YOUR VIRTUAL ASSISTANT

P.O. Box 2771
Addison, TX 75001-2771
Tel/fax 972.661.1121
tstewart@SOSservice.org
www.SOSservice.org

Advantages and Disadvantages of Forming a Corporation- Source- All Business

A *corporation* is defined as a legal entity or structure created under the authority of a state's laws, 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.

Regardless of the tack you take, 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 them 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. The owners of a corporation are shareholders, who elect a Board of Directors, which then elects the officers. Other than the election of directors, shareholders do not participate in the operations of the corporation. The Board of Directors is responsible for managing and exercising the rights and responsibilities of the corporation. The Board sets corporate policy and the strategy for the corporation, and 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 tends 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 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 four types of fees: 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 attorneys' fees. But every year, tens of thousands of businesses choose to incorporate online without the use of an attorney. For example, basic incorporation before filing fees at a site like LegalZoom.com costs just $99.
- **Formalities.** The proper corporate formalities of organizing and running a corporation must be followed, to receive the benefits of being a corporation.
- **Paperwork.** Paperwork is a huge component of the corporate formalities that must followed. 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 the 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.