CHOOSING THE SHARE STRUCTURE OF A WASHINGTON BUSINESS CORPORATION

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The principals in a business corporation can make part of their investment in the corporation in the form of loans, and they can defer decision on this until after incorporation. They must, however, make some part of their investment in the form of an ownership or share interest, and they must provide for this in their articles of incorporation. For Washington corporations the choice of these provisions is needlessly complicated by the existing Business Corporation Act. And no improvement is in sight under the American Bar Association-American Law Institute Model Business Corporation Act (hereinafter, "Model Act") which is being proposed for enactment to replace the present act.

One purpose of this article is to discuss the choice of an appropriate share structure under both the existing Washington statutes and the proposed Model Act, with a view toward minimizing filing and license fees, and possibly lawyers' fees. This involves a consideration of the classes (if any), kinds (par and no par) and number of shares to be

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1 For a summary of advantages and tax factors to be considered in casting investments in the form of loans, see Weis, The Labyrinth of the Thin Incorporation, 40 TAXES 568 (July 1962); Caplin, The Caloric Count of a Thin Incorporation, N.Y.U. 17TH INST. ON FED. TAX. 771 (1959). Casting investments in the form of equity interests has been made more attractive taxwise in the case of "small business corporations"; Int. Rev. Code of 1954, § 1244.

2 RCW 23.01.030 (1) (d), (e) & (f), .180. For cases holding that inadequate equity investments may be a factor in the judicial disregard of the corporate entity, see Annot. Inadequate capitalization as factor in disregard of corporate entity, 63 A.L.R.2d 1051 (1959); Ballantine, Corporation 302-3, 314 (rev. ed. 1946); 1 Fletcher, Cyc. of Law of Private Corps., (Supp. 1959, at 115). For a discussion of the Washington requirement of a minimum "paid-in capital," see text discussion, infra.

3 Washington's BUSINESS CORPORATION ACT, adopted in 1933 (RCW Title 23) is essentially the UNIFORM BUSINESS CORPORATION ACT, 9 U.L.A. 39 (1932).

4 If the principals of a Washington corporation expect at the outset that the corporation will do business in other jurisdictions, the choice of a share structure should also be made in the light of the laws of those jurisdictions. Suppose, for example, that a newly formed Washington corporation is expected to do business in Idaho. If the corporation uses no par shares it may have trouble with filing and license fees in Idaho. In Idaho, no par shares "shall be taken to be of the par value of $100.00 each" for the purpose of computing, on a sliding scale, the fee for filing articles of incorporation, and the annual license fee. Idaho Code 30-118.

5 It is hard to imagine a layman preparing and filing articles of incorporation or articles of amendment, or any of the other documents that corporations may be required to file with the secretary of state or county auditor. It would probably cost him more, in terms of his own time, to find out what to do than it would to hire a lawyer to do it for him.
authorized in the articles of incorporation, and the choice of that important amount which is now called "capital stock" and which the Model Act would call "stated capital." Another purpose of this article is to suggest improvements in the present business corporation statutes (and the Model Act, if it should be adopted) by abolishing the term par value and the confusing and useless provisions for "capital stock" and "paid-in capital," and by changing the method of fixing the state's filing and license fees.

**Classes of Shares**

Articles of incorporation now must describe the classes, if any, of shares which the corporation will be authorized to issue. The Model Act would make no change in this respect. If the shareholders of a corporation are to share profits and voting rights in proportion to their investments, there is need for only a single class of shares, to be issued to the holders in proportion to their investments. In this event the articles need not say anything about classes of shares. Without a contrary provision in the articles, the shares are unclassified and identical, each entitling its holder to one vote and to one unit of dividends when distributed. Although such shares often are called "common" shares or "stock," the name "common" is redundant when there is only a single class of shares.

The need for more than one class of shares arises only when it is desired to sell to others a profit-sharing interest in the corporation,

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6 RCW 23.01.030 (1) (e).
7 ABA-ALI Model Bus. Corp. Act §§ 14, 48 (e), (f).
8 RCW 23.01.010 (6), .130, .290 (1); ABA-ALI Model Bus. Corp. Act §§ 2 (d), 31.
9 Under both existing Washington statutes and under the Model Act, the ownership or equity interest in a corporation is divided into units called "shares." RCW 23.01.010 (6); ABA-ALI Model Bus. Corp. Act. § 2 (d). A "shareholder" is a person who owns one or more shares. RCW 23.01.010 (7); ABA-ALI Model Bus. Corp. Act § 2 (f). This terminology focuses attention on the direct nature of a shareholder's partial interest in the corporation. Yet lawyers and business men have long used the word "stock" to refer both to the shareholders' interests and to the wholly distinct concept of a limitation upon the right of the shareholders to receive dividends. The confusion attendant upon this dual usage has been written into the present Business Corporation Act—a confusion which the Model Act avoids. In the existing statutes the word "stock" is used, on the one hand, as a synonym for "share" or "shares," as in the phrase "certificate of stock." RCW 23.01.101 (8), .140, .160. Contrast ABA-ALI Model Bus. Corp. Act § 21 ("certificates representing shares"). Popular usage goes on to the redundant phrase "share of stock." On the other hand, in existing statutes the word "stock" is used in a wholly distinct sense in the term "capital stock," to refer to a monetary amount which appears on the liability and net worth side of the corporate balance sheet and which acts as a restriction upon the amount of assets which the corporation can distribute to its shareholders at a given time. RCW 23.01.010 (10), .250 (4). The two usages continue in the wholly misleading phrase "share of capital stock" in RCW 23.01.120. See Gose, Legal Significance of "Capital Stock" 32 Wash. L. Rev. 1, 4-5 (1957).
without voting rights, or with a limitation on the right to dividends. Suppose, for example, that the principals of a corporation wish to obtain investment by selling a profit-sharing interest in the corporation, but wish to retain all control themselves. There might be created two classes of shares. Class A shares, issued to the principals, might have voting rights and the right to 20% of the dividends. Class B shares, issued to outsiders, might have no voting rights and the right to 80% of the dividends. Or a corporation might wish to attract investment by offering shares with limited voting rights but with preferential rights to profits and return of investment. The corporation might create a class of "preferred" shares entitled to certain dividends before any distribution is made to the holders of "common" shares, and having the right to vote only if dividends go unpaid for a specified period. The other class of shares would be "common" shares entitled to the rest of the corporate profits and having the only general voting rights.

KINDS OF SHARES: PAR VALUE AND NO PAR VALUE

The articles of incorporation must state what number of shares, if any, will have par values; what these par values are; and how many shares, if any, will have no par value. The Model Act would make no change in this respect. The term par value is misleading because it has nothing to do with the "real" value of a share. Par value is rather a statement of the minimum price at which the share may be issued by the corporation to a subscriber without the subscriber incurring some personal liability for corporate debts. The statement that a share has a par value of $10 or $5 or ten cents means that the corporation either has received or is entitled to receive at least that amount for that share, in cash or property or services, from the shareholder who has subscribed for it. If a corporation receives less than that par amount, it can compel the subscribing shareholder to pay it the difference.

To some extent a par amount or minimum issue price for shares prevents the directors from diluting the interests of existing shareholders in favor of new shareholders. A man who pays a corporation $10 per share for his shares does not like to see the corporation issue

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10 RCW 23.01.030 (1) (d).
11 ABA-ALI MODEL BUS. CORP. ACT §§ 48 (d).
12 RCW 23.01.150 (3), 200 (2); ABA-ALI MODEL BUS. CORP. ACT §§ 17, 23. See WASH. CONST. art. XII, § 4.
13 Suppose that a corporation has two original shareholders, each holding 100 shares having a "par value" of $10 per share and on actual value of $15 per share. If the corporation sells 50 new shares to an outsider for $10 per share, he obtains for $500 a 20% interest in the corporation worth $700. The other two shareholders have each given him $100.
the same kind of shares to another man for only $5 per share. While there are equitable limitations on the right of directors to issue shares for such varying prices, the existing shareholders may feel safer if $10 is fixed as the minimum issue price for any shares.

On the other hand the designation of a par amount per share will hinder the corporation's sale of additional shares in the future, if the actual value of outstanding shares falls below the arbitrary par amount. If shares having a par amount (minimum issue price) of $10 each become worth only $5, a potential new shareholder who is aware of this will not want to pay more than $5 per share for new shares issued to him. Yet the corporation cannot sell to him for less than $10 per share. If instead the corporation prospers, so that its shares having a par amount (minimum issue price) of $10 each become worth $15, the corporation should receive the latter price for newly issued shares. But the unsophisticated new shareholder, confusing the par value printed on a share certificate with actual value, is apt to think he would be bilked if he paid more than $10 per share. If the corporation principals are similarly confused, they may cause the corporation to sell the new shares for the par value of $10 per share, thus diluting their own interests. The legislature would do the public a service by abolishing the term par value and substituting the term "minimum issue price."

If a corporation has shares with a par amount, it can change this amount by amending its articles of incorporation. This can become bothersome, however, with changes in the financial condition of the corporation. And it entails filing fees, perhaps additional license fees, and, usually, legal fees.

A simpler way to get price flexibility on the future issuance of shares is to have shares with no minimum issue price or par value, which can be issued for whatever price a majority of the shareholders or (if the articles so provide) the directors choose, according to economic conditions. No misleading statement about "value" appears on the share certificate.

"CAPITAL STOCK"

In choosing par or no par shares, and in fixing the par amounts,
the principals of a corporation should recognize the extent to which they may, voluntarily, be restricting their right to withdraw their investment before the corporation is completely liquidated.

A basic concept underlying incorporation is that of encouraging business ventures by allowing the owners, as shareholders of a corporation, to relegate their business creditors to the assets of the corporation in order to satisfy their claims. In turn the law seeks to protect the creditors by prohibiting shareholders from withdrawing assets which the creditors have provided. Beyond this the law entertains an ancient notion that creditors should be further protected by requiring the shareholders themselves to make an investment in the corporation, part of which should be "frozen" against withdrawal.\textsuperscript{19} In Washington this additional protection is largely illusory. On the one hand the shareholders are required to make an initial investment—at least $500 (called "paid-in capital") at present, and $1,000 under the \textit{Model Act}\textsuperscript{20}—which may be withdrawn immediately.\textsuperscript{21} On the other hand, whatever the amount of the shareholders' investment, the shareholders are permitted to elect how much of it shall be "frozen" against withdrawal. This provision for voluntary restriction against withdrawal is presently contained in the concept of "capital stock" ("stated capital" in the \textit{Model Act}).

In general, both accounting convention and statutes require a Washington corporation to keep a record of the dollar amounts invested in its assets, and a balancing record of the nature and sources of these dollar amounts, under some description such as "liabilities and net worth." The conventional summary of assets, liabilities and net worth is the balance sheet. Among the items traditionally accounted for is the sum paid or to be paid for the subscribed shares of the corporation.

\textsuperscript{19} See Ballantine, \textit{op. cit. supra} note 2, \S 243.
\textsuperscript{20} RCW 23.01.070, .080; ABA-ALI \textit{Model Bus. Corp. Act} \S 51.
\textsuperscript{21} Suppose that a corporation issued 1,000 shares, having a par value of $1 each, and having no preferences on liquidation, for a cash payment of $1,000. At this point the corporation has complied with existing and proposed statutes regarding the minimum amount to be paid in for its shares. And the corporation would have $1,000 of "capital stock" under existing statutes, or $1,000 of "stated capital" under the \textit{Model Act}. RCW 23.01.010(10) (a); ABA-ALI \textit{Model Bus. Corp. Act} \S 2(j). Then the shareholders could, by appropriate action, reduce the "par value" of the shares to one cent each, and reduce the "capital stock" or "stated capital" to $10. RCW 23.01.400, .410, .430; ABA-ALI \textit{Model Bus. Corp. Act} §§ 53(e), 63. Thereupon the corporation could distribute $990 to the shareholders, so long as there remained assets which exceeded liabilities by $10. RCW 23.01.250. See also Gose, \textit{Legal Significance of "Capital Stock"}, 32 \textit{Wash. L. Rev.} 1, 22 (1957). Under the \textit{Model Act}, the distribution would be subject to a further restriction that the corporation be not insolvent and that the distribution not render it insolvent. ABA-ALI \textit{Model Bus. Corp. Act} §§ 2 (i), (j), (k), (m), 41.
Some part of this sum must be separately labeled "capital stock": an amount which is equal to the aggregate par values (minimum issue prices) of all issued shares having par value, plus the aggregate of that part of the consideration agreed to be paid for issued shares having no par value which the shareholders or the board of directors have designated as "capital stock." If the amount of "capital stock" is less than the total consideration paid for all the issued shares, then an amount equal to the difference is separately designated as "paid-in surplus." A corporation could receive $100,000 for its issued shares and, depending upon its choice of a share structure, it could have a "capital stock" of $100,000 and no "paid-in surplus," or a "capital stock" of one cent and a "paid-in surplus" of $99,999.99, or any combination in between.

The "capital stock" is the theoretical margin of assets which the corporation must try to keep in excess of the corporate debts. The corporation can distribute assets to its shareholders only if the distribution leaves in the corporation assets equal to the corporation's liabilities and "capital stock." Suppose that a corporation which has done business for some time has assets consisting of cash, land, buildings, equipment, etc., representing an aggregate investment of $325,000;

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22 RCW 23.01.010(10), (11), ABA-ALI MODEL BUS. CORP. ACT §§ 3 (j), 19. The definition of "capital stock" in the Business Corporation Act is virtually the definition of "stated capital" in the Model Act. One difference is that the Model Act speaks in terms of "issued" shares while the present statute distinguishes between shares, which are said to be "allotted," and share certificates which are "issued." See RCW 23.01.010 (9), (16); 9 U.L.A. § 20 (Note) (1932).

"Paid-in surplus" should not be confused with "paid-in capital," which is the total consideration received for issued shares. With respect to the amount received for shares having no par value, the corporation, under existing statutes, may designate part of the amount as "paid-in surplus" and the rest as "capital stock," and under the Model Act could designate part of the payment as "capital surplus" and the rest as "stated capital." Under existing statutes there is no limit to the portion of the payment which the shareholders or directors, as the case may be, can classify as "paid-in surplus," thus allowing such amount to be returned to the shareholders. Under the Model Act the directors are limited in the amount of the payment for shares which they can classify as "capital surplus." ABA-ALI MODEL BUS. CORP. ACT § 19. But the directors and shareholders can classify a greater amount as "capital surplus," by reducing "stated capital" (and, if need be, amending the articles of incorporation), thus paving the way for a return of the shareholders' investment. ABA-ALI MODEL BUS. CORP. ACT §§ 41, 63.

If shares having a par value are issued at prices higher than par, the excess would be "paid-in surplus" under existing statutes, and "capital surplus" under the Model Act.

23 While the Model Act would require the directors to allocate at least 75% of the consideration paid for no par shares to "stated capital," ABA-ALI MODEL BUS. CORP. ACT § 19, the "stated capital" can be reduced by the shareholders or by the repurchase of shares. See note 32, infra.

24 The language of the existing statute is that dividends shall not be paid "except from the surplus" of corporate assets over "its liabilities, including ** the amount of its capital stock." RCW 23.01.250(4). The language of the Model Act is that dividends shall not be paid except "out of the surplus" of corporate assets over debts plus "stated capital." ABA-ALI MODEL BUS. CORP. ACT §§ 2 (i)-(m), 40, 41. Existing statutes do not distinguish between "earned" surplus (accumulated profits) or "paid-in" or "capital" surplus as a source of dividends. The Model Act does, and puts more
that the corporation has issued 1,000 shares for a total consideration, all paid in, of $100,000; that none of the shares is entitled to any preference upon liquidation; and that the corporation has accumulated undistributed profits of $25,000. Depending upon the kind of share structure the corporation has chosen (and the possible variations are almost infinite), and the way it has treated the consideration paid for its shares, the balancing statement of its liabilities and net worth might appear as in Situation 1 or in Situation 2 (the bracketed captions and descriptions do not conventionally appear on a balance sheet):

<table>
<thead>
<tr>
<th>[AMOUNTS INVESTED BY CREDITORS]</th>
<th>Situation 1</th>
<th>Situation 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes payable, Accounts payable, etc.</td>
<td>$200,000.00</td>
<td>$200,000.00</td>
</tr>
</tbody>
</table>

| [AMOUNTS INVESTED BY SHAREHOLDERS] | |
|-----------------------------------|---|---|
| Amount paid for shares | |
| Capital stock | 100,000.00²⁶ | 1,000.00²⁷ |
| (1,000 shares issued) | |
| Paid-in surplus | 99,000.00 |
| Earned surplus²⁸ | 25,000.00 | 25,000.00 |
| [undistributed profits] | |

$325,000.00 $325,000.00

restrictions on distributions from "capital" than from "earned" surplus. ABA-ALI Model Bus. Corp. Act §§ 40, 41. The Model Act also puts more restrictions on distributions from "capital" surplus than existing statutes put on distributions from "paid-in" surplus. See notes 31 and 32 infra.


²⁶ Under the existing Business Corporation Act and the proposed Model Act (which would use the term "stated capital" instead of "capital stock"), this amount could reflect either of the following variations (among others):
(a) 1,000 shares having a "par value" of $100 each, and sold for that amount; or
(b) 1,000 shares having no "par value" and sold for $100 each, with the entire payment being treated as "capital stock."

²⁷ Under the existing Business Corporation Act and the proposed Model Act, this amount could represent either of the following variations (among others):
(a) 1,000 shares having a par value of $1 each, and sold for an average of $100 each or an aggregate of $100,000; or
(b) 600 shares having a par value of 50 cents each, and sold for an average of $90 per share or an aggregate of $54,000, and 400 shares having no par value and sold for an average of $115 per share or an aggregate of $46,000, with $700 treated as "capital stock."

The variation (b) could be achieved at the outset under existing statutes. Under the Model Act, this would take two steps. With respect to the $46,000 received for shares without par value, the directors would first have to classify 75% of this as "stated capital." ABA-ALI Model Bus. Corp. Act § 19. With shareholder approval they could reduce this amount to $700. ABA-ALI Model Bus. Corp. Act § 63.

²⁸ RCW 23.01.240 (2). The Model Act would call this "capital surplus." ABA-ALI Model Bus. Corp. Act § 2 (i)-(m).

²⁹ "Earned surplus" has long been the term used to denote undistributed corporate
Under the present Business Corporation Act and the proposed Model Act, the corporation in Situation 1 could distribute $25,000 to its shareholders, representing the corporation's undistributed profits, but in Situation 2 it could distribute $124,000 to its shareholders, representing the undistributed profits of $25,000 plus $99,000 of the shareholders' original investment. The difference between the permissible distribution in the two situations is the difference in the restrictive amounts of the corporation's "capital stock" (or, under the proposed Model Act, its "stated capital"). Yet the amount of "capital stock" (or "stated capital") is voluntary with the shareholders who can reduce it from the $100,000 in Situation 1 to the perfunctory $1,000 in Situation 2, or perhaps to zero.

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Under present law and under the proposed *Model Act*, the entire protection which is theoretically afforded creditors by the notion of "capital stock"—keeping a margin of assets over debts—turns out to be only a system of keeping some kind of public record which creditors may inspect. A corporation can return its shareholders' investment to them, down to an equivalence of assets and liabilities, so long as the corporation files the right papers with the secretary of state and county auditor.

The information which existing statutes require corporations to furnish via public records is of little use to creditors. There is no requirement that corporations report the amount of their supposedly significant "capital stock." The *Model Act* would at least improve this record system by requiring annual reports of "stated capital," and by require-
ing public records of reductions of this amount. But even under the *Model Act*, the current record of "stated capital" does not protect creditors against a reduction of "stated capital" which the directors or shareholders may put into effect tomorrow. If a creditor wanted to rely upon a given amount of "stated capital," he would have to contract with the corporation not to change it.

It is therefore small wonder that creditors now seldom pay any attention to the "capital stock" of a corporation, and probably they would pay no more attention to the parallel "stated capital" of a corporation under the proposed *Model Act*. Trade creditors generally extend credit to a corporation on the basis of their own judgment of the business and of the people running it, and on the basis of the faith that they rarely will get stung. Cautious creditors require corporations to furnish certified financial statements which are more up to date and which provide more detailed information than anything in the public records. Underwriters handling a corporate bond issue usually require the corporation to accept restrictions on the distributions of assets to shareholders which are considerably more refined than anything required by statute. Banks often require a borrowing corporation and its shareholders to sign a "standby" agreement prohibiting dividends to shareholders while the bank loan is outstanding. Often they go further and require the principal shareholders to guarantee personally the repayment of the loan.

It should be recognized, of course, that the shareholders as well as the creditors of a corporation may be interested in placing restrictions upon the distribution of assets to shareholders. At present such restrictions are mainly a matter of contract among the shareholders. The most common restriction, of course, is that in favor of the holders of par value shares: the aggregate of the par values represents assets "frozen" against distribution to the shareholders until they specifically consent. This use of par value, however, tends to "use up" the corporation's "authorized capital stock," a subsequent increase in which requires the filing of articles of amendment with the secretary of state and the county auditor, with attendant filing fees and a legal fee, and possibly resulting in an increased license fee. The situation would be the same under the *Model Act*. It is possible, however, to provide this same type of restriction without using par value shares. If a corpora-

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35 See note 32 *supra* (second paragraph).
36 See *BALLANTINE*, *op. cit. supra* note 2, at 572.
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tion has shares entitled to a preference in the distribution of assets on liquidation, the articles of incorporation can prohibit distributions of assets to shareholders unless there remain, after the distribution, assets equal to liabilities plus the aggregate amount of the liquidation preferences. The Model Act would provide this protection by statute.37

It would be possible to carry the statutory protection of creditors and shareholders far beyond the largely illusory provisions of existing statutes and the Model Act.38 Corporations might, for example, be prohibited from distributing assets to shareholders except to the extent of profits.39 Or corporations might be prohibited from distributing assets to shareholders unless there remained, after the distribution, some prescribed ratio of assets to liabilities, or assets equal to the amount of the corporate liabilities plus the amount of the consideration paid for the outstanding shares.

The present Business Corporation Act (or the Model Act, if it is to be adopted) should be amended to achieve simplicity without sacrificing any of the protection now afforded or proposed to be afforded creditors, while also providing needed protection for preferred shareholders. There should be eliminated all the lengthy and useless provisions regarding "capital stock" or "stated capital," "paid-in surplus" or "capital surplus," together with the requirements for the filing of periodic reports regarding the amounts paid for shares, and the requirement for filing certificates reducing "capital stock" or "stated capital."

With the elimination of the concept of "capital stock" or "stated capital," the concept of "par value" performs no function in restricting corporate distribution of assets to shareholders. The other function of par value—that of providing a minimum price at which shares can be issued—could be dealt with more simply by abolishing the term par value and providing by statute that, if the articles of incorporation so specify, shares may be issued only for a stipulated "minimum issue price," otherwise they may be issued for any price the directors (or, depending upon the articles, the shareholders) provide. However, any statutory tinkering with the term "par value" should take into account the problems that might be faced in qualifying Washington corporations in other states.40

A streamlined corporation act should provide that all the considera-

38 See generally, Ballantine, op. cit. supra note 2, at § 243.
40 See note 4 supra.
tion paid for any shares is "capital," so that the right-hand side of a corporate balance sheet would show liabilities, capital, and earned surplus. Other provisions should be those of the Model Act. \(^{41}\) Dividends should be allowed first to the extent of earned surplus, and then to the extent of capital, provided that distributions of capital were accompanied by an explanation regarding their source, and were authorized as provided in the articles of incorporation or, in the absence of any provision in the articles, by a two-thirds vote of the shareholders. All distributions to the shareholders would always be subject, however, to the overriding restrictions that no distribution could be made to the shareholders (1) unless, after the distribution, there remained corporate assets equal to the amount of corporate liabilities plus the aggregate amount of any preferences to which shareholders may be entitled upon liquidation, and (2) if the corporation is then insolvent or if the distribution would make it so.

**Number of Shares**

The articles of incorporation must state the number of shares which the corporation is authorized to issue. \(^{42}\) No change would come from the Model Act. \(^{43}\) Customarily, if not necessarily, this is a whole number, \(^{44}\) and it should be chosen after considering several factors.

In the first place, there must be authorized in the articles of incorporation at least that number of shares which will be issued at the outset to the principals. Whether the number is relatively high or low makes no difference in the financial positions of the shareholders. A shareholder with 100 out of 200 outstanding shares, each worth $10,000, has the same interest he would have if he held 1,000,000 out of 2,000,000 shares, each worth $1. If he transferred all his shares at one time he would incur a federal transfer tax which varies with the value per share. The shareholder who transfers 100 shares each worth $10,000 would pay a transfer tax of $8, while the shareholder who transfers 1,000,000 shares each worth $1 would pay a tax of $400. \(^{45}\) On the other hand,

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42 RCW 23.01.030 (d).  
44 See RCW 23.01.140 (d); ABA-ALI Model Bus. Corp. Act § 22.  
45 The federal tax on the transfer of shares is based partly upon the actual value of the shares (tax of 4 cents per $100 or major fraction thereof of value) and partly upon the number of shares transferred (not less than 4 cents per transfer nor more than 8 cents per share). Int. Rev. Code of 1954, § 4321 (1954). The latter provision increases the tax, out of proportion to value, for a large number of low-value shares. More sensibly, the federal tax on the issuance of shares is based wholly upon the actual value of the shares (10 cents per $100 or major fraction thereof of value). Int. Rev. Code of 1954, § 4301 (1954).
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breaking one's shareholdings into a relatively greater number of shares increases the transferability of varying portions of the holder’s interest in the corporation. The person who holds 1,000 shares instead of ten shares can conveniently transfer 1/50th, 1/100th, or 1/1000th of his interest.

In the second place, the number of authorized shares should depend upon whether the principals want to leave to the shareholders or to the directors the power to increase the share investment through the issuance of additional shares. If the principals want to let the corporation issue additional shares only with the approval of the existing shareholders, then the articles of incorporation should authorize only the number of shares that will be issued at the outset. If it is desired, the articles might also contain a provision for their amendment by the vote of less than two-thirds of the voting power. But then if the shareholders wish to allow the issuance of additional shares, the articles of incorporation must be amended, entailing possibly higher filing and license fees, and a lawyer’s fee. It is common to see corporations thus change their articles several times in a few years to authorize additional shares.

If, on the other hand, the principals want to let the directors decide on any increase in the equity investment, the articles of incorporation should authorize the corporation to issue a greater number of shares than will be issued at the outset. Then the directors can cause the issuance of shares up to the number of authorized shares, without any amendment of the articles.

**STATE FILING AND LICENSE FEES**

Both the kind (par and no par) and number of shares to be authorized in the articles of incorporation, and the amount of “capital stock,” should be determined after considering their effect upon the filing fee and the annual license fees which the corporation has to pay. In order to file articles of incorporation with the secretary of state, a Washington corporation must now pay a filing fee that ranges from $50 to $5,000.

In the absence of a contrary provision in the articles of incorporation, existing shareholders may have a “pre-emptive” right to purchase subsequently issued shares in proportion to their respective holdings. See 11 Fletcher, Cyc. of Law of Private Corporations § 5135 (1932). The Model Act has alternative provisions regarding preemptive rights. One grants such rights except as limited by the articles; the other denies such rights except as granted by the articles. ABA-ALI Model Bus. Corp. Act § 24.

See note 5 supra.

RCW 23.60.010.
In addition the corporation must pay an annual license fee that ranges from $30 to $2,500. In order to file an amendment of its articles, a corporation must pay a filing fee that ranges from $10 to $4,950.

It is easy for a corporation to minimize these fees, for beyond the minimum they are a percentage of a dollar "fee base" which the corporation itself can select, and which it can minimize easily and with perfect propriety. It is therefore surprising to note that many corporations start off by paying filing fees much higher than necessary, and that they continue for years paying similarly higher license fees.

The "fee base" for filing and license fees is at present the corporation's "authorized capital stock," i.e., the total amount of "capital stock" which the corporation would have upon the allotment of all its authorized shares. This figure is the aggregate of the par amounts of all the authorized shares having par value and, presumably, that part of the issue prices of the shares without par value which the corporation estimates it will allocate to "capital stock."

A corporation having only par shares can minimize its filing and license fees by restricting the aggregate par amounts of its authorized

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50 RCW 23.60.030.
51 RCW 23.60.010.
52 RCW 23.60.010, .030.
53 The definition is the author's, for the term "authorized capital stock" is not defined in the statutes. See note 54 infra.
54 The explanation of this statement requires an analysis of RCW 23.01.010, and .240, and 23.60.010, .020, and .030. If a corporation has only par value shares, it is reasonable to assume, as the secretary of state does, that its "authorized capital stock," the aggregate par amount of all its authorized shares.

Situation 1: A corporation's articles of incorporation authorize 100,000 shares having a par value of $1 per share. If the corporation sells 50,000 shares for $10 per share, it must treat $50,000 as "capital stock" and $450,000 as "paid-in surplus." If the corporation sells all 100,000 shares for $10 per share, it will have a "capital stock" of $100,000 and a "paid-in surplus" of $900,000. RCW 23.01.010 (b), .240 (b). Yet its "authorized capital stock," on which its filing and license fees are based, would be $100,000 all along.

Situation 2: A corporation's articles of incorporation authorize 100,000 shares having no par value. The corporation sells 50,000 shares for $10 per share and treats $50,000 as "capital stock" and $450,000 as "paid-in surplus." Eventually it sells 100,000 shares for $10 per share and treats $100,000 as "capital stock" and $900,000 as "paid-in surplus." RCW 23.01.240. What is its "authorized capital stock," for filing and license fee purposes? RCW 23.60.020 says that "the value of the assets received and to be received...for the issuance of its nonpar value stock," as estimated in advance, is "the amount of the capitalization represented by such nonpar value stock" for filing and license fee purposes. This would appear to say that the "authorized capital stock" in Situation 2 would be the entire $1,000,000 received for the shares. Yet this interpretation results in needless inconsistency between the fee treatment of shares without par value and the treatment in Situation 1 of shares having par value. When the language of RCW 23.60.020 was first adopted in Wash. Sess. Laws 1923, ch. 144, there was no provision for allowing part of the payment for shares without par value to be treated as "capital stock" and the rest as "paid-in surplus." With this treatment now allowed under the newer RCW 23.01.240, the fee statute RCW 23.60.020 should be interpreted so that "the value of the assets received and to be received" for no par shares is read as "the amount to be treated as capital stock upon the issuance of all its nonpar shares."
CHOOSING SHARE STRUCTURE

shares to $50,000 (e.g., 50,000 shares with a par amount of $1 each, or 100 shares with a par amount of $500 each). The corporation will then pay the minimum filing fee of $50 and the minimum annual license fee of $30. The corporation can, if it wishes, issue these shares for a consideration above the par amounts, thus obtaining a shareholders' investment far greater than that on which its filing and license fees are based, without having to pay any higher fees. The shareholders might actually pay, for example, an average of $100 per share or an aggregate of $5,000,000, for shares having an aggregate par amount of only $50,000; still the corporation would pay only the minimum filing and license fees. On the other hand, if the corporation had 50,000 authorized shares with a par value of $100 per share, it would pay a filing fee of $2,400 and an annual license fee of $1,205 no matter how many shares it issued.

A corporation having only no par shares can authorize any number of shares in its articles, and yet minimize its filing and license fees by estimating that no more than $50,000 of the proceeds from the issue of its shares will be allocated to "capital stock." and then by allocating only a nominal amount of the issue price per share (perhaps only a cent) to "capital stock," and the rest of the price to "paid-in surplus." A flat filing and license fee is provided for in the Model Act as originally drafted. The Corporation Law Committee of the Washington State Bar Association, however, has tentatively recommended retaining the present system of sliding scale fees, with an amendment changing the "fee base" from the present "authorized capital stock" to "stated capital," in apparent conformity with the change of terminology adopted by the Model Act. As written, however, this amendment in the Model Act would result in a situation even worse than the present one. "Stated capital" does not exist when a corporation is formed (it comes into being only upon the issuance of shares), and no provision has been made in the proposed amendment for estimating it in advance (as "authorized capital stock" is now required to be estimated for shares having no par value). Moreover, the Model Act, under the proposed

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55 RCW 23.60.010. The corporation's "authorized capital stock" will be $50,000. See note 54 supra.
56 Then the corporation would have a "capital stock" of $50,000 and a "paid-in surplus" of $4,950,000.
57 RCW 23.60.010. The corporation's "authorized capital stock" would be $5,000,000. See note 54 supra.
58 See note 22 supra.
59 ABA-ALI MODEL BUS. CORP. ACT §§ 121-26.
amendment relating to filing and license fees, would be unfair in using "stated capital" at all as the basis for these fees. This would discriminate in favor of the corporation having shares with only a low par value which are sold at high prices (thus giving the corporation a low "stated capital" and a low filing and license fee), and it would discriminate against the corporation with only shares having no par value which are sold at high prices (75% of which would become "stated capital" and increase the filing and license fees).

It makes little sense for the filing and license fees to be computed on a sliding scale according to a base which those paying the fee can so easily minimize, and which has no relation to the size or worth of the corporation nor to the work involved by the secretary of state in checking the corporate papers. The legislature should provide for these fees to be computed on the basis of gross receipts which are already being reported to the state for the purpose of the business and occupation tax, or else the legislature should go back to the former system of a flat filing and license fee for each corporation.61

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61 Flat filing and license fees were in effect until 1923. See Rem. 1915 Code §§ 3709, 3714.