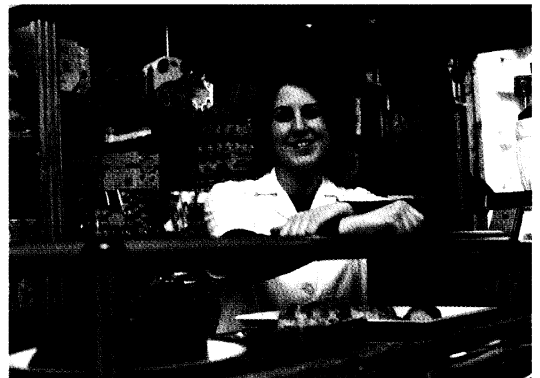


Published by

**Inc.**

# How To *Really* Structure Your Business:

A Guide to Forming a Corporation  
or Limited Liability Company (LLC)



IN COOPERATION WITH

**SCORE**<sup>®</sup>

Counselors to America's Small Business

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The Company Corporation® is an incorporation service company and is not a substitute for the advice of a licensed attorney.

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Any opinions, findings, and conclusions or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the SBA.

## THE COMPANY CORPORATION®

Dear Business Owner,

Congratulations on taking your first step toward protecting your personal assets! We applaud you for choosing to learn more about incorporating or forming a Limited Liability Company (LLC).

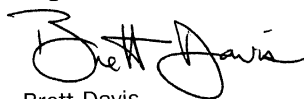
As a dedicated partner to thousands of small businesses across the United States, The Company Corporation invites you to read the following information about choosing a business structure. Small businesses provide the foundation for our country's economic growth. We want to assist you by providing the products and services you need to succeed.

The Company Corporation and SCORE have co-developed this *How to Really Structure Your Business: A Guide to Forming a Corporation or Limited Liability Company* workbook. We intend to provide small business owners with a foundation for selecting the business structure that best fits their needs and to remove the mystery surrounding the incorporation process.

We're proud to provide this educational tool for use by SCORE counselors and their clients. SCORE counselors volunteer their time and expertise to help small businesses with confidential, free business counseling. The SCORE Association has helped more than 7.8 million small business clients since 1964.

The Company Corporation has helped more than 300,000 small business owners just like you to incorporate or form Limited Liability Companies (LLCs). We provide a range of products and services including business licenses, corporate kits, self-help books, certificates of good standing, and registered agent service. Our mission is to help businesses start and succeed. With our business start-up services and our compliance management tools, more and more businesses are turning to The Company Corporation each and every month. Together with SCORE, The Company Corporation wishes America's small business community continued success.

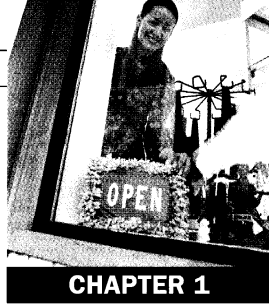
Regards,



Brett Davis  
General Manager  
The Company Corporation

Our Web site [www.incorporate.com/score3](http://www.incorporate.com/score3)  
**1-800/472-2709**

*The Company Corporation is a service company and does not provide legal or financial advice.*



# Think Inc.

**WHY INCORPORATE OR FORM AN LLC?  
TRY TAX SAVINGS (INCORPORATION) AND  
LIABILITY LIMITS (LLC) FOR STARTERS.**

**MANY SMALL-BUSINESS** owners are so preoccupied with the daily tasks of managing their companies that they don't stop to consider whether they are operating under the most advantageous organizational structure. Decisions about choosing a business structure have far-reaching tax and liability consequences. If you structure your business inappropriately, for example, you could be personally liable for business debt or pay thousands of dollars more in taxes than necessary.

The most common organizational structure for small businesses is a sole proprietorship, in which the business is owned and operated by one person (although there may be other employees). Another popular form is a partnership, in which two or more individuals conduct business as co-owners. While both of these forms of ownership provide flexibility in the way in which a business is run, the main drawback is that the owner or owners are personally liable both for the business's debts and any judgements against the business that arise. In short, creditors can target your personal assets to obtain payment for business obligations.

The decision to incorporate or form an LLC provides a number of clear advantages including: **Personal liability protection.** Corporations and LLCs are legal business entities that are separate from their owners. This means that corporate shareholders and LLC owners are protected from liability for the company's debts. If a business gets into serious financial trouble, the law

prevents creditors from coming after shareholders' or LLC owners' assets, so long as that debt was not personally guaranteed. Shareholders and LLC owners have only the money they put into the company to lose.

**Financial flexibility.** A corporation can raise money directly through the sale of stock and bond offerings, and can borrow from commercial sources, using corporate assets to secure the loan. A partnership cannot raise capital by selling shares to investors, and a sole proprietor's financial resources are limited to personal assets and loans. Investors are much harder for partnerships and sole proprietorships to attract because of the personal liability.

**Get ready to save on taxes!** Forming a corporation or LLC helps business owners save on self-employment taxes. Self-employed owners pay 15.3% of their total earnings to cover Medicare and Social Security obligations. Contrast this with the business owner who forms a corporation or LLC who pays self-employment taxes only on that portion of profit that is paid out as salary. Note: S corporation dividends are not subject to self-employment tax.

**Credibility.** A business that can add "Inc.", "Corp" or "LLC" after its name gains credibility. It sends a powerful message to your customers, suppliers, and potential investors about your commitment to the success of your venture. Even if you are the only stockholder or employee, your incorporated business may be perceived as a larger and more professional company.

## Ways to Organize Your Business

Type of Organization	Main Advantages	Main Disadvantages
<b>Sole Proprietorship</b>	<ul style="list-style-type: none"> <li>• Simple and inexpensive to create and operate.</li> <li>• Owner reports profit or loss on personal tax return.</li> </ul>	<ul style="list-style-type: none"> <li>• Owner personally liable for business debts.</li> <li>• Not a separate legal entity.</li> </ul>
<b>C Corporation</b>	<ul style="list-style-type: none"> <li>• Clients have less risk from government audits.</li> <li>• Owners have limited personal liability for business debts.</li> <li>• Owners can deduct fringe benefits as business expense.</li> <li>• Owners can split corporate profit among owners and corporation, paying lower overall tax rate.</li> </ul>	<ul style="list-style-type: none"> <li>• More expensive to create and operate than sole proprietorship or partnership.</li> <li>• Double taxation threat because the corporation is a separate taxable entity.</li> <li>• No beneficial employment tax treatment.</li> </ul>
<b>S Corporation</b>	<ul style="list-style-type: none"> <li>• Clients have less risk from government audits.</li> <li>• Owners have limited personal liability for business debts.</li> <li>• Owners can use corporate losses to offset income from other status.</li> <li>• Owners can save on employment taxes by taking distributions instead of salary.</li> </ul>	<ul style="list-style-type: none"> <li>• More expensive to create and operate than sole proprietorship.</li> <li>• Fringe benefits for shareholders are limited.</li> </ul>
<b>Partnership</b>	<ul style="list-style-type: none"> <li>• Simple and inexpensive to create and operate.</li> <li>• Owners report profit or loss on personal tax returns.</li> </ul>	<ul style="list-style-type: none"> <li>• Owners personally liable for business debts.</li> <li>• Two or more owners required.</li> <li>• No beneficial employment tax treatment.</li> </ul>
<b>Limited Liability Company</b>	<ul style="list-style-type: none"> <li>• Owners have limited liability for business debts if they participate in management.</li> <li>• Profit and loss can be allocated differently than ownership interests.</li> </ul>	<ul style="list-style-type: none"> <li>• No beneficial employment tax treatment.</li> </ul>

Reprinted with permission from *Working for Yourself*, by Stephen Fishman (Nolo).

**Longevity.** Corporations have unlimited life, extending beyond the illness or death of the owners. They continue to exist, regardless of what happens to the directors or shareholders. If a sole proprietor or partner dies, the business may automatically end or may become involved in legal entanglements.

When should you incorporate? Business owners choose to incorporate their companies for many different reasons. You can begin as a sole proprietorship or partnership and change over to a corporate structure when your business has grown to a stage where you need legal protection and financial credibility. However, for any business with potential legal exposure (which is nearly any company selling a product and many service companies), incorporating at the outset is a wise choice. Also, if you plan to add employees and/or you want to obtain financing soon after starting up, choosing to incorporate will enable you to establish the mechanisms for distributing ownership to attract key employees and outside financing.

When Barbara Reardon launched Educating Underwriters, Inc., a training company for insurance underwriters, she incorporated to protect her personal assets and control her tax liabilities. As an underwriter by trade, "I was aware of the risks involved in owning and running a business," she explains.

Joe Oriente, CEO of capturepoint.com, an e-marketing technology company, decided to incorporate to establish big business credibility. When

he launched the company, originally eWeb City, it began with two people working from a home office. In just a year and a half, it grew to 15 employees working out of 3,500 square feet of space. With clients like Simon & Schuster, IBM, Compaq and 3Com, Oriente wanted his company to have a professional, legitimate corporate identity. "I knew we had to incorporate," he says.

Oriente chose to form a general corporation with "S" tax status, but deciding which type of corporation is best for you depends on your circumstances. The basic options are an S status corporation or a C (general) corporation. A third alternative growing in popularity among small businesses is the limited liability company (LLC), a hybrid of corporate and partnership forms of organization. All three structures provide personal liability protection. Beyond that, here are some pros and cons to consider:

**C corporation.** The main advantage of a C corporation is that it has no limitations on the number of shareholders or classes of stock. It's obviously appropriate for companies planning to have more than 30 stockholders or large public stock offerings, but smaller companies often choose it as well. The major disadvantage is that profits may be subject to double taxation: that is, corporate income is taxed, and then dividends paid to each stockholder are taxed as part of the individual's income. C corporations also are referred to as general corporations.

**S corporation.** A corporation with subchapter S

tax status is a general corporation that has selected a special tax status with the IRS after the corporation has been formed. The S corporation may be more appropriate for small companies that want to gain the advantages of a corporate structure without the disadvantage of double taxation. All profits are distributed on a pro rata basis to stockholders, who then pay personal income taxes on them. In the early stages of a business, when losses can be incurred, the owners can take advantage of tax benefits by writing off operating losses on their personal returns.

When Andy Levine decided to incorporate his bike tour company, DuVine Adventures, he went searching for the most advantageous corporate structure. "I was immediately drawn to an S corporation because my accountant showed me how much it would save me in taxes," says Levine, who wheels in \$200,000 in revenues from his two-person company.

For Chamin O'Mahoney, an added attraction of the S corporation was the potential for write-offs. Like many new entrepreneurs, O'Mahoney wasn't sure if The Creole Cat, her art poster business, would make money right away. So, just in case, she held onto her regular job at the U.S. Chamber of Commerce. "By incorporating, I knew that I could write off my losses, even though I was holding a paying job elsewhere," says O'Mahoney, who soon began to see more profit than expected.

One disadvantage of the S corporation is that it

is limited to 75 owners, all of whom must be U.S. citizens or permanent residents. Also, there can be only one class of stock and there are restrictions on fringe benefits.

**Limited liability company (LLC).** LLC's have grown quickly as a favored business structure for small businesses. They are recognized in all United States jurisdictions. It represents the best of both worlds—the flexibility of a partnership and the liability protection of a corporation, but with far less paperwork. Like a C corporation, an LLC can have an unlimited number of owners; like an S corporation, its profits and losses may pass directly to owners (no double taxation); and, like a partnership, it allows greater flexibility in the management of the business. The owners can establish their own membership agreements, with voting rights and income divided as desired. Thus, for many start-up and growing businesses, the LLC may offer the best of all operating structures.

"We wanted to run our store cooperatively, which suggested a partnership," says Carine Ullom, co-owner of Simple Goods General Store, a retailer of environmentally safe products. "But we were afraid of the liability risks we'd assume if we opted for a traditional partnership status." So Ullom and her co-owners set up the company as an LLC.

Accountants often recommend an LLC to hold appreciating assets such as real estate. Because of the flow-through taxation, taking appreciated assets out of an LLC may not trigger capital gains.

## Incorporating or Forming an LLC for Your Business

If you answer yes to any of these questions, incorporating your business may be the right step for you.

- Would you like to protect your personal assets against liabilities that your company may incur, either in the form of debt or lawsuits?
- Would you like the option to raise capital through the sale of stock?
- Do you have—or plan to have—employees?
- Do you have co-owners or investors?
- Do you want your business to continue to operate after your death or a partner's death?
- Would including "Inc.," "Corp." or "LLC" as part of your business name enhance your credibility with investors, suppliers and customers?

\*A service company can help you form your corporation or LLC cost effectively, but you may want to consult an attorney or accountant to help you select your structure.



# Designate a Registered Agent

**STATE LAWS REQUIRE** that you have an “agent” of the corporation or LLC who is responsible for receiving and forwarding vital legal and tax documents. The designated registered agent must be a resident of the state of the corporation or LLC formation. The address of the agent must be a physical address, not a post office box, and it must be open during all normal business hours.

## Choosing a Registered Agent

- RESIDENCY:** must be a resident of and have an office in the state in which you incorporate; sometimes referred to as a “resident agent”
- AVAILABILITY:** must be available during all normal business hours
- RELIABILITY:** can be counted on to promptly notify you of the receipt of important state and federal documents or notices of litigation
- CONFIDENTIALITY:** can be trusted to keep potentially sensitive legal issues *confidential*

### Candidates:

1. \_\_\_\_\_
2. \_\_\_\_\_
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8. \_\_\_\_\_

\*Service companies often act as the registered agent for small businesses nationwide.

Your agent serves as a critical conduit for managing ongoing legal requirements associated with your company. Your agent receives official state and federal mail, such as tax forms and annual report notices. The agent may also be served with legal papers (notice of litigation) if a lawsuit is filed against the corporation or LLC.

The person designated to be the registered agent may or may not be affiliated with the corporation. The agent may be an employee, officer, director or shareholder of the corporation, or may be a third party.

You may serve as your own agent, with your principal office as the registered agent address. However, most business owners choose a third party to act in this capacity, for one or more of the following reasons:

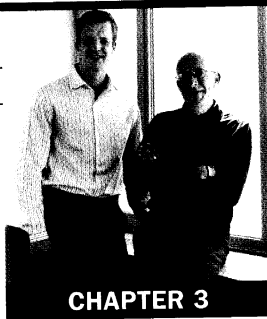
**Availability.** You may be out of the office when key legal documents requiring immediate action might be delivered. If you are not there to respond promptly to a notice of litigation, for example, you could get a default judgement against you for failing to answer a claim in a timely manner.

**Privacy.** Having a legal process server show up would disrupt your business and be an embarrassment in front of customers, employees or neighbors. A third-party agent offers a layer of privacy, protecting you from publicly being served at your place of business and making your personal address less accessible to strangers.

**Location.** There is a possibility that you might relocate your business in the future. Maintaining an outside registered agent enables you to change the location of your company without filing a costly change of address with the state.

**Documentation.** The paperwork involved in being your own agent would take up too much of your time, or you might simply prefer to have a third party remind you when it's time to file important documents.

Many small business owners turn to an incorporation service company to serve as their registered agent. Corporations that sign on with an agent service are often those that are incorporated in one state and operating in another.



## CHAPTER 3

# Lock in Your Location

**WHERE SHOULD YOU INCORPORATE?** That depends on whether you will do business outside your home state. If not, forming a corporation in your state will generally require less paperwork and less cost. You will only need to account for income generated in one state while filing one state tax return and one set of corporate notices. Plus, you will avoid paying franchise taxes and filing annual reports in more than one state.

If you incorporate in another state, such as Delaware or Nevada, you may need to submit an application to qualify as a “foreign” (out-of-state) corporation in the state where you are located. Without qualifying to do business locally, it could be difficult to open a bank account in your company’s name.

If you plan to do business in more than one state, look at which state requires the least amount of paperwork and has the least expensive incorporation fees. Also consider corporate and personal income tax rates and compliance regulations. If you plan to expand the business rapidly or go public—or if you intend to seek venture funding—many accountants and lawyers would recommend incorporating in Delaware or Nevada.

**Delaware** has low incorporation and LLC formation fees, low annual franchise taxes and no state corporate income tax for companies that operate outside Delaware. It also has no minimum capital required for incorporation and one person can hold all corporate offices. Shares of stock owned by nonresidents are not subject to Delaware personal income tax or inheritance tax. You need not have an office or bank account in Delaware, just a registered agent, and names of initial directors need not appear in public records. With its separate “Chancery Court” for business disputes, Delaware’s court system facilitates speedy dispute resolution.

More than half of the New York Stock Exchange companies are Delaware corporations. If you plan to go public, the stock market respects Delaware. Venture capital investors tend to favor Delaware corporations because they want the companies they fund to go public as soon as possible.

## Choosing a State

- Will you be doing business in one state or several states?
- Do you plan to go public?
- Will you seek venture capital?
- What is the state’s corporate income tax, if any?
- What is the state’s personal income tax, if any?
- What are the state’s filing fees and annual franchise tax?
- Are there capital requirements for incorporating in that state?

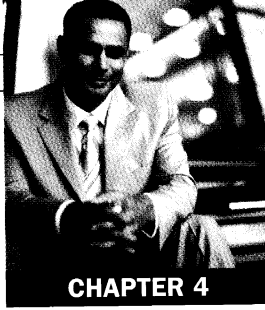
**Nevada** has no state tax on corporate profits, no state annual franchise tax and no state personal income tax. Stockholders of Nevada corporations are not a matter of public record, which provides privacy.

On the downside, Nevada companies may need to qualify or register to do business in their local jurisdiction. That may result in an additional fee to the state where you operate the business. Plus, Nevada’s corporation and LLC formation fees are higher than many states.

A corporation with business sites in multiple states will typically incorporate or form an LLC in a single state, then qualify to do business in other states. This requires formally registering in those states, paying additional franchise taxes and filing annual reports. An incorporation service firm can help you file state qualifications as needed.

Your decision on where to incorporate affects your business on many levels. If you expect fast growth in many states or want to establish partnerships around the country, you may prefer to incorporate in Delaware or Nevada. This is more convenient than repeatedly starting—and dissolving—in-state companies as you move around the nation.

Because liability protection varies by state, you may also consider incorporating in business-friendly Delaware or Nevada if you engage in a higher-risk industry.



CHAPTER 4

# Pin Down Your Company Name(s)

**EARLY IN YOUR** incorporation or LLC formation planning, choose—and reserve—the company name that will be included in your articles of incorporation, as well as the Internet domain name. You should have several alternative names in case your first choices are unavailable.

Your corporate name must be unregistered—that is, no other corporation in the state where you are filing already is using the name or a similar name. Also, each state has rules as to words that can (or cannot) be used in your name. Most states require that a word such as *Incorporated*, *Company* or *Limited* be included in your name; many prohibit the use of the words United States, Federal or National.

As a rule of thumb, you can select a name that will help identify the type of products or services your business provides. Or, you may prefer a name that conveys technical or professional expertise that will catch attention and be easy to remember. Sometimes the name(s) of the founder or founding members is used.

**Reserving your name.** As soon as you select a name, contact the secretary of state's office in your incorporation state or an incorporation service company to find out if it is available. If not, you will have to try other alternatives. If you have confirmation that a name is available, but you're not ready to file corporate papers, most states

allow you to reserve the name for up to 60 days by filling out the appropriate form and paying the required fee.

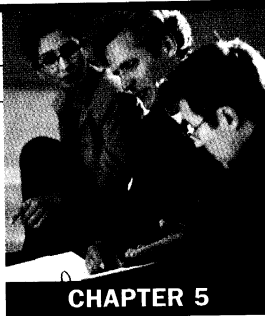
If you will be doing business in more than one state, consider reserving your name in every state where you will be doing business prior to incorporating in any state. Otherwise, if your name is not available in another state, you will have to choose a different name before you can do business there.

**Winning the domain game.** For many companies, reserving an Internet domain name is as important as reserving a corporate name. Registering your domain name early in the incorporation process ensures that it will be available when you launch your Web site. With more than 400,000 domain names registered or transferred per day on the internet, online names are becoming scarce. The longer you wait, the less likely your preferred domain name will be available.

Ideally, your domain name will be the same as your corporate name or closely related. The easiest way to start selecting and reserving a domain name is to do a simple Web search under "domain name registration." You'll find a long list of accredited domain registration services that can check a name and register it if available. If a preferred name isn't available, many sites will offer suggestions for alternatives.

Possible Corporate Names	Possible Domain Names
1. _____	1. _____
2. _____	2. _____
3. _____	3. _____
4. _____	4. _____
5. _____	5. _____
6. _____	6. _____





# Setting Up Shares

**IF YOU PLAN TO** incorporate your business as a C or an S status corporation, you have to indicate in the articles of incorporation the number of shares and classes of shares the corporation is authorized to issue. Each share of stock represents ownership in the company. Some corporations have a single shareholder, who may also be the only officer and director of the corporation. For others, the only shareholders are the husband and wife or family members. For still others, the shareholders and officers are the group of individuals involved in starting and managing the business.

The amount of authorized shares a corporation issues depends on the size of the business, its short-term needs and long-term plans. If you plan on going public or have private offerings to individuals in the future, for example, you may want to issue a sufficient amount of stock with that intent in mind. Perhaps you need capital or want to recruit an experienced professional team early on. Selling stock to prospective shareholders can raise money needed to fund growth. Prospective shareholders can also bring experience, contacts and professional skills to the corporation.

The different classes of stock determine how much money will be paid for each share and how dividends will be paid. Par value is the designated minimum price of an authorized share, below which it cannot be sold. No-par value stock has no stated minimum price; the shares may be issued for any price determined by the board of directors. No-par value is generally recommended because it allows the maximum flexibility to value shares later.

Most small corporations issue a single class of common stock, in which all shares have equal dividend and voting rights. Some C corporations also authorize preferred stock, which conveys preference on the right to receive annual dividends, among other things. The corporation must pay dividends to preferred stockholders before common stockholders. S status corporations may only issue a single class of stock and LLCs do not issue stock at all.

## Tuning in to a Sounding Board

Regardless of how small your corporation may be, set up a team of outside advisers to serve as a sounding board. Besides ideas and objective analyses, the board members can offer guidance in areas of outside expertise that could help you avoid financial and legal pitfalls. Here are five guidelines for building a board that can really help you:

- ❑ **COMPOSITION.** A good board consists of several unrelated counterparts. Your advisers might include an accountant, banker, attorney, insurance broker, CEO of a company in a related business or a business school professor.
- ❑ **SIZE.** Don't load your advisory board with so many people that you'll never get anything done. A good rule of thumb: five to seven members are all you need.
- ❑ **SCHEDULING.** Set up a regular meeting time—every month or quarter—depending on the complexity of the issues to be discussed. Schedule meetings with a SCORE counselor as an outside adviser.
- ❑ **PROFESSIONALISM.** Don't burden members with petty issues, such as what kind of computer to buy. Deal with wider issues, such as identifying emerging markets and ways to motivate your sales force.
- ❑ **COMPENSATION.** Be prepared to pay travel expenses and a small stipend to attract the best team.

**Shareholder's agreement.** Even if you start out with just a handful of trusted stockholders, a written agreement is essential for ensuring smooth working relationships among shareholders. Shareholder agreements spell out in writing—in advance—how potentially controversial issues or “what if” scenarios will be resolved. Typically, a shareholders' agreement will provide answers to questions such as:

- Who can be a shareholder?
- Who can serve on the board of directors?
- What happens if a shareholder becomes disabled or dies?
- What happens if a shareholder resigns or retires?
- Will the corporation be required to purchase the shares of a shareholder who leaves the company or decides to sell his or her stock?
- What method will the corporation use for determining how much its shares of stock are worth at any given point?

Besides a stockholders' agreement, corporate bylaws should be put in place when you incorporate. Bylaws are the rules and procedures that the corporation and its officers and directors must follow. For example, they specify how many directors there will be, how they are elected, what their powers will be, and if and how they will be compensated.

The bylaws also include administrative details such as the time and place for the annual meeting of shareholders, what constitutes a quorum, actions that shareholders can take by written consent without a formal meeting, and who can inspect corporate books and records.

**Adviser Candidates**

1. \_\_\_\_\_
2. \_\_\_\_\_
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**Bylaws (Corporations) and Operating Agreements (LLC) Are Key List Your Policies and Procedures**

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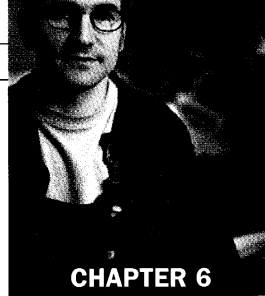
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# Five Steps to Compliance

**AS A CORPORATION OR LLC**, you will have to satisfy federal, state and local regulations that apply to most enterprises. Beyond that, there are legal formalities and paperwork required for maintaining your corporate status.

One of the first things you must do after filing articles of incorporation is apply for a federal tax identification number. No bank will let you open a corporate bank account until you have one. The application form—SS-4 Application for Employer Identification Number—is available from the IRS and can be downloaded from its Web site, [www.irs.gov](http://www.irs.gov). Many states have a similar form that must be completed.

Necessary licenses and permits for your business must also be secured. Your secretary of state's office is a good starting point for accessing information about which permits you will need, depending on the nature of your business. Some states have one-stop shops for accessing a single contract or form to complete their required registrations. Others involve a number of agencies—employment departments, workers' compensation divisions, revenue departments—to accomplish this task.

It pays to research, in advance, which permits and licenses you'll need, some of which may include certain state and local environmental or zoning laws.

Employment regulations also should be near the top of your compliance checklist. Federal and state laws specify how often your employees must be paid and what you have to deduct from their paychecks. Federal taxes that must be deducted and recorded include income tax withholding, Social Security and Medicare taxes, and unemployment tax. On the state level, you also may have to withhold for income tax. And all states require that you have workers' compensation insurance before employees start their jobs.

To protect your status as a corporation, you must adhere to certain formalities and legal requirements. For example, to protect the personal liability of its shareholders, your company must perform as a corporation and be recognized as

## Complying With the Rules and Regulations

Here's a sampling of the periodic paperwork required to retain your corporate or LLC status:

- Federal taxes (e.g., corporate income, Social Security, Medicare, unemployment)
- State taxes (corporate income; annual franchise; payroll, including unemployment, disability and workers' compensation; sales; certain property)
- Federal, state and local licenses and permits (certification, operating and safety)
- Shareholder agreements
- Company records (articles of incorporation and bylaws; personal; key transactions; minutes of meetings; etc.)
- State annual reports

one. Not only must a separate identity be maintained, but personal financial matters and business matters must be kept entirely separate.

Here are five rules for protecting your corporate status and minimizing liability exposure for corporate activities:

### **1. Keep your corporation or LLC in good legal standing.**

File all required reports on time, and don't neglect to pay your corporate taxes. Failure to plan for taxes—income taxes, payroll or other withholding taxes—is one of the primary causes of small business failure. Specific statutory authority allows federal and state officials to assess liability for certain unpaid taxes against individuals responsible for the corporation. Common targets are corporate presidents and treasurers, although directors and shareholders of small businesses may also be liable.

Most states require corporations to file an annual report and an annual franchise tax report; some have other forms that must be

filed as well. Annual reports provide states with current information on such things as corporate address, business activity and changes in the roster of officers or directors.

Some states charge a franchise tax that must be paid when you file the franchise report. The tax is a fee assessed for doing business in the state. If you fail to file your annual report or franchise tax in a timely fashion, your corporate charter may be revoked, effectively dissolving the corporation.

## **2. Keep proper corporate records.**

This includes those required by law as well as documentation of key corporate meetings and transactions. In addition to basic documents, such as articles of incorporation and bylaws, most states require you to maintain a record of the minutes of shareholder meetings and consent resolutions, and all written communications to shareholders within the last three years, including copies of any financial statements furnished to them.

The IRS and other parties with claims against the corporation may be able to compel disclosure of a much broader range of documents, including detailed financial information, tax returns, sales records, personnel records and company contracts. If you fail to keep appropriate records, a court of the IRS could impose personal liability against individual officers, directors and shareholders of the corporation.

To maintain your corporation's status as a separate legal entity, important activities should be documented, usually in corporate minutes, contracts or both. If you don't hold the corporation out as a separate legal entity, you make it easier for creditors and other claimants to assert personal liability against you rather than the corporation.

While corporate minutes don't have to include specific reference to day-to-day business operations, extraordinary items or matters that fall outside the category of daily activity should be expressly noted in the minutes. This would include, for example, decisions relating to the purchase or lease of expensive equipment or real estate, borrowing money or pledging corporate assets as security for a loan, or declaring a dividend or redeeming a corporate stock. Other important transactions can be documented through a bill of sale, invoice, promissory note or contact.

## **3. Do not commingle personal assets with business assets or make personal use of business property.**

A corporation should have its own bank account distinct from any personal account you may have. It's much harder to demonstrate that certain expenditures were made for the benefit of the business when personal and business accounts are the same. If personal items are used by the business—tools, office supplies or computer equipment, for example—corporate minutes should document which items are personal.

Something as simple as personal use of a company-owned car can create potential legal problems. Even if you use the car just to tote the kids back and forth from school, you should document this time for the corporate records. Also, don't try to deduct or depreciate, as business assets, property that is used almost exclusively for personal purposes.

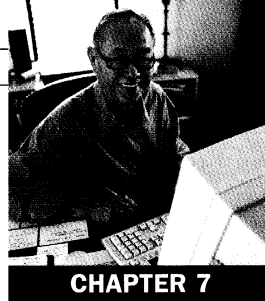
## **4. Operate your corporation at arm's length.**

It's common for shareholders, officers and directors of small corporations to enter into business transactions with the corporation. For start-up businesses, corporate loans often come from these individuals. Any such loans should be documented with a corporate resolution or promissory note. Interest rates and repayment provisions should be comparable to those the corporation would have to meet had the lender been a bank or other unrelated party.

The same rules apply if the corporation is the lender and an officer or shareholder is the borrower, and in cases where shareholders sell or lease assets to the corporation. The temptation to offer favorable terms to individuals associated with the corporation is great, but it must be avoided. "Sweetheart" deals between an individual shareholder, officer or director and the corporation are subject to close scrutiny by the IRS, other shareholders and creditors.

## **5. Always identify your business by a corporate name.**

Whenever you do something on behalf of the corporation, make it clear you are not doing business in an individual capacity. If you sign a contract for the corporation, for example, be sure to include your title. Sign as "John Doe, President," and not simply "John Doe." By remembering to use the corporate name and referring to yourself with your corporate capacity, you can insulate yourself from personal liability.



# Resources for Forming Your Company

**ONCE YOU DECIDE** to incorporate, there are three ways to do it. One way is to have an attorney file your incorporation. This is reliable, but it is also time-consuming and expensive. As a second option, to save expenses, you can do it yourself. Most states allow individual business owners to file their own incorporation documents. However, this can take valuable time away from minding the store. The third way, which can be the most efficient and cost effective option, is to rely on an incorporation service company. Some incorporation service companies maintain offices nationwide, while others offer services only locally or regionally. Most are available both by phone and online, and will file your documents within 24 hours.

Whatever route you choose, there's an abundance of information on how to incorporate and numerous associations and services that will lend you assistance. Here are some resources to help you get started:

## WEB SITES

The Company Corporation® —

**www.incorporate.com/score3** (1-866/544-6805)  
One-stop incorporation service company; includes preparation and filing the articles of incorporation (with expedited handling/walk-in service), name search and registration, registered agent and compliance tools

AllBusiness — **www.allbusiness.com**

This comprehensive resource for small businesses and entrepreneurs provides useful industry information, business-related services and extensive Internet functions to help business owners manage their companies

eVenturing — **www.eventuring.org**

An endeavor of the Kauffman Foundation, this site provides information on starting and growing a business with many resources on incorporating

*Inc.* magazine — **www.inc.com**

Information, products, services, and online tools for starting and growing your business

Internal Revenue Service — **www.irs.gov**  
(1-800/829-1040)

Insider tax information for small businesses  
(click on the tab for Business)

National Federation of Independent Business — **www.nfib.org** (1-800/NFIB-NOW)

Contains a broad array of educational information for small-business owners in areas such as starting a company, accounting, sales and marketing, law, taxes and e-commerce

Nolo — **www.nolo.com**

Information for starting a business, choosing a business structure and writing a business plan; includes a wide range of small business legal topics

SCORE "Counselors to America's Small Business" — **www.score.org** (1-800/634-0245)

Expert problem-solving assistance, ranging from information on business structures to growing your business (resources include 1,200 active online counselors, plus 389 counseling offices across the country)

*Entrepreneur* magazine — **www.entrepreneur.com**

Site for empowering entrepreneurs to start and grow successful companies. Products, services and information to help entrepreneurs make informed decisions

U.S. Chamber of Commerce/ChamberBiz — **www.uschamber.com** (1-888/948-1429)

Network of more than 300 state and local chambers of commerce and the U.S. Chamber of Commerce; provides services and information for business problem-solving and improvement

U.S. Small Business Administration (SBA) — **www.sba.gov** (1-800/827-5722)

Guidelines for starting a business; links to incorporation information for each state; loan information

## BOOKS AND SOFTWARE

### Incorporating

*The Corporate Minutes Book: A Legal Guide to Taking Care of Corporate Business* by Attorney Anthony Mancuso (Nolo Press, 2002; \$69.99) Updated 2nd edition helps you create and track corporation preparation planning while keeping minutes of this process. Includes all the answers, instructions and forms that you'll need to get the job done

*LLC or Corporation? How to Choose the Right Form for Your Business* by Attorney Anthony Mancuso (Nolo Press, 2004; \$24.99) The only book on the market that explains each kind of business structure, how they differ and how each can affect your bottom line

*Incorporating Your Business for Dummies* by The Company Corporation® (IDG Books Worldwide, 2001; \$21.99) A user-friendly guide to incorporation for the entrepreneur

*The Small Business Start-Up Kit* by Peri H. Pakroo, J.D. (Nolo Press, 2004; \$24.99) Nuts-and-bolts guide to starting your own business

quickly, easily and with confidence; includes a CD-ROM

### LLCs

*Your Limited Liability Company: An Operating Manual* by Attorney Anthony Mancuso (Nolo Press, 2003; \$49.99) Recently updated 3rd edition, this hands-on manual provides all the information and documentation you'll need to maintain the validity of your LLC before the courts and the IRS

*Nolo's Quick LLC: All You Need to Know About Limited Liability Companies* by Attorney Anthony Mancuso (Nolo Press, 2004; \$29.99) All the basics of limited liability companies and how to determine whether an LLC is right for you

### S Corporations

*How to Start Your Own S Corporation* by Robert A. Cooke (John Wiley & Sons, 2001; \$24.95) Pros and cons, as well as procedures, for setting up an S corporation; includes a CD-ROM

*Small Business Start-Up Kit: S Corporations* by Daniel Sitarz (Nova Publishing, 2000; \$24.95) Forms and instructions for setting up an S corporation; includes a CD ROM

## 10-Point Pre-Incorporation Checklist

1. Corporate or LLC name: \_\_\_\_\_
2. Alternative name: \_\_\_\_\_
3. State of incorporation: \_\_\_\_\_
4. Type of corporation or LLC: \_\_\_\_\_
5. Registered agent: \_\_\_\_\_
6. Number of shares of stock (LLCs do not issue stock): \_\_\_\_\_
7. Par value of one share: \_\_\_\_\_
8. Names of directors or LLC members (separate list)
9. Items to include in articles of incorporation or LLC information (separate list)
10. Items to include in bylaws (separate list)

### Small Business Law

*Legal Guide for Starting & Running a Small Business* by Fred S. Steingold (Nolo Press, 2005; \$34.99) All the legal info you need to get your business up and running

*Legal Forms for Starting and Running a Small Business* by Fred S. Steingold (Nolo Press, 2004; \$29.99) All the necessary legal forms required for starting your business

### Tax Issues

*Tax Savvy for Small Business* by Frederick W. Daily (Nolo Press, 2004; \$36.99) Tax laws and rules on deductions, plus tax implications on each type of business structure—all delivered in plain English

# The Company Corporation®

Incorporating What's Right For You

As an industry leader, The Company Corporation has helped more than 300,000 small business owners protect their personal assets by incorporating. We provide traditional corporation, S Corporation, nonprofit and Limited Liability Company (LLC) formation services.

Along with our commitment to America's small business owners, The Company Corporation supports the SCORE organization and provides educational materials for use by SCORE counselors and clients.

We provide our services to thousands of small business owners every month. In addition to forming corporations and LLCs in all 50 states and the District of Columbia, The Company Corporation offers a range of products and services including business licenses, corporate kits, self-help books, certificates of good standing, registered agent and business start-up services.

For more information about incorporating or forming an LLC, please visit our Web site at [www.incorporate.com/score3](http://www.incorporate.com/score3) or speak with one of our Business Specialists at **1-800/472-2709**.

*The Company Corporation is a service company and does not provide legal or financial advice.*

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INCORPORATING WHAT'S RIGHT FOR YOU

## SCORE

“Counselors to America's Small Business”

SCORE is a nonprofit association dedicated to entrepreneur education and the formation, growth and success of small business nationwide. SCORE is a resource partner with the U.S. Small Business Administration.

Founded in 1964, the SCORE Association has helped more than 7.8 million entrepreneurs build, expand, and protect their small businesses. SCORE provides information and advice on topics such as business start-up, financing, growth, marketing and technology. More than 10,500 SCORE business counselors volunteer their time and expertise to provide *free and confidential* mentoring. SCORE counselors are active and retired business owners and executives, with extensive experience in a variety of fields.

For *free and confidential* assistance, contact your local SCORE office or Ask SCORE online at [www.score.org](http://www.score.org). To find an office near you or obtain more information on our business workshops, call **1-800/634-0245**.

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