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Guide to Starting a Corporation in California

Unless otherwise mentioned, the corporation mentioned in this quotation specifically refers to a company limited by shares registered in California, USA, in accordance with California General Corporation Law.

Introduction

In California, corporations and limited liability companies (LLCs) are the most prevalent business forms. Investors must consider each type of business form carefully because one business form may be an advantage to certain investors but not to others.

Due to the location advantage, California is one of the most popular options for both domestic and foreign investors. Investors can choose to establish a corporation or an LLC subsidiary in California. A corporation offers limited liability to its shareholder and has centralized governance structures. An LLC has the similar characteristics. While the corporation is the first choice for foreign investors, the LLC is an acceptable alternative. Whatever type of business is chosen, investors should carefully consider the governance and tax aspects discussed below.

California corporations and LLCs must be established in compliance with California General Corporation Law and California Revised Uniform Limited Liability Company Act separately. Both statutes are available online.

The California Secretary of State is the administrative agency, and is responsible for accepting and processing all required documents and application fees to register a business entity in California.

1. California Corporation Characteristics

(1) Name of Company

The name of a corporation must include one of these words: "Company", "Corporation", "Incorporated", "Limited", "incorporation", "Corp", "Co", "Inc", "Ltd", and "Professional Corporation".

In addition, the name of a corporation must be distinguishable from the names reserved or already registered with the office of the Secretary of State.

(2) Capital

California does not have a minimum capital requirement to incorporate a corporation. The shareholders can decide the amount of initial capital.

(3) Shareholders

There are no restrictions on the number of shareholders (equity holders) in a California company. A corporation can have one or more shareholders. The shareholder can be a legal entity or natural person, without nationality limitation.

(4) Incorporators

An incorporator's primary role is to file the Articles of Incorporation. The incorporator's name must be listed on the certificate. All the business registered in California need an incorporator. The incorporator should be a natural person, but not have to reside in California.

(5) Directors

There are no general restrictions or requirements on the appointment of directors, except that they must be natural persons. Typically, the corporation's initial directors consist of one or more of its founders, but there is no statutory requirement that a director must be a shareholder. There is no requirement that the directors must reside in California or in the US. There is also no requirement that any number of directors must be US citizens or permanent residents. All directors can be foreign citizens.

(6) Registered Agent

All corporations registered in California must have a registered agent on behalf of the corporations to receive legal documents. A registered agent may be an individual who resides in California or a business entity that authorized to do business in California. The registered agent must have a physical address in California. Kaizen can provide a registered agent for your corporation in California.

(7) Articles of Incorporation

Articles of Incorporation is the official document received from California state registration office after the registration is approved.

To register a corporation in California, the incorporator needs to submit the application form to California registration's office and pay the registration filing fee. The officer will review the document, and mail back the sealed Articles of Incorporation with the filing date and filing number if approved. Kaizen offers a free Articles of Incorporation template for your reference.

(8) Bylaws

Bylaws is a corporate's internal rules and operating procedure, it's not required to file with the Secretary of State. Bylaws may include internal organizational structure, responsibility of each position, and personnel appointment and removal, etc. Bylaws cannot include anything that is inconsistent with the California law. The incorporators or directors must sign on the initial bylaws.

2. Corporation V.S. LLC

Similarities:

(1) Limited Liability

Both corporations and LLCs shield their owners from personal liability. The shareholders/the members take on limited liability of the corporations or LLCs up to their percentage of stocks/shares, but not personally liable for the debts, obligations and liabilities of the entity.

(2) Perpetual Existence

California corporations and LLCs have a statutory right to exist perpetually.

Differences:

(1) Taxation

A corporation may subject to double taxation. Specifically, a corporation must file and pay corporate income tax during each taxable year, and the shareholders must pay taxes on any dividends or other distributions during the taxable year when they got them from the corporation. However, the corporation can choose to retain the earnings to finance growth and reasonable needs of the business up to USD 250,000 (USD 150,000 for personal service corporation) to avoid double taxation temporarily. However, if the retain earnings exceed USD250,000 (USD 150,000 for personal service corporation), Accumulated Earnings Tax with tax rate 20% will be added to regular income tax.

In contrast, an LLC with 2 or more members, is deemed as a pass-through entity. An LLC should file tax return, but not pay entity-level taxes on its tax return; instead, profits and losses should pass through to the members, then the members will add the apportioned profits on their own income tax returns with applicable tax rates, regardless of whether the income is distributed or not. Specifically, if the LLC is profitable but does not distribute any cash to the owners, the owners are still subject to tax on the income of the LLC. Similarly, the owners can take advantage of company losses on their own tax returns.

(2) Management

Corporations have comparably centralized management. The board of directors participate in daily operation, while the shareholders generally are not involved in the day-to-day affairs of the corporation. However, shareholders' approval is required for certain significant transactions such as mergers.

On the other hand, LLCs can be managed either by the members themselves or by managers appointed by the members.

3. Corporation Registration Procedures

(1) Choose a Corporate Name

Proposed corporation name cannot be similar to other names that already on file with California Secretary of State. Kaizen can check the name availability for you. Also, you can reserve a name online through California Secretary of State website.

(2) Prepare and File Articles of Incorporation

To register your corporation in California, the application form and the application fee should be submitted to California Secretary of State by postal mail.

The application form includes the corporation's name; the registered office name and street address in California; the number of shares authorized to issue; the mailing address and the name of the incorporator.

(3) Appoint a Registered Agent

Every corporation in California must have an agent for service of process in the state. This is an individual or corporation that agrees to accept legal papers on the corporation's behalf.

The agent may be an individual California resident, or a business entity authorized to do business in California. The registered agent must have a physical address in California.

(4) Setup a Corporate Records Book

Set up a corporate records book in which you keep all your corporation's important papers, including stock certificates, list of shareholders, list of directors, shareholder transfer ledger, meeting minutes, etc. Keep your corporate records book at the principal office of your corporation.

(5) Prepare Corporate Bylaws

Bylaws is an internal corporate document that sets out the basic rules for operating your corporation. A corporation is not legally required to have bylaws; however, Kaizen advise you to prepare it in record. Because it specified the corporate's management practice and other aspects which should be followed to meet the compliance requirements.

(6) Appoint Initial Corporate Directors

The incorporator must appoint the initial corporate board of directors, while the board members who will serve for the next term are elected by the shareholders. The incorporator must fill an "Incorporator's Statement" showing the names and addresses of the initial directors. The statement should be placed in the corporate records book.

(7) Hold Your First Board of Directors Meeting

The first meeting of the initial board of directors should be held about appointing corporate officers, adopting bylaws, selecting a corporate bank, authorizing the issuance of shares of stock, setting the corporation's fiscal year, and adopting an official stock certificate form and corporate seal. All the directors' actions should be recorded the in minutes.

(8) File Initial Statement of Information

The California Corporation needs to submit the initial Statement of Information within 90 days after the incorporation. The Statement of Information shows a company's owners/members, business address, and business management structure.

(9) Issue Stocks

Although most states do not have legal requirements, small corporations usually issue paper stock certificate, and record each shareholder's name and contact information in the corporation's stock transfer ledger.

4. Compliance Requirements

(1) Annual Renewal and Franchise Tax Requirements

All active corporations registered in California must file Statement of Information with California Secretary of State every year. Failure to file the required Statement of Information may result in penalties assessed by the Franchise Tax Board and suspension or forfeiture.

California Franchise Tax Board requires that all active business entities registered in California or doing business in California must file and pay the USD 800 minimum franchise tax. For corporations, the due date is the 15th day of the 4th month of current tax year.

(2) Other Regulatory Requirements

(a) EIN

All the U.S. corporation must obtain a federal employer identification number (EIN). EIN can be obtained by completing an online application on the IRS website if the responsible person has SSN. Otherwise, EIN application can only be filed via postal mail or fax.

(b) S Corporation Filing

Only all the shareholders of the corporation who are tax residents can elect S corporation status for tax purposes. The corporate must submit Form 2553 which should be signed by all the shareholders. The election should be filed within two months and 15 days after the beginning of the tax year on which the election is to take effect, or at any time during the tax year preceding the tax year it is to take effect.

(c) Business Licenses

Depending on the type of business activities and the physical location, your corporation may need to obtain other state and local business licenses. Please consult with Kaizen consultants for more details.

5. Taxation

A California corporation is subject to the following taxes:

(1) California Income Tax

Every business entity doing business in California is required to file a state income tax return regardless of the amount, if any, of its net taxable income. California state corporate income tax returns are due on the 15th day of the fourth month after the close of the year. If the due date falls on a Saturday, Sunday, or legal holiday, the filing date becomes the next business day.

California income tax for Corporation is the greater amount of 8.84% of the corporation's net income or USD 800 minimum franchise tax.

(2) Federal Income Tax

According to the Internal Revenue Service (IRS), all business entities, regardless of the taxable income, if any, must file an income tax return on or before the following April 15th of the tax year, or Oct 15th with extension, if calendar year is applied on tax purpose. However, the business entity must pay the tax due in full no later than the original due date for filing its tax return (not including extensions). Interest and penalty will be charged on taxes paid late even if an extension of time to file is granted.

6. Foreign Corporations Doing Business in California

All corporations organized outside of California must register with California Secretary of State to do business in California. Foreign corporations must appoint a registered agent for service of process physically located in California. It should be noted that the Certificate of Existence dated within 6 months prior to the filing of the certificate is required from the foreign corporation's home state.

If you wish to obtain more information or assistance, please visit the official website of Kaizen CPA Limited at www.kaizencpa.com or contact us through the following and talk to our professionals:

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