Choosing a Legal Structure, pt.2:
The Corporation

The corporation is by far a more complex business structure. A corporation is a distinct legal entity. That is, it is separate from the individuals who own it. A corporation is formed by the authority of a state government. Corporations that do business in more than one state must comply with each state's law regarding qualification of foreign corporations to do business in each state. These laws may vary considerably. All businesses must comply with and are affected by interstate commerce provisions.

Two Types of Corporations - "C" and "S"

The IRS classifies corporations for tax purposes. There are two tax designations given to corporations, the C corporation and the S corporation. Alabama defines an S corporation for state tax purposes by IRS elections. Some states do not tax corporations at all. C corporations are taxed as a separate legal entity from their shareholders, and C corporations pay their own taxes.

The S corporation, sometimes called the small business corporation, is taxed like a partnership. In the S corporation, the tax is passed through to the shareholder's personal income tax. Several additional restrictions, such as limits on the number and type of shareholders and means of capitalization, apply to the S corporation. When the incorporation process is complete, the firm is automatically classified as a C corporation. To be classified as an S corporation, an election must be made by the corporation and Form 2553 must be filed with the IRS.

Forming the Corporation

The procedure ordinarily required to form a corporation is that first a subscription for capital stock must be taken and a tentative organization created. Then articles of incorporation in statutory form must be filed in the county probate office and with the secretary of state in the state in which the corporation is to be formed. A certificate of incorporation is then issued by the secretary of state, acknowledging the corporation's existence.

Advantages

- One or more stockholders
- Limitations of the stockholder's liability to a fixed amount of investment, unless voluntarily assumed
- Ownership is readily transferable
- Separate legal existence
- Stability and relative permanence of existence
- Relative ease of securing capital
- Centralized management of business
- The ability to draw on the expertise and skills of many

Disadvantages

- Activities may be limited by the charter and various laws
- Minority stockholders may be exploited
- Extensive government regulations and required reports
- Less financial incentive for the manager
- Double Taxation on C corporation (does not apply to S corporation), income tax on corporate net income (profit) and also on salaries, dividends, and capital gains