly Tax: Payment triggers ($1k+ after credits); deadlines (4/15, 6/15, 9/15, 1/15).
- Utah Estimated Quarterly Tax (Corporations): $3k+ liability threshold; Form TC-559; 4 equal payments (15th of 4th/6th/9th/12th months); safe harbor (90% current/100% prior year); minimum $100 prepay option.
- Utah Sales & Use Tax: Seller-collected/remitted; contractor exemptions (items attached to real property); filing tiers ($1k annual/1/31; $1k–$50k quarterly; $50k–$96k monthly; $96k+ monthly EFT); Publication 42 resource.
- Utah Prompt Payment Act: 60-day payment rule for state agencies; 2% interest on overdue (above IRS refund rate).

II. ***Financial Statements***

- Balance Sheet: Assets = Liabilities + Owners' Equity; snapshot at point in time. Section 1: Current assets (cash, receivables, inventory, prepaid). Section 2: Long-term/fixed assets (equipment). Section 3: Liabilities (current: AP, notes; long-term: notes). Comparative versions for trends.
- Income Statement: Revenue – Expenses = Net Income. Section 1: Primary revenues/COGS/Gross Profit; operating expenses (selling/admin). Section 2: Operating income + non-operating (interest, gains/losses). Section 3: Net income. Example: $100k sales, $75k COGS, $13k op ex, $6k non-op → $18k net.
- Statement of Cash Flows: Operating (net income + depreciation – AR/inventory increases + AP/accrued increases); Investing (equipment); Financing (notes). Example: $200 net income → $165 ops cash → net cash change ($205). Indirect method focus.
- Owners' Equity Statement: Beginning capital + Net Income – Withdrawals = Ending capital. Example format with $35k start → $86k end. Tracks volume/mix/cost/scrap changes.

III. ***Cost Analysis & Profitability***

- Variable/Direct Costs: Labor, subs, job superintendent, fees/permits, raw materials (tied to production volume).
- Fixed/Indirect/Overhead Costs: Office rent/utilities, salaries (non-job), advertising, insurance, professional fees, auto (non-project).
- Gross Profit Margin: (Sales Price – Job Cost)/Sales; or (Sales – COGS)/Revenue. Impacts: price changes, material/labor variances.
- Markup: (Sales – Cost)/Cost. Conversion: Markup = Gross Margin/(1 – Gross Margin); Gross Margin = Markup/(1 + Markup). Example: $1.50 sale/$1 cost → 50% markup/33% margin.
- Contribution Margin: (Product Revenue – Variable Costs)/Product Revenue. Per-product focus vs. company-wide gross margin.
- Break-Even Analysis: Fixed Costs ÷ Contribution Margin %. Example: $10k fixed/25% CM → $40k sales BE. Target profit: (Fixed + Target Profit) ÷ CM %. Example: +$100k profit → $440k sales. Volume-based or price-based calcs.

IV. ***Financial Ratios***

- Liquidity: Current Ratio (CA/CL); Quick Ratio ((CA – Inventory)/CL); Working Capital (CA – CL).
- Leverage: Debt Ratio (TL/TA); Debt-to-Equity (TL/TE).
- Profitability: Gross/Net Profit Margin; ROA (Net Income/TA); ROE (Net Income/TE).

V. ***Cash Flow Management*** (Construction-Specific)

- Key: Progress draws timing; high margins ≠ strong cash; front-end draws vs. back-end deficits. Monitor cash on hand for creditors/payroll.
- Invoicing Best Practices: Clear summary of work/amount; detailed support (change orders, subs/vendors); match billing cycle; extra info reduces disputes/delays.
- Pitfalls: Mistaking draw cash for profit; poor cash masks losses until too late.

VI. ***Recordkeeping & Compliance***

- Why Keep Records: Tax deductions/prep/audits; loans; business decisions/growth monitoring; withholdings/payments.
- What & Retention: Payroll (4 yrs); Tax returns/1099/W2/W4 (3+ yrs, longer if underreported); Bank statements/invoices/receipts (3+ yrs); Property (until sale + statute); Tax-deferred (forever). IRS links provided. Insurance/creditors may require longer.
- Double-Entry Concept: Every transaction twice (debits = credits); T-accounts (left debits, right credits); balances required.
- GAAP Principles: Business entity (separate finances); Cost (actual, not market); Objectivity (verifiable); Going concern; Stable dollar (ignore inflation); Accrual (match revenue/expense, completed contract or % complete for construction) vs. Cash basis examples.
- Chart of Accounts: Customizable list (assets, liabilities, equity, revenue, expenses); NAHB resources for contractors; sample only—use CPA for full.

VII. ***Resources & Additional***

- IRS: Record retention, small business start, forms.
- Use of FS: Lenders, owners, managers, IRS for stability/profits/tax. Comparative statements for trends.

VIII. ***Tax Planning Strategies***

- Augusta Rule.
- Paying of Children.

1. ***Cash Flow in Project Management***

- Differs from basic financial mgmt: deeper focus on project-specific cash in/out timing
- Specialized equipment often requires loans (costs rolled into project)
- Timing of borrow/payback is critical to project timeline

2. ***Progress Payments*** (Construction)

- Definition: partial payment for work completed up to invoicing point
- Structures payments to maintain cash flow

3. ***Billing Methods***

- By stage
- By % completion (e.g., 30%, 60%, 100%)
- Architect/engineer certifies for owner approval

4. ***Timing & Planning Risks***

- Align draws with subcontractor payments/payroll
- Short-term loans common; poor planning causes cash shortages/no credit line
- Requires careful projected draw scheduling

5. ***Accounting for Cash Flow***

- Small volume: standard reports suffice
- High volume/multiple projects: track each project independently to show working capital needs

6. ***Management Imperative***

- Plan ensures timely debt payment + on-time materials/equipment delivery
- Skilled managers use contingency plans for minor changes