Business Law
Text & Exercises 6th Ed.

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Chapter 30: Formation and Termination of a Corporation

Learning Outcomes

LO1 • Set out the differences among the classifications of corporations.

LO2 • Summarize incorporation procedures and corporate powers.

Learning Outcomes

- LO3 Define the methods of corporate financing.
- LO4 Identify the basic steps in a merger, consolidation, and purchase of assets or stock.
- LO5 Discuss the phases involved in the termination of a corporation.

LO1 Classification of Corporations

- **Domestic, Foreign, and Alien Corporations.**
  - Domestic: corporation that does business in, and is organized under the laws of, that state.
  - Foreign: corporation that does business in the state without being incorporated therein.
  - Alien: corporation doing business in the United States but formed in another country.

Classification of Corporations

- **Public Corporation:** formed by the government to meet some political or governmental purpose.
- **Private Corporation:** created either wholly or in part for private benefit.

Classification of Corporations

- **Close Corporation.**
  - Shareholders are limited to a small group of persons, often including only family members.
  - The rights of shareholders are restricted regarding the transfer of shares to others.

Classification of Corporations

- **Nonprofit or Not-for-Profit Corporations:** usually private corporations, they can be used in conjunction with an ordinary (for-profit) corporation to facilitate making contracts with the government.

Classification of Corporations

- **S-Corporation:**
  - A business corporation that has met certain requirements as set out by the Internal Revenue Code and thus qualifies for special income tax treatment.
  - S-corporations are taxed the same as a partnership, but shareholders enjoy the privilege of limited liability.
  - Requirements. →

Qualification Requirements for S-Corporations

- **Under Subchapter S Revision Act of 1982, the most important qualification requirements:**
  1. The corporation must be domestic.
  2. Must not be a member of an affiliated group of corporations.
  3. Shareholders must be individuals, estates, or certain trusts.

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Qualification Requirements for S-Corporations

4. The corporation must have no more than 100 shareholders.
5. Must have only one class of stock.
6. No shareholder of the corporation may be a nonresident alien.

Benefits of S Corporations

- **Losses can be used to offset other income.**
- **If a shareholder's tax bracket is lower than the corporation's, it is taxed at the lower rate.**
- **Income is not taxed twice.**

Corporate Formation

- **Promotional Activities.** →
  - Promoters, subscribers, subscriptions.
- **Incorporation Procedures.** →
  - State chartering.
  - Articles of incorporation.
- **Certificate of Incorporation.** →
- **First Organizational Meeting.** →

Promotional Activities

- **Promoter:** entrepreneur who takes preliminary steps of organizing he corporation.
  - Personally liable on pre-incorporation contracts with third parties
  - Liability continues after incorporation until corporation formally accepts and creates a <u>novation</u> with third party.

Promotional Activities

- **Subscribers and Subscriptions.**
  - Potential pre-incorporation investors are called subscribers. Their contracts to invest are call subscriptions.
  - These subscriptions are “continuing offers” to invest in the corporation once it is formed. After incorporation, the board can choose to accept or decline the offer.

LO2

Incorporation Procedures

- **State Chartering:** Exact procedures differ by state.
- **Articles of Incorporation:** document filed with the appropriate governmental agency, usually the secretary of state, when a business is incorporated. State statutes usually prescribe what kind of information must be contained in the articles of incorporation. →

Articles of Incorporation

Articles of Incorporation Sample

ARTICLE ONE

The name of the corporation is ______________________________.

ARTICLE TWO

The period of its duration is perpetual (may be a number of years or until a certain date).

ARTICLE THREE

The purpose (or purposes) for which the corporation is organized is (are) ______________________________

______________________________.

ARTICLE FOUR

The aggregate number of shares that the corporation shall have authority to issue is ________ of the par value of ________ dollar(s) each (or without par value).

ARTICLE FIVE

The corporation will not commence business until it has received for the issuance of its shares consideration of the value of $1,000 (can be any sum not less than $1,000).

ARTICLE SIX

The address of the corporation's registered office is ______________________________, and the name of its registered agent at such address is ______________________________

______________________________.

(Use the street or building or rural address of the registered office, not a post office box number.)

ARTICLE SEVEN

The number of initial directors is ________________, and the names and addresses of the directors are ______________________________

______________________________.

ARTICLE EIGHT

The name and address of the incorporator is ______________________________

______________________________.

(Signed)______________________________

Incorporator

Sworn to on ________________ by the above-named incorporator.

(Date)

____

Notary Public ______________________________

(Notary Seal)

Incorporation Procedures

- **Articles of Incorporation.**
  - Corporate Name.
  - Nature and purpose.
  - Duration.
  - Capital Structure.
  - Registered office and agent.
  - Incorporators.

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Incorporation Procedures

- **Certificate of Incorporation:** evidences corporate existence (referred to as articles of incorporation in some states).
- **First Organizational Meeting.**
  - Board of Directors elected, who then hire officers (in small companies these may all be the same people).
  - Adoption of Bylaws: set of governing rules or regulations adopted by a corporation.

Defects in Formation

- ***De Jure.***
  - Because a de jure corporation is one that is properly formed, neither the state nor a third party can attack its existence.
- ***De Facto.***
  - Can only be challenged by the state.
- **Corporation by Estoppel.**

Corporate Powers

- **Express Powers:** found in its articles of incorporation, in the law of the state of incorporation, and in the state and federal constitutions.
- **Implied Powers:** upon formation, a corporation has legally implied powers to do what is reasonably necessary – and legal – to accomplish its corporate goals.

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Corporate Powers

- ***Ultra Vires:***
  - A Latin term meaning "beyond the powers." Activities of a corporation's managers that are outside the scope of the power granted them by the corporation's charter or the laws of the state of incorporation are *ultra vires* acts.

LO3

Corporate Financing

- **To obtain financing, corporations issue securities.**
  - Stocks: to finance its tocks (purchase of ownership in the firm).
  - Bonds (debentures; long-term borrowing of funds by the firm).

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Securities

- **Stock:** in corporation law, an equity or ownership interest in a corporation, measured in units of shares.
- **Bond:** certificate that evidences a corporate debt. It is a security that involves no ownership interest in the issuing corporation.
  - Bond Indenture: contract between the issuer of a bond and the bondholder.

Types of Stock

TYPE	DEFINITION
Common stock	Voting shares that represent ownership interest in a corporation. Common stock has the lowest priority with respect to payment of dividends.
Preferred stock	Shares of stock that have priority over common-stock shares as to payment of dividends and distribution of assets on dissolution. Dividend payments are usually a fixed percentage of the face value of the share.
Cumulative preferred stock	Required dividends not paid in a given year must be paid in a subsequent year before any common-stock dividends are paid.
Participating preferred stock	The owner is entitled to receive the preferred-stock dividend and additional dividends after payment of dividends on common stock.
Convertible preferred stock	The owner has the option to convert his or her shares into a specified number of common shares either in the issuing corporation or, sometimes, in another corporation.
Redeemable, or callable, preferred stock	Preferred shares issued with the express condition that the issuing corporation has the right to repurchase the shares as specified.

Important Characteristics of Stock

1. They need not be paid back.
2. Stockholders receive dividends only when so voted by the directors.
3. Stockholders are the last investors to be paid off on dissolution.
4. Stockholders vote for directors and on major issues.

Common *vs.* Preferred Stock

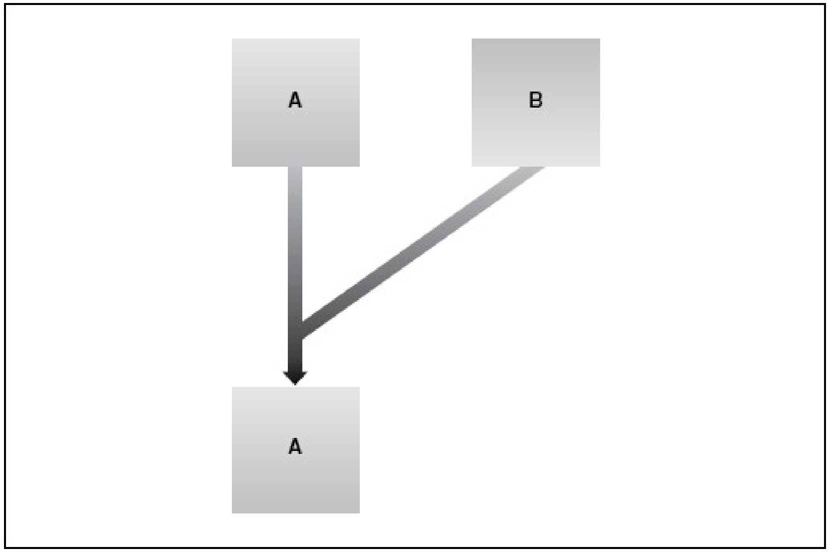
- **Common Stock:** shares in a corporation that are lowest in priority with respect to payment of dividends and distribution of the corporation's assets on dissolution.
- **Preferred Stock:** classes of stock that have priority over common stock both as to payment of dividends and distribution of assets on the corporation's dissolution.

LO4

Merger and Consolidation

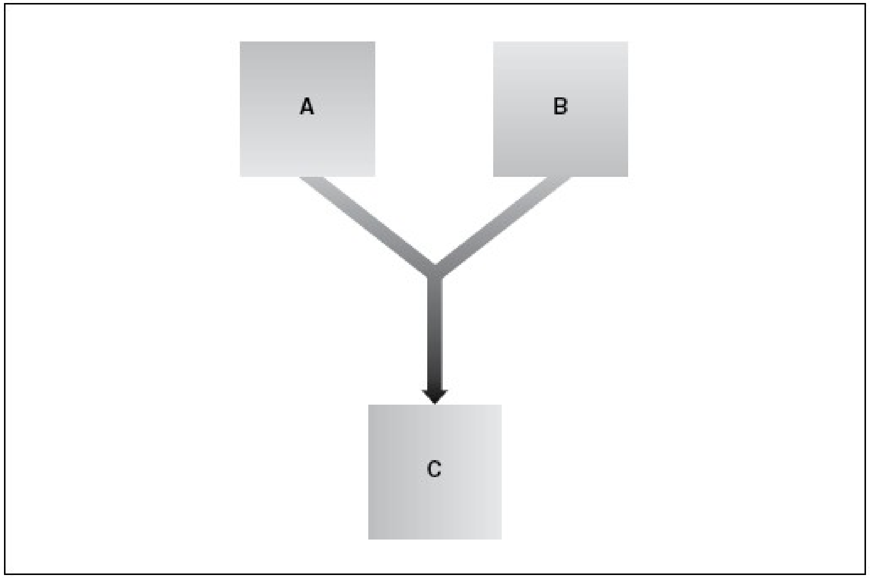
- A merger involves the legal combination of two or more corporations in such a way that only one of the corporations continues to exist.
- In a consolidation, two or more corporations combine in such a way that each corporation ceases to exist, and a new one emerges.

Merger and Consolidation



Merger

Consolidation



Procedures

- Board of directors must approve the plan.
- Shareholders of each corporation must vote approval.
- The plan is filed with the secretary of state.
- State issues a certificate of merger or consolidation.

Procedures: Short-Form Merger

- **A merger between a subsidiary corporation and a parent corporation that owns at least 90 percent of the outstanding shares of each class of stock issued by the subsidiary corporation. Short-form mergers can be accomplished without the approval of the shareholders of either corporation.**

Procedures

- **Appraisal Rights:** A dissenting shareholder's right, if he objects to an extraordinary transaction of the corporation (such as a merger or consolidation), to have his shares appraised and to be paid the fair market value of his shares by the corporation.
- **Shareholder Approval:** extraordinary matters, such as merger or sale, requires approval by shareholders.

Purchase of Assets or Stock

- **U.S. Department of Justice has issued guidelines that significantly constrain, and often prohibit, mergers that could result from a purchase of assets.**
- **Generally, a corporation that purchases the assets of another corporation is not responsible for the liabilities of the selling corporation.**

Purchase of Stock

- **Target corporation:**
  - The acquired corporation in a corporate takeover; a corporation to whose shareholders a tender offer is submitted.
- **Tender offer:**
  - An offer made by one company directly to the shareholders of another company to buy the shareholders’ shares in that company.

LO5

Termination

- **Dissolution of a Corporation:**
  1. An act of the legislature in the state of incorporation.
  2. Expiration of the time provided in the articles of incorporation.
  3. Voluntary approval by shareholders and board of directors.
  4. Unanimous action by all shareholders.
  5. Court decree.

Termination

- **Liquidation (Winding Up):**
  - The sale of the assets of a business or an individual for cash and the distribution of the cash received to creditors, with the balance going to the owner(s).
  - Receiver is appointed when creditors force a liquidation of the corporate assets.