

Corporations

Purpose

- ◆ Entity created by the law to conduct any lawful business
- ◆ Generally two types: Stock and Non-Stock
- ◆ Stock Corporation is a business entity authorized by law to issue shares of equity;
 - (1). Regular Corporation: called a C Corp or a S Corp
 - (2). Professional Corporation: organized for sole purpose of rendering certain professional services whose shareholders are authorized to render such professional services. Shareholders are personally liable for their own negligence
- ◆ Non-Stock Corporation for clubs, charities and entities not operated for profit

Organization

- ◆ Must file *Articles of Incorporation* with the Arizona Corporation Commission
- ◆ *Bylaws* set forth rules of day-to-day business
- ◆ Name must be distinguishable from every other corporation
- ◆ Name must contain work “Company,” “Limited,” “Incorporated,” or an abbreviation of same

Control

- ◆ Shareholders elect directors who are charged with managing business
- ◆ Directors do this through officers they elect who have day-to-day control

Duration

- ◆ Perpetual existence

Liability

- ◆ The corporation is a separate entity from the shareholders
- ◆ The corporation, not the shareholders, is liable for the obligations of the business
- ◆ *Caveat* Shareholders become personally liable if the Court can “*pierce the corporate veil*.” This occurs if (1) you fail to follow organizational formalities

Transfer of Interests

- ◆ Shares are freely transferable by sale, gift or devise (unless restricted by stock agreement)

Tax Treatment: C Corp

- ◆ Controlled by Subchapter C of Internal Revenue Code
- ◆ Corporation pays taxes on earnings
- ◆ Shareholders pay taxes on dividends
- ◆ Double taxation

Tax Treatment: S Corp

- ◆ Controlled by Subchapter S of Internal Revenue Code
- ◆ Corporation treated as partnership (i.e. not taxed on its earnings)
- ◆ Profits flow through to shareholders who pay taxes in proportion to ownership interests

Advantages: C Corp

- ◆ Limited liability for individual owners
- ◆ Ability of owners to participate in management through election of Board and right to vote on certain fundamental matters
- ◆ Only one person needed to form a C Corp
- ◆ Commonly accepted business entity with a lot of case law
- ◆ Particularly suited for broad public investment

Advantage: S Corp

- ◆ Same “non-tax” advantages as C Corp (i.e. limited liability, participate in management, etc)
- ◆ No double taxation: items of income, loss deductions and credit are passed through to shareholders in proportion to their stock ownership and are not taxed to the corporation
- ◆ Especially good for a business that anticipates initial losses but long-term profits. It can begin as a S Corp so that shareholders can deduct losses on individual tax returns, and later convert to a C Corp. Can only switch every 5 years

Disadvantages :C Corp

- ◆ Double taxation
- ◆ Must use accrual method of accounting
- ◆ Relatively inflexible in structure and ability to adjust voting rights or to allocate tax and economic benefits in any proportion other than stock ownership
- ◆ High initial start up costs
- ◆ More formalities in conducting business; failure to do so may allow Court to pierce the corporate veil (i.e. no limited liability)

Disadvantages: S Corp

- ◆ No more than 35 owners who all must be individuals (no corporations and no foreigners)
- ◆ Can issue only one class of stock (i.e. less flexible than C Corp)
- ◆ Cannot be member of an “affiliated group” (i.e. own more than 80% of voting stock of another entity)
- ◆ One major tax disadvantage, compared to a partnership or LLC, is that deductibility of losses by a shareholder is limited to the shareholder’s basis resulting from capital contributions or loans from the shareholder. Corporate debt is not allocated to the shareholder’s basis even if guaranteed by him