



**YOUR
QUESTIONS
ABOUT
INCORPORATION
ANSWERED**



Incorporating Your Business

What is Involved and How to Select a Corporate Law Service Provider

Incorporating your business can have many advantages. Adding "Inc." to your company name can lend a great deal of credibility and help your business establish a professional image. Because corporations involve more complex legalities than unincorporated businesses, it is generally advisable to seek the advice of an attorney who specializes in corporate law and will work to protect the rights of your corporation. This guide is designed to help you make an informed decision when it comes to incorporating your business and to choose the right corporate law service provider for your business.

Should You Incorporate Your Business?

There are several factors to consider when making this decision, so it's wise to conduct thorough research to be sure you are making the best choice for your company.

A main factor that distinguishes a corporation is that it legally exists separately from its owner or owners. A corporation's owners are its shareholders, whose percentage of ownership in the business is represented by corporate shares or stocks. Shareholders can choose a board of directors to manage business operations, or they can create a shareholders' agreement, which will allow them to manage the business directly. This brings several advantages and also some disadvantages to think about when making your decision.

Advantages of Incorporation

1. Since the corporation is a separate entity, its owners and directors are protected from liability in the event of a lawsuit. Shareholders cannot be held personally liable for corporate debt.
2. Corporations have a distinct advantage in the ability to raise capital through the sale of company stock.
3. Certain tax advantages are inherent in owning a corporation; as the owner, your profit from the corporation will be paid to you in the form of a salary, plus any dividends and bonuses. Any additional profits from the business will be taxed at a lower, corporate rate.
4. Many corporations prefer to do business with other corporations. This can be a definite advantage if your company provides business to business services.



5. A corporation is a more permanent type of organization, because it does not end with the death of its founders.
6. Investors tend to have more confidence in businesses that are incorporated, which can make it easier for corporations to raise investment capital.
7. Corporations can provide benefits such as health insurance to members and employees. The corporation can then deduct a portion of the cost of these benefits at tax time.
8. As a corporation, your business can offer advantages such as stock options, making employment with your company appealing to highly qualified talent.

Some Disadvantages of Incorporating

1. Starting and operating a corporation can involve a great deal of time, energy and expense. Incorporating your business will entail start-up and operating costs that other business models do not require.
2. Prepare to be faced with increased paperwork when you incorporate your business. Corporations are expected to comply with federal, state and local agency regulations, which can mean a considerable amount of record-keeping.
3. Corporations can, essentially, end up paying taxes twice, both on the initial profits, and also when its shareholders pay taxes on dividends paid to them.

Forming a Corporation

If you decide to form a corporation you will need to register your business name with your state government. Corporations are formed under the laws of the state with which they are registered. The Small Business Association (SBA) guidelines state that for corporations, your legal name is the one you register with the state. If you plan to conduct business under a different name, you will need to file an assumed business name, or a "doing business as" (DBA) name. Depending on the laws in your state, your business name may be required to include its corporate designation, i.e., "Corporation," "Limited" or "Incorporated."



You will also need to file certain documents, articles of incorporation, with the Secretary of State office in your state when you register as a corporation. Your state may have its own particular requirements for registering businesses as corporations. You may also be required to issue stock certificates to your initial shareholders, for example, or to establish your board of directors as part of the registration process.

Regulations regarding required permits and businesses licenses vary according to state, industry and vicinity. The SBA website's Licensing and Permits tool can help you find a list local, state and federal permits and registrations you will need to operate a business in your area.

How Corporations are Taxed

Most businesses will need to register with the IRS and state and local revenue agencies, and receive a tax ID number or permit.

Corporations are required to pay federal, state, and in some cases, local taxes. Most businesses must register with the IRS and state and local revenue agencies, and receive a tax ID number or permit.

When you form a corporation, you create a separate tax-paying entity. Regular corporations are called "C corporations" because Subchapter C of Chapter 1 of the Internal Revenue Code is where you find general tax rules affecting corporations and their shareholders.

Unlike sole proprietors and partnerships, corporations pay income tax on their profits. In some cases, corporations are taxed twice - first, when the company makes a profit, and again when dividends are paid to shareholders on their personal tax returns.

Corporations use IRS Form 1120 or 1120-A, U.S. Corporation Income Tax Return to report revenue to the federal government.

Shareholders who are also employees pay income tax on their wages. The corporation and the employee each pay one half of the Social Security and Medicare taxes, but this is usually a deductible business expense.



Should You Form a C Corporation or S Corporation?

Another decision you will encounter when taking the step of incorporating your business is whether to form a traditional type of corporation, known as a C corporation (C Corp), or an S corporation (S Corp).

S corporation status allows your company, as a qualifying domestic corporation, to avoid double taxation (once to the corporation and again to the shareholders).

The key difference between an S Corp and a C Corp is this: with an S Corp, your profits and losses can pass through to the personal tax returns of the company's shareholders. As a result, only the shareholders are taxed, and not the business itself. There is a significant qualification, however; any shareholders who also work for the company must pay themselves "reasonable compensation." Essentially, each employee shareholder must be paid fair market value; otherwise, the IRS may reclassify any further corporate earnings as "wages."

Below are some advantages and disadvantages of an S corp, according to the SBA:

Advantages of an S Corporation

Tax Savings - One of the best features of the S Corp is the tax savings for you and your business. While members of an LLC are subject to employment tax on the entire net income of the business, only the wages of the S Corp shareholder who is an employee are subject to employment tax. The remaining income is paid to the owner as a "distribution" which is taxed at a lower rate, if at all.

Business Expense Tax Credits - Some expenses that shareholder/employees incur can be written off as business expenses. Nevertheless, if such an employee owns 2% or more shares, then benefits like health and life insurance are deemed taxable income.

Independent Life - An S Corp designation also allows a business to have an independent life, separate from its shareholders. If a shareholder leaves the company, or sells his or her shares, the S Corp can continue doing business relatively undisturbed. By maintaining the business as a distinct corporate entity, clearer lines are defined between the shareholders and the business that improve the protection of the shareholders.



Disadvantages of an S Corporation

Stricter Operational Processes - As a separate structure, S Corps require scheduled director and shareholder meetings, minutes from those meetings, adoption and updates to by-laws, stock transfers and records maintenance.

Shareholder Compensation Requirements - A shareholder must receive reasonable compensation. The IRS takes notice of shareholder red flags like low salary/high distribution combinations, and may reclassify your distributions as wages. An audit could result in paying a higher employment tax.

Combining the Benefits of an LLC with an S Corp

Another option is to request S Corp status for your limited liability company (LLC).

An LLC is basically a hybrid legal structure for businesses. It combines the limited liability features of a corporation with the operational flexibility and tax advantages inherent in a partnership.

The owners of an LLC are referred to as "members." Depending on the laws in different states, LLC members can consist of a single individual (one owner), two or more individuals, corporations, other LLCs, and even other entities.

Unlike shareholders in a corporation, LLCs are not taxed as a separate business entity. Instead, all profits and losses are "passed through" the business to each member of the LLC. Members report profits and losses on their personal federal tax returns, just as the owners of a partnership would.

You will need to make a special election, using Form 2553, with the IRS to have your LLC taxed as an S Corp. This must be done within the first two months and fifteen days of the tax year in which the election is to take effect.

Your LLC will still be a limited liability company from a legal perspective; it will only be treated as an S Corp for tax purposes. Contact your state's income tax office where the election form will be filed to find out whether your state recognizes the S Corp election and what the tax requirements are. You should also consult your corporate law attorney about whether this would be a good option for your company.



Forming an S Corporation

An S Corp is a corporation that has received the Subchapter S designation from the IRS. If your company is an eligible domestic corporation, it can elect to be treated as an S corporation.

To be considered an S Corporation, your company must first be chartered as a corporation in the state where it's headquartered. According to the IRS, S corporations are "considered by law to be a unique entity, separate and apart from those who own it." This allows for a limit on the financial liability for which an owner (aka "shareholder") is responsible. Liability protection is limited, however; forming an S Corp will not automatically protect you from all legal action, such as an employee's tort actions pertaining to a workplace incident.

To form an S corporation you must first determine if your company qualifies under the IRS stipulations.

Before filing as an S Corporation, you must first file as a corporation. Once you have become a corporation, each shareholder must sign and file Form 2553 to elect your corporation to become an S corporation.

As with any business, you must obtain all appropriate business licenses and permits. Requirements vary by industry, state and locality. The SBA offers a [tool](#) to help you find the federal, state and local permits, licenses, and registrations you will need to obtain.

How to Select Corporate Law Services

A primary consideration when looking for a corporate law attorney is whether to go with a small or large firm. Smaller firms can be less costly and can offer you the opportunity to work closely with an attorney rather than a paralegal or an associate. Larger firms may cost more per hour, but they can offer the advantage of a wider range of specialists with experience handling a greater variety of cases.

Look for an attorney who is accustomed to working with clients in your type of business; such a firm will be accustomed to dealing with legal issues common to your industry.



Find a provider who is willing to answer all of your questions and address any concerns, such as how C-corporation or S-corporation status will affect taxes for your company. A good corporate attorney will be able to explain to you both sides an issue and offer his or her viewpoint on the possible effect a given course of action will have on your company. A quality corporate law provider will take the time to get to know you and understand the needs of your business.

Check with the Bar Association to confirm that the attorney or firm you are considering is in good standing. Be sure to obtain references from the law firm itself. You can also ask for recommendations from other business owners. Visit the law firm's website for more information about the provider's credentials, specialties, experience, and philosophy.

Price will also be a factor, but it should not be your primary focus in searching for a quality provider. However, you won't necessarily have to pay top dollar for good legal services. The Boston Business Journal states, "many firms will work with growth-stage companies by creating payment plans or deferring full payment until capital is freed up through a sale or financing, or in some cases even by taking an equity stake in a startup." Keep in mind too, that a highly experienced attorney or firm with a higher hourly rate might also be more efficient at getting the job done, giving you more value for every hour billed.

Your [corporate law provider](#) can continue to look out for the best interests of your company long after the incorporation process is complete. He or she will ensure that your business is in compliance with the law and that it deals fairly with employees, shareholders, invested parties, clients, customers, and the environment. Choosing a good corporate law attorney for your company is undoubtedly an important step if you plan to incorporate your business. InsideUp can make the process easier by providing quotes from top corporate law providers that match your company's needs.



Glossary

ACQUISITION

The purchase of one corporation by another, through either the purchase of its shares, or the purchase of its assets.

ADMINISTRATIVE DISSOLUTION

The involuntary dissolution of a corporation by the Secretary of State, or other equivalent department, due to the failure of a corporation to meet statutory requirements such as periodic filing and tax reporting requirements.

ADVISORY BOARD

A body that advises the board of directors and management of a corporation but does not have authority to vote on corporate matters.

AGENT FOR SERVICE OF PROCESS

The person or entity that is authorized to receive legal papers on behalf of a corporation.

ALTER EGO LIABILITY

Doctrine that attaches liability to corporate shareholders in cases of commingling of assets and failure to observe corporate formalities.

AMENDMENT OF ARTICLES OF INCORPORATION

The procedure by which one or more changes is made to a corporation's articles of incorporation.

ANNUAL MEETING OF DIRECTORS

A meeting held each year to elect officers of a corporation, and to address other corporate matters. Usually follows immediately after an Annual Meeting of Shareholders.

ANNUAL MEETING OF SHAREHOLDERS

A meeting held each year to elect directors of a corporation, and to address other corporate matters.

APPORTIONMENT

The allocation of income earned from activities in a particular state or assets present in a particular state to determine the tax due in that state.

ARTICLES OF INCORPORATION

The document which gives birth to a corporation by filing in the state of incorporation. Articles cover foundational matters such as the name of the corporation, the shares it is authorized to issue, its corporate purpose, and its agent for service of process.



AUTHORIZED CAPITAL

The total number of a corporation's authorized shares multiplied by the share's par value. For example, 1,000,000 authorized shares of stock with a one cent par value equals an authorized capital of \$10,000.

AUTHORIZED SHARES

The number of shares of a corporation's stock that the corporation has the authority to issue. The authorized shares of a class of stock is stated in a corporation's articles of incorporation.

BLUE SKY LAWS

The securities laws of individual states, collectively. These laws seek to protect people from investing in sham companies - companies that offer nothing more than 'blue sky.'

BOARD OF DIRECTORS

The directors of a corporation, collectively. The directors of a corporation are its governing board. Elected by shareholders, they vote on major corporate matters such as the issuing of shares of stock, election of officers, and approval of mergers and acquisitions.

BOND

An interest-bearing instrument issued by a corporation or other entity that serves as evidence of a debt or obligation.

BUSINESS JUDGMENT RULE

The rule that shields directors from liability for mismanagement of the corporations that they serve.

BYLAWS

The internal operating rules of a corporation, usually set out in a five- to twenty-page document. Bylaws govern such matters as holding meetings, voting, quorums, elections, and the powers of directors and officers.

C CORPORATION

Any corporation that has not elected S Corporation status.

CERTIFICATE OF AUTHORITY

A document issued by the secretary of state or equivalent department that authorizes a foreign corporation to operate in a state other than its state of incorporation.

CERTIFICATE OF GOOD STANDING

A document issued by the secretary of state or equivalent department that certifies that a corporation is validly existing and in compliance with all periodic and taxation requirements.



CLOSE CORPORATION

A corporation owned by a small number of individuals. Corporations must elect to be close corporations by inserting a statement in their articles of incorporation. State laws typically permit close corporations to be operated more informally than non-close corporations

COMMON STOCK

A corporation's primary class of stock. Common stock holders typically have voting rights.

CONVERSION; CONVERSION RIGHTS

Rights allowing the holder of shares of stock or other financial instrument to convert to other shares of stock.

CONVERTIBLE INSTRUMENT

Financial instruments such as bonds or notes that can be converted into shares of stock. Shares of stock may also be convertible into shares of another class.

CORPORATE SECRETARY

A corporate officer, elected by the directors, usually charged with record-keeping responsibilities.

CUMULATIVE VOTING

A system of voting shares of stock used in some states. Cumulative voting gives minority shareholders additional voting power by allowing them to 'cumulate' their votes for a single director.

DEADLOCK

The circumstance that arises when either the board of directors or shareholders are evenly split on a vote and cannot take action. Deadlock can lead to judicial resolution of the underlying dispute.

DEBT FINANCING

A method of financing where the company receives a loan and gives its promise to repay the loan.

DILUTION

The effect of reducing an existing shareholder's interest in a corporation when new shares are issued.

DIRECTOR

The directors of a corporation are its governing board. Elected by shareholders, they vote on major corporate matters such as the issuing of shares of stock, election of officers, and approval of mergers and acquisitions.



DISSOLUTION

The process of shutting down a corporation, settling its affairs, and ending its life.

DISTRIBUTION

A transfer of profits or property by a corporation to its shareholders.

DIVIDEND

A share of profits issued to the holders of shares in a corporation. Dividends can be paid in shares of stock or other property such as shares in a subsidiary or parent company.

DIVIDEND PRIORITY

Special rights enjoyed by holders of a secondary class of stock that entitle holders to receive dividends before other shareholders.

DOING BUSINESS AS (DBA)

A company whose operating name differs from its legal name is said to be 'doing business as' the operating name. Some states require DBA or 'fictitious business name' filings to be made for the protection of consumers conducting business with the entity.

DOMESTIC CORPORATION

In general, a corporation whose articles of incorporation are filed in the state in which it operates and maintains its principal office.

EQUITY FINANCING

A method of financing where a company issues shares of its stock and receives money.

EQUITY INTEREST

Another term for an ownership interest in a company.

FICTITIOUS BUSINESS NAME

A company whose operating name differs from its legal name is said to be doing business under a fictitious business name. Some states require DBA (doing business as) or fictitious business name filings to be made for the protection of consumers conducting business with the entity.

FIDUCIARY RELATIONSHIP

A special relationship in which one party, the fiduciary, owes heightened duties of good faith and responsibility to the other party.

FOREIGN CORPORATION

In general, a corporation that operates in one state but whose articles of incorporation are filed in another state; the state in which it operates refers out-of-state corporations as 'foreign.' The term also refers to corporations chartered in foreign nations.



FRANCHISE TAX

A tax levied in consideration for the privilege of either incorporating or qualifying to do business in a state. A franchise tax may be based upon income, assets, outstanding shares, or a combination.

FULLY REPORTING COMPANY

A public company that is subject to the Securities and Exchange Commission's periodic reporting requirements.

GOING PUBLIC

The process of becoming a public, fully reporting company either by filing a registration statement with the SEC, or by merging with a public company.

GOOD STANDING

A state a corporation enjoys when it is in full compliance with the law.

ILLIQUIDITY DISCOUNT

A discount in the value of an interest in a business because of legal restrictions on the resale of such interest.

INCORPORATOR

The person or entity that organizes a corporation and files its Articles of Incorporation. The incorporator can take corporate actions before directors and officers are appointed.

INVOLUNTARY DISSOLUTION

The forced dissolution of a corporation by a court or administrative action.

JUDICIAL DISSOLUTION

The forced dissolution of a corporation by a court at the request of a state attorney general, shareholder, or creditor.

LIMITED LIABILITY COMPANY (LLC)

A new and flexible business organization that offers the advantages of liability protection with the simplicity of a partnership.

LIMITED PARTNERSHIP

A business organization that allows limited partners to enjoy limited personal liability while general partners have unlimited personal liability.

LIQUIDATION PREFERENCE

Certain classes of stock (usually preferred stock) may have a liquidation preference, which entitles the holders to be paid first in the event of the liquidation of a corporation's assets.

MERGER

The combination of one or more corporations into a single corporation.



NO PAR SHARES

Shares for which there is no designated par value.

NONPROFIT CORPORATION

A business organization that serves some public purpose, and therefore enjoys special treatment under the law. Nonprofits corporations, contrary to their name, can make a profit, but cannot be designed primarily for profit-making. Distributions upon liquidation typically must be made to another nonprofit.

OFFICER

The managers of a corporation such as the President, CFO, and Secretary. The officers are appointed by the board of directors.

OUTSIDE DIRECTOR

An independent member of the board of directors that is not a shareholder or regular employee of a corporation.

PAR VALUE

The issued price of a security that bears no relation to the market price.

PARENT CORPORATION

A corporation that either owns outright or controls a subsidiary.

PARTNERSHIP

A business organization formed when two or more persons or entities come together to operate a business for profit. Partnerships do not enjoy limited liability, except in the case of limited partnerships.

PIERCE THE VEIL

Doctrine that attaches liability to corporate shareholders in cases of commingling of assets and failure to observe corporate formalities.

PREEMPTIVE RIGHTS

Rights enjoyed by existing shareholders to purchase additional shares of stock in the same proportion to their existing holdings.

PREFERRED STOCK

A separate and/or secondary class of stock issued by some corporations. Preferred stock typically has limited or no voting rights, but its holders are paid dividends or receive repayment priority in the event the corporation is liquidated.

PROFESSIONAL CORPORATION

A corporation whose members are all licensed professionals, such as doctors, lawyers, accountants and architects.



PROXY

An authorization by one shareholder giving another person the right to vote the shareholder's shares. Proxy also refers to the document granting such authority.

QUALIFICATION

The process by which a foreign corporation registers in a state of operation other than its state of incorporation.

QUORUM

The minimum percentage of either shareholders or directors that must be present at a meeting in order for a vote to be legally effective.

REDEMPTION

A repurchase of shares from shareholders by a corporation.

REDEMPTION RIGHTS

Right of repurchase enjoyed by a corporation that exist for certain shares of stock.

REGISTERED AGENT

The person or entity that is authorized to receive legal papers on behalf of a corporation.

REGISTERED OFFICE

The official address of a corporation. Typically this address is the same as that of the registered agent.

RESIDENT AGENT

The person or entity that is authorized to receive legal papers on behalf of a corporation.

S CORPORATION

A 'subchapter S' corporation is a corporation that elects by filing with the IRS to be treated as a partnership for taxation purposes.

SECRETARY (CORPORATE SECRETARY)

A corporate officer, elected by the directors, usually charged with record-keeping responsibilities.

SECRETARY OF STATE

A state official charged with responsibility for the filing of legal documents, including corporation papers.

SECURITIES

The broad term that refers to shares of stock, bonds, and some debt instruments.



SHAREHOLDER

An owner of a corporation and one who holds shares of stock in a corporation

SHAREHOLDER'S AGREEMENT

An agreement between the shareholders of a corporation that can cover various matters such as a commitment to vote particular persons as directors and

SHELF CORPORATION

A fully formed corporation without operations, assets, or liabilities that remains in inventory, or on a 'shelf,' waiting for a buyer. The advantages

SIMPLE MAJORITY

With respect to shareholder and director voting, more than 50%.

SOLE PROPRIETORSHIP

Simply, a business owned and managed by one person. Sole proprietorships do not enjoy liability protection.

SPECIAL MEETING OF DIRECTORS

A meeting of directors, but not an annual meeting, called for a specific purpose.

SPECIAL MEETING OF SHAREHOLDERS

A meeting of shareholders, but not an annual meeting, called for a specific purpose.

STOCKHOLDER

An owner of a corporation and one who holds shares of stock in a corporation.

SUBSCRIBER

A person who contracts to purchase the shares of a corporation.

SUBSCRIPTION AGREEMENT

A contract to purchase the shares of a corporation.

SUBSIDIARY

A corporation that is owned outright or controlled by a parent corporation.

SUPERMAJORITY

With respect to shareholder and director voting, any required percentage higher than 50 percent.

UNDERCAPITALIZATION

The condition that exists when a company does not have enough cash to carry on its business and pay its creditors.

VOLUNTARY DISSOLUTION

The intentional dissolution of a corporation by its own management.



VOTING RIGHT

The right enjoyed by shareholders to vote their shares.

WARRANT

An instrument which grants its holder the option or right to purchase shares of stock at a future date at a specific price. Warrants are tradeable.

WINDING UP

The process of paying creditors and distributing assets that occurs before the dissolution of a corporation.

WRITTEN CONSENT

A document executed by either the shareholders or directors of a corporation in lieu of a formal meeting.