



STRUCTURING

How to start a corporation: A 9-step guide

By Chris Scott December 12, 2019



If you're an entrepreneur looking to become a small business owner, one of the first things you're going to have to decide on is how to structure your company. [Business structure options](#) include sole proprietorships, general partnerships, limited liability companies, and corporations. There are pros and cons to each type of entity.

Corporations are the most complicated and regulated type of business entity. But while they may be the most difficult entity to create, they also offer the greatest liability protection for owners and shareholders.

Today, we'll cover the pros and cons of corporations, plus how to start a corporation if you decide it's the right structure for you.

By the end of this article, you'll have a clear understanding of whether you should open your own corporation and, if so, how to go about doing so.

What is a corporation?

A corporation is a business structure that allows owners to establish their company as a separate legal entity. Incorporated companies enjoy “corporate personhood,” meaning that, like a person, they have the right to enter into contracts, loan and borrow money, sue and be sued, and so on.

Because of this, the owners and shareholders of a corporation are not held personally liable for its debts and obligations.

Corporations have a two-level structure. The first level is the ownership level. Typically, shareholders are the ones who own a corporation. The second level is the active management level, which features a board of directors and corporate officers.

Shareholders are responsible for electing members of the board of directors, who are then responsible for choosing the corporate officers, including the Chief Executive Officer (CEO), Chief Marketing Officer (CMO), Chief Financial Officer (CFO), and so on.

Officers and directors do not necessarily have to be shareholders, although they can be. Typically officers and directors may double as shareholders in smaller firms, but not in larger firms.

The most basic corporation is known as a [C corporation](#). C corporations can have unlimited shareholders and may become public and listed on the stock exchange. This means that members of the public can purchase shares of the company, thereby making them partial owners.

The ability to sell shares of ownership is often particularly attractive to companies seeking significant investments from multiple investors.

However, registering as a C corp does not mandate that a company exists publicly. They could still issue stock privately, at which point other owners would have more control over who purchases shares.

The other type of corporation available is an [S corporation](#). An S corp is unique because it’s not a type of business structure. Instead, it’s a type of elected tax status.

The [Internal Revenue Service](#) defines S corps as “corporations that elect to pass corporate income, losses, deductions, and credits to their shareholders for federal tax purposes.” Electing S corp status allows owners to pass-through business income to their personal tax returns, avoiding double taxation.

So when setting up a corporation, owners do not need to choose between a C corp or an S corp. All businesses begin as a C corporation. After registering as a C corp with their state’s Secretary of State’s Office, owners can then elect to become an S corp by filing [IRS Form 2553, Election by a Small Business Corporation](#).

The benefits of forming a corporation

Why should you create a corporation? Let's take a look at some of the benefits this business structure offers..

Limited liability

Perhaps the most significant benefit of corporations is that they offer personal liability protection to shareholders. Owners are only responsible for the amount they invest in the company, and their personal assets are not subject to seizure. This is different from what's offered by [sole proprietorships](#) and [general partnerships](#) where owners are responsible for the debts and obligations of the company.

Credibility

Registering as a corporation can make your business appear more credible in the eyes of:

- Potential customers
- Employees
- Partners
- Vendors

Additionally, many investors are hesitant to work with companies that do not have a corporation or LLC status because the lack of liability protection puts the investors' funds at greater risk. So registering as a corporation could make you more legitimate to investors as well. Businesses can also sell stock to raise capital.

Unlimited life and transferable ownership

Corporations have an infinite life. If an owner passes away or wishes to sell his or her share of the company, the business will still exist and can continue to do business. Additionally, ownership is transferable. There are some restrictions in place for S corps, but generally speaking, owners can sell or pass shares to another person or business.

Tax advantages

Electing corporation status offers numerous tax advantages. For instance, owner-paid health insurance premiums are tax-deductible. Owners can also save from having to pay Social Security, Medicare, and Workers Compensation taxes, which corporate income is not subject to. Furthermore, as mentioned, S corps allow owners to opt in to pass-through taxation.

The downsides of forming a corporation

Although corporations can offer numerous benefits, there are a couple of disadvantages potential owners need to consider.

Cost

The fees to register a corporation vary from state to state, but they often cost a couple hundred dollars. This is different than, say, a sole proprietorship, which exists automatically without owners having to pay any filing fees. In addition to filing fees, you'll have to pay for things like business license fees. And you'll have to do this in every state, and potentially every county, in which you operate.

Administrative duties

There is a lot of paperwork involved in operating a corporation. Again, this varies from state to state, but you may need to do things like file annual reports or other similar documents to remain compliant. Other things you'll need to keep on file include:

- Certificate of incorporation
- Corporate bylaws
- Certificate of good standing if operating in another state
- Corporate minutes

If there are only a couple of owners involved in your small business – such as yourself and one or two others – then the administrative upkeep may not be worth it, and you may be better off selecting another business structure.

How to start a corporation

If you've weighed the pros and cons and determined that a corporation is right for you, you're likely curious about what to do next. Starting a corporation is a bit tedious, so it's critical that you're diligent during the registration process. The following is a step-by-step guide to creating a C corporation.

1. Select a corporate name

While it may seem like a minor detail, choosing the right name for your corporation is a crucial step. The name of your corporation must not match or be similar to that of an existing corporation. Check with your local secretary of state's office to see the availability of your proposed name.

Additionally, if you want to conduct business under your corporation's name, check with the [U.S. Patent and Trademark Office \(USPTO\)](#) to make sure the [trademark](#) or service mark is available. You might consider talking to an attorney or receiving legal advice for help with the trademarking process.

You should also check to see if the domain name associated with your chosen business name is available. Perform a search of local directories to see if any local businesses are currently operating with the same or with a similar name.

2. Draft and file your articles of incorporation

Articles of incorporation, or certificates of incorporation, are required to document the formation of a corporation. While some states may have more stringent requirements, in general, the articles of incorporation outline necessary company information such as the business's name, street address, and the amount and type of stock issued.

You are required to prepare your articles of incorporation, have the articles signed by the incorporator, and file with the secretary of state in the state where you incorporate your business. When registering, you will also need to pay a filing fee and obtain an extra certified copy of the document.

3. Create corporate bylaws

Not all states require corporations to draft corporate bylaws, but you should consider developing them either way. Bylaws are some of the most important documents for a corporation because they set forth the rights and duties of the shareholders, directors, and officers, as well as outline how the corporation will operate.

Check with your local secretary of state's office to see if corporate bylaws are required in the state in which you plan to incorporate your business.

4. Draft a shareholders' agreement

If desired, be sure to prepare and execute a shareholders' agreement. A shareholders' agreement is often utilized by small, "closed" corporations that want to restrict who can become a new shareholder and set provisions for how existing shareholders can exit the corporation and sell their shares, among other requirements.

5. Maintain corporate minutes

Corporate minutes document the meetings of shareholders and the board of directors. They allow the corporation to formalize its appointment of board members, officers, and other relevant resolutions, such as the decision to obtain a federal ID number, open a corporate bank account, choose a tax status, and many other tasks described therein. Minutes must be used to record actions during all board and shareholder meetings.

6. Issue shares of stock

Prepare and execute stock certificates, and update the corporation's share ledger. The share ledger keeps track of who owns shares and how many they own. Corporations are required to keep track of how many shares they issued, who owns them, and how many are outstanding.

7. Obtain an Employer Identification Number

The [Employer Identification Number \(EIN\)](#) is basically the corporation's Social Security number. (Social Security numbers can only be issued to people, whereas the IRS issues EINs to businesses.)

This number is necessary to open a corporate bank account and file taxes. Some of the questions on the EIN application have tax implications, so it might be a good idea to consult an attorney or tax professional before registering. Owners can obtain an EIN by submitting an [IRS Form SS-4](#).

8. Select a tax election

For federal income tax purposes, a corporation can elect to be taxed as an [S corporation](#) or [C corporation](#). This decision has significant tax consequences. You don't need to file anything additional if you would like the IRS to tax you as a C corp. If you would like the IRS to tax you as an S corp, now would be the time to file [IRS Form 2553](#).

9. Obtain required licenses and permits

Your corporation should determine whether it needs any permits or licenses to operate. If so, you must apply for both, likely with both a state and local agency.

Start your corporation today

While the process for incorporation may be complicated, there are many benefits to doing so. If you elect this business structure, it's vital to fulfill corporate requirements in order to maintain corporate personhood and liability protection.

Make sure you perform due diligence when filing and seek legal assistance if needed. If you register correctly, choosing a C corp structure could put your company in a position for long-term success.