

BUSINESS 1 CLASS NOTES

Business Environment and Concepts (BEC) is a 2 ½ -hour exam consisting of three multiple choice testlets of 30 (or so) questions each. There are five major content areas on **BEC**:

1. **Business Structure (BEC1)** 17%-23% of points (covered in this outline)
2. **Economic Concepts (BEC 2)** 8%-12% of points
3. **Financial Management (BEC 3)** 17%-23% of points
4. **Information Technology (BEC 4)** 22%-28% of points
5. **Planning and Measurement - Cost/Managerial Accounting (BEC 5)** 22%-28% of points

Business Structure is the topic of BEC 1. The CPA exam **Content Specification Outline** assigns a range of 17%-23% of points to the area broken down as follows:

- Advantages, implications and constraints of legal structures,
- Formation, operation and termination of business,
- Financial structure, capitalization, profit and loss allocations, and distributions, and
- Rights, duties, legal obligations, and authority of owners and management.

I. **SOLE PROPRIETORSHIPS - NOT A SEPARATE LEGAL ENTITY**

- A. Unlimited liability of the single owner and the difficulty of obtaining financing for growth
- B. Sole proprietorship profits or losses flow through to the individual owner's Form 1040 on a Schedule C. A sole proprietorship is not considered a separate legal entity from the owner.

II. **GENERAL PARTNERSHIPS**

- A. Association of two or more person who agree to carry on as co-owners a business for profit.
 1. Unlimited liability
 2. Each partner is both jointly and severally (individually) liable for partnership obligations
 3. Each partner is a **mutual agent** of other partners and, thus, the laws of Agency (from Regulation) will apply.
 4. A partnership interest is a personal asset of each partner.
- B. Profits and losses flow through to the partners' individual tax returns through Form 1065 and Schedule K1
- C. Each partner is entitled to participate in management.
- D. Partnerships should have a formal agreement, or **Partnership Agreement**, which details the rights and obligations of the partners. In the absence of such an agreement, all partners are considered **equal** in the eyes of the law.
- E. Dissociation is a change in the relationship of the partners caused by any partner ceasing to be associated in the carrying on of the business.

- F. Dissolution involves winding up the partnership's affairs; it is often triggered by a dissociation.
- G. A partnership is **liquidated** when it ceases to do business and the assets are distributed to the partners to pay back their capital investments.
- H. A **Limited Liability Partnership (LLP)** is a form of business in which partners are generally not liable for contracts of the partnership or acts of fellow partners, employees, or agents; however, partners are still be liable for **their own negligence** (or the negligence of those under their direct control). An LLP requires a filing with the state in which it is operating to be formed. LLPs are an increasingly popular form of business because of their advantages in the area of partner legal liability.
- I. A **Limited Partnership (LP)** is a partnership in which the limited partners are similar to stockholders in a corporation (discussed later). Limited partners may sell or assign their partnership interest (consisting only of their right to receive profits) without the consent of other partners, and they are generally only liable for partnership obligations to the extent of their investment. On the other hand, they may not participate in management of the partnership. LPs must have **at least one general** partner who manages the partnership and has **unlimited** personal legal liability. In order to be formed, LPs must file with the state in which they operate and may have to register with the IRS as "tax shelters."

III. JOINT VENTURES

- A. Very similar to partnerships; but typically formed for a specific transaction or series of related transactions, while partnerships are an ongoing form of business. In general, the rules of partnership will apply to joint ventures.

IV. CORPORATIONS

- A. A corporation is a legal entity distinct from its owners (the shareholders) and its managers. To create a corporation, **Articles of Incorporation** must be filed with the state in which it is to be incorporated. It is important to know the rights, duties, obligations and authority of the three major groups: **shareholders**, **directors**, and **officers**.
- B. For tax purposes, a "regular" corporation is called a **C Corporation** and files a form 1120, paying taxes at corporate rates on its Taxable Income.
- C. The life of a corporation is theoretically unlimited, unlike other forms of business that are dependent on individuals.
- D. A corporation must keep its *invested* (paid-in) equity separate from its *earned* equity. If authorized in the Articles of Incorporation, the corporation may issue preferred stock in addition to common stock.

V. SUBCHAPTER S CORPORATIONS (tax status)

- A. Election allows the corporation to be treated as if it were a proprietorship or partnership for tax purposes, and any income or loss "flows through" to the shareholders as personal income through Form 1120S and its associated K1. An S Corporation is strictly an IRS creation and is limited by a number of restrictions by law.

VI. LIMITED LIABILITY COMPANY (LLC) - has similarities to a corporation while also having aspects of both limited and general partnerships

- A. Owners (**members**) of an LLC are not personally liable for the obligations of the company while the LLC can choose to be taxed as if it were a partnership.
- B. LLCs must file within their state in order to be formed, and members may not transfer their ownership interest without consent of other members.

For a good overview of the forms of business, check out the **Overall Summary of Entities and their Attributes** on page B1-54 of your text. Concentrate your study efforts on **Corporations** first.