THE Burton Law Firm

Foreign LLCs

Should You Set Up Shop in Nevada?

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Setting up LLCs in Nevada and Wyoming has become increasingly popular in recent years; however, for businesses operating mainly in California, this can have some serious consequences. This short article is designed to explain the positives and negatives of setting up a foreign LLC, and will attempt to expose some of the myths associated with its benefits.

Why would I want to be a Foreign LLC?

LLCs governed by a different state often have a lot of advantages over California LLCs. The cost for setting up an LLC, licensure fees, yearly operating fees, and entity taxes are generally less in Wyoming and Nevada than they are in California. Further, the laws applicable to the internal affairs of the LLC are often much more lax in Nevada, Wyoming, and Delaware than they are in California. From the limited reporting requirements to the allowance of fiduciary waivers on Member Managed LLCs, the potential benefits of creating a foreign LLC are sometimes attractive. For businesses based out of state, or online companies with fractionalized ownerships to out of state parties, Foreign LLCs can save the creator thousands of dollars a year. So, why wouldn't everyone create Foreign LLCs?

The Myths of Foreign LLCs

When a Las Vegas based company calls California businesses on the phone, they generally tout the previous mentioned benefits of setting up an LLC in Nevada. They fail to mention, however, the fact that 98% of California businesses will not receive any of the benefits mentioned, and, in fact, wind up paying a significant amount more in taxes and fees. A foreign LLC transacting "intrastate business," (to enter into repeated and successive transactions of business in California other than interstate or foreign commerce), is governed by California Corporations Code, mainly sections 17450-17457. These regulations negate most of the benefits of a Foreign LLC that is based in California, or that does repeated business in California. To legally transact business in California, a Foreign LLC will have to obtain a certificate of qualification with the California Secretary of State.

To obtain that certification, the Foreign LLC needs to provide an agent of service of process, as well as agree to many stipulations in order to transact business. These

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stipulations include filing a biennial statement of information, listing its member managers, officers, etc, and obligating itself to pay California tax. This annual statement of information often negates the privacy reasons for creating a Foreign LLC. Failure to register opens that LLC to fines of over 7,000 dollars a year.

Foreign LLCs transacting business in California are required to pay the same annual $800 franchise tax and the same annual fees based on total income that are payable by domestic LLCs. Further, an LLC is subject to an additional California "fee" on its "total income" (not just net income) from all sources "derived from or attributable" to operations in California. These additional tax burdens are generally much higher than if the business had formed under California Law to begin with; compounded with the Foreign State Tax requirements, a California Business created as a Nevada or Wyoming LLC, generally pays much higher State Level Taxes.

Furthermore, Foreign LLCs operating in California are capable of being sued in California, just like any other California business. In fact, California businesses that set up in Nevada, Delaware, or another state, can be sued in both the state of formation and California. This can get quite costly for a California business when a suit is brought in Delaware, just because they happened to form there.

Then why would anybody do it?

There are a number of good reasons why creating a Foreign LLC makes sense, such as Delaware's allowance that permits members to waive the fiduciary duties owed by a member manager to the other members. This waiver option could be preferable for tax exempt entities for which the assumption of fiduciary duties may jeopardize their tax exempt status, (for tax exempt organizations). Delaware law also allows separate assets to be held in series, which could insulate the assets held in any one particular series from the assets held in another. This provides additional liability protection under certain circumstances. Neveda LLCs enjoy certain rights relating to standards of conduct for members, voting rights of members, rights of withdrawal or resignation and remedies for a member's failure to make required contributions. All of these reasons can make a Foreign LLC attractive, under certain circumstances.

The Bottom Line…

Don't buy the sales pitch and hire a person over the phone or attempt to create an LLC online. Most California Law Firms, that handle business law, are capable of creating corporations or LLCs in any US State and many foreign countries, and the fees they charge will, more than likely, be similar, (if not the same,) as the fees they charge to set up a California LLC. There is no incentive to that Firm to sell you on

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California formation rather then Nevada or Delaware. Instead, they are going to be held to the fiduciary obligation of assisting you in picking the best solution available.

The benefits and the rewards of a Foreign vs. California LLC should be weighed as to your specific situation by a qualified professional that understands the tax and legal consequences involved. A mistake, one way or the other, generally costs business owners thousands of dollars a year. This is particularly true for companies that only operate in California, such as California real estate holding companies or California based retail businesses. Don't gamble with your company's future on a Nevada LLC, seek the advice of a qualified attorney.

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