How To Form A Corporation

Corporation is a legal form of organization of persons and material resources, chartered by the state, for the purpose of conducting business. Corporation is owned by shareholders, the Board of Directors governs the business, and elected officers manage the day-to-day activities. Corporation must adhere to corporate tax laws and file corporate taxes regularly.

A Corporation, also referred to as Standard Corporation, C-Corporation, or Regular Corporation, may have an unlimited number of shareholders, including foreign citizens, may be public (when shares are offered for sale to the public) or privately held (when shares are not sold to the public). Usually shares of the corporation are held by the founders, board members and private investors, such as venture capitalists, who may or may not sit on the board of directors.

C Corporation is the most common type of incorporation. C Corporation is considered to be a for-profit, state-incorporated business. Registration is done with state authorities and must abide by corporate laws in the state where it is incorporated.

Corporation provides protection to its shareholders from the corporation's liabilities, thus the term "limited liability". However, C-Corporations also have what is called "double taxation" - first the corporation is taxed on its profits, and then shareholders are taxed on the distributions they receive, such as profit sharing payments or dividends.

To incorporate you will need to register your business name, file a certificate of incorporation or articles of incorporation, and pay a fee. You will also need to draft corporate bylaws and hold a board of director's meeting.

Why Should I Incorporate?

Incorporating is one of the best ways to protect your personal assets while doing business. Most people choose to incorporate solely for this reason, but its not the only advantage of incorporation.

For example, owning a corporation can save you tax money, allows for a greater business flexibility, reduces your chances to be audited, provides tools for better itemization, and makes raising capital less complicated.

Advantages of Incorporating

- **Limited Liability:** A corporation is a legal entity that exists separately from its owners or shareholders. With some exceptions, shareholders are not liable for the debts and obligations of the corporation or from any litigation where the corporation is the defendant. Some form of insurance may still be necessary, but incorporation contributes an added layer of protection (also called "corporate veil").
- **Tax Savings:** Careful planning of your business expenses can result in lower overall tax rates. There are many tax benefits for doing business under incorporation, depending on your business income. Even if your young business becomes quite profitable soon, a corporation is entitled to many deductions otherwise not available to you, resulting in significant tax savings. An example of such tax-deductible expense would be salaries of your employees and yourself.
- **Reduces Likelihood of IRS Examination (Audit):** Non-incorporated businesses, particularly of higher gross income levels, are targets of many IRS Audits. Incorporated businesses have a much lower audit rate, even if they have high income levels.
- **Anonymity:** Depending on the state where you choose to incorporate in, a corporation can be established in such a way that shareholders/owners remain anonymous. Often same level of anonymity can be provided for officers and directors.
- **Added Credibility:** A corporate structure communicates permanence and credibility, even if it's a company with only one stockholder and employee.
- **Easier Access to Capital Funding:** With a corporation it is much easier to attract investors through the sale of stock.
- **Easier Transfer of Ownership:** Ownership of a corporation may be transferred without substantial disruption of operations through the sale of stock. This way the need for complex legal documentation is reduced.
- **Flexibility of Share Ownership:** Owning shares gives you the flexibility needed, among other things, to effectively capitalize your business, or to retain key employees. To further capitalize the business successful C-Corporation can be taken public in a process called Initial Public Offering (IPO). You can also issue stock or stock options to your key employees, "binding" them to the business and thus retaining them (common in hi-tech industry among others).

- **Longevity:** The board carries on the corporation, not the owner. That means that a corporation formation can last longer than an owner-based company such as an LLC.

Main Disadvantages of C-Corp.

C Corporations have certain disadvantages. The main disadvantage is the fact that the profit of a C-Corporation is taxed to the corporation when earned, and the corporation does not get a tax deduction when it distributes dividends to shareholders. Then when dividends are distributed to the shareholders they are taxed again at the shareholder level. This phenomenon is called "double taxation".

Similarly, when C-Corporation has a loss, its shareholders cannot deduct it from their personal income.

C-Corp. vs. S-Corp. vs. LLC

Other forms of incorporation of business organization include S-Corporation and LLC. Each of those types of entities have certain advantages and disadvantages when compared to the common C-Corporation.

For an itemized comparison between those three types of entities please consult our article "LLC vs. Corporation".

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