



## OH WHERE, OH WHERE WILL MY CORPORATION GO? OH WHERE, OH WHERE CAN IT BE? CALIFORNIA VS. NEVADA

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Entrepreneurs often inquire about incorporating businesses in Nevada because the Nevada Secretary of State web pages<sup>2</sup> and online incorporation services profess many enticing reasons to do so. Perceived benefits of avoiding state income taxes, shareholder privacy, and cheaper startup costs all sound alluring. However, if it sounds too good to be true, it usually is.

***Simply stated, if a Nevada corporation will substantially conduct its business in California<sup>3</sup>, it will most likely (i) be deemed a “foreign corporation”<sup>4</sup> transacting repeated and successive transactions of its business in California, (ii) will be subject to many of the below discussed California corporate laws, and (iii) will be subject to California taxes, fees, registration and annual filings.*** In most cases, incorporating in Nevada a California enterprise will increase, not decrease, the cost of incorporating in Nevada; require registration in California

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<sup>2</sup> “The Nevada Advantage” at <http://nv.sos.gov>.

<sup>3</sup> Section 191(a) - For the purposes of Chapter 21 (commencing with [Section 2100](#)), “transact intrastate business” means entering into repeated and successive transactions of its business in this state, other than interstate or foreign commerce. A foreign corporation shall not be considered transacting intrastate business merely because its subsidiary transacts intrastate business or merely because of its status as any one or more of the exceptions provided in CCC Section 191(b).

<sup>4</sup> Section 171 - “Foreign corporation” means any corporation other than a domestic corporation and, when used in [Section 191](#), [Section 201](#), [Section 2203](#), [Section 2258](#) and [Section 2259](#) and Chapter 21, includes a foreign association, unless otherwise stated.

**Disclaimer Notice: Due to the generality of this publication, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice. Readers are encouraged to discuss their specific facts and seek advice from a business/ corporate attorney.**

as a foreign corporation; increase the annual costs of maintaining the corporation; and California income taxes will not be avoided. In the end, the company will inevitably require costly redomestication<sup>5</sup> back to California.

The root misperceptions about Nevada incorporations are the erroneous assumption that the state of incorporation determines all taxes, fees, and required filings<sup>6</sup>, and an unknown California “long arm statute” applicable to businesses substantially operating or conduct business in California. This publication<sup>7</sup> will explore the common misperceptions of incorporating a California business in Nevada, minimize the misguided appeal of incorporating in Nevada, and focus entrepreneurs on more pressing issues involving the startup of a business.

Whether a business’s activities constitute “transacting intrastate business” in California or whether a business would be deemed a “pseudo-foreign” corporation under California Corporation Code Section 2115<sup>8</sup>, requires analysis by an attorney or tax accountant which is beyond the scope of this publication. Therefore, readers are encouraged to consult an attorney or tax accountant to analyze this pivotal issue.

**Alleged Reasons and Misnomers of Nevada Corporate Benefits.** Below is a critique of the many of the alleged reasons or benefits specified by the Nevada Secretary of State’s website labeled “the Nevada Advantage” and various Nevada online incorporation services regarding a Nevada corporation that is “transacting intrastate business” in California, or constitutes a “pseudo-foreign” corporation in California under Section 2115.

1. **No Corporate Income Tax.** **False.** Although Nevada has no corporate income tax, Nevada corporations conducting business in California are subject to California corporate income taxes regardless of its state of incorporation. In addition, ***Nevada has a Commerce Tax.*** The Nevada Commerce Taxes is an annual tax imposed on the Company’s gross revenue for the tax period July 1<sup>st</sup> through June 30<sup>th</sup>. There is no tax liability unless a Company’s gross revenue during the taxable fiscal year ending June 30<sup>th</sup> exceeds \$4,000,000.
2. **No Tax on Corporate Shares.** **False.** This self-proclaimed benefit by the Nevada Secretary of State is not applicable to California. California does not levy taxes on corporate shares. This benefit is more appropriately applicable to Delaware which does calculate a franchise tax based upon the number of authorized shares or par value of shares. However, this

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<sup>5</sup> The process of transferring the state of incorporation from one state to another.

<sup>6</sup> Many web based incorporating services do not sufficiently, if at all, explain the potential California taxes, fees, and filing requirement, and the California corporate law “long arm” statutes.

<sup>7</sup> Unless otherwise identified, all section references in this Memorandum are to the California Corporations Code (“CCC”), as amended and in effect as of the date of this Memorandum.

<sup>8</sup> Foreign corporations, including a foreign parent corporation even though it does not itself transact intrastate business, is subject to the requirements of Section 2115(b) if: (1) The average of the property factor, the payroll factor, and the sales factor (as defined in [Sections 25129, 25132, and 25134 of the Revenue and Taxation Code](#)) with respect to it is more than 50 percent during its latest full income year and (2) more than one-half of its outstanding voting securities are held of record by persons having addresses in this state appearing on the books of the corporation on the record date for the latest meeting of shareholders held during its latest full income year or, if no meeting was held during that year, on the last day of the latest full income year.

alleged benefit is misleading. Under Nevada Revised Statutes Section (“NRS”) 78.760<sup>9</sup>, Nevada’s initial filing fees and annual fees are calculated based upon the value of the total number of authorized shares stated in the articles of incorporation.

3. No Franchise Tax. **False.** Regardless of the state of incorporation, California generally imposes its franchise tax on corporations “doing business in California”, which is broadly defined as a company actively engaging in transactions for purposes of financial and pecuniary gain or profit.<sup>10</sup> Notwithstanding the state of incorporation, foreign corporations must register in California and are subject to the California’s \$800 minimum franchise tax.
4. Nevada Corporations May Issue Stock for Capital, Services, Personal Property, or Real Estate, Including Lease and Options. **Mostly False.** Nevada law<sup>11</sup> is almost identical to California with the exception that shares in a California corporation cannot be issued for future services to be performed.<sup>12</sup> California allows the value of such consideration to be conclusively determined by the directors, but contrary to Nevada law, with the exception for fraud.<sup>13</sup>
5. No Corporate or Personal Income Tax. **False.** Although Nevada does not have a personal income tax, this benefit would not be applicable to California residents who pay California personal income taxes on their worldwide income. In addition, California business located in California will be subject to California corporate income taxes. While Nevada likes to promote that there are “no corporation taxes”, there is a gross receipt tax.<sup>14</sup>
6. Nominal Annual Fees. **False.** Nevada corporations doing business in California are also subject to the California’s \$800 minimum annual franchise tax. However, businesses incorporated or qualifies to do business in California does not pay any minimum franchise tax for its first taxable year.<sup>15</sup> After July 1, 2016, Nevada’s annual business license fee increase from \$200/ yr. to \$500/yr.<sup>16</sup>
7. Treasury Shares. **True, but not relevant.** In Nevada, “treasury shares” are shares of a corporation issued, and thereafter acquired by the Corporation, which have not been retired or restored to the status of an issue share.<sup>17</sup> California does not allow corporations to hold “treasury shares” unless it provides so in its articles of incorporation. In terms of corporate finance, treasury shares have little significance today; however, there are cases where

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<sup>9</sup> NRS Section 78.760. For purposes of computing the filing fee. The value (capital) represented by the total number of shares authorized in the Articles of a capital Corporation is determined by computing the (A) total authorized shares multiplied by the par value, or (B) the total authorized shares without par value multiplied by one dollar (\$1), or the sum of both (A) and (B) if there are both par and no par shares periods. Filing fees are calculated on a minimum par value of 1/10 of a cent (.001), regardless if the stated par value is less.

<sup>10</sup> Revenue & Tax Code Sections 23151(a), 23101(a) and 23101(b)

<sup>11</sup> NRS Section 78.211

<sup>12</sup> Section 409(a)(1). Section 409(a)(1) does not preclude the granting of employee stock options which vest based upon employment services.

<sup>13</sup> Section 409(b).

<sup>14</sup> During Nevada’s 2015 Legislative Session, Nevada Senate Bill No. 483 was passed and signed into law by Governor Sandoval. This bill mandates all business entities to file a Commerce Tax return.

<sup>15</sup> California R&TC 23153(f)(1). Provides every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, shall not be subject to the minimum franchise tax for its first taxable year.

<sup>16</sup> Nevada S.B. 483m Nev. Rev. Stat. § 80.110

<sup>17</sup> NRS Section 78.283. CCC 510(a) states “when a corporation re-acquires its own shares, those shares are restored to the status of authorized but unissued shares, unless the articles prohibit the reissuance thereof.

investors wish to keep a tight control on the capital structure of the Corporation, and may wish restrict the reissuance of treasury shares. Generally, the holding of “treasury shares” are not particularly beneficial to startup corporations.

8. Cheaper to Incorporate in Nevada. **False.** In addition to paying the initial Nevada filing fees, the Annual List Fee (which is based upon the current total annual stock as explained in the Annual List Fee Schedule for Profit Corporations), and the Nevada business license fee of \$200, a Nevada corporation transacting business in California is *also* required to file in California a “Statement and Designation by Foreign Corporation (\$100 filing fee) and Statement of Information (\$25 filing fee). Any Nevada Corporation deemed a “pseudo-foreign” corporation also would be subject to California’s minimum franchise tax of \$800 per year, payable the first year of incorporation. In addition, additional attorneys’ fees will be incurred by preparing and filing documents in both California and Nevada.
9. Privacy. **False.** Both California’s Statement of Information Form (Form SI-200), and Nevada’s Initial/Annual List of Officers, Directors and State of Business License Application do not require identification of shareholders. Nevada does allow for the use of “bearer” shares; the benefits to which are negligible, if not problematic.<sup>18</sup> The defining characteristic of bearer shares is that the stock is owned by the physical holder of the stock certificate. While Nevada claims the privacy benefits of such bearer shares, one widely acknowledged problem is the risk of substantial personal loss if the certificate is misplaced or stolen.
10. Officers and Directors of Nevada Corporation Have Limited Personal Liability for the Lawful Acts of Corporation. **False.** CCC Section 2115(a) imposes California’s director’s standard of care under CCC Section 309, liability of a director for unlawful distribution under CCC Section 316, and indemnification of director, officer and others under CCC Section 317.
11. Directors Do Not Have To Be Shareholders. **False.** California also does not require directors to be shareholders of a corporation.
12. Minimal Reporting and Disclosure Requirements. **False.** A “pseudo-foreign” Nevada Corporation must file a Statement of Information with the California Secretary of State<sup>19</sup> under Section 2117 and still provide annual and other reports to shareholders pursuant to Section 1501.
13. Ease of Formation. **True.** California does have to give kudos to the Nevada Secretary of State for its more efficient online services. California has a more antiquated paper filing system that is burdened by slow governmental review and frequent delays. The lethargic California system requires the use of professional filing agents to process filings quicker than the weeks or months it takes the California Secretary of State processing staff. Nevada has chosen the wiser business friendly route of emulating Delaware’s more expedient, and simpler filing processes.
14. Closing, Dissolving and Withdrawing from the State of California. **Partially True.** Dissolving a Nevada Corporation requires the filing of a Certificate of Dissolution with the

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<sup>18</sup> NRS Section 104.8102(1)(b) which defines the bearer form as applied to certificated security.

<sup>19</sup> Failure to file this Statement of Information by the due date will result in the assessment of a \$250.00 penalty.

Nevada Secretary of State pursuant to NRS Section 78.580 along with a filing fee of \$100. Similar Certificate of Dissolution is filed with the California Secretary of State has no filing fee. A foreign corporation surrenders its right to transact intrastate business in the State of California by filing a Certificate of Surrender of Right to Transact Intrastate Business pursuant to Section 2112. There is no additional fee associated with such Certificate; however, attorneys' fees or paralegal preparation costs will be incurred.

In Summary. A California resident managing or owning a Nevada LLC will not get the advertised benefits, and pay at least \$730 more costs and expenses than maintaining a California LLC as shown below.

<u>Description</u>	<u>Foreign LLC Costs</u>	<u>Cost as a California LLC</u>
Your Nevada LLC must annual register in California as a "Foreign LLC".	\$800	\$800
Your Foreign LLC must file a biannual Statement of Information in California as a Foreign LLC.	\$25	\$25
Your Nevada LLC must annually register in Nevada and pay \$100 Annual List Filing Fee & \$200 Business License Fee (50% Late Penalties).	\$350	\$0
Your Nevada LLC must maintain a Corporate Agent for Service of Process.	\$180	\$0
Your Nevada LLC must file either by yourself or through an accountant an Annual List of Managers.	\$200	\$00
Your Foreign LLC may have to pay the Nevada Commerce Tax for Gross Receipt of greater than \$4M.	TBD	\$0
<b>Total Annual Differential</b>	<b>\$730+</b>	