

CAN INCORPORATION BE A DISADVANTAGE?

There are numerous articles addressing the advantages of incorporating your business. In this article I would like to point out some disadvantages of incorporating a business under certain circumstances under California law.

Corporate Formalities

Running a business in corporate form requires far more formalities than running unincorporated businesses. Corporations must hold an annual shareholders' meeting and an annual directors' meeting. In addition, if a corporation contemplating an extraordinary transaction, should hold a special meeting of shareholders and directors to approve the same. All corporations incorporated under California law (or foreign corporations qualified to do business in California) must annually file a Statement of Information with the California Secretary of State and pay the \$25 filing fee. In the Statement of Information--which is a public document--the corporation discloses its address, the names and addresses of its officers, directors and agent for service. By contrast, sole proprietorships and general partnerships are not subject to the above formalities.

Federal Taxes

A corporation is considered a separate legal entity from its shareholders. Therefore, a corporation's income is taxed once at the corporate level, and again at the shareholder level when the money is distributed to the shareholders. A significant portion of the corporate income can be lost in such a "double taxation". Some corporations may qualify to make "Subchapter S" election which will eliminate double taxation.

California Taxes

A corporation formed under California law (or a foreign corporation that qualified to do business in California) will have its income subject to California franchise taxes. Section 23151(d) of the California Revenue and Taxation Code sets the minimum franchise tax rate at 8.84 percent. Except for the initial year of formation, a corporation must pay a minimum franchise tax of \$800, as estimated tax, by the 15th day of the fourth month of a corporation's taxable year. As well, the income will be subject to a second level of taxation at the shareholder level.

Local Law Restrictions

Sometimes being incorporated hinders you under local ordinances. For example, some rent control laws allow a property owner to evict a tenant from the rental property for landlord's own use (commonly referred to as "owner occupancy"). However, rent control laws in Los Angeles, Santa Monica and West Hollywood will not allow use of owner occupancy if the property's title is held by a corporation (or a partnership). This is true even if there is the corporation has one single shareholder and that shareholder will move

into the unit after the tenant is evicted. These are clear instances where incorporation can be a disadvantage under the local ordinance.

Appearing in Lawsuits

In California, a corporation can appear in a lawsuit only through a licensed attorney. In fact, it is misdemeanor for a non-attorney to represent a corporation in a lawsuit. Therefore, if your corporation is sued or wishes to bring a lawsuit, you must first retain a lawyer before you can appear in the legal action. Moreover, if a corporation is not in good standing with the California Secretary of State, it will lack standing to appear in a lawsuit whether as a plaintiff or as a defendant. These restrictions do not apply to unincorporated entities such as sole proprietorships and general partnerships.

*This article is informational only and should not be relied upon as legal advice. The subject of incorporation and selecting a proper business form is very expansive. For more information you can refer to *Forming and Operating California Limited Liability Companies* (published by Continuing Education of the Bar—California), *Advising California Partnerships* (published by Continuing Education of the Bar—California), or consult your own attorney.*

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