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Business Entities in Texas: What form of business is right for you?
Corporation

One of the most important decisions you can make as a business owner is deciding what form your business should take. There are several forms of business entities; each has advantages and disadvantages that should be considered as regards your specific situation. Below you will find the benefits and disadvantages of a corporation.

What is a corporation?

A corporation is a business entity created under the Texas Business Organizations Code. The corporation's owners are called shareholders. They own shares, or percentages, of the organization. The corporation is a separate legal entity from the shareholders.

How do I form a Corporation?

Texas requires that a Certificate of Formation be filed with the Texas Secretary of State's Office for the formation of a corporation, along with the filing fee of \$300.00. Do a name search to make sure that the name you would like to use for your corporation is not already in use. This can be done through the Texas Secretary of State's Office.

Corporations must also register and maintain a "registered office" and a "registered agent." This does not need to be at the corporation's main place of business. The registered agent is the person who will receive governmental and other important notices on behalf of the corporation. This can be a shareholder, but it does not have to be; there are businesses that provide registered agent and registered office services for a fee.

A shareholder's stake in the business is governed by the corporation's "bylaws." This is an agreement that sets out the rules for how the corporation is run, how profits and losses and voting rights are allocated between different classes of stock, etc.

How are corporations operated?

Corporations must be operated according to the rules set out in the bylaws. Corporations issue shares of stock and sell them to generate revenue. These shares represent an ownership interest in the corporation, and carry with them voting rights and the right to a share of the dividends, which is the profit the corporation pays to the shareholders. The shareholders elect the corporation's directors, who direct the management of the company. The directors can then appoint officers who manage the day-to-day operation of the company. Shareholder and director meetings must be held annually, and corporations are required to keep and make available accurate accounting records, business records, and minutes of meetings. In a very small corporation, one person can be the sole shareholder, director and necessary officers.

What licenses and certificates must I obtain?

Texas requires many types of business to obtain licenses and permits at the state and local levels. The licenses and certificates you must obtain will differ depending on the business location, business activities and industry that you will be in. For example, the owner of a moving company must register with the Texas Department of Transportation and obtain the legally required insurance. Corporations conducting business activities are subject to these requirements as are any business.

You may also be required to have a Certificate of Occupancy from your local authority if you are going to be running your business out of a commercial space. If the Corporation is going to be operating under a trade name that is not its official name, it must file an assumed name certificate, or DBA with the Texas Secretary of State's Office.

A list of license and permit requirements can be found at:

<http://www.state.tx.us/category.jsp?language=eng&categoryId=9>

What tax-related requirements should I know about?

All Corporations must obtain a federal Employer Identification Number (EIN) for tax filing and reporting purposes.

For federal tax purposes, there are two different treatments given to corporations: "S" Corporations, and "C" Corporations. You should consult with an accountant regarding any income tax filing requirement.

"C" Corporations are the default tax treatment of corporations. They file their income tax on IRS Form 1120 or 1120-A. The corporation will pay income taxes on its profits, and the shareholders will individually report and pay income taxes on any dividends received.

"S" Corporations must file for the S election with the IRS relatively quickly after incorporating. If the corporation, as it is organized complies with the requirements set out by the IRS, it may be granted "S" status, which makes it a "pass-through" tax entity. The "S" Corporation will file an informational return on IRS Form 1120S and its shareholders will use IRS Form 1040 Schedule E to report income and expenses.

If the corporation hires independent contractors, the business may be required to issue IRS Form 1099-MISC to the contractor. If the corporation has employees, the business is required to withhold its employees' income taxes and FICA taxes and pay federal withholding tax and needs to submit W-2 and W-3 forms to the IRS, as well as IRS Forms 940 and 941. The corporation may also be subject to state and federal unemployment tax as well.

Depending on the type of business being conducted, the business may have to collect Texas Sales Taxes and remit these to the Texas Comptroller. There are other industry-specific Texas taxes administered by the Texas Comptroller Office that may apply to your business' activities.

Corporations are subject to the Texas Margin Tax. This is a state tax that applies to business with gross revenues over \$300,000. Even if your corporation will not ultimately owe any tax, it must file the Margin Tax return annually. The return is due each May 15.

Corporations must also report the value of their business' income-producing personal property and inventory to the Appraisal District in which the business is located. Each Appraisal District has its own form and sets the date by which the form must be filed.

What are the advantages of a Corporation?

Corporate shareholders have limited liability for the debts or other liabilities of the business. This means that the liability of the shareholder is limited to the amount he or she has invested in the corporation.

“C” Corporations can raise additional capital by going public, which is offering additional shares for sale in an attempt to raise money for the business.

“S” Corporations are “pass-through” entities for federal tax purposes, which means the “S” Corporation’s income is taxed only once.

What are the disadvantages of a Corporation?

Setting up a corporation is costly; the filing fee alone is \$300.00. Additionally, the members must create the bylaws that will set out how the corporation is run. Another disadvantage is a relative lack of flexibility in the management of corporations due to the requirements of the corporate structure. Corporations are required to comply with many rules and formalities, which can be costly and time-consuming.

“C” Corporations are subject to “double taxation;” the corporation pays taxes on its income, and the shareholders also pay taxes on their dividends.

There are limitations on the number and types of shareholders in “S” Corporations, which makes it impossible for an “S” Corporation to raise capital by going public.

Where can I find more information?

Internal Revenue Service: <http://www.irs.gov/businesses/small/index.html>

Texas Secretary of State: <http://www.sos.state.tx.us/corp/index.shtml>

United States Small Business Administration: <http://www.sba.gov>

Texas Comptroller of Public Accounts: <http://www.window.state.tx.us/m23taxes.html>