

How--and Why--to Incorporate Your Business

Is incorporation right for you?

The term *corporation* comes from the Latin *corpus*, which means *body*. A corporation is a body--it is a legal person in the eyes of the law. It can bring lawsuits, can buy and sell property, contract, be taxed, and even commit crimes. It's most notable feature: a corporation protects its owners from personal liability for corporate debts and obligations--within limits.

The corporation is considered an artificially created legal entity that exists separate and apart from those individuals who created it and carry on its operations. With as little as one incorporator, a corporation can be formed by simply filing an application for a charter with the respective state. By filing this application, the incorporator will put on record facts, such as:

- the purpose of the intended corporation,
- the names and addresses of the incorporators,
- the amount and types of capital stock the corporation will be authorized to issue, and
- the rights and privileges of the holders of each class of stock.

Why Incorporate?

It is true that operating as a corporation has its share of drawbacks in certain situations. For example, as a business owner, you would be responsible for additional record keeping requirements and administrative details. More important, in some cases, operating as a corporation can create an additional tax burden. This is the last thing a business owner needs, especially in the early stages of operation.

Remember, aside from tax reasons, the most common motivation for incurring the cost of setting up a corporation is the recognition that the shareholder is not legally liable for the actions of the corporation. This is because the corporation has its own separate existence wholly apart from those who run it. However, let's examine three other reasons why the corporation proves to be an attractive vehicle for carrying on a business.

- **Unlimited life.** Unlike proprietorships and partnerships, the life of the corporation is not dependent on the life of a particular individual or individuals. It can continue indefinitely until it accomplishes its objective, merges with another business, or goes bankrupt. Unless stated otherwise, it could go on indefinitely.

- **Transferability of shares.** It is always nice to know that the ownership interest you have in a business can be readily sold, transferred, or given away to another family member. The process of divesting yourself of ownership in proprietorships and partnerships can be cumbersome and costly. Property has to be retitled, new deeds drawn, and other administrative steps taken any time the slightest change of ownership occurs. With corporations, all of the individual owners' rights and privileges are represented by the shares of stock they hold. The key to a quick and efficient transfer of ownership of the business is found on the back of each stock certificate, where there is usually a place indicated for the shareholder to endorse and sign over any shares that are to be sold or otherwise disposed of.
- **Ability to raise investment capital.** It is usually much easier to attract new investors into a corporate entity because of limited liability and the easy transferability of shares. Shares of stock can be transferred directly to new investors, or when larger offerings to the public are involved, the services of brokerage firms and stock exchanges are called upon.

Advantages of Incorporating

- Owners are protected from personal liability from company debts and obligations.
- Corporations have a reliable body of legal precedent to guide owners and managers.
- Corporations are the best vehicle for eventual public companies.
- Corporations can more easily raise capital through the sale of securities.
- Corporations can easily transfer ownership through the transfer of securities.
- Corporations can have an unlimited life.
- Corporations can create tax benefits under certain circumstances, but note that C corporations may be subject to "double taxation" on profits. To avoid this, many business owners elect to operate their corporations under subchapter S of the Internal Code. Also known as an S corporation, this entity allows income to pass through to the individual shareholders.

Disadvantages of Incorporating

- Corporations require annual meetings and require owners and directors to observe certain formalities.

- Corporations are more expensive to set up than partnerships and sole proprietorships.
- Corporations require periodic filings with the state and annual fees.