Hello, and welcome to one in a series of RightRisk videos on business structures.

[click] There are a number of legal organizational structures available to entrepreneurs. Today, I will focus on corporations.

[click] I am Jeff Tranel, an agricultural and business management economist with Colorado State University. Joining me is **[click]** John Hewlett, a farm and ranch management specialist at the University of Wyoming and Doctor Jay Parsons, professor and extension specialist with the University of Nebraska – Lincoln. The three of us are also founding members of RightRisk.

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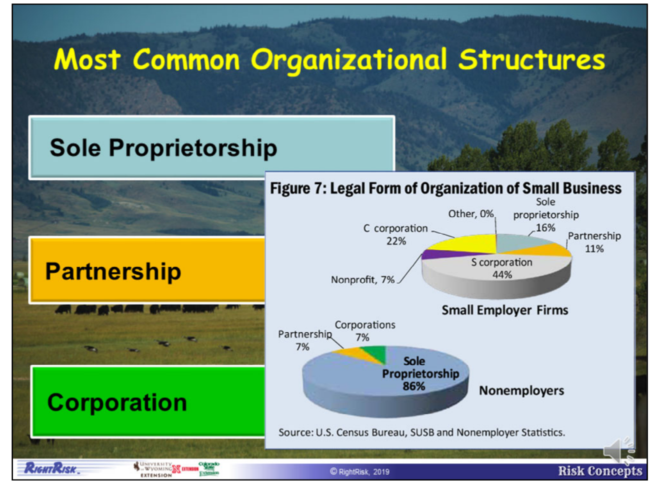

[click] There are three basic types of business structures – sole proprietorships, partnerships, and corporations. Each structure has advantages and disadvantages, different tax ramifications, alternative impacts to estate and succession plans, etc.

[click] According to the Small Business Administration, 86 percent of all organizations are sole proprietorships. Partnerships and corporations each account for 7 percent of businesses. These numbers are higher for small businesses that have employees.

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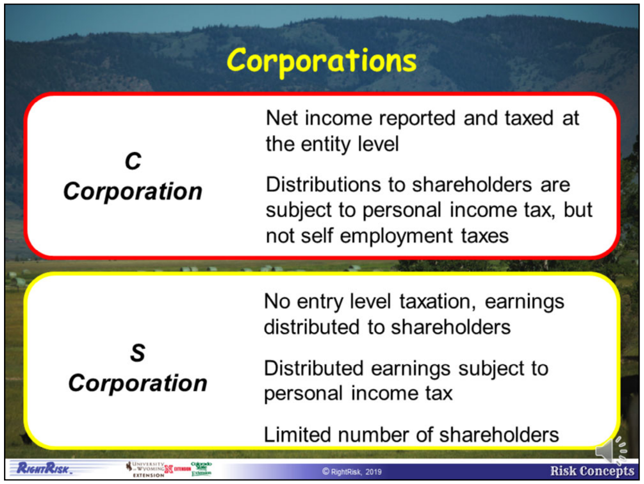

[click] The Internal Revenue Code provides for two types of corporations. Both types have statutory requirements, and are thus quite formal.

[click] A C corporation is a form of business entity which pays taxes at the entity level. Any distributions paid to the shareholders is then subject to each shareholder's personal income tax computations. Corporate distributions are not subject to self-employment taxes.

[click] The S corporation is an otherwise ordinary corporation which is eligible for and has elected to be taxed under subchapter S of the Internal Revenue Code. For state law purposes, it is formed like any other corporation, and the provisions of the general business corporation statutes apply. Another significant difference is that S corporations can have only a limited number of owners.

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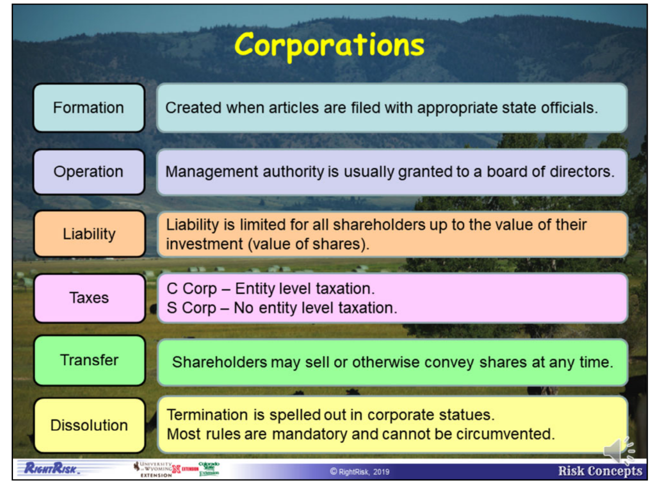

[click] The corporation is a creature of statute. The statutory requirements must be complied with in order for a corporation to come into existence. In most states, a corporation comes into existence when the articles are filed with the Secretary of State or other appropriate state official.

The articles of incorporation, sometimes called the corporate charter, contain basic information about the corporation and are not intended to govern the day-to-day operation of the business. Once the articles are filed, the organizers will typically meet to select the initial directors unless they were named in the articles. The initial directors authorize the enactment of bylaws that will govern the day-to-day operations of the corporation. They will also authorize the issuance of shares and take whatever actions are necessary to get the corporation started.

[click] Under normal circumstances, all management authority is to be exercised by or under the authority of the board of directors. Because this level of complexity and formality may not be desirable or necessary in a small corporation, some state statutes allow smaller corporations to elect to have shareholders retain management authority by including a provision to that effect in the corporation's articles of incorporation.

[click] Owners of a corporation have limited liability for corporate debts. In other words, a shareholder stands to lose only the value his or her investment in the corporation.

[click] As was previously mentioned, net income of C corporations is subject to an entity level tax. Any distributions to shareholders in the form of dividends is subject to taxes at the shareholders tax rate. Thus, the term "double taxation". The corporation will pay taxes on taxable income and the shareholders will pay taxes on any distributed profits. The Internal Revenue Service does impose a special tax on excess retained earnings.

Conversely, a Subchapter S corporation is taxed as a "pass through entity". Income and losses are reported to the owners, and they pay income and self-employment taxes at the applicable rates.

[click] Absent agreement to the contrary, a shareholder may sell or otherwise convey shares at any time to any other legal person. The buyer or transferee becomes a shareholder, with all the rights such a position entails. While a shareholder who has control over the corporation cannot knowingly sell the control shares to someone who intends to come in and "loot" the corporation, there are very few limits on a shareholder's right and power to transfer shares.

[click] The process of terminating a corporation is spelled out in the corporate statutes. Most of these rules are mandatory and cannot be circumvented by agreement of the parties.

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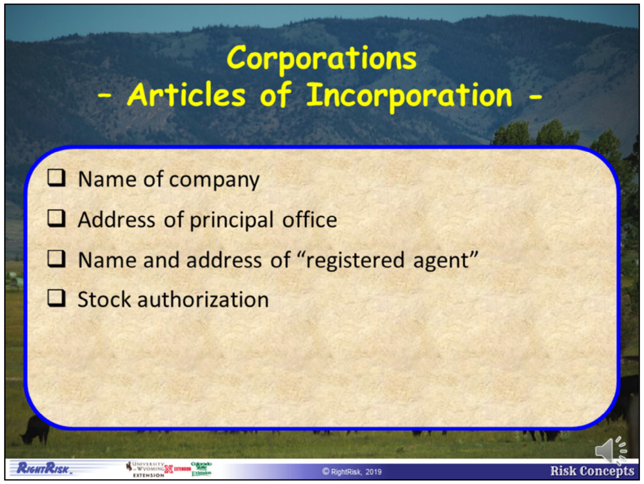

[click] The articles of incorporation, or corporate charter, contain basic information about the corporation and are not intended to govern the day-to-day operation of the business. The articles contain information such as the name of the company, the address of the principal office, a registered agent and office in the state for service of process, detailed information about the stock which the corporation is authorized to issue, information about the incorporators, and possibly the purposes for which the corporation is to be formed. The articles may, but generally are not required to, include the names of the initial directors of the corporation.

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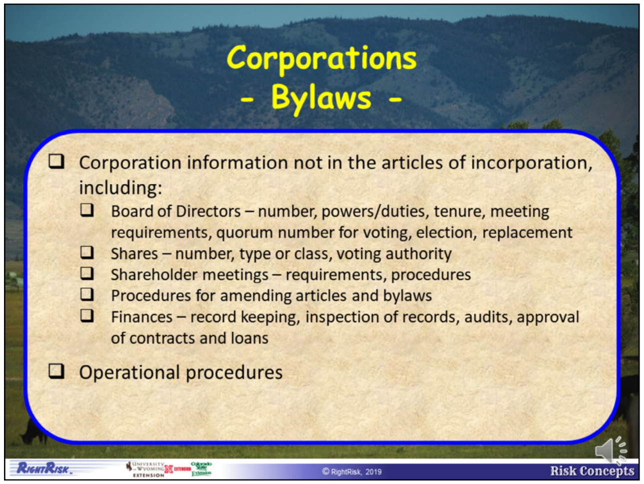

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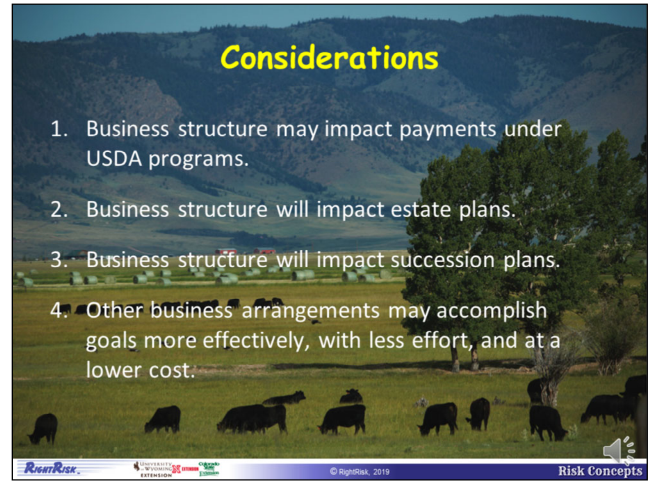

[click] A person forming a business should consider all the factors which will impact the business and help him or her reach the desired goals. Professional counsel from an attorney, certified public accountant, and other knowledgeable professionals is critical before selecting a specific structure for the business.

[click] For example, a selected business structure may impact eligibility for and payments under various USDA programs.

[click] Likewise, a selected business structure will impact the owner's estate and succession plans. Each organizational structure allows one to implement certain strategies, but the impacts of those strategies may differ.

[click] Other business arrangements such as labor sharing agreements, livestock production contracts, and strategic alliances may allow a business owner to accomplish his or her goals more effectively, with less effort, and at a lower costs.

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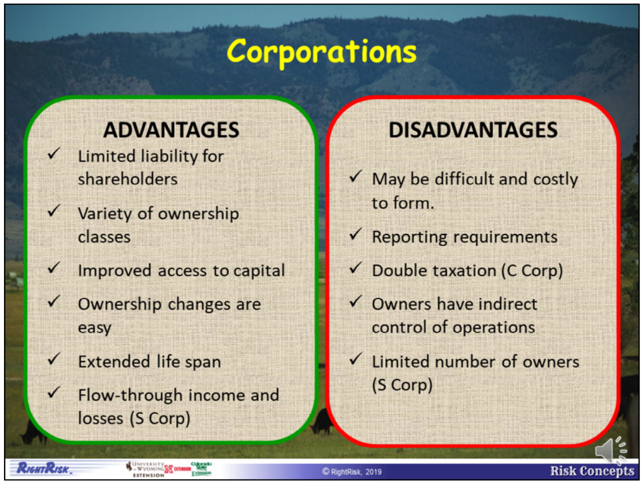

The corporation has a number of advantages and disadvantages. Some of which are dependent upon whether the corporation is a C or an S entity.

[click] Advantages of a corporation are that owners have limited liability for business debts; there are a variety of share classes; transfers of ownership is easy and do not normally impact day-to-day operations; and the business has an extended life span. This type of business structure may allow the business to borrow capital more easily than other organizational types. Also, some business owners may see an S Corporation as advantageous in that it has a very formal structure yet profits and losses flow through to the owners.

[click] On the other had, corporations may be difficult and costly to form and have reporting requirements. C corporations, but not S corps, report and pay taxes at the entity level. Corporations have a board of directors and a hired manager or Chief Executive Officer who manages the business, so owners generally have only indirect control of day-to-day operations. However, this may be viewed by some owners as an advantage.

Finally, S corporations are restricted to the number of owners. If the S corp exceeds the allowable number of owners, currently 75, it will lose it status as an S corporation and become taxable as a C corporation. This situation may arise under normal circumstances but especially when an owner transfers owners to a number of heirs via his or her estate.

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[click] RightRisk has a plethora of resources available on its web site. Specifically, under the resources tab are written and other materials pertaining to organizational structures **[click]** titled Risk Concepts. You will find several 4-page fact sheets describing selected organizational structures **[click]** and a 2-page table comparing the attributes of seven most common organizational structures.

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In summary, there are a number of organizational structures available to business owners. Each structure has advantages and disadvantages, ramifications, and impacts to the business and to the owners.

[click] There are two types of corporations – the C or regular corporation and the S corporation. Each as its advantages and disadvantages, but the greatest difference is that a C corporation pays taxes at the entity level while an S corporation is a flow through entity for tax purposes.

A person should seek appropriate professional counsel BEFORE forming a business.

[click] Please look for information about organizational structures and additional educational resources at the RightRisk web site – rightrisk.org. Thank you. Have a great day. **[click]**