

Starting a Business in DC:

What Type of Business is Right for You?



The S-Corporation (S-Corp)

One of the most important decisions for a businessman or businesswoman is determining the form of business organization to use for his or her enterprise. There are several forms of business organization that are available to you. This information sheet discusses the benefits and disadvantages of an S-Corporation (S-Corp). This information sheet reflects changes in the DC Code that went into effect on January 1, 2012.

- **What is an S-Corp?**

S-Corps are corporations, organized and operated like C-Corps, but receive "pass-through" taxation like partnerships. S-Corps have shareholders who own an interest in the corporation. S-Corps can only have up to 100 shareholders, all of whom must be US citizens or residents, and S-Corps may issue only one class of stock. The shareholders elect directors to oversee the operation of the corporation, and the directors appoint officers to manage day-to-day operations. Except for tax purposes, S-Corps are separate legal entities. For a corporation to become an S-Corp, the corporation and all its shareholders must vote to approve S-Corp status and file with the IRS.

- **How are S-Corps operated?**

Other than with respect to Federal tax treatment, S-Corps are generally operated like C-Corps. Upon purchase of shares of stock, the shareholder becomes an "owner" of the corporation and gains voting rights and the right to a share of dividends, which are profits the corporation pays to its shareholders. Subject to its governing documents and applicable law, S-Corps may vary the voting or economic rights associated with shares. Though technically owners of the corporation, shareholders do not participate in the management of the corporation. The corporation's directors have a fiduciary duty to act in good faith and in the best interest of the company.

DC requires corporations to have at least one director, and corporations usually have multiple directors. The directors, in accordance with the bylaws, appoint officers. The DC Code does not require specific amount or titles of officers. However, an S-Corp must have one officer who is responsible for preparing meeting minutes and maintaining corporate records.

- **What are the advantages of an S-Corp?**

- *Limited Liability*

S-Corp shareholders have limited liability; they are liable for only the amount that they have invested in the corporation. This means that their personal assets, such as a home and personal accounts, generally do not have to be used to pay off the liabilities incurred by the S-Corp. Additionally, S-Corps may adopt governing documents that partially limit the liability of their directors.

- *"Pass-Through" Taxation*

S-Corps enjoy "pass-through" taxation at the Federal level. The IRS taxes an S-Corp's income on a shareholder's individual tax return, not on the S-Corp. Meanwhile, C-Corps have to pay tax

on their income as an entity, and their shareholders then have to pay additional tax when they receive dividends.

While both S-Corps and Partnerships are "pass-through" entities, S-Corp shareholders can structure a mix of compensation and distributions that permits shareholders who are also officers or employees of the S-Corp to avoid having to pay the self-employment tax. This is not possible for partnerships.

- **What are the disadvantages of an S-Corp?**

DC does not recognize an S-Corp's federal tax treatment. S-Corps are still legal in DC. However, they will be treated as an S-Corp by the federal government (receiving "pass-through" taxation) but as a C-Corp by DC (receiving double taxation). In essence, an S-Corp must pay the DC corporate income tax (8.25%) and shareholders must also pay DC taxes for any dividends received.

Another disadvantage is a relative lack of flexibility in the management of the S-Corp due to the corporate structure. S-Corps are required to comply with many rules and formalities imposed as requirements or defaults by the DC Code; however, S-Corps can alter default rules through a shareholder agreement. In any case, establishing a corporate structure can be costly and time-consuming. For example, S-Corps must hold annual meetings of their shareholders and must have a board of directors in addition to officers.

In addition, unlike C-Corps, S-Corp cannot use the process of going public to raise capital, due to limitations on the number and qualifications of S-Corp shareholders.

- **How do I form an S-Corp?**

- *Registration of the S-Corp*

DC requires S-Corps to register with the Department of Consumer and Regulatory Affairs (DCRA), which is done by filing an "Articles of Incorporation." Registration costs a minimum of \$220 and can increase depending on the amount of stock to be issued by the corporation. Articles of incorporation include, at a minimum: the name of the entity, the number of authorized shares, the registered agent and the name and address of each incorporator. Form DBU-1, an instruction sheet and Articles of Incorporation sample sheet, is available to [download](#) and can also be completed online at <https://corponline.dcrd.dc.gov>.

Corporations are required to have either "Corporation," "Company," "Incorporated," or "Limited" or an abbreviation of these words in its name. Also, corporations are not allowed the same or a deceptively similar name as another corporation. A business name can be registered or reserved online at <https://corponline.dcrd.dc.gov> or by [downloading Form GN-3](#).

Businesses may also operate under a registered trade name besides the S-Corp's legal name. This can be completed online at <https://corponline.dcradcr.gov> or by mail by [downloading Form TN-1-4](#).

- *Registration of an Agent*

S-Corps must register a "registered agent" within DC. The registered agent receives official notices. It can be either an individual or a business entity, provided that the registered agent has a street address in DC that is not a post office box. The agent need not be someone who is a part of the business; for a small fee, third-party services will act as a registered agent. For further information consult:

<https://dcradcr.gov/service/corporate-registration-registered-agent>

To change a previously designated registered agent, complete the form online at <https://corponline.dcradcr.gov> or by mail by [downloading Form RA-1-7](#).

- *Drafting the Bylaws*

The bylaws generally address such issues as: the types of stock to be issued, the corporation's voting system regarding election of its directors, the place and organization of the corporation's annual shareholder meeting, how long directors will serve before re-election and the number of corporate officers and how they are to be selected.

- **What additional requirements govern S-Corps?**

S-Corps must file a two-year report with DCRA that provides basic information about the corporation, such as: a list of the corporation's directors, a description of the corporation's business, and the number of shares of stock the corporation has issued. The filing fee is \$300. Form BRA-25 is available to [download](#) or can be completed online at <https://corponline.dcradcr.gov>.

S-Corps are also required to hold shareholder meetings each year. Each shareholder must be notified of the meeting place and time. At the meeting, the shareholders elect the corporation's director(s) and the company's business and status is usually discussed. In-person attendance at these meetings is not required as shareholders are permitted to vote by proxy.

In addition, S-Corps are required to keep and make available accurate accounting books, pertinent business records and the minutes of its meetings.

- **What other licenses and certificates must I obtain?**

DC requires many types of businesses to obtain specific licenses and permits. Even if a specific license is not required, a general basic business license often is. A list of business activities having special license and permit requirements and information about the general basic business license can be found at: <https://dcradcr.gov/node/514522>

Once you have determined where your business will be located, you will need to obtain either a Certificate of Occupancy (running the business from an office or storefront) or a Home Occupation Permit (running the business from your home). Generally, if you are leasing space and the owner of the building has already obtained a Certificate of Occupancy that covers your type of business, then you do not need to do so individually.

Applications for these permits must be submitted in person at the DCRA Permit Center and can be downloaded from:

<https://eservices.dcradcr.gov/DocumentManagementSystem/Home/retrieve?id=Certificate%20of%20Occupancy%20Application.pdf>

(Certificate of Occupancy)

<https://eservices.dcradcr.gov/DocumentManagementSystem/Home/retrieve?id=Home%20Occupation%20Permit%20Application.pdf>

(Home Occupation Permit)

- **What tax-related requirements should I know about?**

S-Corps must obtain a Federal Employment Identification Number (FEIN) for tax filing and reporting purposes. The FEIN Form SS-4 can be found at: <https://www.irs.gov/pub/irs-pdf/fss4.pdf>

Organizations can now apply for a FEIN online at:

<https://sa.www4.irs.gov/modiein/individual/index.jsp>

DC businesses must also complete the Combined Business Tax Registration, Form FR-500. For FR-500 requirements and online registration information, visit:

<https://otr.cfo.dcradcr.gov/page/new-business-registration>

For federal tax purposes, an S-Corp files its income tax on IRS form 1120S and its shareholders use form 1040, schedule E. If the S-Corp has employees, it is subject to federal withholding tax and the S-Corp must submit W-2 and W-3 forms to the IRS. An S-Corp with employees needs to file a Form 941 every quarter and Form 940 annually. These forms are available at:

<https://www.irs.gov/businesses/small-businesses-self-employed/small-business-forms-and-publications>

- **Where can I find more information?**

For general DC business information visit the DC Department of Consumer and Regulatory Affairs website at

<http://www.dcradcr.gov> or call at (202) 442-4400.

For DCRA documents and forms, visit:

<https://eservices.dcradcr.gov/DocumentManagementSystem>

For additional information on starting and maintaining a business, visit <https://business.dcradcr.gov>

For an overview of federal tax information, visit the IRS website at: <http://www.irs.gov>

For more information about small businesses, you can visit the Small Business Administration website at:

<http://www.sba.gov>

For the DC Business Corporation Act of 2010 (DC Code, Title 29, Chapter 3), visit:

<https://code.dccouncil.us/dc/council/code/titles/29/chapters/3>

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