The Corporation

Objectives

1. To identify the characteristics of a corporation.
2. To evaluate the three types of corporations.
3. To determine and compare the pros and cons of each type of corporation.

Corporation

- When a group of people form a business or organization which has rights and liabilities separate from those of the individuals involved

Three Types of Corporations

- C Corporation
- S Corporation
- Limited Liability Company

Main Menu

- C Corporations
- S Corporations &
  Limited Liability Companies

C Corporations

Main Menu

C Corporations

- Are also known as general corporations
- Are the most widely used form of business
- Are created by filing the required documents with a particular state government through a process called “incorporation”

C Corporations

- Must adhere to different requirements and fees for filing articles of incorporation in every state
- Require annual fees and annual reports to be filed to maintain the corporation in good standing with the state

C Corporations

- Are treated as separate legal entities from shareholders
- Have the ability to sue or be sued
- Are capable of holding assets in their own names
- Can sign contracts
- Have the ability to make by-laws
  - which govern internal affairs

Shareholder: any person, company, or other institution owning at least one share in a company (also known as a stockholder)

C Corporations

- Contain key workers consisting of directors, officers and shareholders
- Are best suited for:
  - large companies planning to seek outside investors or go public
  - companies operating internationally
  - business owners who have significant personal assets needing to be protected
  - businesses operating in high-risk industries with large liability potential

C Corporations

- Usually limit stockholders' personal liability to the amount of investment in the corporation and no more

Asset: item of ownership having an exchange value
Liability: money or debt owed

C Corporation

- Pros include:
  - unlimited life extending beyond the illness or death of the owners
  - tax-free benefits such as insurance, travel and retirement plan deductions
  - ease in raising capital through sale of stocks and bonds
  - having an unlimited number of stockholders

C Corporation

- Cons include:
  - the use of the double taxation method
  - the high cost of start-up
  - legal formalities required to begin and maintain
  - numerous state and federal rules and regulations

Double Taxation: federal corporate income taxes are paid on profits, as well as stockholders' personal income on any dividends

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C Corporations Assessment

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Assessment

1. C corporations are also known as which of the following?
   A. Incorporated executive companies
   B. Documented businesses
   C. General corporations
   D. Government-certified firms

2. Which of the following are C corporations NOT able to do?
   A. Sue or be sued
   B. Circumvent laws requiring annual reports be filed
   C. Hold assets in their own names
   D. Make by-laws which govern their internal affairs

Assessment

3. C corporations are best suited for which type of business?
   A. Small companies which do not want outside investors
   B. Companies with owners who have few or no personal assets to protect
   C. Business operating in low-risk industries
   D. Businesses operating internationally

4. How many stockholders can a C corporation legally have?
   A. None
   B. 75
   C. 150
   D. An unlimited number

Assessment

5. Which of the following accurately describes double taxation?
   A. Corporate income taxes are paid at the federal and state levels
   B. Corporate income taxes are paid on profits and on stockholders’ personal income dividends
   C. Corporate income taxes are paid for an amount which is double to company’s profits
   D. Corporate income taxes are paid twice each year

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S Corporations & Limited Liability Companies

S Corporations

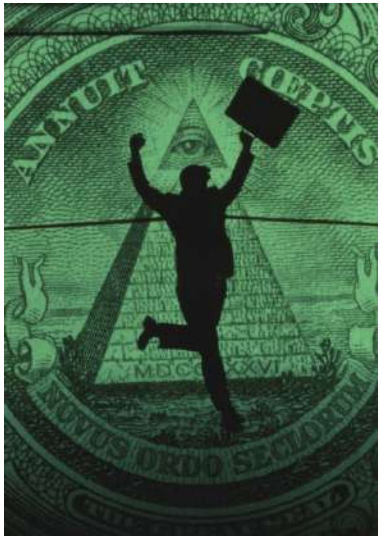
- Are general corporations having elected a special tax status with the IRS after the corporation has been formed
- Are most appropriate for small-business owners and entrepreneurs who prefer to be taxed as if they were still sole proprietors or partners

S Corporations

- Avoid the “double taxation” concept because all income or loss is reported only once on the personal tax returns of the stockholders

S Corporation

- Pros include:
  - not using the double taxation system, so profits are only taxed once at the personal level and not at the corporate level
  - shareholders' assets are not at risk due to liability protection



S Corporation

- Pros include:
  - no corporate alternative minimum tax
  - FICA taxes (relates to social security and Medicare) are not owed on the regular business earnings of the corporation, only on salaries paid to employees

S Corporation

- Cons include:
  - not all domestic general business corporations are eligible for S Corporation status including:
    - a financial institution
    - an insurance company taxed under Subchapter L
    - a domestic international sales corporation (DISC)
    - certain affiliated groups of corporations
  - cannot have more than 75 shareholders

DISC: created to encourage exports and improve the balance of trade

S Corporation

- Cons include:
  - subsidiaries may not be owned
    - which causes expansion to be difficult
  - only U.S. citizens can be shareholders
  - can only issue one form of stock

Subsidiary: an entity controlled by another entity (or parent company)
Stock: the outstanding capital of a company or corporation

Limited Liability Corporations

- Have the qualities of both partnerships and corporations
- Fall under either a C corporation, an S corporation or a partnership depending on the decision of how to be treated for taxation when it is first formed

Limited Liability Corporations

- Are especially suitable for smaller companies with a limited number of owners
- Are treated as a separate legal entity from owners (members) just like a corporation
- Can determine if the members want to manage themselves or have an actual manager with more authority over them

Limited Liability Corporation

- Pros include:
  - owners have limited personal liability
  - corporation can "choose" at the beginning whether or not to use the double taxation method
  - no restrictions of ownership like in S corporations, so they are ideal business structures for foreign investors

Limited Liability Corporation

- Pros include:
  - flexibility of management agreements
  - less formal operations than a typical corporation and do not require annual meetings of members

Limited Liability Corporation

- Cons include:
  - difficulty in raising financial capital
  - often have a limited life span (not to exceed 30 years in many states)
  - cannot utilize the benefits of stock ownership and sales
  - cannot be formed for most businesses providing professional services or for businesses required to be licensed, registered or certified under the Business and Professions Code (such as building contractors and cosmeticians)

Review of Pros & Cons

PROS

	C CORPORATION	S CORPORATION	LIMITED LIABILITY CORPORATION
PROS	• Unlimited # of stockholders • Tax-free benefits • Unlimited life	• Liability protection • No double taxation method • FICA taxes only apply to employees	• Limited personal liability • Less formal • No ownership restrictions
CONS	• Double taxation method • Legal formality • Sufficient funding to get started	• Not all businesses eligible • Only 1 form of stock • No more than 75 shareholders	• Limited life • No stock • Harder to raise capital

CONS

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S Corporations & Limited Liability Companies Assessment

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Assessment

1. After a C corporation is formed, what must happen for it to become an S corporation?
   A. The company must reach a specific earnings level
   B. The company must elect a special tax status with the IRS
   C. The company must be certified as a financial institution
   D. The company must choose a board of directors and give all decision-making powers to a president

2. S corporations are most appropriate for entrepreneurs who prefer which of the following?
   A. To sell unlimited stock to raise money for the business
   B. To choose whether or not to use the double taxation method
   C. To have international shareholders
   D. To be taxed as if they were sole proprietors or partners

Assessment

3. Which of the following is an S corporation permitted to do?
   A. Have an unlimited number of shareholders
   B. Own subsidiaries
   C. Pay FICA taxes on salaries only
   D. Issue multiple forms of stock

4. Limited liability corporations can NOT do which of the following?
   A. Utilize the benefits of stock ownership and sales
   B. Determine if members want to manage themselves of have a manager with authority over them
   C. Have foreign investors
   D. Choose whether or not to use the double taxation method

Assessment

5. In many states, limited liability corporations have a life span of which of the following?
   A. Not to exceed 10 years
   B. Not to exceed 20 years
   C. Not to exceed 30 years
   D. Not to exceed 40 years

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The Corporation Final Assessment

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Assessment

1. What are the three types of corporations?
2. How are C corporations taxed?
3. What is a limited liability corporation a combination of?
4. What is a corporation?
5. What is the most widely used form of business in the world?

Assessment

6. Name one con of a C corporation.
7. Which type of corporation can only have up to 75 shareholders?
8. Which type of corporation can choose how they are managed?
9. Which type of corporation only has one form of stock?
10. Name one pro of a C corporation.

References Used

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Acknowledgements

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Liz Weber & Amy Hogan

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Project Coordinator:

Maggie Bigham

Graphic Designer:

Ann Adams

Technical Writer:

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