

# The World of the Corporations

By Liliana Parker

When speaking of business entities, the subject of corporations is a bit more complex. Corporations can be publicly or privately owned. Public corporations whose shares are traded on Wall Street are too complex a topic to discuss in this article.

But let's talk about privately owned corporations. The most important aspect of these is that legally they are separate entities from the individuals who operate or own them.

A corporation can be owned and operated by only one person. Even the board can consist of a single director, depending on the number of shareholders.

Having a corporation limits liability also. This means that as long as you act in your corporate capacity either as employee, officer or director, your personal assets can't be touched by a creditor or by people injured by your business activity. In the real world, however, banks and financial institutions often require the personal guarantee of individuals of the corporation.

Federal taxation of corporations is very complicated also. A "C" corporation is treated as a separate entity from its investors, which in effect creates double taxation. For federal tax purposes, it is better to start an "S" rather than a "C" corporation, because an "S" corporation is taxed at only one level. Also, if you are expecting losses for the first year, you can claim these on your personal tax return, whereas if you are expecting profits you miss this advantage.

But if you, as the owner, don't work actively in the corporation there are potential problems with claiming losses and deductions because these might be considered losses from passive activities.

Interest on financing an "S" corporation is deductible as an investment interest expense. If you sell the assets of your "S," you might be taxed less on your gain. Shareholders pay income tax on their profits if they receive the money or not, but at the same time if they incur losses they can claim their shares as a loss. To be treated as an "S" corporation, all shareholders must sign and file IRS Form 2553.

"C" corporations allow a degree of flexibility in planning and controlling federal income taxes that is not possible under other entities. Benefits given to corporation employees and owner-employees such as deferred compensation plans, group term life insurance, reimbursement of employee medical expenses not covered by insurance and health and disability insurance can enjoy a tax advantage. But the real advantage is in how these benefits are treated on your personal tax return; they can be deducted as business expenses and no one can be taxed on these benefits. This is different than other entities where if owners receive benefits they are taxed on their value.

There are pros and cons to each type of entity. The most important thing is to select the one that best fits your situation and needs. Remember also that you can change your entity in whatever stage of your business if the one you've chosen isn't a good fit.