

**Starting Your Own Business**  
*A Series for Budding Entrepreneurs*  
**Corporate Structure – Part 1**



## Corporate Structure

“What type of corporation should I start?” With that question ringing in my ears, I began my journey to figure out what to do, and how to do it. I started with the Huntsville/Madison County Chamber of Commerce – this is the best place to begin for anyone thinking about starting a business in Huntsville. The Chamber’s small business office – the Northeast Alabama Regional Small Business Development Center, also called NEAR SBDC – was my first stop (there are a number of SBDCs around the country, if you are not located in the Huntsville area).

I was informed that I could start a variety of different business entities: sole proprietorship, partnership (general, limited, and limited liability), traditional type corporation (called a C corporation), subchapter S corporation (also called an S corporation), and limited liability corporation. I believe that I may have missed others here, so let’s just say that my head was spinning after the NEAR SBDC meeting. What I wanted was someone to tell me which one.

A follow up conversation with the NEAR SBDC, a lawyer that I was interviewing for my corporate attorney, and a potential CPA for my business narrowed my choice to one – the S corporation. Why S corporation? For me, the answer was easy.

### Why an S Corporation?

My business model provides business development and marketing to companies who buy services on a monthly basis. While many small companies are adept at sole proprietors and consulting agreements, larger businesses have a difficult time contracting for individuals’ services. Corporations like to do business with other corporations for a variety of reasons: a corporation provides their employees’ benefits including the corporate contribution to social security and medicare. As a sole proprietor, if I do not pay what I owe the federal government in social security and medicare, the government will try to collect from the companies who paid the sole proprietor.

It is also easier to put a subcontract agreement in place between corporations, as opposed to a consulting agreement. If you don’t believe me, just try to get an individual consulting agreement with any large defense contractor. It will take numerous reviews by many corporate officers – sometimes ending up on the desk of the President for approval. Good luck on getting someone to ask the President to get that signed.

S corporations are similar to the C corporations since their names end with “, Inc.” All the big companies that we know, who are publicly traded are C corporations. The S corporation is the little brother (or sister) to the C.

Both C and S corporations start with articles of incorporation, filing them with the proper state authority, and paying all required fees. Each is a legal business entity that exists separately from the owners. The owners and shareholders are protected from the company’s debts and obligations. If an owner dies or sells their interest, the corporation continues to exist unless it is legally dissolved. Both corporation types can issue stock as incentives to employees or outside investors.

## Taxes

C corporations are taxed for both the corporation and individual. This means the corporation pays taxes on business profits, and shareholders pay income tax for any money they draw from the corporation, including salary, dividends, or bonuses. This results in a double tax for small business owners who have C corporations. Most of the small business owners that I know, who began as a C, changed to S as soon as it was possible.

The S corporation receives a special tax status from IRS where income passes directly to shareholders. The shareholders then report this on their tax returns, and the S corporation pays no income tax. S corporations can also distribute money as profits, instead of salary, to employees who are shareholders. These profits are not subject to social security and medicare taxes like salaries.

## S Corporation Requirements

Each S stockholder must be a U.S. citizen or permanent resident, and there can never be more than 75 stockholders, and only one class of stock can be issued. Banks, some insurance companies, and certain affiliated groups of corporations can not become S corporations.

S corporations are best for small business owners and entrepreneurs who want the legal protection of a corporation but want to be taxed as if they were sole proprietors or partners.

Before deciding which sort of corporation to form, it is best to consult an attorney who specializes in corporate law, and a CPA to discuss your business plans before deciding on your corporate structure. This is what I did, and the recommendation was S Corporation.

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