# CPA BEC - STUDY UNIT 3
# Corporations: Formation, Powers, and Financing: Core Concepts

## A. Definition

1. A **corporation** is a legal entity created under a statute to carry out the purposes permitted by law and the articles of incorporation. The corporation is a legal person separate from its shareholders. Corporations are governed by shareholders who elect a board of directors and approve fundamental changes in the corporate structure. Directors establish corporate policies and elect or appoint corporate officers. These carry out the policies in the day-to-day management of the organization.

## B. Characteristics of a Corporation

1. A business is organized in corporate form to provide **limited liability**, **separation of ownership from management**, **free transferability of interest**, **perpetual life**, and **ease of raising capital**.

## C. Powers of a Corporation

1. Authority for corporate action derives from the state incorporation statute or the articles of incorporation. The **Revised Model Business Corporation Act (RMBCA)** grants a corporation the "same powers as an individual to do all things necessary or convenient to carry out its business and affairs."

## D. Preincorporation Contracts

1. A **promoter** is one who arranges for formation of the corporation. The promoter provides for the capital structure and financing of the corporation and for compliance with any relevant securities law. The promoter also may arrange for procurement of necessary personnel, services, assets, licenses, equipment, leases, etc.

## E. Incorporation

1. Each state requires that **articles of incorporation** be filed with the secretary of state or another designated official. (A corporation may incorporate in one state but have its principal place of business or conduct its business operations in another state or states.) The RMBCA requires that the articles of incorporation include the corporation's name, number of authorized shares of stock, street address of the corporation's initial registered office, name of the registered agent at that office, and name and address of each incorporator.

## F. Financial Structure

1. The basic ways to finance a corporation are to issue equity or debt.
   a. A corporation accomplishes long-term debt financing through issuing **debt** securities, e.g., the sale of bonds. Debt securities represent, not an ownership interest in the corporation, but a debtor-creditor relationship between the corporation and the security holder.
   b. **Equity** securities represent an ownership interest in the corporation, but a share of stock does not confer title to any specific property owned by the corporation. Most state incorporation statutes require that the articles of incorporation specify the number of authorized shares and the classes of stock. The most widely used classes of stock are common and preferred (but the RMBCA does not use these terms).
      1) **Common shareholders** are entitled to receive distributions only after all other claims have been satisfied, including those of preferred shareholders. Common shareholders elect directors.
      2) **Preferred shareholders** have the right to receive dividends at a specified rate stated on the face of the shares (before common shareholders may receive any) and the right to receive distributions before common shareholders upon liquidation or bankruptcy. Preferred stock also may be cumulative, participating, redeemable, or convertible.

## G. Distributions

1. The board has discretion to determine the time and amount of dividends and other distributions as long as the corporation can pay its debts as they become due. **Dividends** are usually paid in cash or property (a dividend in kind). A **stock dividend** is payable in the stock of the dividend-paying corporation. A **stock split** is an issuance of shares for the purpose of reducing the unit value of each share. Accordingly, the par or stated value, if any, is also reduced.