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EXTENSION MARINE ADVISORY PROGRAM

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INCORPORATING A FISHING BUSINESS

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This manual is intended to assist in determining whether or not to incorporate a small fishing business. It lists a number of considerations including management, ownership, liability, taxation, finance, and fringe benefits. A review of these considerations provides a basis for deciding whether to employ an incorporation specialist. This manual is not a substitute for the services such a specialist provides.

CHARACTERISTICS OF A CORPORATION

A corporation is one of three types of legal business entities. A *single proprietor* owns and manages his own business. A *partnership* owns and manages in partnership with two or more people according to some agreement. A *corporation* owns the business and people own or have a share in the corporation.

A Legal Entity

A corporation as a legal entity has most rights of natural persons. That is, it can own property, buy, sell, trade, sue, be sued, borrow, make contracts, conduct business, pay taxes, and so forth. A corporation has no right to vote and, unless engaged solely in interstate commerce, it cannot establish an agent or office or conduct business in another state without the authorization of that state (it can sell fish and buy supplies, however). A corporation also differs from a natural person in that it can live forever (in most states) if provided in its charter and certain state requirements are met.

Ownership and Management

Stockholders of the corporation (who are owners) elect a board of directors. This board makes major policy decisions, and appoints officers to manage the business within the framework of adopted policies. For legal purposes, therefore, ownership and operation are separate. In most closely held fishing business corporations, however, officers, board of directors, and stockholders are the same people. Hence, for all practical purposes, ownership and management are not separated. Likewise, the outward appearance of a fishing business that has been incorporated is not distinguishable from an unincorporated one.

Once you have decided that incorporation would be advantageous for your operation, pre-incorporation conferences with the aid of a specialist will aid in making sound decisions.

CHECKLIST OF CONSIDERATIONS BEFORE YOU INCORPORATE

A corporation as a legal entity is subject to some statutes and regulations which do not apply to proprietorships or partnerships. Also, since owners might not be managers and vice versa, the operation of a corporation may be quite different from that of a proprietorship or partnership.

Divisibility of Ownership

A fishing business may be owned entirely by the corporation or the corporation may own only such things as the vessel, gear, electronics, gear shed, drift rights, and trucks. The corporation itself would be owned by stockholders and would be represented by shares of stock in the form of certificates. For example, if the corporation had issued one thousand shares of stock, four equal owners would each own 250 shares. These shares represent an equal interest in the entire business and not in a particular piece of property. Division of shares can thus be made easily, whereas equitable division of specific property can be difficult.

Certain people may not desire this sort of pooled ownership through a corporation. Many may wish to own specific property rather than a share of the whole. To meet this objection, a lease or rental arrangement can be worked out permitting the corporate business to rent these specific properties from their owners.

The fact that stock represents shares of a whole business and not specific properties is one of the most important considerations in incorporating. A corporate business theoretically can be divided among as many owners as there are shares of stock. Various arrangements and divisions of ownership are practically unlimited.

Continuity of Ownership and Management

The corporation does not dissolve with death or withdrawal of a major stockholder, director, or officer. Adjustments may be needed, as in Oregon where there must be at least three directors and two officers (except when there are fewer than three shareholders). But the business can continue without disruption under the direction of remaining stockholders, directors, and officers.

A single proprietorship or partnership business is technically dissolved upon death or withdrawal of the proprietor or partner. The business must be reorganized and may become disrupted or discontinued.

Stock Purchase and Transfer

With fishing business corporations likely to be closely-held or family corporations, it usually is desirable to form an agreement among stockholders to keep stock within the group. For this purpose stock purchase plans and transfer agreements can be developed for purchasing stock of a deceased or withdrawing stockholder.

In a closely-held or family corporation transfer or sale of stock outside the small group of existing stockholders may create problems. Outsiders may not have the same interests in the business as existing stockholders. They may demand changes in operations or officers, or may wish policy not concurrent with the desires of existing stockholders. Dissenting stockholders in a closely-held corporation can cause difficulty and hard feelings. A family may not wish to accept a stranger into their "family" corporation.

Advance action is often taken to prevent this situation by using stock purchase agreements. These agreements basically provide that any stock to be sold will first be offered in some specified manner to existing stockholders or to the corporation. This agreement would be binding on the stockholder while he lives and on his estate at death. Surviving stockholders of the corporation might also be bound by agreement to purchase stock of the deceased stockholder. These agreements usually include a method for valuing stock to be bought and sold.

There are several advantages to these agreements: (1) Estate or heirs of a deceased stockholder can be assured of a market for this stock at a fair price. (2) Surviving stockholders can be assured continuity of ownership and management by not having stock go to outsiders who could become disinterested or dissenting stockholders. (3) Establishment of a stock price for transfer agreement may assist in establishing an evaluation of the stock for estate tax purposes.

Operation and Management

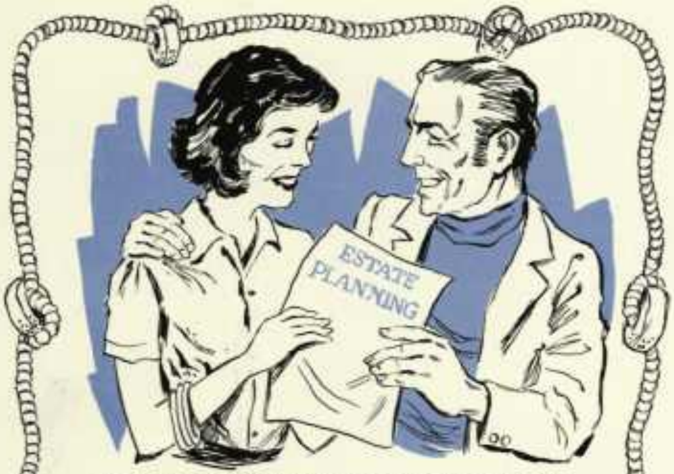
Management decisions must be made for fishing business corporations just as with any other type of ownership. However, corporate management usually involves more group management than an ordinary fishing operation. In a corporation there are three distinct groups; stockholders, directors, and officers. Even though each group may consist of the same persons, certain rights and responsibilities exist in each position.

Stockholders—Stockholders do not participate directly in ordinary corporate management. Unless a stockholder has been given express authorization to act for the corporation, he cannot bind it to any contract or obligation. Business actions of stockholders must be transacted at regular or special meetings unless all stockholders consent to action outside such meetings. Stockholders may meet often but are required by law to meet once a year. Chief responsibility of stockholders is to elect directors. Stockholders indirectly control the corporation by their power to select directors who will carry out desired policies of the electing stockholders. If changes or amendments to articles of incorporation are desired, stockholders must approve these changes unless specific provision is granted to directors for such changes. Stockholders in their annual meeting will usually receive the corporation annual report.

Directors—Directors receive authority from the corporate charter or articles of incorporation. Directors represent and are entrusted with interests of stockholders who elect them. Directors of the corporation, under the guidance of a chairman elected by them, are charged with the responsibility of conducting the business. Directors establish a framework of management policy. They then elect or appoint a manager and other officers to execute management within limits of their established policy.

Directors act as agents of the corporation, and actions and policy decisions are done in the name of the corporation and not as individuals. Directors are not personally liable for authorized acts in managing the affairs of the corporation when they have exercised reasonable care.

Officers—Officers are elected or appointed by directors. They are responsible for the day-to-day operation and internal management of the business within a policy framework laid down by the directors. Officers may have broad or limited powers as determined by bylaws and directors. Within these given powers their actions are binding upon the corporation. Like directors, they act as agents for the corporation. Officers, like directors, are not personally liable for authorized acts in managing the business when they have exercised reasonable care.



Economic advantages may result from combining capital, labor, and management. Also, characteristics of a corporation are easily adapted to successful estate planning.

Limited Liability

In a non-incorporated business, an individual's personal assets are subject to claims against the business as well as any judgment which may be brought against the individual for injuries or damages caused by his or her employees. In an incorporated business, the shareholders are liable for the debts of the corporation and for any liability caused by negligent employees who injure others in the course of their empolyment, but only to the extent of their investment in the corporation. A corporation, being a legal entity, is responsible for contracts and acts of liability in its own name. Thus, it is responsible for its own debts or lawsuits independent of personal assets of its stockholders. The corporation is not responsible for personal acts or obligations of its stockholders or employees outside the scope of their employment. Thus the corporation has no obligation and cannot be forced to pay the personal debts of any stockholder, but a court of proper jurisdiction may hold the owners or managers individually liable for corporate debts incurred beyond good business management practices.

Federal Income Tax

The decision to incorporate a fishing business is influenced by income tax considerations. A new taxpayer is created whenever a business is incorporated. The corporation is subject to income taxes apart from the individuals involved, both employees and owners.

The employees of a corporation are taxed as any other salaried persons or wage earners. Most corporations are taxed on their earnings. Furthermore, the owners or shareholders are taxed on the returns (dividends) they receive. This latter essentially leads to double taxation; first on the income of the corporation, and second on the dividends distributed by the corporation to its shareholders.

To maximize owners' after tax income, the directors may shift income among (1) the corporation itself (as retained earnings for debt repayment and/or reinvestment, (2) its employees (as salaries and/or wages), and (3) its shareholders and/or owners (as dividends). The method of disposing or distributing this income is very important. This is because once the earnings of a corporation go beyond $25,000 the tax rate jumps from 22 to 48 per cent. The tax rates on personal incomes are graduated in not just two but 24 steps and they range from 14 to 70 per cent.

Unfortunately, a direct comparison of tax rates is not relevant. It is instead the additional taxes that must be compared to one another along with the influence of personal exemptions, deductions, exclusions, and personal income from other sources.

When a fishing corporation's retained earnings are below $25,000, it is advantageous to keep the managers' salaries low—at no more than $8,000 plus any personal exemptions, deductions, and exclusions, and minus all income from other sources. Corporate earnings and manager salaries (personal income) are thus both taxed at about the 22 per cent rate.

When these same retained earnings range from $25,000 to $40,000, and the managers' salaries approximate the corporation's retained earnings, the two are taxed at nearly equal tax rates.

When a corporation's retained earnings go beyond the $40,000 level, the manager's salary should be held at or near $40,000 plus any personal exemptions, deductions, and exclusions, and minus all income from other sources. Otherwise, the tax rate on managers' salaries exceeds the 48 per cent tax rate on corporate earnings.

The reasons the figures come out the way they do is that the personal tax rate hits 22 per cent at $8,000 and 48 per cent at $40,000.

The stockholders of a fishing business corporation may request from the IRS that the corporation not be taxed. If the corporation qualifies, all corporate profits are passed through the corporation to the owners (shareholders) who in turn report their share as personal taxable income. Some of the qualifications for this tax treatment are: (1) ten or fewer shareholders, (2) shareholders must be individuals, not partnerships or other corporations, (3) one class of stock, and (4) all shareholders must consent to the non-tax status.

The "not taxed" corporation avoids the higher tax rates applied to corporations as described earlier but also has some limitations. For example, corporate losses as well as profits pass through to the shareholders and excess losses can be carried backward and forward only by the shareholder. Also the shareholder may be forced to pay taxes on income from the corporation which he does not realize during the year. This is because the "not taxed" corporation passes through its taxable income the year it is earned even though that income may be undistributed to shareholders. Careful consideration should be given to corporate taxation versus proprietor or partnership taxation and the tax options available to the corporation before the fisherman incorporates his business.

Fringe Benefits

Several fringe benefits are available to corporations and not to proprietorships or partnerships. If properly set-up, pension and profit sharing plans covering all regular employees including shareholder employees are tax deductible. Up to $5,000 death benefits may be paid to the beneficiaries or estate of an employee and excluded from their gross income, if paid by their employer. The group life insurance premium paid by the employer is excluded from the taxable income of the employee (up to $50,000). Although single proprietors can take advantage of tax deferred annuities through the Keogh Act, employees of a corporation may still gain additional "tax shelter" benefits not available to the proprietor.

The capital construction fund as provided for in Public Law 91-469 is available to fishing business corporations as well as proprietors or partnerships. The fund allows for tax deferred deposits to a fund to be withdrawn at a later date for the acquisition, construction or reconstruction of a qualified fishing vessel. If the withdrawal is made from a capital gains source, the basis of the new vessel must be reduced by 62.5 per cent for a corporation but only 50 per cent for a proprietor or partnership.

Capital

Incorporation makes it more feasible to pool the resources of several fishermen or other interested parties and provide the capital for a more efficient and profitable fishing operation. The corporation provides a legal and business-like framework for owning and operating one or more vessels and corresponding gear which may have previously been the private property of several proprietors. In addition to pooling of existing resources, capital may be obtained in several other ways.

Loans may be obtained from banks and insurance companies without the cosignatures of stockholders. But if the financial condition of the corporation is not strong, personal guarantees of one or more stockholders may be necessary. If corporate management is in the hands of several well-qualified officers who are supported with adequate insurance, stock purchase plans, and retirement benefits, it should make continued good management more certain and loans more secure. The fact that management, continuance of the corporation, or the loan does not depend on the life of a single individual may have favorable influence on lending institutions.

A corporation can raise capital funds through the sale of stocks or bonds in accordance with state and federal security laws. Potential purchasers are relatives, friends, or the general public. This type of financing for the fishing business corporation is not yet wide spread. Because most fishing business corporations will be family groups, outsiders are apt to be reluctant to purchase stock in a corporation operated primarily for benefit of a family. Being a minority stockholder in a closely-held family corporation may fail to provide reasonable returns on investment. General sale of stock or bonds is not likely to be an important immediate source of corporate funds in fishing, although this may grow in importance.

Renting or leasing property for corporate use is also a method of expanding corporation operations and increasing working capital without additional capital expenditure or investment. Rental arrangements may be with individuals or firms entirely outside the corporation, or stockholders, if they wish, may continue to own specific individual property and receive income from it if leased or rented to the corporation. This adds further flexibility to corporate ownership, operation, and income. Fishermen creating a corporation with the exchange of property might wish to withhold some property from corporate ownership in order to make this flexibility a part of the capital structure.

INCORPORATION PROCEDURES

The procedures and requirements for incorporation are dictated by the state. In Oregon the basic requirements are one or more natural persons at the age of 21 years or more, $1,000 or equivalent property value as a basis for stock issuance, delivery of articles of incorporation to the corporate commissioner, and a payment of the required fee.

Preincorporation Agreement

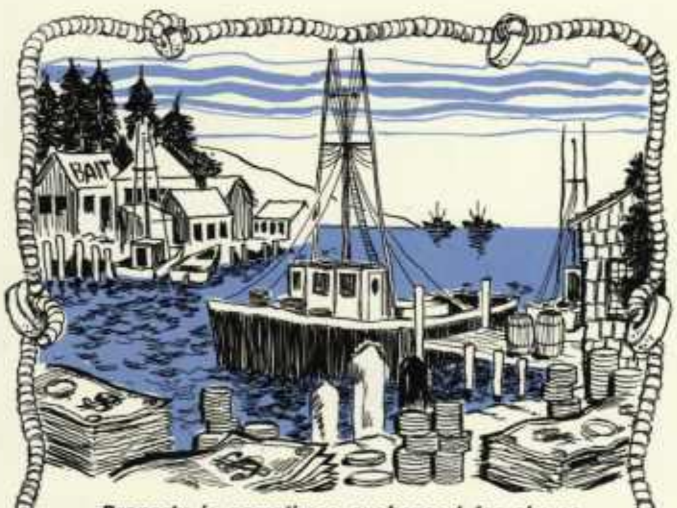
Assuming these basic requirements will be no barrier to incorporating, a preincorporation agreement should be drawn up. This agreement is not legally necessary and can be oral or written. But a more formal written agreement may be desirable, particularly if more than one major stockholder is involved.

The type of stock, number of shares to be authorized and issued, price and agreements to purchase stock, or the property to be exchanged will be particularly important.

A certain understanding needs to exist concerning stockholders who will be employees, officers, and directors, even though official election of directors and officers cannot come until after the charter has been granted. Salary agreements are desirable prior to incorporation. Duties and obligations of officers should be spelled out.

Any arrangements concerning such things as stock transfer restrictions, purchase agreement, voting trusts, and life insurance funds should all be a matter of agreement and record. A method for evaluating stock in transfer or purchase should be included to reduce later disagreement. This is usually not an easy matter and may be done by accepting book value, market value, appraisal value, or some other agreed value.

Since corporations, particularly from a tax standpoint, can be costly to dissolve, every precaution should be taken and every possible area of conflict eliminated prior to incorporation. Thus attempting to arrive at a preincorporation agreement may prove it is undesirable to incorporate, but this is better found out before—than after—incorporation.



Property is sometimes exchanged for shares of stock in the original financing of a fishing business corporation.

Articles of Incorporation

In Oregon, following all preliminary agreements, articles of incorporation signed by one or more natural persons at the age of 21 years or older must be presented to and endorsed by the corporate commissioner. Following are some general requirements to be included in the articles of incorporation.

Corporation name must be stated and must contain the word corporation, company, incorporated or limited, or an abbreviation of one of such words. The name cannot be the same or similar to the name of any existing domestic corporation in the state. Therefore, a chartered corporation has the exclusive right to the name it chooses. This may have valuable prestige or advertising value. Even prior to incorporation a corporate name may be reserved and renewed year-to-year by making application and payment of a nominal fee.

A corporation may have a stated life in years, or it may have perpetual life as long as requirements are fulfilled. Its life must be stated in the articles of incorporation. Most corporations have a perpetual life rather than a life in years because if desirable, they can be terminated at any time by fulfilling certain legal requirements.

Nature of business to be pursued by the corporation must be stated. This section usually is written carefully so that broad general operation and expansion of business activity will be possible without violating terms of the corporation charter.

A statement is necessary regarding the number of shares, classes of stock, and if par or no-par stock of each class is to be issued. Any limitations or special rights of stocks must be listed.

A corporation is required to maintain an office and a registered agent in this state to whom official communication can be directed. This agent can be a corporation officer at his home or office or it can be another business firm or lawyer. One corporation to act as agent for another corporation must have such authority provided in its articles of incorporation.

A listing is required of the name and address of each incorporator (minimum of three) and each director who is to serve until official elections are held. Three directors are required in Oregon, none of whom need to be stockholders or residents of Oregon.

It is required that duly signed duplicate originals of the articles of incorporation be delivered to the corporation commissioner together with the appropriate fee. If found to be in order, the commissioner will endorse the articles with "filed" indicating the month, day, and year. He will then issue a certificate of incorporation, and the corporation will have come into being. The articles of incorporation filed with the corporation commissioner are a matter of public record. They can be changed only by official amendment. The corporation may then commence business as soon as at least $1,000, or property of this value, has been paid into the corporation for issuance of shares. An organizational meeting should follow immediately to officially elect directors, appoint officers and adopt bylaws, as well as handle other organizational matters.

Bylaws

Bylaws are the regulations directing internal affairs of a corporation. They are approved by the board of directors, and they can be changed by the board of directors unless changes are reserved to the stock holders by the articles of incorporation. Bylaws are general guides for conduct of business. They are arranged under properly designated headings called "articles" and numbered consecutively for reference purposes. Each article may be subdivided into numbered sections.

Although name of the corporation and the registered office and agent are included in articles of incorporation, certain other information of this nature should be repeated and possibly expanded in the bylaws. They should include business location, address of business offices, and so forth.

A fiscal year must be designated for the corporation. It may agree with the normal calendar year or coincide with some more natural business year. There may be some natural time of year when fishing activity is at a minimum which would work best to end and commence the business year. This choice of fiscal year may be important for income tax purposes.

Provisions should be made to establish date, time and place for required yearly stockholders' meetings and to call any special meetings as prescribed by law. Written notice must be given of special meetings not less than 10 nor more than 50 days prior to such meetings.

Each share of stock outstanding is entitled to one vote on matters brought before stockholders. It is the stockholders' responsibility to elect the board of directors. In election of directors, each stockholder has votes equal to the number of shares owned, multiplied by the number of directors to be elected. If cumulative voting is to be allowed, it must be so stated in the articles of incorporation.

Bylaws should state the number of directors. Oregon law requires three. They need not be residents of Oregon or stockholders unless the articles of incorporation require it. Qualifications and manner of election should be spelled out as well as terms of office and salaries if any. Any special provisions concerning directors' meetings should be explained. General or specific duties of directors should be listed giving them certain rights and responsibilities or withholding certain authority or rights. Directors' voting procedures and procedures for election or selection of corporate officers should be included.

Officer positions in a corporation should be stated in the bylaws. Oregon law requires a corporation to have a president, one or more vice presidents, a secretary, and a treasurer elected by the board of directors. Any two or more offices may be held by the same person except those of president and secretary. General duties and range of salaries might be included in the bylaws, but they should not be made so rigid as to be unworkable.

Records and Reports

After articles of incorporation have been filed, they can be amended as desired from time to time by application to and acceptance by the corporation commissioner. Any change in registered office or agent must be reported to the corporation commissioner.

A corporation is required by state law to "keep correct and complete books and records of accounts and shall keep minutes of the proceedings of its shareholders and board of directors"; also a record of its shareholders is required giving names and addresses with number of shares and class of stock held. This record must be current with all transfers.

All corporations registered in Oregon are required to file an annual report with the corporation commissioner. Information contained in this report shall be given as of 30 days before the anniversary date of the corporation. This report is primarily to determine changes in officers and capital structure and provide a billing form for payment of an annual license fee.

COSTS OF INCORPORATING

Incorporation costs at first glance may seem large and an additional expense of doing business. Except for the recurring annual license fee, and usually some additional accounting and legal fees, other costs of incorporating are incurred only once and can be written off or amortized over a period of years. Therefore, if the fishing business corporation as a tool of financial planning and management has any significant value to a fishing business, costs of incorporating should be only a minor determinant in the decision.

Incorporation and License Fees

Oregon requires an initial incorporating fee which must be paid at filing of articles of incorporation. A prorated license fee for the remainder of that year must also be paid at time of incorporating. An annual license fee is paid each year thereafter. Both of these fees are based on value of authorized capital stock. This is the capital value of stock authorized to be issued and stated in the articles of incorporation. This does not necessarily mean actual shares outstanding. There may be more shares authorized than issued. Because fees are based on value of authorized capital stock, authorized value should not significantly exceed (within range limits) the total amount of stock contemplated to be issued. Authorized capital stock can be increased at a later date, if desired, by amendment to the articles of incorporation.

Table 1, based on capital value of authorized shares, currently (1971) applies in Oregon for filing articles of incorporation and paying the annual license fee. Par value stock is valued at par whereas no-par stock for fee purposes is deemed equivalent to shares having a par value of $10 each.

Fees will be only one consideration as to whether par or no-par value stock is used, but it may help to decide if other aspects are considered unimportant to a specific case. Closely-held or family corporations will not be concerned with many of the considerations of corporations that sell stock to the public.

Organizational and Legal Fees

Because of technical and legal procedures involved, it would not be advisable to incorporate without the services of a competent lawyer and tax consultant. These services may be extensive depending upon the amount of consultation and detailed planning necessary.

No specific cost for legal services can be given but the Oregon Bar Association recommends a minimum of $300.

There also may be additional consultation needed for which an attorney may charge on a time-spent basis. Many businesses pay for legal aid on a monthly retainer fee basis. This may be advisable if regular legal services are used.

A rough estimate of total incorporation costs, if 1,000 shares of no-par value stock were authorized, follows:

TABLE 1:

Initial filing fee (Oregon)	$ 15.00
Annual license (assume full year)	15.00
Attorney and accountant fees	350.00
	$380.00

SUMMARY

This manual discusses a number of considerations regarding the incorporation of a fishing business. These are:

1. **Division of ownership is more feasible within a corporation.**
2. **The corporation may have a perpetual life and the business transferred from generation to generation regardless of the life span of various individuals involved.**
3. **Operation and management of a corporation usually implies more clearly specified management responsibilities and procedures but may be more complicated than with a proprietorship.**
4. **Owners of a corporation assume liability up to their share of ownership while the proprietor may be liable up to the value of his entire business and personal property.**
5. **Corporations pay taxes at one of two rates while the rates for a proprietor range from 14 to 70 per cent in 24 steps. Taxation procedures for a corporation can be much more complicated than for the proprietor and the total tax may be higher.**
6. **A number of fringe benefits such as group insurance, profit sharing and retirement plans can be obtained by incorporating.**
7. **Incorporating may make it more feasible to borrow money and makes it possible to issue stock to the public to raise money.**
8. **Incorporating usually requires more records and paperwork. Although this requires more time and probably more accounting expense, it may also improve the management and profitability of the business.**
9. **A corporation normally incurs more legal and accounting expenses than a proprietorship, not only in the process of incorporating but in conducting its business each year.**

OSU SEA GRANT MARINE ADVISORY PROGRAM

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OSU Sea Grant Extension Marine Advisory Program activities are carried on throughout the state and region as a means of conveying knowledge that will help people use the ocean's resources. Marine Advisory staff members also identify the problems of resource users and relate them to research people who can help solve the problems.

The Marine Advisory Program—conducted as part of OSU's Cooperative Extension Service—is the most highly developed in the nation. Its staff of specialists and marine extension agents are experts in their special areas of Sea Grant extension work.

Pictured at right is Fred Smith, OSU Marine Advisory Program marine economics specialist as he conducts one of the Fishermen's Series held throughout Oregon yearly.

Other MAP activities that help fishermen manage a fishing business have been the Town Hall Meetings and a commercial fisheries business exposition. Publications are available to further aid the fisherman.

For information about how the OSU Marine Advisory Program can help you, contact: Extension Specialist, Marine Economics, Department of Agricultural Economics, Oregon State University, Corvallis, Oregon 97331, or any of the marine extension agents in Oregon.

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OSU Marine Advisory Program

COMMERCIAL FISHERMAN'S DATA BOOK

The Oregon State University Sea Grant Marine Advisory Program has made available to commercial fishermen a sturdy, vinyl bound three-ring binder to hold Marine Advisory Program publications and data from other sources of interest to the commercial fishing industry.

Designed to be kept aboard boat and to serve as a ready reference of marine data, the notebook is available free of charge to bona fide professional fishermen from any OSU Sea Grant Marine Advisory Program marine extension agent, located at your Oregon coastal county Cooperative Extension Service office.

Your OSU Marine Advisory Program marine extension agent is always available to assist the commercial fisherman in matters pertaining to his operation and our marine environment.