
CORPORATIONS

DEFINITION:

A corporation is a limited liability entity in that none of its owners (i.e. shareholders) is typically personally liable for the corporation's obligations by reason of being a shareholder. However, if a court determines that the corporation is the "*alter-ego*" of its shareholders, or merely a shell, a third party claimant may be permitted to "*pierce the corporate veil*" to satisfy contract, tort, and federal and state tax claims from the shareholders' personal assets. Adhering to corporate formalities offers protection to the corporation's integrity, and thus, its shareholders. In addition to the legal services in forming a corporation, KIRK & SIMAS offers several services, such as annual reminders to update your corporation's minutes to comply with the requisite formalities.

FORMATION:

A corporation is formed by filing the articles of incorporation with the California Secretary of State. There is a filing fee of \$100 plus \$15 charged by the Secretary of State to file the articles and an "*over the counter*" fee.

In addition, unless exempt, California requires an \$800 minimum tax deposit against the current year's taxes to be paid by the 15th day of the fourth month after the beginning of the taxable year. Revenue and Taxation Code Section 23153(f) provides that "*every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, shall not be subject to the minimum franchise tax for its first taxable year,*" however, you should check with your accountant to determine precisely how this will affect your company's cash flow. Certain corporations may qualify for a lower minimum tax deposit.

After formation, directors and officers are appointed or elected, bylaws are adopted, and shares of stock are issued to the owners, all of which are reflected in the corporation's minutes.

TAXES:

Generally a corporation's income is taxable (unless the corporation is an S corporation), both by federal and state governments at the corporate rate. Thus, a corporation and its shareholders are subject to double taxation because: (1) the corporation pays tax on its income and is not allowed to deduct as an expense the dividends issued to the shareholders, and (2) the shareholders are taxed on the dividends received from the corporation.

Double taxation may be minimized in certain cases by paying salaries to shareholders and the use of shareholder loans. In addition, a corporation that retains most of its income may benefit from the corporate rate structure because the marginal rates applicable to the corporations are often lower than the marginal rates available to individuals.

Qualifying corporations may ameliorate the effect of double taxation by making an S corporation election. If a corporation makes a valid S corporation election, the corporation's net profits,

losses, and tax credits are passed through (and taxed) for federal purposes to the corporation's shareholders without being taxed to the corporation. Thus, S corporations are treated similarly, but not identically, to partnerships. S corporations have their limitations. Internal Revenue Code § 1362(b) limits S corporations to no more than 75 shareholders (California limits the number to 35), who must be individuals, estates, tax-exempt organizations, or certain trusts. Non-resident aliens may not be shareholders in S corporations. Additionally, S corporations may only issue one class of stock.

OTHER CONSIDERATIONS:

Federal and state securities laws must be considered, however, many small corporations qualify for an exemption from these regulations. Unless a statutory exemption applies, the corporation must first obtain a permit, register with the Securities and Exchange Commission, and comply with all applicable state securities laws of each purchaser's state of residence before offering shares of stock for sale. Analyzing these issues and forming the corporation in such a manner to qualify for these exemptions is one of the tasks which KIRK & SIMAS supervises as part of the organization process.