

# INCORPORATING FOR FREE

## **An Article by William A. Taylor One of the Business Lawyers**

The cost of incorporating in California just became less expensive. The price will be right - because the state will not charge the \$800 annual franchise tax for the first two years of a new corporation's existence.

Starting January 1, 2000, a corporation being newly incorporated will be exempt from paying not one, but the first two years of the \$800 annual franchise tax.

The "franchise tax" is a fee a corporation pays to the state (through the Franchise Tax Board), regardless of profitability, for the privilege of being recognized as a corporation. Otherwise, i.e., without that privilege, a corporation would be as effective in shielding a shareholder from liability as a fictitious business name: no protection.

With the privilege of being recognized as a corporation, that corporation's contracts will be upheld, it will be able to defend itself in court and prosecute cases in its name and, most important, it will be able to shield its owners from liability. Without the privilege (and suspended corporations and out-of-state corporations that have not registered as "foreign corporations" do not have the privilege) a shareholder who is operating as a corporation in California is merely waiting to be personally ambushed in court - a legal lynching.

In recent years, the state's politicians have been stating that California was not a business friendly state. To remedy that perception, they legislated changes to take effect. One such change, implemented a few years ago, was a reduction of the franchise fee to be paid upon incorporation - for corporations anticipating less than one million dollars in gross receipts - to be reduced to only \$600 instead of the normal \$800. The \$200 deferral was payable later at the filing of the corporation's tax return.

A short time ago, the franchise fee to be paid upon incorporation - for corporations anticipating less than one million dollars in gross receipts - was further reduced to only \$300, the \$500 being deferred until the filing of the corporation's tax return. Now, the first two years are free - regardless of anticipated gross receipts.

There will still be the Secretary of State \$100 processing fee, and, of course, the attorney's fee. However, after January 1, 2000, the price of incorporating in California should reflect the absence of franchise tax for the year of incorporation and for the next year - not as deferrals but as exemptions not requiring future payment.

Foreign corporations attempting to register with the Secretary of State to qualify to do business in the state are also exempt from the franchise tax for the first two years. This applies to the numerous Nevada and Delaware corporations that are created to operate in the state.

The \$800 minimum franchise tax is not to be confused with the corporate income tax. If a corporation's income is high enough to cause taxation, the tax will apply. However, start-up corporations are thought to need the help during their difficult early years when, due to start-up costs and low market recognition, no profit is to be anticipated.

The exemption from the minimum franchise tax applies to corporations only, not LLCs or limited partnerships, which also pay the \$800 franchise tax for the privilege. Also not eligible for the

exemption are charitable organizations that will have unrelated business taxable income, credit unions, REITs, qualified Subchapter S corporations and corporations that were reorganized solely to avoid paying the minimum franchise tax.