

Protect What's Yours: Incorporate by Quenda Behler Story

A lot of small construction companies are incorporated. There are so many advantages to being incorporated, it surprises me everybody doesn't do it.

The Corporate Veil

The main reason to incorporate is to protect your personal assets. Even the best-run companies can get into financial trouble. The cost of lumber might suddenly double, or you could face a big liability because an employee runs over someone with the company truck or a past customer discovers mold growing behind the bathroom drywall. When problems like these occur, incorporation keeps creditors from garnishing your personal bank account or seizing such personal assets as your home, boat, or car.

The protection that incorporation affords is referred to as the "corporate veil." The corporate veil draws a bright line between the company's assets and cash and your personal assets and cash. This is true even if you are the only stockholder, which is entirely legal. Many corporations have only one stockholder.

Some contractors reject the idea of incorporating because they think it's too complicated. However, it's not as complicated or expensive as you may think, and if things go wrong it could be the cheapest insurance you ever bought. There are kits you can buy at the office-supply store and Web-based services that will help you self-incorporate, but I personally recommend hiring a lawyer to help you file your articles of incorporation. Each state is different, so you need advice from someone who understands the ins and outs

SCC619
(02/03)

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

ARTICLES OF INCORPORATION
OF A VIRGINIA STOCK CORPORATION

The undersigned, pursuant to Chapter 9 of Title 13.1 of the Code of Virginia, state(s) as follows:

- The name of the corporation is: _____
- The number (and classes, if any) of shares the corporation is authorized to issue is (are):
Number of shares authorized _____
Class(es) _____
- A. The name of the corporation's initial registered agent is _____
B. The initial registered agent is (mark appropriate box):
(1) an individual who is a resident of Virginia and
 an initial director of the corporation,
 a member of the Virginia State Bar.
OR
(2) a domestic or foreign stock or nonstock corporation, limited liability company or
registered limited liability partnership authorized to transact business in Virginia.
- A. The corporation's initial registered office address, which is the business office of the initial registered agent, is:

(number/street) _____ (city or town) VA _____ (zip code)
B. The registered office is physically located in the { } city or { } county of _____
- The initial directors are:
NAME(S) _____
ADDRESS(ES) _____

INSTRUCTIONS

- Name:** The corporate name must contain the word "corporation," "incorporated," "company" or "limited"; or the abbreviation "corp.," "inc.," "co." or "ltd." The name of the corporation may not contain any word or phrase which indicates or implies that it is organized for the purpose of conducting any business other than a business which it is authorized to conduct. See § 13.1-630 of the Code of Virginia.
- Shares:** List the total number of shares the corporation is authorized to issue. If more than one class of shares is to be authorized, list the number of authorized shares of each class and a distinguishing designation for each class (e.g., common, preferred, etc.) and state the relative rights, limitations & preferences of each class. See §§ 13.1-619 and 13.1-638 of the Code of Virginia.
- Registered agent:** A. Provide the name of the registered agent. The corporation may not serve as its own registered agent. See §§ 13.1-619 and 13.1-634 of the Code of Virginia.
B. Check one of the boxes to indicate the qualification of the registered agent. The registered agent must be one of the options listed. No other person or entity may serve as the registered agent.
- Registered office:** A. The location of the registered office must be identical to the business office of the registered agent. See § 13.1-634 of the Code of Virginia. The address of the registered office must include a street address. A rural route and box number may only be used if no street address is associated with the registered office's location. A post office box is only acceptable for towns / cities that have a population of 2,000 or less if no street address or rural route and box number is associated with the registered office's location.
B. Provide the name of the county or independent city where the registered office is physically located. Counties and independent cities in Virginia are separate local jurisdictions. See §§ 13.1-619 and 13.1-634 of the Code of Virginia.
- Directors:** If the registered agent's status in 3.B is that of initial director, then the names and addresses of the initial directors must be included in the articles of incorporation. A corporation can have directors immediately upon formation only if they are named in the articles.
- Incorporator(s):** One or more persons must sign the articles of incorporation in this capacity. See § 13.1-604 of the Code of Virginia.

It is a Class 1 misdemeanor for any person to sign a document he knows is false in any material respect with intent that the document be delivered to the Commission for filing.

of the laws in your state. These are legal documents, and you can lose the protection incorporating affords if you do not cross all the T's and dot all the I's.

Do you lose any control over your company by incorporating? Not exactly. Your corporation might have only one shareholder (you), but there must be a board of directors to vote on management decisions. Some states require a minimum of three directors, while others require only "one or more." Does having more than one director mean losing control? No, because guess who picks the members of that board of directors: the shareholders. One of the directors could be your wife, and the others could be friends or relatives of your choosing.

But — I hear you asking — won't I really be this corporation's employee? Yes, technically you will be, but you own the company. If you fire yourself, you can hire yourself back.

What about a contractor's license for that corporation? How does that work? If a corporation is a fictional person, how can a fictional person show up for a test?

Yes, a corporation does have to have a license. Here's how it works: The board of directors designates an officer to take the test on behalf of the corporation. Again, that should be you.

Taxes Made Easier

Lots of guys say they don't want to incorporate, because of the more complex and expensive tax structure. But it doesn't have to be a big problem. True, if you are taxed in the way that most corporations are taxed, it can be a big deal. A straight Subchapter C corporation is taxed on its income. After it pays taxes on that income, if it then passes out that income to its shareholders, they pay taxes again on the same dollars.

Is this a good deal? Sometimes it is, thanks to the mysteries of the tax code, but it's probably not a good deal for you.

There's a solution: You can elect to have your small corporation taxed as a Subchapter S. That means your corporation would be taxed in the same way as a partnership.

As a Subchapter S corporation, your company would report (not pay) its income and its deductions at the end of the working year. Then it would issue a K-1 (think of this as a kind of W-2) telling each shareholder what his or her share of the company's net income is. Or, as the case may be, what his or her share of the company net loss is.

The term Subchapter S corporation does not refer to a particular kind of company. It simply refers to a corporation that has filed a form with the IRS, asking to be taxed under Subchapter S of the Internal Revenue Code.

Can just any corporation do this? No. The corporation must have no more than 75 shareholders and only one class of stock.

But — I've heard some guys say — I don't want everybody and his brother knowing my business. Don't worry. That's an issue only for corporations that sell stock to the public. They are highly regulated and by law must open up their books. None of these rules kick in unless you're actually selling shares in your corporation to the public. I assume you are not, because there aren't many publicly held corporations in the construction industry.


Don't Lose the Veil

Is there any other problem that could come up with a corporation? Yes, it's possible to lose the protection of that corporate veil. There are typically two ways this could happen. The first and most common occurs when whoever is in charge of the company papers forgets to file the required annual reports with the state. In most cases you have to file annual reports that describe where you do business, what your business address is, and who serves on your board of directors. In some states you have to list

the corporate directors, the people who run the company. If you don't file the correct paperwork, you could lose your corporate charter.

The second way people get into trouble with their corporation is that they don't treat it any differently from how they treated their sole proprietorship. A corporation is supposed to have a separate existence from the person who controls it. This means you should not mingle personal and corporate funds. If you need something to live on, pay yourself a regular salary. Do not pay your mortgage, income taxes, or boat payments out of the corporate account. If you do, and someone sues the corporation, he or she may be able to get at your personal assets by "piercing" the corporate veil. The court will look at how you run the corporation, and if you mingled funds or engaged in sloppy recordkeeping, it may find that the corporation is merely your alter ego, not a separate entity.

A good lawyer can tell you exactly what papers you need to file in your state and what kinds of records you need to keep. You will probably be required to hold an annual meeting, elect officers, create corporate bylaws, and keep records regarding major business decisions and executive compensation.

Whenever you sign anything on behalf of the corporation, be sure to sign in your capacity as a corporate officer. If you sign a lease or a contract, never sign your name alone. Instead of signing "Joe Smith," sign "Joe Smith, President of XYZ Construction, Inc." There have been cases where mistakes like this have allowed creditors to get at the personal assets of company officers who were conducting legitimate corporate business. 

Quenda Behler Story has practiced and taught law for over 25 years and is the author of The Contractor's Plain-English Legal Guide (www.craftsman-books.com).