

FORMING A CORPORATION

Forming a corporation is a complicated process, and operating a corporation after it is formed is an even more complicated process. All that is required in order to form a corporation in Pennsylvania is to file Articles of Incorporation, along with a Docketing Statement, with the Corporation Bureau of the Pennsylvania Department of State. Pennsylvania has adopted a simplified form of Articles of Incorporation, which, along with the Docketing Statement, can be obtained from the State sponsored website: <http://www.paopen4business.state.pa.us/>, or as another reference document on this site. The filing fee is \$125.00. After Articles of Incorporation are filed, notice of filing must be advertised in two newspapers of general circulation in the county where the company's principal office is located. One of these papers must be the official legal journal for the county. In Westmoreland County this is the Westmoreland Law Journal, 129 N. Penna. Ave, Greensburg (724) 834-7260.

Although the steps listed above are all that is required to form a corporation, there is much more that ought to be done. There are three important documents that should be prepared: a Preincorporation Agreement, a Shareholders Agreement, and Corporate Bylaws. In addition, a corporate Minute Book should be maintained, in which to record that the requisite corporate formalities have been properly observed.

A Preincorporation Agreement identifies the initial shareholders and what capital contribution will be made to the company by each one, by subscribing to purchase shares of stock. An example of a typical Preincorporation Agreement is attached.

A Shareholders Agreement is more complicated than a Preincorporation Agreement. The most important component of a Shareholders Agreement is a Buy/Sell provision that prohibits any shareholder from selling his/her shares to somebody else without first offering to sell them to the company and to the other shareholders. This prevents the business owners from suddenly having a stranger as a business partner. An example of a Shareholders Agreement is attached.

Corporate Bylaws spell out how the company will operate and be governed in accordance with State corporation law. Bylaws typically list the scope of

authority, duties and responsibilities of the company's directors and officers. An example of a corporation's Bylaws is attached.

Once the corporation is formed, it is complicated to operate in compliance with State corporation laws. There are certain corporate formalities that must be observed. For example, a corporation has a complex, three-tier structure of ownership and management. The owners of a corporation are called shareholders. The shareholders are issued shares of stock that should be recorded in a stock transfer register. The shareholders must meet every year to elect or appoint directors, who manage the company for the shareholders, who own it. The directors then elect or appoint officers, who run the company for the directors, who manage it for the shareholders, who own it. In Pennsylvania, officers of a corporation must include, as a minimum, a president, a secretary and a treasurer. Each of these actions must be carefully documented and recorded in the corporate Minute Book. If this is not done properly, the shareholders risk losing their protection of having limited personal liability, which the corporation is intended to provide.

It is possible to have a one-person corporation, with one person being the sole shareholder, the sole director and all three officers. However all of the corporate formalities listed above must still be observed every year. Otherwise, the corporation could be considered to be the alter ego of the shareholder, and limited personal liability protection could be lost.

To help in observing all of the requisite corporate formalities, vendors of legal supplies offer something called a Corporate Kit. A Corporate Kit typically includes a Minute Book, in which to record corporate actions, a corporate seal to affix to official documents, printed stock certificates, and may even include a set of Bylaws. One source for Corporate Kits, among many other suppliers, can be found on the Internet at www.corporatekits.com. Another one is at www.fastkit.com.

There is little or no benefit to be gained by forming a corporation in any state other than the one where the company is located. There are other states considered to be friendly to corporations, such as Delaware and Nevada. However, if a corporation is formed in one of these states, it must then be registered with Pennsylvania as a "foreign" corporation, at additional expense.

Although the Commonwealth of Pennsylvania has adopted simplified forms and filing procedures for Articles of Incorporation, it is highly recommended that persons forming a corporation use the services of a qualified attorney to prepare the documents associated with forming a corporation, such as a shareholders Buy/Sell agreement, because of their importance and complexity.

Limited Liability Company (LLC)

An attractive alternative to forming a corporation is the LLC. The main reason most people form corporations is to obtain the protection of having limited personal liability for claims made against the company and/or its business. The LLC provides exactly the same degree of protection from personal liability that a corporation does, without the necessity of observing the cumbersome corporate formalities referred to above. In fact, the LLC may even provide greater liability protection than a corporation. In certain circumstances, a creditor in a lawsuit against a shareholder may be able to acquire his shares of stock in the corporation. Then, he can vote the shares of stock with adverse consequences, even forcing the dissolution of the corporation. Since a LLC does not issue stock, this risk of losing control of the company does not exist with a LLC. One disadvantage that the LLC presents when compared to a corporation is that the owners of an LLC, called Members, may have to pay self-employment tax on money paid to them by the LLC. Be sure to consult with a CPA about this when choosing a legal business structure. This tax disadvantage does not apply to a corporation. Otherwise, the simplified management structure of a LLC makes it a viable alternative to forming a corporation.

State of Incorporation

There is a popular belief that there is some benefit to incorporating in certain favorable states, notably Delaware and Nevada, instead of the state where the business is located. Any benefit to incorporating in one of these states is illusory. Furthermore there are considerable, unnecessary additional costs involved, because a company formed in any state other

than the one where its principal office is located, is considered a “foreign” company, and must register as such in its home state where it does business. This requirement to re-register as a foreign company involves substantial filing fees (many hundreds of dollars typically) on top of the cost of incorporation in the foreign state. There is no benefit to foreign incorporation to offset this added expense. Additional expense without any compensating benefit seems pointless.

Unless there is some particular reason for doing otherwise, any company should be organized in the same state where its principal office is located.