

# Incorporating Your Business

by:



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# Incorporating Your Business

## **The Incorporation Checklist**

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- Hold the First Meeting of the Board of Directors
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## **Select a Business Structure**

The first step in starting a small business is to select the legal structure for your business. Legal business structures will vary in formation costs and in complexity of management.

The list of business structures presented below present the most popular legal structures utilized by most business owners in the United States:

### ***Popular Business Structures***

- Sole Proprietorship
- General Partnership
- Joint Venture
- Limited Partnership
- Limited Liability Partnership
- Limited Liability Company (L.L.C.)
- Corporation

- S Corporation
- Not-for-Profit Corporation
- Professional Corporation

## ***Is Incorporating Right for you?***

### **Reasons for NOT Incorporating**

While most individuals with business savvy recognize that there are benefits to incorporating a business, many are discouraged from doing so for the following reasons:

- Costly Legal Fees
- Lengthy filing process
- Complexity of the incorporation process
- Lack of information as to the requirements for properly maintaining a corporation

### **Who SHOULD Incorporate?**

Today, however, the process has been significantly simplified. State offices now offer free sample forms and sample articles of incorporation. Document filing services such as MyCorporation.com offer an affordable, reliable, and fast method for preparing and filing corporate documents in any state.

Thus, many of the reasons for NOT incorporating have been removed thanks to technology and innovation. Still, however, incorporating a business is not for everyone. Please review the questions below to better determine whether incorporating your business may be a good choice for you.

- Do you own real estate?
- Are you concerned about protecting your personal assets from business creditors?
- Will your business have partners or other stakeholders?
- Are you concerned about a partner possibly binding you and your personal assets without your consent or knowledge?
- Would your business benefit from tax benefits extended solely to corporations?
- Do you plan to hire employees in the next 12 months?
- Do you want to raise capital for your business through the sale of stock?
- Are you seeking a government contract in a municipality that requires bidders be incorporated entities?
- Do you want your business to continue after your death or the death of a partner?

If you answered “Yes” to any of the above questions, incorporating your business may be in your best interest.

## **Business Structures Compared**

The table below presents some of the most important features of the different business structures.\*

	Protection of Personal Assets	Unemployment, Fringe, & Other Tax Benefits	Ability to Raise Capital	Duration of Existence	Formalities Required
Sole Proprietorship	None	Few Benefits	Difficult	Cancellation of DBA or Death of Owner	Fewest
General Partnership	None	Few Benefits	Complex	Dissolution or Death or Bankruptcy of a Partner	Fewest
Joint Venture	None	Few Benefits	Complex	Dissolution or Death or Bankruptcy of a Partner	Fewest
Limited Partnership	None for General Partners.	Some Benefits	Complex	Dissolution or Death or Bankruptcy of a Partner	Some
Limited Liability Partnership	Maximum Protection	Many Benefits	Simple (restrictions apply)	Dissolution or Death or Bankruptcy of a Partner	Some
Limited Liability Company	Maximum Protection	Many Benefits	Simple (restrictions apply)	Dissolution or Death or Bankruptcy of a Member; OR Perpetual (Most States)	Some
Corporation	Maximum Protection	Many Benefits	Simple (Restrictions Apply)	Perpetual	Most
S Corporation	Maximum Protection	Many Benefits	Simple (Restrictions Apply)	Perpetual	Most
Non Profit Corporation	Maximum Protection	Maximum Benefits	Simple (Restrictions Apply)	Perpetual	Most
Professional Corporation	Varies by State Law	Many Benefits	Simple (Restrictions Apply)	Perpetual	Most

*NOTE: This chart has been drafted based on the laws in the majority of states and have been presented in a simplified form to illustrate general differences amongst entities; for example, although the chart states that a General Partnership will dissolve upon the death or bankruptcy of a partner, it is possible to prevent such a dissolution through a proper drafting of a written partnership agreement. These details, however, are beyond the scope of this publication.*

## **Choose a State of Formation**

### ***Delaware Corporations***

Most legal professionals recognize that Delaware has some of the most advanced and flexible corporation statutes in the nation. In addition, Delaware courts possess over 200 years of court decisions and legal precedents in corporation law. Other reasons to incorporate in Delaware include:

#### **The Delaware Advantage**

- Delaware State legislature is vigilant in properly updating corporation statutes and other business laws.
- Delaware Office of the Secretary of State, the office responsible for all corporate filings in Delaware, operates much like a business rather than a government bureaucracy.
  - State-of-the-art document imaging and filing system
  - Extremely customer service-oriented staff
  - Accepts filings of annual reports online through its online filing system.
- Fifty Percent (50%) of corporations listed on the New York Stock Exchange are incorporated in Delaware
- No minimum capitalization requirement
- One person may hold all officer positions in the corporation (e.g. president, vice president, secretary, and treasurer).
- No state income tax imposed upon Delaware corporations that do not operate within Delaware.
- Shares of stock owned by individuals that are not residents of Delaware are not subject to Delaware personal income tax.
- Delaware inheritance tax NOT levied on stock held by nonresidents.
- Delaware maintains the only separate court system for business which may be a significant advantage if legal matters arise involving a trial in Delaware.
- A Corporation can be formed quickly and easily (within 2 hours). NOTE: Additional Expediting fees and restrictions may apply for Rush services.

### ***Nevada Corporations***

In recent years, the state of Nevada has also assumed a pro-business posture. The state of Nevada offers the following reasons as advantages to incorporating in Nevada.

#### **The Nevada Advantage**

- No Nevada State Corporate Income Tax
- No Nevada Taxes on Corporate Shares
- No Nevada Franchise Tax
- No Nevada Personal Income Tax
- No I.R.S. Information Sharing Agreement

- Nominal Annual Fees
- Minimal Nevada Reporting and Disclosure Requirements
- Stockholders are not Public Record
- Stockholders, directors and officers need not live or hold meetings in Nevada, or even be U.S. Citizens.
- Directors need not be Stockholders
- Officers and directors of a Nevada corporation can be protected from personal liability for lawful acts of the corporation
- Nevada corporations may purchase, hold, sell or transfer shares of its own stock
- Nevada corporations may issue stock for capital, services, personal property, or real estate, including leases and options. The directors may determine the value of any of these transactions, and their decision is final.

### ***Your Home State***

While Delaware and Nevada have been historically recognized as offering significant advantages to corporations, some of these “advantages” may not apply to a corporation that maintains “significant business contacts” or “significant shareholder contacts” (a.k.a. "presence") within a particular state.

For example, forming a California corporation for a small business located in California is usually the logical choice for the following reasons:

#### **Filing Fees.**

An out-of-state corporation (e.g. A Delaware Corporation) that will be conducting business in California must "qualify" to do business in California. This "qualifying" requires the corporation to pay filing fees to the California Secretary of State in addition to whatever filing fees were paid in the state of incorporation (e.g. Delaware).

#### **State Taxes.**

An out-of-state corporation doing business in California will have to pay franchise taxes to California. The corporation may also have to pay franchise taxes in its state of incorporation (even if the corporation is not conducting business in that state). Thus, the corporation is potentially exposed to taxing by more than one state.

#### **Securities Laws.**

The California Corporate Securities Laws apply to any offer or sale of a security "in this state" regardless of the issuer's state of incorporation.

#### **Corporate Rules.**

Regardless of where the corporation is formed, many provisions of the California Corporation Law, for example, apply if the corporation has a sufficient "presence" in California.

## **Name Your Corporation**

In general, most states require that a corporation's name contain one of the following corporate indicators:

### ***Required Corporate Indicators***

- Incorporated
- Inc.
- Corporation
- Corp.

### ***Prohibited Words and Phrases***

Additionally, most states prohibit the use of a corporate name that is "substantially similar" to that of a corporate name already in existence or dissolved within the past 2 years. Also, the use of obscenities, profanity, or a name that may be considered "deceptive" is prohibited in most states.

### ***Words Requiring Special Processing***

Some states may impose additional restrictions for naming your corporation where the name implies certain activities that are regulated by state licensing boards. While these names are not prohibited from use, additional steps are required before they may be used in a corporate name. Such words may include:

- Bank
- Insurance
- Trust
- Accounting
- Medical

### ***Protecting a Corporate name***

Generally, incorporating a business under a specific name will only prevent another individual from forming a corporation with the same name in the same state. Thus, it is possible that an individual may incorporate with your corporate name in another state. In some states, it is also possible that an individual may form an LLC or sole proprietorship in the SAME state as your corporation.

To protect your corporate name from use by others, please review the information at our website regarding "trademark protection"

## **Determine the Type of Corporation**

### ***The C Corporation***

#### **The Most Popular Form of Corporation**

The "C-Corporation" designation merely refers to a standard, general-for-profit, state-formed corporation. This is the most popular form of corporation.

To be formed, an Incorporator must file Articles of Incorporation and pay the requisite state fees and prepaid taxes with the appropriate state agency (usually, the Secretary of State -- Corporations Division).

#### **Separate Legal and Tax Life**

A corporation which is properly formed and operated as a corporation assumes a separate legal and tax life distinct from its shareholders. A corporation pays taxes at its own corporate income tax rates and files its own corporate tax forms each year (IRS Form 1120).

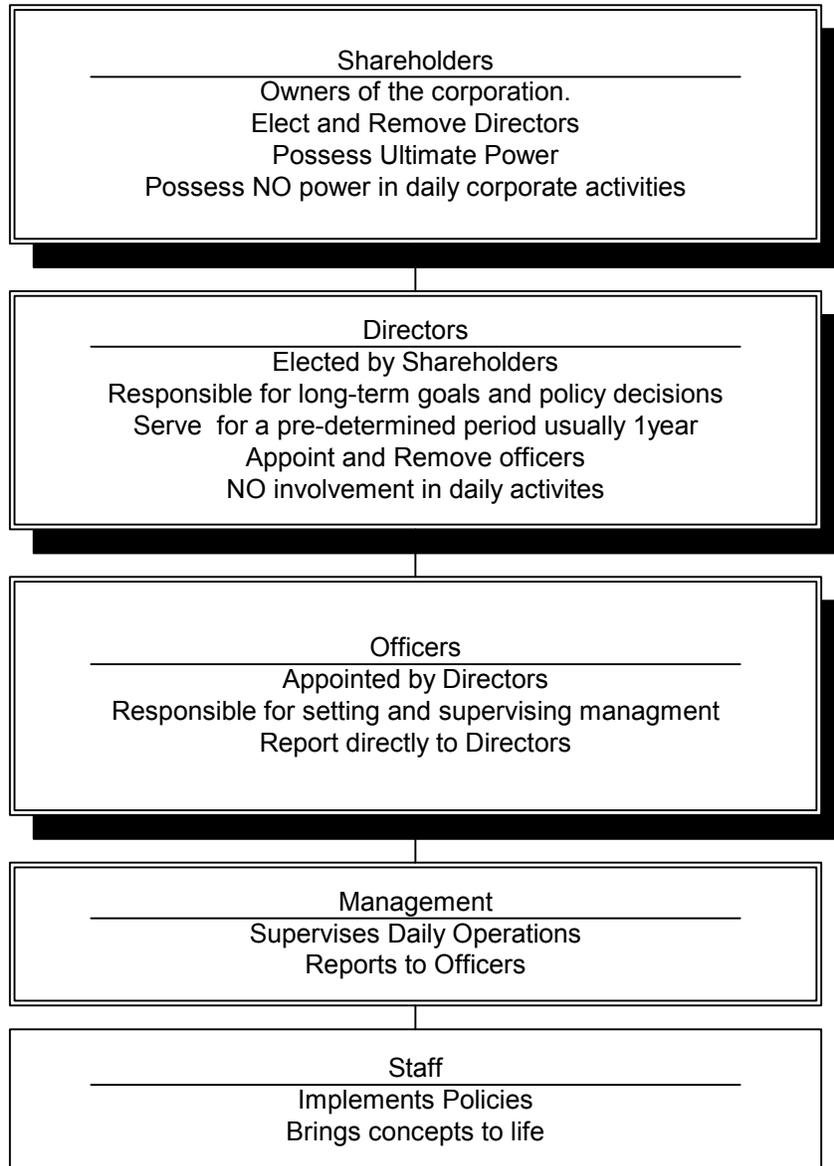
#### **Management and Control in Corporations**

Normally, a corporation's management and control is vested in the board of directors who are elected by the shareholders of the corporation. To maintain a corporation's good standing and thus receive the benefits that incorporation has to offer, individuals in a corporation must assume certain roles.

The illustration below presents a brief overview of the hierarchy of power observed in a corporation.

# My Corporation

Corporate Structure



## **Number of Persons Required**

In most states, one or more persons may form and operate a corporation. Some states, however, require that the number of persons required to manage a corporation be at least equal to the number of owners. For example, if there are two shareholders, there must also be a minimum of two directors.

## **Corporate Formalities**

To retain the corporate existence and thus the benefits of limited liability and special tax treatment, those who run the corporation must observe corporate formalities. Thus, even a one-person corporation must wear different hats depending on the occasion. For example, one person may be responsible for being the sole shareholder, Director, and Officer of the corporation; however, depending on the action taken, that person must observe certain formalities: Annual meetings must be held, corporate minutes of the meetings must be taken, Officers must be appointed, and shares must be issued to shareholders. Most importantly, however, the corporation should issue stock to its shareholders and keep adequate capitalization on hand to cover any "foreseeable" business debts.

## **Shareholder Liability for Corporate Debts**

Where corporate formalities are not observed, shareholders may be held personally liable for corporate debts. Thus, if a thinly capitalized corporation is created, funds are commingled with employees and officers, stock is never issued, meetings are never held, or other corporate formalities required by your state of incorporation are not followed, a court or the IRS may "pierce the corporate veil" and hold the shareholders personally liable for corporate debts.

## **Fringe Benefits**

Corporations may often offer their employees unique fringe benefits. For example, owner-employees may often deduct health insurance premiums paid by the corporation from corporate income. In addition, Corporate-defined benefit plans often afford better retirement options and benefits than those offered by non-corporate plans.

## **Avoiding Double Taxation**

Generally, the corporation is taxed for its own profits; then, any profits paid out in the form of dividends are taxed again to the recipient as dividend income and the individual shareholder's tax rate.

However, most small corporations rarely pay dividends. Rather, owner-employees are paid salaries and fringe benefits that are deductible to the corporation. The result is that only the employee-owners end up paying any income taxes on this business income and double taxation rarely occurs.

## **Duration of a Corporation**

As a separate legal entity, a corporation is capable of continuing indefinitely. Its existence is not affected by death or incapacity of its shareholders, officers, or directors or by transfer of its shares from one person to another.

## **Constitutional Protections for Corporations**

Although a corporation is not a "citizen" under the privileges and immunities clause of the Fourteenth Amendment to the U.S. Constitution, a corporation may

exercise some of the constitutional protections granted to natural persons such as:

- Right to Due Process and Equal Protection
- Freedom of Speech
- Right to Counsel

### ***S-Corporation***

An S Corporation begins its existence as a general, for-profit corporation upon filing the Articles of Incorporation at the state level. A general for-profit corporation (also known as a 'C corporation') is required to pay income tax on taxable income generated by the corporation.

However, after the corporation has been formed, it may elect "S Corporation Status" by submitting IRS form 2553 to the Internal Revenue Service (in some cases a state filing is required as well). Once this filing is complete, the corporation is taxed like a partnership or sole proprietorship rather than as a separate entity. Thus, the income is "passed-through" to the shareholders for purposes of computing tax liability. Therefore, a shareholder's individual tax returns will report the income or loss generated by an S corporation

### ***The Limited Liability Company (LLC)***

Because of its similarities to the corporate structure, the Limited Liability Company (LLC) is often considered by the general public to be a type of corporation. Legally, however, the LLC is not at all considered to be a corporation. In fact, most states have enacted a completely separate and distinct set of statutes specifically regulating the LLC form of business structure.

The LLC is actually a hybrid between a partnership and a Corporation. The most significant feature of the LLC is that it provides many of the features of the corporation while requiring fewer formalities.

#### **One LLC Member Required.**

Historically, most states require that a Limited Liability Company be comprised of at least two LLC members. Today most states and the IRS recognize the single-member LLC as a legitimate business structure.

#### **Separate Legal Entity.**

Like limited partnerships and corporations, the Limited Liability Company shares a similar advantage -- it is recognized as a separate legal entity from its "members."

#### **Limited Liability.**

LLC Members (owners) receive protection of personal assets in a manner very similar to that afforded to corporations

### **Fewer Formalities**

If a corporation fails to observe corporate formalities, such as holding an annual meeting, individual shareholders may be held personally liable for the corporation's business debts. In an LLC, however, fewer formalities exist. For example, in California, an LLC's failure to hold an annual meeting is NOT grounds for holding the LLC's members personally liable for an LLC's business debt since an LLC's failure to hold meetings of members or managers is not usually considered grounds for imposing the alter ego doctrine where the LLC's Articles of Organization or Operating Agreement do not expressly require such meetings.

### **Management and control.**

Management and control of an LLC is vested with its members unless the Limited Liability Company's articles of organization provide otherwise.

### **Voting Interest.**

Ordinarily, voting interest in an LLC directly corresponds to interest in profits, unless the articles of organization or operating agreement provide otherwise.

### **Transferability.**

No one can become a member of an LLC (either by transfer of an existing membership or the issuance of a new one) without the consent of members having a majority in interest (excluding the person acquiring the membership interest) unless the articles of organization provide otherwise.

### **Duration.**

Historically, an LLC was required to specify a date of dissolution in its articles of organization. Today, however, many states will allow an LLC to maintain a perpetual existence.

### **Formation**

The existence of an LLC begins upon the filing of the Articles of Organization with the Secretary of State. The articles must be on the form prescribed by the Secretary of State. Among the required information on the form is the latest date at which the LLC is to dissolve and a statement as to whether the LLC will be managed by one manager, more than one manager, or the members.

To validly complete the formation of the LLC, members must enter into an Operating Agreement. This Operating Agreement may come into existence either before or after the filing of the Articles of Organization and, in many states, may be either oral or in writing.

## ***Non Profit Corporation***

### **Similarities to “For-Profit” corporations**

Many of the characteristics of the C-Corporation discussed herein apply to nonprofit corporations as well. Nonprofit corporations, however, have some very distinct features specific to this type of entity

### **Tax Exemption under 501(c)(3)**

In contrast to the other types of corporations discussed herein, under Federal Tax Code Section 501(c)(3), a tax-exempt corporation cannot pay dividends AND, upon dissolution, must distribute its remaining assets to another nonprofit group or certain other recipients as mandated by the statutes.

### **Miscellaneous Advantages**

- Lower postal rates on bulk mail
- Discounted advertising rates provided by organizations that support nonprofit entities
- Discounted Internet Access rates
- Discounted membership rates offered by national chain stores such as Costco
- Federally subsidized job-training and work-study programs for nonprofit corporation employees

### **The Burdens of Operating a Nonprofit Corporation**

- Enormous paperwork and filing requirements to obtain tax exempt status
- Federal & State Filings required to obtain tax-exempt status
- Limitations imposed on the types of activities that may be conducted by the corporation

### **Miscellaneous Limitations**

- Pursuit of the following corporate purposes only:
  - Charitable
  - Educational
  - Religious
  - Literary
  - Scientific
- No distribution of financial gains to directors, officers or members.
- Corporate assets may only be distributed to another tax exempt organization upon dissolution of the nonprofit corporation.
- Participation in political campaigns for or against persons running for public office is prohibited.
- Substantial engagement in legislative political activities is forbidden.

## ***Professional Corporation***

Most Corporations are formed as General, for-profit corporation. However, where the corporation will be engaging in what your state might call "professional services," the Articles of Incorporation must bear special language and the corporation must be formed pursuant to certain statutory provisions.

"Professional Services" according to most states usually consists of the following activities:

### **Professional Services**

- Medical Services
- Legal Services and Representation
- Accounting and Financial Services
- Architectural Services
- Other services may be included in this list depending on your selected state of incorporation.

### **Seek Legal Advice**

MyCorporation.com STRONGLY recommends that you seek the advice of an attorney if you fall within the "Professional Services" statute of your state. However, once you decide that you would like to form a Professional Corporation, MyCorporation.com will gladly assist you with the corporate filing.

Please be advised: Most states vary in their requirements regarding licensing of professional activities. In addition, Mycorporation.com cannot provide you with our CorpPack®. Instead, you'll receive an Elite Corporate Kit with each order.

## **Determine the Composition of Your Stock**

Many different options are available in regards to the structure and composition of a corporation's stock. Where the corporation has fewer than 35 shareholders, a simple, inexpensive model for the structure of corporate stock may be most appropriate. Thus, most small business owners incorporate their businesses with only one class of stock.

In addition, a savvy business owner will recognize that authorizing a number of shares that will qualify for the minimum annual state filing fee is often a wise, money-saving choice. After the corporation begins to thrive and is considering issuing shares to the public, modifying the stock structure can be accomplished by filing an amendment to your articles of incorporation with the state at any time.

## **Designate Corporate Directors**

The Board of Directors is essentially the management body for the corporation. Responsibilities of the Board of Directors include establishing all business policies and approving major contracts and undertakings. In addition, the Board may also elect the President.

Ordinary business practices, however, are carried out by the Officers and employees of the corporation under the directives and supervision of these Directors.

When considering which individuals shall serve on your corporation's Board of Directors, please consider the following:

- Directors must act collectively pursuant to a vote
- The Board of Directors must meet on a regular basis. Monthly or quarterly is acceptable, however, the meeting **MUST** occur at least once per year.
- Board members must be trustworthy as they have a fiduciary duty to act in the best interests of the corporation and cannot put their own interests ahead of corporate interests and concerns.
- Board members must be prudent and not act negligently.
- Meetings must observe corporate formalities

### **Designate a Registered Agent**

Almost ALL jurisdictions require that the corporation designate a registered agent for service of process. However, in most cases, anyone who has a street address (NO PO BOXES) within the state of incorporation may act as a registered agent for the corporation.

The main purpose of the registered agent requirement is to provide potential claimants against your corporation with a live person, whose whereabouts are available in public records, who may accept service of process on behalf of the corporation. In addition, tax notices and other official documents are usually forwarded to the address of the registered agent.

MyCorporation.com can select a registered agent service for you if you are in need of such services. Persons who require our registered agent services are usually those who are incorporating in one state (Nevada, for example) and operating a business in another state (California, for example)

Most often, YOU may act as registered agent for your corporation as long as your Registered Address is within the state of incorporation. Please note, this address MAY NOT be a post office box.

### **Draft and File Articles of Incorporation**

Similar to a Birth Certificate, A corporation's existence begins upon the filing of a document entitled "Articles of Incorporation." Once filed, the corporation comes into existence.

The level of complexity for a corporation's Articles of Incorporation can range from very simple to extremely complex. Generally, most jurisdictions require Articles of Incorporation to contain, at a minimum, the following information

- Corporate Name

- Name and Physical address of the Registered Agent
- The Corporation's business address
- The number of shares the corporation is authorized to issue and, in most states, the par value per share.

## **Hold the First Meeting of the Board of Directors**

During this meeting, the Board of Directors will resolve the following matters. Note, in many states, this "Board" may be comprised of one person:

- Adopt Bylaws
- Issue Stock
- Adopt a corporate seal
- Designate a Banking institution to serve the corporation's banking needs.

## **Operate Your Corporation**

### ***Record-Keeping***

Proper observance of corporate formalities and record-keeping requirements is critical to the continued good-standing of your corporation. Each corporation formed by MyCorporation.com includes our CorpPack which contains all of the following items:

### ***MyCorporation.com has a solution***

MyCorporation.com provides ALL of the following with each corporation formed:

- Preliminary Name Availability Search (Most States)
- Articles of Incorporation prepared and filed with the state of your choice
- 10 Personalized, Security-Coded Share Certificates
- Customized Corporate Bylaws
- Waiver of Notice of First Meeting of Board of Directors
- Notice of Regular Meeting of Board of Directors
- Minutes of Regular Meeting of Board of Directors
- Waiver of Notice of First Meeting of Shareholders
- Notice of Annual Meeting of Shareholders
- Minutes of Annual Meeting of Shareholders
- Stock Transfer Ledger

### ***Observing Corporate Formalities***

Once a corporation is formed, the obvious priority is to ensure that your business thrives from your efforts and maintains stability through your management expertise. However, because a corporation is considered a separate, legal entity, separate and apart from its owners, directors, officers, and employees,

certain formalities must be observed in order to maintain this Good Standing and thus retain a strong “Corporate Shield”

The following list presents issues you should consider when observing corporate formalities:

### ***Corporate Formalities Checklist***

- Are meetings of the Board of Directors regularly scheduled and conducted?
- Are Shareholder meetings regularly scheduled and conducted?
- Do such meetings adequately cover the business that is currently being conducted in the corporation?
- Do meetings provide Shareholders and/or Directors with agendas and goals along with the necessary background information necessary to make an informed decision? Are these materials provided to the Shareholders and/or Directors in advance of the meeting?
- Do Directors have a reasonable opportunity to add items of concern to the meeting's agenda before the directors meet?
- Are agenda items acted upon; or, rather, are they postponed and advanced to future meetings?
- Does the meeting provide adequate time for Board members or Shareholders to discuss each agenda item?
- Is each Director and/or Shareholder afforded a reasonable opportunity to discuss each issue?
- Are Corporate Minutes of each meeting accurately recorded by the Secretary?
- Does the Board meet with and/or receive direct reports from legal counsel, accountants, or other outside advisors? Are these reports included with the Corporate Minutes?
- Are the Corporate Minutes of Board meetings reviewed at subsequent meetings?
- Are the Corporate Minutes amended or corrected for clarity and accuracy?
- Are the dissents to the Corporate Minutes duly recorded?
- Do Board meetings adequately cover substantive policy issues involving the corporation rather than only trivial or administrative detail?
- Is the Board Chairperson effective in conducting Board meetings?

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