

NEW YORK BUSINESS ADVISORY & CORPORATE SERVICES INC.

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INCORPORATING IN DELAWARE

Forming a new entity, question often asked is Delaware the best state of domicile. Following a July 1, 2014 increase in Delaware franchise taxes, many companies are choosing to domicile outside of Delaware. Delaware remains the gold standard; however, there has been a definite shift and Delaware is now not the “only standard.” Part of the reason for the shift away from Delaware has been the increase in fees. Delaware calculates annual fees based on one of two methods: (i) the authorized share method; and (ii) the assume par value capital (asset value) method. For either method the annual fee is capped at \$180,000.00. Even for small- and micro-cap business issuers, the annual fee often reaches the tens of thousands. For example, a company with 300,000,000 common shares authorized with a \$.001 par value per share and 30,000,000 shares issued and outstanding and \$20,000,000 in gross assets would pay \$180,000.00 per year using the authorized share method and \$70,350.00 per year using the assumed par value method. This is a very significant expense for a small company and, as you can see, the assumptions made reflect a very small business.

A second reason for the shift away has been that over the years, the Delaware General Corporation Law (DGCL) has become more aligned with the Model Business Corporation Act (MBCA), which in turn has become the standard followed by many states. In other words, the differences between, for example, Delaware and Florida have narrowed.

Delaware originally established itself as the best state of incorporation for several reasons including that the Delaware Court of Chancery hears all matters in Delaware courts involving business and corporate disputes and has done so since its formation in 1792. Accordingly, the judges are well informed on business matters and corporate law in general, and there is a large body of precedence from which corporate management and their advisors can garner and use when planning transactions and other corporate actions, and determining related risk management.

For instance, in today’s active merger and acquisition marketplace, Delaware courts have led the way in deciding cases involving appraisal and dissenters’ rights and directors’ duties and responsibilities..

Moreover, often times institutions prefer to invest in Delaware domiciled corporations in making their own risk assessments. The reason is not always because Delaware is better but rather the funds’ insiders or counsel may be familiar with Delaware law and, in making a relatively quick investment decision, do not want to expend the time or resources researching a different state’s body of law.

The two most popular states for incorporation by business entities remain Florida and Delaware, both of which offer corporations a degree of flexibility from a menu of reasonable alternatives that can be tailored to the companies’ business sectors, markets and corporate culture. Other states have also gained popularity for various reasons. Florida has gained popularity due to the rise in Florida businesses and Florida-based public companies and also due to low annual filing fees and management-friendly provisions.

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STATE TAX RATES, ADVANTAGES VERSUS DISADVANTAGES OF INCORPORATING IN DELAWARE

TAX YEAR 2019 DELAWARE INCOME TAX BRACKETS TY 2019-2020

Tax Bracket	Tax Rate
\$10,000.00+	4.8%
\$20,000.00+	5.2%
\$25,000.00+	5.55%
\$60,000.00+	6.6%

ADVANTAGES

A1. Predictable outcomes in law disputes from many past cases

The high volume of corporate cases in Delaware means there are likely several similar cases where advisors can look for precedents, rulings on past cases, and create deals that lead to more predictable outcomes and less uncertainty in a legal dispute.

A2. Corporate Statutes are more flexible in Delaware

Delaware is very flexible in the organization of the corporation and the rights and duties of the board members and shareholders. As an example: In Delaware, one person can be the only director, shareholder, and officer, but in other states there would need to be at least three people to fill the officer and director positions

A3. Investment Bankers prefer Delaware Corporations for IPOs

Investment bankers typically require a company to incorporate in Delaware before the company can go public

A4. Relocating the corporation can be less expensive

Relocating the corporation could be less expensive - the annual franchise tax in Delaware can be as low as \$125 / year with reporting fees whereas in California the annual franchise tax is \$800.

A5. Greater Privacy Protections in Delaware than some other states

Officer and director names aren't necessary on the formation documents. This creates a level of anonymity and privacy not experienced in other states.

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DISADVANTAGES

D1. Additional filing costs

Forming a corporation in Delaware can cost between \$1-2K more than in other states. Recurring annual cost for registered agent and attorney in Delaware

You will have to pay registered agent fees to receive legal correspondence if your business isn't in Delaware. These charges can range from \$129+ per year. You may also need to retain a Delaware corporate lawyer

D2. Extra Franchise Taxes

You must pay the annual Delaware franchise tax and franchise taxes in the state where you are doing business. The amount will be based on the value of your corporate shares. The tax starts at \$75, plus a \$50 filing fee, and can go higher than \$100,000+

D3. Extra reporting requirements

Delaware requires you to file annual reports even if you already have in your home state.

D4. Registering in multiple states

You'll have to register the business in more than one state if you'll do business outside of Delaware.

D5. Extra foreign qualification costs

You may need to register to transact business in another state if you have a physical location and employees outside of Delaware. Foreign qualification registers a company to do business in a state other than the state of incorporation. There may be foreign qualification costs and ongoing fees in other states where you transact business.

More about Franchise Tax

DUE DATE

The Franchise Tax for a corporation is due by March 1 of every year. If the tax is not paid on or before March 1, the state imposes a \$200 late penalty, plus a monthly interest fee of 1.5 percent.

The Franchise Tax for a Delaware LLC is due by June 1 of every year. The limited partnership (LP) Franchise Tax is also due by June 1 of every year. If the tax is not paid on or before June 1, the state imposes a \$200 late penalty, plus a monthly interest fee of 1.5 percent.

Corporations, LLCs and LPs are taxed in arrears, meaning the tax due by each due date is for the previous calendar year. The franchise tax is due even if the business didn't conduct any activity or lost money.

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FRANCHISEE TAX CALCULATION

The Franchise Tax for a Delaware limited liability company (LLC) or Delaware limited partnership (LP) is a flat annual rate of \$300.

The Franchise Tax for a corporation is a little more complicated. It is based on your corporation type and the number of authorized shares your company has. The total cost of the Franchise Tax is comprised of an annual report fee and the actual tax due.

A non-stock/non-profit company is considered exempt with the state of Delaware. This type of company does not pay the annual tax but must file and pay the annual report fee. The annual report fee is \$25 per year.

A corporation with 5,000 authorized shares or less is considered a minimum stock corporation. The annual report fee is \$50 and the tax is \$175 for a total of \$225 per year.

A corporation with 5,001 authorized shares or more is considered a maximum stock corporation. The annual report fee is \$50 and the tax would be somewhere between \$200 and \$200,000 per year.

AUTHORISED SHARES METHOD

The state of Delaware uses this method to initially calculate your taxes. This method is calculated based on the number of authorized shares. The calculation is as follows:

5,000 shares or less: \$175; 5,001 - 10,000 shares: \$250

Additional 10,000 shares or portion thereof: add \$85. The maximum annual tax is \$200,000

Don't forget to add the \$50 annual report fee to the Franchise Tax after it is calculated.

ASSUMED PAR VALUE CAPITAL METHOD

The state of Delaware allows you to pay the lower of the two calculation methods. Therefore, if you receive a bill from Delaware for tens of thousands of dollars, it may be in your best interest to try calculating your Franchise Tax with the assumed par value capital method.

In order to utilize this filing method, you will need to provide the company's total gross assets (as reported on the Form 1120, Schedule L) and the total number of issued shares. Many times the tax is then calculated to the minimum payment of \$400 Franchise Tax plus the \$50 annual report fee.

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