Despite the problems of double taxation, corporations can have certain tax advantages. For example, a number of business incentives, such as the reduced tax rates applicable to gains on the sale of "qualified small business stock,"[47] historically have been limited to corporations.

S Corporations

Notwithstanding the foregoing, certain corporations may elect to be taxed under subchapter S of the Internal Revenue Code, which generally provides a form of pass through tax treatment similar to that typically enjoyed by partnerships and LLCs.[48] The S election should be made with the Internal Revenue Service and any state in which the corporation does business that does not automatically recognize an election made for federal tax purposes. If such an election is made, each shareholder is allocated a proportionate amount of the corporation's income, gains, deductions, losses and credits based on his or her percentage of stock ownership in the corporation. The shareholders then report their share of the corporation's tax items on their individual tax returns and pay tax on their share of the corporation's taxable income or gain, if any. Conversely, the corporation does not pay tax on such income or gain, and distributions of cash or other property to shareholders generally will not be subject to a separate level tax (unlike the dividends of a C corporation).

Importantly, not all states have adopted, or fully adopted, the pass-through treatment applicable to S corporations under the Internal Revenue Code. For example, California continues to apply a 1.5% tax on the net income of S corporations.

Not all corporations qualify for the S corporation election. Among other things, an S corporation generally must have solely individuals as shareholders, one class of stock and 100 or fewer shareholders.

g) Financing

One major benefit to the corporate form is that it offers a wide variety of options for financing and raising funds for the business. Fundamentally, a corporation can raise money through borrowing (issuing debt securities) or selling ownership interests in the company (issuing equity securities). Initial shareholders usually consist of a corporation's founders and can be expanded to a circle of their family, friends and business associates. As a company grows and additional capital is required, it must decide whether to use debt or equity to finance its operations.

Debt Financing

The mechanics of corporate debt work like any conventional loan. A certain amount of money is borrowed from a creditor and must be repaid with interest at the rate and time set forth in the loan agreement. The downside risk of taking out a loan as a corporation is that it must be repaid regardless of whether or not the business is successful. Additionally, even though the owners' exposure in a corporation is usually limited to their investment, creditors often require the founders of a new business to personally guarantee a corporate loan before they are willing to extend credit. However, if the business thrives financially, the corporation is only obligated to repay the creditor the agreed upon amount of the loan and may retain any additional earnings for itself.

47. See Internal Revenue Code § 1202.
48. See generally, Internal Revenue Code § 1362, et seq.