



CAREER CLUSTER
Finance

CAREER PATHWAY
Corporate Finance

INSTRUCTIONAL AREA
Business Law

CORPORATE FINANCE EVENT

PARTICIPANT INSTRUCTIONS

- The event will be presented to you through your reading of the General Performance Indicators, Specific Performance Indicators and Case Study Situation. You will have up to 30 minutes to review this information and prepare your presentation. You may make notes to use during the role-play situation.
- You will have up to 15 minutes to make your presentation to the judge (you may have more than one judge).
- Turn in all your notes and event materials when you have completed the event.

GENERAL PERFORMANCE INDICATORS

- Communications skills—the ability to exchange information and ideas with others through writing, speaking, reading or listening
- Analytical skills—the ability to derive facts from data, findings from facts, conclusions from findings and recommendations from conclusions
- Production skills—the ability to take a concept from an idea and make it real
- Priorities/time management—the ability to determine priorities and manage time commitments
- Economic competencies

SPECIFIC PERFORMANCE INDICATORS

1. Explain types of business ownership.
2. Explain the nature of taxes.
3. Discuss the effect of tax laws and regulations on financial transactions.
4. Develop a pro forma income statement.
5. Select form of business ownership.

CASE STUDY SITUATION

You are the project analyst for CROMWELL DEVELOPMENT, a commercial real estate developer. The CEO of the company has asked you to explain different types of business ownership and the taxation associated with each before purchasing a new property.

The CEO owns several real estate investment properties and each is separately organized as its own business entity. The owner is evaluating the purchase of a medical office building that is for sale for \$2.1 million.

The building is adjacent to the local hospital and has 17,500 total square feet separated into eight tenant suites of approximately 2,200 square feet each. Medical office buildings are historically stable investments. The CEO believes this investment will add great diversity to the portfolio, which is currently made up of residential apartment buildings. Two of these apartment buildings are currently losing money.

In order to purchase the medical office building, the CEO will need a \$1.6 million loan. During a recent meeting with a potential lender, it was suggested that the CEO evaluate different forms of ownership for this building in order to fully understand the tax and personal liability consequences that come with the different forms of organization. All of the CEO's other real estate investment properties are organized as Limited Liability Companies (LLCs). The CEO has come to you for information.

YOUR CHALLENGE

The CEO has asked you to explain the different types of business ownership and how profit will be taxed in different business structures. The CEO is considering organizing this property as a corporation, but needs you to illustrate the tax effect of that decision. The CEO has given you financial data on the investment property and has asked you to develop a pro forma income statement for the corporate form of organization.

Financial Data:

Square Footage (SF)	17,500
Annual rent/SF	24.50
Vacancy rate	4.50%
Operating expenses (as % of gross rental income)	47%
Annual depreciation expense	52,500
Interest expense on \$1.6MM loan	120,000
Tax rate	15%

The CEO has also asked that you make a recommendation about the form of organization that you believe might be right given the limited information you have available. Additional company executives may be present when you make your recommendation.

You will receive 2-3 questions from the judge pertaining to the case situation.

SOLUTION

There are three major **types of business ownership**. Each has advantages and disadvantages.

- **Sole Proprietorship** – a business owned by one person in which that person and the company are viewed as one entity for tax and liability purposes. No special legal requirements must be met to start a proprietorship. It is a separate entity for accounting purposes, but it is not a separate legal entity from its owner. This means that a court can order an owner to sell personal belongings to pay for the debts of the proprietorship – this is known as unlimited liability. The proprietorship does not pay income tax; profits are reported and taxed on the owner's personal income tax return.
- **Partnership** – a business owned by two or more people, called partners, which are jointly liable for tax and other obligations. Like a proprietorship, no special legal requirements must be met to start a partnership. The only requirement is an agreement between partners. A partnership is not legally separate from its owners. This means that each partner's share of profits is reported and taxed on that partner's tax return. It also means unlimited liability for its partners.
- **Corporation** – also called a C Corporation is a business legally separate from its owner or owners; the corporation is responsible for its own acts and its own debts. Separate legal status means that its owners (shareholders) are not personally liable for corporate acts and debts. The main disadvantage of this form of organization is double taxation, meaning that the corporation's income is taxed and any distribution of income to its owners through dividends is taxed as part of the owners' personal income.
- **Other hybrid forms of organization** – S Corporations, LLCs, LLPs, LP.

How the business is taxed depends on how the firm is owned and organized. Sole proprietorships, partnerships, S Corporation and LLCs are flow-through entities, meaning that any profit/loss flows through to the owner or owners' personal tax return and is taxed accordingly. C Corporations pay taxes on profit; the greater the profit, the greater the tax rate. In 2012 tax rates ranged from 15% to 38%.

Effect of tax laws on financial transactions

All transactions have tax consequences. Tax consequences can significantly affect financial performance. Firms should plan transactions to take maximum effect of the tax laws given the firm's tax posture at the time of the transaction. Depreciation expense and interest expense (paid on debt) are both tax deductible, meaning they reduce the firm's tax liability. Depreciation is a non-cash expense, and therefore is particularly valuable in tax planning.

Pro forma income statement

Gross rental income	428,750
Less: vacancy	<u>19,294</u>
Net rental income	409,456
Operating expenses	201,513
Depreciation expense	<u>52,500</u>
Earnings Before Interest & Taxes	155,444
Less: interest expense	<u>120,000</u>
Earnings Before Taxes	35,444
Less: tax expense	<u>5,317</u>
Net Income	30,127

Select a form of business ownership – this is a subjective response, meaning there is not an absolute correct answer. However, given the fact that other properties in the CEO’s portfolio are losing money, it is likely that the CEO would want to organize this property as a flow-through entity as well. In that, the losses on other properties would reduce (potentially eliminate) any tax consequences associated with the medical office building.

Most investment real estate properties in the U.S. are organized as either single-member, or multi-member LLCs.



CORPORATE FINANCE, 2018

Participant: _____

JUDGE'S EVALUATION FORM
State/Provincial Event 2

I.D. Number: _____

INSTRUCTIONAL AREA
Business Law

Did the participant:

Did the participant:		Little/No Value	Below Expectations	Meets Expectations	Exceeds Expectations	Judged Score
PERFORMANCE INDICATORS						
1.	Explain types of business ownership?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
2.	Explain the nature of taxes?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
3.	Discuss the effect of tax laws and regulations on financial transactions?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
4.	Develop a pro forma income statement?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
5.	Select form of business ownership?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
PRESENTATION						
6.	Demonstrate clarity of expression?	0-1	2-3	4	5	
7.	Organize ideas?	0-1	2-3	4	5	
8.	Show evidence of mature judgment?	0-1	2-3	4	5	
9.	Overall performance: appropriate appearance, poise, confidence, presentation, technique and responses to judge's questions?	0-1-2	3-4-5	6-7-8	9-10	
TOTAL SCORE						