

## Corporation Basics

1. **Corporation Basics:** A corporation is a legal entity established to do business. A corporation is a separate and distinct legal entity from its owners, the shareholders. When properly formed, the corporation's shareholders are not held personally liable for the corporation's debts or liabilities.

1.1 **Shareholders.** Shareholders own the corporation. Ownership interest is represented by stock certificates representing a number of shares in the corporation. Different types of stock can be issued with different rights and participation associated with each type of stock.

1.2 **Directors and Officers.** The directors, elected by the shareholders, manage the corporation. The directors elect the corporation's officers, such as President, Vice-President, Secretary-Treasurer. Directors set the policies and the officers implement the policies of the directors.

(a) In large corporations, the board of directors elect a chairman of the board. The board may be subdivided into committees with specific authority. Executive committees may also have authority to make certain decisions without approval by the full board of directors.

(b) There can also be other officers, including chief executive officer (CEO), chief operating officer (COO), and chief financial officer (CFO).

2. **Formation:** State law governs the formation of a corporation. A corporation is formed under the laws of one state, but can do business in multiple states. In order to do business in a different state, the corporation must qualify in each states where it conducts business.

2.1 **Articles of Incorporation.** A corporation is formed by filing the Articles of Incorporation with the Secretary of State. The Articles are brief, containing only the most basic information about the corporation, such as the name of the company, the location of the principal office, the agent for service of process, the number of stocks, and the names of the officers and directors.

(a) Registered Agent. The corporation must appoint a registered agent for service process. This is a person or business in Nevada that agrees to be served in the event of a lawsuit. This agent must accept that position in writing, and file it with the Articles of Incorporation.

(b) Initial List of Officers and Directors. On or before the last day of the first month following the filing of the Articles of Incorporation, an officer of the corporation must sign containing the names and mailing addresses for all officers and directors of the corporation.

**2.2 Bylaws.** The bylaws outline the government of the corporation. The bylaws specify the duties and responsibilities of the corporations shareholders, directors, and officers. The Articles of Incorporation are brief; the bylaws are much more detailed. The provisions in the Articles of Incorporation will govern over any contrary provision in the bylaws.

**2.3 Organizational Meetings.** Once the corporation has been formed, the Articles of Incorporation, the corporation must be organized. The directors named in the Articles must meet to authorize the issuance of stock, elect officers, and adopt the bylaws. The directors may also want to approve a corporate seal, authorize the opening of one or more bank accounts, and make other decisions relating to the start up of the business or its transition into corporate form.

**2.4 Federal Tax Identification Number.** Once the corporation is formed, the corporation must obtain a federal tax identification number, TIN, also called an EIN or employer identification number. The EIN is required in order to open a bank account and to complete other registrations.

**2.5 Out-of-State Registrations.** If a corporation's business is outside of Nevada, there needs to be compliance with the laws of each state in which the corporation is doing business. Each state defines what constitutes "doing business" differently. If a corporation has out-of-state employees, representatives are located in another state, or deal directly with clients in that state, business is being conducted in that state.

**3. Maintenance:** Proper operation of a corporation requires the following maintenance:

**3.1 Financial Records.** A corporation's most important records are its financial records. Accounting records should be kept current, and tax returns should be filed timely. It is important to keep the company's financial records separate from those of any shareholder or officers. The corporation's EIN should be used for all business transactions and tax returns. Company assets, including bank accounts, investments, real property, and vehicles should be titled in the name of the corporation. If a shareholder or employee of the company uses company assets for personal use, he/she must either pay rent or recognize the fair market value of the use as taxable income. Once the corporation is formed and officially recognized, a corporate obligation should not be paid with personal funds, and no one should pay a personal obligation with corporate funds.

3.2 **Meetings.** The shareholders and directors should meet as often as necessary, but not less than at least once a year. Generally, shareholder and director meetings are on the same day, and for a closely held business where the shareholders and directors are the same people, the meeting of the shareholders and directors can be a joint meeting.

(a) Meeting minutes are kept to record the decisions that are made, usually in the form of resolutions.

(b) Nevada law permits resolutions to be adopted in the absence of a formal meeting, if a consent resolution is signed. The consent resolution must be signed by all directors also known as a unanimous consent resolution.

(c) Consent resolutions by shareholders require consent by the same number of shareholders that would have been required if a meeting had been held and all eligible voting shareholders had attended.

4. **Protecting against Liability.** There are exceptions to the rule that a corporation's shareholders are not liable for the company's obligations.

4.1 **The "Alter Ego" Rule.** The corporation will be ignored by the courts if it is deemed to be nothing more than the "alter ego" of its shareholder(s). The "alter ego" argument is used by creditors when they want the corporation to be ignored so they can seek payment from the corporation's owners. Creditors can be successful in having the corporation disregarded as a legal entity if the legal formalities are not observed. Disregarding legal formalities includes comingling personal and company assets, using corporation funds to pay for personal obligations, using corporation assets for personal use without fair payment to the corporation, or failing to properly maintain financial records.

4.2 **Co-Obligor vs. Guarantor.** For a new corporation with little net worth or an established track record, a company creditor may require a shareholder to either be a guarantor or co-obligor with the corporation.

(a) A guarantor agrees to meet the corporation's obligation if the corporation is not able. Traditionally, a guarantor is not responsible for a guaranteed obligation unless and until the creditor has exhausted its remedies against the primary obligor (i.e. the corporation).

(b) The enforcement of a guarantee can be unnecessarily burdensome, and so instead, a creditor may insist that the shareholder be a co-obligor with the corporation. This provision requires that the corporation and the shareholder have joint and severable liability for the obligation. Such a provision allows the creditor to sue either the corporation or the shareholder or both, and the

shareholder can be required to pay the entire obligation even if the corporation is able to do so.

5. **Conclusion.** The establishment of a corporation involves the observance of proper legal formalities. It also requires the advice of qualified financial and legal advisors. A trusted attorney and CPA will be a very important tool when starting and operating a Nevada corporation.

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