

Incorporation Basics

A corporation is defined as a legal entity or structure created under the authority of the laws of a state consisting of a person or group of persons who become shareholders. The entity's existence is considered separate and distinct from that of its members. Like a real person, a corporation can enter into contracts; sue and be sued; pay taxes separately from its owners; and do the other things necessary to conduct business.

Incorporation can be a complicated process. Take into consideration the advantages and disadvantages listed below before you embark on incorporating your company.

Advantages

- **Limited Liability.** One of the key reasons for forming a corporation is the limited liability protection provided to its owners. Because a corporation is considered a separate legal entity, the shareholders have limited liability for the corporation's debts. The personal assets of shareholders are not at risk for satisfying corporate debts or liabilities.
- **Corporate Tax Treatment.** Since a corporation is a separate legal entity, it pays taxes separate and apart from its owners (at least in the typical C Corporation). Owners of a corporation only pay taxes on corporate profits paid to them in the form of salaries, bonuses, and dividends. The corporation pays taxes, at the corporate rate, on any profits.
- **Attractive Investment.** The built-in stock structure of a corporation makes it attractive to investors.
- **Capital Incentive .** The stock structure also allows corporations to attract key and talented employees by offering an ownership interest in the form of stock options or stock.
- **Owner/Employee.** A business owner who works in his or her own business may become an employee and thus be eligible for reimbursement or deduction of many types of expenses, including health and life insurance.
- **Operational Structure.** Corporations have a set management structure. Shareholders are the owners of a corporation, who elect a Board of Directors, which then elects the officers. Other than the election of directors, shareholders do not typically participate in the operations of the corporation. The Board of Directors is responsible for the management of and exercising the rights and responsibilities of a corporation. The Board sets corporate policy and the strategy for the corporation. The Board elects officers; usually a CEO, vice president, treasurer and secretary, to follow the policies set by the Board and manage the corporation on a day-to-day

basis. In a small corporation, the lines between the shareholders, Board of Directors, and officers tend to blur because the same people may be serving in all capacities.

- **Perpetual Existence.** A corporation continues to exist until the shareholders decide to dissolve it or merge with another business.
- **Freely Transferable Shares.** Shares of corporations are generally freely transferable because as a separate entity, the existence of a corporation is not dependent upon who the owners or investors are at any one time. A corporation continues to exist as a separate entity and is not terminated or dissolved even when shareholders die or sell their shares. Shares of corporations are freely transferable unless shareholders have "buy-sell" agreements limiting when and to whom shares may be sold or transferred. Also, securities laws may restrict the transferability of shares.

Disadvantages

- **Fees.** It costs money to incorporate. There are typically four types of fees, including: a fee to file the articles of incorporation with the secretary of state; a first year franchise tax prepayment; fees for various governmental filings; and attorney fees.
- **Formalities.** The proper corporate formalities of organizing and running a corporation must be followed in order to receive the benefits of being a corporation.
- **Paperwork.** A huge aspect of the corporate formalities that must be followed consists of paperwork. Reports and tax returns must be compiled and filed in a timely fashion; business bank accounts and records must be maintained and kept separate from personal accounts and assets; records must be kept of corporate actions, including meetings of shareholders and Board of Directors; and licenses must be maintained.
- **Disclosure of Names of Corporate Officers and Directors.** Most states do not require that names of shareholders be a matter of public record; however, many states require that the names and addresses of corporate officers and directors be listed on one or more documents filed with the Secretary of State.
- **Dissolution.** Since corporations have a perpetual existence, states provide a mechanism for dissolving a corporation and liquidating its assets. Dissolution does not happen automatically. A corporation can be dissolved voluntarily or involuntarily. A corporation's officers and directors are charged with responsibility for dissolving the corporation, including gathering corporate assets, paying creditors and outstanding claims, and distributing remaining assets to shareholders.

- Tax Consequences. C corporations have potential double tax consequences-once when the company makes its profit and a second time when dividends are paid to shareholders. S corporations can mitigate this tax issue.

Questions to ask your Business Attorney

Once you decide to hire a business attorney, you have to find one who has the right experience for your business needs. Following is a list of questions to ask, the answers to which will help you determine whether you have found the right business attorney:

1. How long have you been practicing law?
2. What is your area of specialty?
3. Have you represented companies like mine?
4. Who are the attorneys and paralegals at your firm that would work on my matters and what experience do they have?
5. How do you charge legal fees and for what expenses will I be charged (e.g., faxing, word processing, copying, postage)?
6. How many businesses have you incorporated?
7. What experience do you have in handling employment matters?
8. What experience do you have in dealing with tax matters?
9. What kinds of advice do you give to businesses to lessen the likelihood of litigation?