Which of the following is *not* an advantage of a sole proprietorship?

- **a.** the owner receiving all the after-tax profit
- **b.** limited liability
- **c.** quick decision making
- **d.** all of the above

**9.**

Double taxation refers to which of the following scenarios?

- **a.** Both bondholders *and* shareholders of a corporation must pay taxes on proceeds received.
- **b.** The corporation pays taxes on its earnings, and creditors pay taxes on interest received.
- **c.** The corporation pays taxes on its earnings, and shareholders pay taxes on dividends received.
- **d.** All of the above statements are correct.

**10.**

In agency theory, the owners of the business are __________ and the managers are ___________.

- **a.** bondholders, principals
- **b.** stockholders, bondholders
- **c.** agents, principals
- **d.** principals, agents

## MINI-CASE Richardses' Tree Farm Grows Up

This mini-case is available in MyFinanceLab.

Jake Richards is surprised to hear from Paul Augustus, his accountant for many years, that income from his tree farm is just over $150,000 for the year and that his land and other assets are valued at almost $2,000,000. The $600,000 he owes to the bank is not a surprise.

Twenty years ago Jake realized that with seven long days of backbreaking labor a week, his western Massachusetts dairy farm was just about breaking even. Without his wife's income as a high school science teacher and the health insurance that came with it, the young family would have been struggling.

Along the way, Jake sold the dairy herd, but he did want to keep the land that had been farmed by his family for three generations. At the time, his plan was to repurpose the farm and some of its equipment by boarding horses, selling hay bales to construction companies, starting a small landscaping business, and plowing snow in the winter. Almost on a whim, he planted a few acres with seedling-size blue spruces and Fraser firs, expecting to sell them as Christmas trees. He quickly found that he could use them more profitably in his landscaping business and that he could sell them to local nurseries and other landscapers. Gradually, he added plantings of other popular landscape trees: arborvitae, yew, dogwood, red maple, ornamental crabapple, pear, and cherry. Demand grew so rapidly that he gave up his other activities to concentrate on tree farming. He now has three full-time employees along with his wife, two college-age children, and several of their friends working for him in the summer. He also owns and leases some rather expensive specialized equipment for planting, digging, and preparing the trees for shipping.

Because the business has grown so rapidly and almost accidentally, Jake has not thought much about its organization. His accountant suggests that it is time to consider converting from an informal partnership with his wife and children to a more formal type of organization. Paul hands Jake some brochures on forming a regular corporation and two alternatives: a subchapter S corporation, or S corporation, and a limited liability company, or LLC. He asks Jake to look them over and get back to him in a week or two.

## Questions

**1.**

Major financial management decisions involve capital budgeting, capital structure, and working capital management. Give an example of each that relates to Richardses' Tree Farm.

**2.**

Should the Richardses form a regular corporation or choose one of the hybrid forms? Whichever form they use, they intend to distribute ownership equally among Jake, his wife, and their two children so that each party will own 25% of the shares. Consider the tax consequences of their decision.

**3.**

How does incorporating affect the family's overall risk exposure?

**4.**

How does incorporating affect the ability of the business to expand?

**5.**