
INTELLECTUAL PROPERTY AND TRANSACTIONAL LAW CLINIC



CORPORATIONS

INTRODUCTORY OVERVIEW

A corporation is a legal entity that is separate from its owners, the shareholders. A corporation typically consists of directors, officers, and at least one shareholder, each with different levels of responsibility, legal duties, and control. Corporations are formed by filing articles of incorporation with the State Corporation Commission and have strict record keeping requirements. A corporation must comply with federal laws and the laws of each state in which it conducts business. The manner in which business profits are taxed depends entirely on the structure of the corporation.

Under Virginia corporate law, corporations are classified as stock or non-stock, and domestic or foreign.

A domestic corporation is a stock or non-stock corporation created under Virginia law by filing articles of incorporation with the State Corporation Commission. A foreign corporation is a stock or non-stock corporation created under the laws of another state, country, or jurisdiction. Every foreign corporation must register with the State Corporation Commission before transacting business in Virginia.

A stock corporation is authorized to issue shares of stock to raise capital and usually is organized for profit. A non-stock corporation is not authorized to issue shares of stock and usually is organized for not-for-profit purposes.

HOW A CORPORATION IS FORMED

A corporation is formed under the laws of the state in which it is registered. To form a corporation, the first step is establishing a business name. A name can be chosen at the time of filing of the articles of incorporation or it can be reserved in advance of filing the articles of incorporation by filing an application for reservation of a corporate name along with a \$10 fee with the State Corporation Commission.

Second, articles of incorporation must be filed. In Virginia, corporations are formed by filing articles of incorporation with the State Corporation Commission. §13.1-619 of the Virginia Code specifies the information that must be included in the articles of incorporation, which includes: (1) a corporate name for the corporation that satisfies the requirements of § 13.1-630, requiring among other things that the name include “corp.,” “inc.,” “co.,” or “Ltd.”; (2) the number of shares the corporation is authorized to issue; (3) if more than one class or series of shares is authorized, the number of authorized shares of each class or series and a distinguishing designation for each class or series; and (4) the address of the corporation's initial registered office. There are also several other provisions which may be listed in the articles of incorporation but are not required.

Next, a corporation should prepare its bylaws. A corporation should have by-laws custom designed for its specific business and situation. Bylaws contain the rules the corporation must follow. Additionally, when a corporation is formed, it must have at least one director and one officer (which can be the same person).

After preparing the bylaws, an organizational meeting should be held. At this meeting, the owners/incorporators, or the initial directors if named in the articles of incorporation, should (1) appoint directors (if not named in the articles); (2) appoint corporate officers; (3) adopt the bylaws; (4) authorize the issuance of stock; (5) set the corporation's accounting year (fiscal year); (6) adopt a stock certificate form; (7) designate a bank; and (8) select a corporate seal. Furthermore, someone present at the meeting should record minutes of the meeting, and the minutes should be stored at the corporation's principal place of business.

After the organizational meeting, stock certificates should be issued to the initial owners and any required local licenses should be obtained.

Another consideration is tax structure. For tax purposes, there are two types of corporations: C Corporations and S Corporations. Any person or entity may own shares in a C Corporation. A C Corporation is taxed on its income and its shareholders are taxed on their dividends – this is often referred to as “double taxation” because the same money is being taxed once at the corporate level and again at the shareholder level. C Corporations may issue

different classes of stock with different rights. An S Corporation is a corporation that has chosen to be treated for federal tax purposes under Subchapter S of the Internal Revenue Code, which allows pass-through taxation – meaning that all profits are taxed only as income of each shareholder and not as income of the corporation (essentially the Internal Revenue Service completely ignores the corporate entity and taxes only the income of the individual owner/shareholders). However, S Corporations can only have a maximum of 100 shareholders, all of whom must be individuals and not other business entities. S Corporations may only issue one class of stock with identical rights.

ADVANTAGES OF CORPORATIONS

Corporations have functional, liability, and tax advantages compared to other business entities.

One of the great functional advantages of corporations is that they have the ability to raise capital for their business through the sale of ownership interests in the business in the form of stock offerings. This can be done initially at the time of formation in the form of an initial public offering, also known as an IPO, or later in the life of the corporation, so long as the articles of incorporation account for the additional shares to be issued. Another functional advantage of corporations is that they are generally able to attract and hire high quality and motivated employees because they tend to offer competitive benefits and the potential for partial ownership through stock options. Another functional advantage of corporations is that their ownership interests can be freely transferred (via transfers of shares of stock) unless limited by the bylaws or some other agreement.

Corporations are often considered most advantageous with regards to liability. A corporation is, for all purposes, treated as a separate and distinct entity from its owners. This means that the owners of a corporation (the shareholders) are not liable for the debts or obligations of the corporation – if the corporation incurs large debts or obligations, the owners’ assets are protected. The most that an owner/shareholder of a corporation can lose is the amount that they put into it, however, if the necessary formalities of the corporation are not maintained or if the corporation is used merely as a “front,” then owner/shareholders could lose the limitation of liability and be held personally responsible for debts and obligations of the corporation.

Corporations also have tax advantages. Corporations typically file taxes separately from their owners. Therefore, owners of a corporation only pay taxes on corporate profits that are actually paid to them in the form of salaries, bonuses, and dividends.

DISADVANTAGES OF CORPORATIONS

While there are no significant disadvantages as far as liability is concerned, corporations do have functional and tax disadvantages.

Functionally, corporations are costly and time consuming to start and operate. Incorporating requires start-up costs, operating costs, and tax costs that are not typically required to form other business entities. Furthermore, because corporations are highly regulated by federal, state, and in some cases local agencies, there are increased paperwork and recordkeeping duties associated with this entity.

With regard to taxes, corporations are sometimes subject to “double-taxation,” meaning that the corporation’s income is taxed once when the business makes the profit (the corporation is taxed), and again when dividends are paid to shareholders (the owner/shareholder is taxed). However, this is only a concern for C Corporations and not S Corporations (which are treated as pass-through entities as described above).

COSTS OF FORMATION AND MAINTENANCE

Formation of a corporation requires the payment of an initial one-time charter fee. This fee is dependent on the number of shares authorized for issuance by the articles of incorporation and range from a minimum of \$75 (for a corporation authorized to issue 1-25,000 shares) to a maximum of \$2,525 (for a corporation authorized to issue more than 1,000,000 shares).

In addition to a one-time initial charter-fee, corporations are also required to file an annual report to retain limited liability as well as pay an annual renewal fee that ranges from a minimum of \$100 (for a corporation authorized to issue 1-5,000 shares) to a maximum of \$1,700 (for a corporation authorized to issue over 270,000 shares).

LIFE AND DEMISE OF THE CORPORATION

A corporation is typically made up of shareholders, directors, and officers, each with different rights and duties. Shareholders have ownership rights that include the election of Directors. Directors govern the general affairs of a corporation and appoint the corporation’s Officers. Officers manage the day-to-day operations of the business.

In addition to requiring bylaws and filing of articles of incorporation, corporations typically have comprehensive record keeping and tax filing requirements.

A Virginia corporation may voluntarily dissolve and terminate its existence by filing articles of dissolution and articles of termination in the Clerk’s Office of the Commission.