

A COMPARATIVE ANALYSIS OF PROPRIETORSHIP vs. CORPORATIONS

Name

Course Title

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Executive summary

Starting a business has always been easier said than done, however with clear analysis of the options available, it can be an easy endeavor. This paper is examining different formations of business, and comparing sole proprietorship to corporations. The purpose for this paper is to establish and operate California Communications Company dealing in the phone and tablet manufacturing, putting into consideration the ramifications of tax formations. When starting a business, it is important that one decides on which form of business entity they wish to establish. The form of business determines which form of income tax return to use. The USA federal government levies four different types of business taxes. The four taxes include

- Income tax
- Taxes for employers
- Self-employment tax
- Excise taxes

The ambition of the business scheme is to capitalize on the buildup of wealth to the running of California Communications Company, the family, after making a consideration of all the taxes. This paper will examine the methodology in different forms of businesses; analyze the basic taxes involved in setting up a business. It analyses the rating of taxes on businesses that are set to run in California.

Marketing Methodology

California Communications Company is a limited liability company that deals in selling of phones and tablets both in the local market and international market. Their phones have android

software and range between \$200 and \$1000. They make their gross revenue from sales of these phones and tablets. The company also has room for collecting used computers and refurbishing them for the market.

Their customers buy products from California and are proud to have one of their own enhancing the telecommunication industry.

There are numerous different forms of business operations which include

- Partnerships
- Sole proprietorship
- Corporation
- S Corporation
- Limited Liability Company

There are numerous differences between a sole proprietorship form of a business and partnership. The differences acts as a help to entrepreneurs to make a selection of the best choice of business form that they would want to operate.

Company expenses

The success of a company is to large extend in the amount of return it can extract from its investment. The California communications company like any other has the challenge to minimize on its costs by finding ways to offset the unnecessary costs or find alternatives which are cheaper. Rent is one of the expenses to be met as an operating cost for the company. The decision on whether to buy a business premise or pay rent will major depend on the rates of the two and doing a cost benefit analysis. It is however cheaper to pay rent than buy a premise, this nonetheless costly in the long run and there is need to acquire a property when it is feasible. Due

to such factor as inflation, the rates of both the employees' salaries and the rent payable is projected to rise.as the employees grow in both experience and age, and for the purposes of motivation them, the average salary expense for the company increases every year. This is illustrated in the sheet next.

California communications company expenses						
year	employees salary \$			rent \$		
1	50,000			90000		
2	50,001			90003		
3	50,002			90006		
4	50,003			90009		
5	50,004			90012		
6	50,005			90015		
7	50,006			90018		
8	50,007			90021		
9	50,008			90024		
10	50,009			90027		
11	50,010			90030		
12	50,011			90033		
13	50,012			90036		
14	50,013			90039		
15	50,014			90042		
16	50,015			90045		
17	50,016			90048		
18	50,017			90051		
19	50,018			90054		

Membership:

A sole proprietorship has a single owner while a partnership has two or more owners limited to ten in the business of banking, and twenty to other business cases.

Formation

A partnership is formed through an oral agreement which might also be in written form while a sole proprietorship form of business is formed through one person's decision without any approval of legal administration.

Registration

Registering a sole proprietorship is not a must. It just has to follow some business compliance to start operating. More so, it is governed by rules though no specific law of statute is set to govern how the business functions.

Partnerships have a higher opportunity of raising capital in big amounts because of the number of contributors. This makes the scope of raising enough financial base be at a down level. Partnerships are managed by every partner since all of them have a right to participate actively in affair management in the business. They all enjoy the authority to unite the firm and the rest of the partners for their actions in the course of business. A sole proprietorship type of business is managed by individuals and the owner's decision is final.

An LLC is a type of entity of business that uses the liability of a person in protection with the benefits accrued with the taxation and simplicity of a partner. The limited liability companies have both the negative side and the positive side. Corporations garner acceptance that is greater as compared to other business forms. This is because not every person is so familiar with the way they operate. Despite the fact that they grow at a relatively perfect speed, some vendors still feel reluctant to extend their credit to limited liability companies. In the US, some states dictate on the type of business activity that a limited liability company runs. The company in question in

this paper is an example of a limited liability company that operates in California and sells phones and tablets.

Corporations also offer a better variety of fringe benefit structures that all other entities of business may fail to get. Numerous stock option, retirement, employees stock purchase plans are available for corporations and sole proprietors, employees and partners who own more than 2% of the S corporation have no option but to pay tax on fringe benefits. These benefits include life insurance for a group term, medical insurance, medical reimbursement plans, parking and premiums. Employee-shareholders do not have to pay taxes on these benefits.

Corporations lower tax through shifting of income. They may be subject to double taxation but a C corporation can make appropriate use of income shifting to take advantage of tax brackets that are lower. For instance, a company that earns \$100,000 and has a sole proprietor that is married and makes a joint filing of 25% of income tax. With a corporation, take it that the business owner saves 50,000 in the corporation as profit (corporate) and takes home 50,000. The corporate rate of taxation for the federal government is 15% of the first 50,000. More so, the owner of the business is in the 15% tax rate of his personal income tax. This can make a reduction off the overall tax liability by above \$8,000.

Liability is limited in a sole proprietorship and owners carry the responsibility for whatever profit the business gets and whatever loss they suffer. Partnerships distribute liabilities and profits between the owners according to their contributions during the starting of the business.

Corporations have limited liability and in cases of failure, shareholders suffer the loss of their investment without being liable to debts of the corporation. Partnerships end with the death of a partner, or bankruptcy of a partner. A corporation is not dead or fallen when one of the directors,

officers, or shareholders. Partnerships have an excess in capital which exceeds that of a sole proprietor but is less than that of a corporation.

Management

Corporations are more tricky and costly to set up, often necessitating applications of the state, paperwork that is such as board resolution, articles of incorporation, and affidavit. A single owner does own all the management and running of the business while in partnerships, agreement of owners in management is required for the business ventures to run. In corporations, the directors' board makes an appointment of the management team. Sole proprietorship business forms are easy to set up since no legal requirements are set in place.

Partnerships' legal requirements are between the business owners and some simple paper work is a requirement to start it. On the other hand, corporations are the most difficult to start because

California tax rates

States have been seen to have different tax rates. California State is ranked ahead of only two states by a nonpartisan tax group. Among most taxed is the sales. The sales stand at an approximated 8.2 percent (Tonya, 2014).this state is also noted to have high income taxes compared to the rest of the states in the United States. The California residents with incomes exceeding a million dollar are subjected to a 1% additional rate.

Corporate tax rates

Entity type	Tax rate
Corporations apart from banks and financial institutions	8.84%
Banks and financials	10.84%
Alternative Minimum Tax (AMT) rate	6.65%

S corporation rate	1.5%
Financial rate and S corporation bank	3.5%

Individual tax rates

The state of California like any other state imposes income taxes on its residents. This state this income taxes can be filled either separately or as a married persons. The residents are expected to complete tax on forms available in either short form, long form or 540-ADS by the stated date in case it falls on a working day. This however can still be done cheaply electronically. Some of the key things to note about the taxes are as listed next.

- The maximum tax rate for individuals is 12.3%
- The AMT rate for every individuals is 7%
- The Mental Health Services Tax Rate - 1% for taxable income in surplus of \$1,000,000.

Exemption credits

Filing Status/Qualification	Exemption amount
Registered Domestic Partner (RDP/Married filing jointly or qualifying widow or widower	\$212
Single or RDP/married filing separately, or household head	\$106
Dependent	\$326
Blind	\$106
Age 65 or older	\$106

All foreign corporations working in California and California corporations must pay California taxes to the FTB- California Franchise Tax Board.

Annual minimum tax: An \$800 annual minimum tax is an important requirement that must appear the first quarter of every accounting period if the corporation is dynamic, works at a loss or is not in operation. In the case of new corporations that qualify or incorporate with the state secretary, the tax is measured basing on the first year income and is subject to requirements of estimate. The minimum tax is \$800 for all subsequent years.

Additional taxes: Corporations with income that goes beyond certain levels must see to it that they add an additional fee basing on their total income annually. The state of California permits an additional sales tax basing on the specific locations of the premises. This can results in rates as high as ten and a half pent in some parts of the state.

Filing procedures: In California regular corporations must file the California Form 100 income Tax return or *Corporation Franchise*. *This must be* by the 15th day in month three at the elapse of the taxable year. All Corporations elected to be taxed as S corporations file Form 100S, *Income Tax Return or California S Corporation Franchise*. Information concerning this is on the website of California Website.

Marketing model of California Communications Company

This is a limited liability company that needs to look into ensuring that it does comply fully with the tax requirements of California Franchise tax Board before venturing into serious marketing of their products. Many people confuse between marketing and actual selling of a product though. In their marketing, they need to identify themselves with a given product that meets the needs of the California market and the general communication market.

Most people confuse between product marketing and selling. In marketing, a company or a business firm identifies a product and anticipate that it will satisfy the societal requirements and the market so that a company makes profit out of it. Any business firm of company must

carry out market research since it is the process involved in identifying the customer wants. California Communications Company needs to identify and select the appropriate market mix.

A savvy owner of a business must carefully consider tax ramifications and nontax when making a decision on how to create a structure of their business. It is not wise to make a selection based upon considerations of tax. It is also unwise to fail to consider impact of the decision. Neglecting some aspects may result into making a wrong decision when planning to start a business.

For instance, in case one runs a business that engages in operations that are risky, or one that is subject to frequent suits of law. The business legal advisors are most likely urge the owner to incorporate legal suits. The incorporations will tend to complicate the business taxes. The owner will be foolish to use their assets at risk for the purpose of tax return that is easy to prepare.

Other considerations that are nontax and that can make the best incorporation choice are

- Increased reorganizing and recapitalizing ability of the business to grow larger
- Ease of investment capital obtaining
- And increased succession planning latitude

In addition, there are advantages of tax. Incorporating makes a provision of access to strategies of tax that are not available. Otherwise, accumulating income in the corporation or making a provision of income to shareholders using distributions and salary. More so, there are a number of potential disadvantages although with recent changes of tax law which are less discouraging

C Corporations taxation rate

The taxation of a regular corporation or a C corporation is taxed as an entity that is standing out separately. It must file form 1120 every year in order to report its income and claim the deductions and credits. Income that is earned by a corporation is always taxed at the level of the corporate using the tax rate corporate income shown in the below table below.

Tax Rates for Corporations		
Taxable Income		
Over	But Not Over	Tax Due
\$0	\$50,000	\$0 plus 15% on amount over \$0
\$50,000	\$75,000	\$7,500 plus 25% on amount exceeding \$50,000
\$75,000	\$100,000	\$13,750 plus 34% on amount exceeding \$75,000
\$100,000	\$335,000	\$22,250 plus 39% on amount exceeding \$100,000
\$335,000	\$10,000,000	\$113,900 plus 34% of amount exceeding \$335,000
\$10,000,000	\$15,000,000	\$3,400,000 plus 35% of amount exceeding \$10,000,000
\$15,000,000	\$18,333,333	\$5,150,000 plus 38% of amount exceeding \$15,000,000

\$18,333,333	---	35% of amount exceeding \$18,333,333
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NB: Corporations that their employees spend at least 95 % of their time in the field of law, health, engineering, architecture, accounting, actuarial science, and performing arts are taxed at a 35% flat rate of net profits.

Tax rate of businesses in the US

Federal government, state and taxation in the locality represent a main cost of carrying out business in America. This is an aspect that is common with upcoming businesses. More so, the assortment of US taxes which minor businesses encounter include tax on their income (corporate and individual), Medicare employment taxes and social security, unemployment taxes of competition and excise taxes.

The federal income tax system and the progressive statutory structure rate apply to business and individual incomes. The income of corporation is double taxed, once at the corporate level through corporate income tax payment and at individual level of a corporation when profits are dispersed in the shape of dividends or gains of capitals. The rest of the business forms are not subject to an entity tax level, and profits of business are taxed only at the individual owner level.

Calculating the general costs of federal tax on income to small owners or upcoming business owners requires an assessment of both persons and income taxes that is mutual to survey those who have the burden of the business income taxes. Federal tax system of income works in a progressive manner, having it that the rate of tax increases with the increase in income and does range from 10 to 35% under the current federal law. Apart from that, normal tax rule exceptions can affect the lowering of general tax rate essentially forced on a rate lower than the

rate of the statute. There is dissimilarity between statutory rate of tax on income of a business and effective rates of tax that a business may face.

Individual Income and Business Taxes, revenues and Tax rates

Individual Income and Business Taxes

The income of an individual at any time or year in Washington DC for 183 or more days

Current Tax Rate(s)

- First \$10,000 = 4 %
- \$10,000 < or equal to \$40,000 but < or equal to \$100,000 = \$400 + 6 % of surplus above \$10,000
- More than \$ 40,000 = \$2,200 + 8.5% of surplus above \$40,000
- Over \$350,000 = \$28,550 + 8.95 % of surplus above \$350,000

NB: the calculations exclude maximum \$3000 exclusion and Social security on pension income, or annuity income from federal government and military retired pay.

Corporate Franchise Tax

All corporations in a business, trade or profession must register.

Current Tax Rate(s)

The franchise tax rate is 9.975% of taxable income plus 5% surtax on the base rate, a 9.5% base rate

- \$1000 minimum tax, if federal gross receipts are less than \$1 million
- \$250 minimum tax, if federal gross receipts are \$1 million or less

Unincorporated Business Franchise Tax

Unincorporated business net income with gross receipts summing up to more than \$ 12000. 30% salary allowance and an exemption of \$5000 for owners are to be deducted from the income (net) to get taxable income.

Any business is exempt from the taxation in cases where more than 80% of their gross income comes from individual services rendered by members.

Current Tax Rate(s)

The franchise tax rate is 9.975% of taxable income, a 9.5% base rate plus 5% surtax on the base rate.

- \$250 minimum tax, if federal receipts (gross) are \$1 million or less
- \$1000 minimum tax, if federal gross receipts are more than \$1 million

Shifting from sole proprietorship to LLC

Moving from a sole proprietor to an LLC is a process done to provide an owner of a business with protection against liability in business claims on individual property. One can use an attorney in case they need professional help in the process of shifting. It is sensible that one hires an attorney rather than risk making an error.

The process of shifting

Create a minimum of three choices for the name of the LLC since each will be searched alongside existing names of other corporate agencies for duplication and similar conflicts. One can still operate their business under DBA, an acronym of doing business as. The legal designation of LLC is governed by the country business laws and is always administered by state secretary. In case a business owner plans to form an LLC, they need to search for a name and talk to the secretary of state.

Conclusions

The best form of ownership by more than one person depends on a number of factors. A corporation and a limited liability company have a number of advantages over partnership business. They both offer protection to owners from numerous liabilities to 3rd parties. More so, they offer protection to the entity from creditors of one of the owners, in cases where the owner does not have effective control of the business entity. Third, business entity has continuity of existence in the case where one of the owners dies. The LLC have many similarities to partnership in a number of ways. An operating agreement of LLC has all the flexibility just like a partnership business. Both forms are treated as a partnership for purposes of federal taxes.

The main drawback of a limited liability company is that one has to pay a fee to be able to file the LLC with the federal state and every year it is compulsory that one file an annual report and pay consequent fees. With a general partnership business, the owners need to file a name application and often should run a legal notice in a newspaper or magazine. This may cost more than the organization filing system. However, there is no annual fee later on. California and Illinois have a higher annual fee that is an approximate \$100 or less.

Recommendations

I recommend that any person aspiring to start a business enterprise begins with looking at the various advantages of all the forms of business, secondly, the individual or the people should weigh the limitations and the rate of taxation of the selected business form. For instance, I suggest that an LLC is better than a partnership and a sole proprietorship since it has numerous aspects related to a partnership form but still stands out from the other two forms of business.

California Communications Company should also ensure that it meets all the tax requirements of the California Franchise Board. This should ensure that they are not running on a loss. I suggest that any manner in which they want to run their company should ensure that they make immense profits from selling of their phones and tablets.