

BASIC BUSINESS STRUCTURES COMPARISON

FEATURE COMPARISON

The structure of the business will determine the documents required to evaluate the borrower's income from self-employment and overall financial condition.

Type of Business	Degree of Liability	Control Over Management	Tax Implications
Sole Proprietorship	Unlimited personal liability	Owner has total control	Taxed at individual rates
General Partnership	Unlimited liability for any and all partnership debts and other liabilities	Majority rule, unless otherwise agreed	Taxed at individual rates on share of net income
Limited Partnership	Liability limited to investment	General partners have operational control	Taxed at individual rates on share of net income
Corporation	Liability limited to investment	Officers elected by Board of Directors <i>(often the same in closely held corporations)</i>	"Double taxation" treatment: taxed at corporate rate; distributed earnings <i>(dividends to shareholders)</i> also taxed at individual rates
S Corporations	Liability limited to investment	Officers elected by Board of Directors <i>(often the same in S corporations)</i>	Taxed at individual rates on share of net income
Limited Liability Company (LLC)	Liability limited to investment	Depends on provisions of LLC agreement. Generally, LLC members have direct control.	Taxed at individual rates on share of net income

TAX REPORTING FORMS

Analysis of the borrower's U.S. Individual Income Tax Return (IRS Form 1040) will provide information about the sources of income available for debt repayment. Further detail of each source of income is provided on supporting schedules and, when appropriate, on separate business tax returns. Complete returns, including all schedules and business tax returns, should be provided so that the underwriter can evaluate the borrower's cash flow and financial condition.

Following is a summary of the most important tax forms for the analysis of a self-employed borrower.

PERSONAL INCOME STATEMENTS

Tax Forms and Schedules	Description
Form 1040	U.S. Individual Income Tax Return - Lists all the income of the borrower; if the borrower is a <i>sole proprietorship, a partnership or an S corporation</i> , the business income is also reported on attached schedules.
Schedule A (1040)	Itemized Deductions - Lists deductions that may be subtracted from the borrower's adjusted gross income before calculating the tax liability, including unreimbursed employee expenses.
Schedule B (1040)	Interest and Dividend Income - Lists the sources and amounts of investment income, including tax-exempt interest, non-taxable dividend distributions, and dividend income earned on stocks sold during the year (<i>capital gains</i>).
Schedule C (1040) or Schedule C-EZ (1040)	Profit or Loss From Business - A separate sheet that details the profit or loss from the <i>sole proprietorship</i> . This form is in an <i>income statement</i> format. Net Profit from Business - A simplified statement of net profit from a sole proprietorship. May only be used if the business reported a profit during the tax year and other limiting conditions are met.
Schedule D (1040)	Capital Gains and Losses - A separate sheet that details gains or losses from <i>investments</i> , i.e., stocks and bonds. (<i>Only a part of cash-flow analysis if it is of a recurring nature.</i>)
Schedule E (1040)	Supplemental Income and Loss - A separate sheet that details supplemental income from <i>rental properties, partnerships, S corporations, estates, trusts, etc.</i>
Schedule F (1040)	Profit or Loss From Farming - A separate sheet that details the profit or loss from farming.
Form 4562	Depreciation and Amortization - A separate sheet that breaks out <i>amortization and depreciation</i> .

While an individual partner's income is summarized on Schedule E and reported on the 1040, the partnership or S corporation must file informational returns.

PARTNERSHIP STATEMENTS

Tax Forms and Schedules	Description
Form 1065	U.S. Partnership Return of Income - Reports the earnings of the Partnership in income statement format.
Schedule L (1065)	Balance Sheets - Summary of assets and liabilities as of the beginning and end of the tax year.
Schedule K-1 (1065)	Partner's Share of Income, Credits, Deductions, etc. - Lists details of each partner's capital account, the individual partner's percentage of ownership, and outlines the profit and loss of a partner.
Form 4562	Depreciation and Amortization - This is a separate sheet that details the <i>amortization and depreciation expense</i> of the partnership.

CORPORATE STATEMENTS

Tax Forms and Schedules	Description
Form 1120	U.S. Corporation Income Tax Return - Reports the earnings of the corporation in <i>income statement</i> form.
Schedule E (1120)	Compensation of Officers - A list of corporate officers that shows each officer's percentage of stock ownership, percentage of time devoted to the business, and amount of annual compensation.
Schedule L (1120)	Balance Sheets - A summary of assets and liabilities as of the beginning and end of the tax year.
Form 4562	Depreciation and Amortization - This is a separate sheet that details the <i>amortization and depreciation expense</i> of the corporation.

S CORPORATION STATEMENTS

Tax Forms and Schedules	Description
Form 1120S	U.S. Income Tax Return for an S corporation - Reports the earnings of the S corporation in <i>income statement</i> form.
Schedule L (1120S)	Balance Sheets - A summary of assets and liabilities as of the beginning and end of the tax year.
Schedule K-1 (1120S)	Shareholder's Share of Income, Credits, Deductions, etc. - Lists the shareholder's share of income, credits, deductions, etc., and reflects assets and liabilities of the shareholder.
Form 4562	Depreciation and Amortization - This is a separate sheet that details the <i>amortization and depreciation expense</i> of the S corporation.

Corporations, just like individuals, pay income taxes. Any corporate earnings distributed to stockholders as dividends or salaries will appear on the individual's 1040s. All corporate income is subject to corporate income tax first.

TAX RETURN FORMS AND SUPPORTING SCHEDULES

