

C corporation as choice of entity

Dear Reader:

As a follow up to our initial meeting regarding which form of business is most suitable for your new business venture, here is a summary of the major advantages and disadvantages of doing business as a C corporation.

A C corporation allows the business to be treated and taxed as a separate entity from you as the principal owner. A properly structured corporation can protect you from the debts of the business yet enable you to control both day-to-day operations and organic corporate acts such as redemptions, acquisitions, and even liquidations.

In order to ensure that the corporation is treated as a separate entity, it is important to observe various formalities required by our state. These include filing articles of incorporation, adopting by-laws, electing a board of directors, appointing a resident agent, holding organizational meetings and keeping minutes thereof. Complying with these requirements and maintaining an adequate capital structure will ensure that you do not inadvertently risk personal liability for the debt's of the business.

Since the corporation is taxed as a separate entity, all items of income, credit, loss, and deduction are computed at the entity level in arriving at corporate taxable income or loss. One potential disadvantage to a C corporation for a new business is that losses are trapped at the entity level and thus generally cannot be deducted by the owners. However, since you expect to generate profits in year one, this might not be a problem.

Another potential drawback to a C corporation is that its earnings can be subject to double tax—once at the corporate level and again when distributed to you. However, since most of the corporate earnings will be attributable to your efforts as an employee, the risk of double taxation is minimal since the corporation can deduct all reasonable salary that it pays to you.

A C corporation can also be used to provide fringe benefits and fund qualified pension plans on a tax-favored basis. Subject to certain limits, the corporation can deduct the cost of a variety of benefits such as health insurance and group life insurance without adverse tax consequences to you. Similarly, contributions to qualified pension plans are usually deductible but are not currently taxable to you.

A C corporation also gives you considerable flexibility in raising capital from outside investors. A C corporation can have multiple classes of stock—each with different rights and preferences that can be tailored to fit your needs and those of potential investors. Also, if you decide to raise capital through debt, interest paid by the corporation is deductible.

Although the C corporation form of business seems appropriate for you at this time, you may in the future be able to change the corporation from a C corporation to an S corporation, if the S corporation form is more appropriate at that time. This change will ordinarily be tax free, except that built-in gain on the corporate assets may be subject to tax if the assets are disposed of by the corporation within ten years of the change.

