



JULIAN GARCIA LAW
Modern Business Counsel

CALIFORNIA VS DELAWARE INCORPORATION HANDBOOK

FACT VS FICTION

PREPARED FOR THE FOUNDER RESOURCE VAULT

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California Founder Forming an Entity in Delaware

Delaware is the gold standard for fundraising companies and VCs. It has established and predictable rules for companies, shareholder rights, and executive compensation, among other things.

However, if you're living or operating in California, out-of-state incorporation does not shield you from California taxes. This guide provides a quick overview of out-of-incorporation as it pertains to your California tax bill.

What Triggers California Tax?

Your company is “doing business” in California if any of the following apply:

- Your company actively engages in any transaction for financial gain in California
- Your company generates more than \$735,019 in California (*2024 threshold*)
- Your company holds real and tangible property in California worth more than \$73,502 (*2024 threshold*)
- Your company's payroll expenses in California exceed \$73,502 (*2024 threshold*)
- More than 25% of your company's sales, real/tangible property, or payroll expenses are in California
- Your company is organized or commercially domiciled (e.g., HQ location) in California

This creates an “economic nexus”, with or without a physical presence.

Consequences of Establishing an Economic Nexus

- You must register as a foreign entity
- You must pay the \$800 annual franchise tax
- You may owe income, sales, or gross receipts taxes



- You are exposed to California Franchise Tax Board audits and back-tax enforcement
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Common Tax Planning Structures

Some founders can reduce California tax exposure by using advanced entity structuring, but only if real work is done and prices are fair. These include:

- **IP Holding Companies** – Example: A Delaware entity owns key IP and licenses it to your California company
- **Management Companies** – Example: A separate services company handles operations (HR, finance, admin) and charges fees to the California operating company
- **Fulfillment or Logistics Centers** – Example: Product-based businesses use non-California hubs to reduce their economic nexus (must avoid warehousing or shipping from California)

Insight: California may still assert that these structures establish an economic nexus in the State. However, if setup properly, businesses can assert federal defenses against California’s franchise and income taxes. Unfortunately, sales tax is likely to apply regardless.

Insight: These are not shortcuts. They require legal documentation, substance, and coordination with your attorney and/or CPA.

Key Citations

- **California Revenue and Tax Code §23101** – Definition of “doing business”
- **California Revenue and Tax Code §23153** – Franchise tax
- **California Revenue and Tax Code §2105** – Foreign registration requirement
- **California Revenue and Tax Code §6203** – Sales/use tax nexus




- **U.S. Internal Revenue Code §482** – Related-entity pricing rules
 - **Quill Corp v. North Dakota (1992)** – Tax requires physical presence
 - **South Dakota v. Wayfair (2018)** – Sales tax requires only economic presence
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Bottom Line

Out-of-state incorporation may help with fundraising or structure, but it does *not* eliminate or reduce California tax exposure without careful planning and execution.

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