

CORPORATE LAW INSIGHTS: DO YOU NEED TO QUALIFY TO DO BUSINESS OUTSIDE OF YOUR STATE OF INCORPORATION?

Most companies, other than large, public companies, are incorporated in the states in which they are headquartered and/or transact a majority of their business. However, even many smaller companies are incorporated, often in Delaware, outside of the primary states in which they do business. A corporation doing business outside of its state of incorporation is considered to be a **foreign corporation**. All states have statutes that require foreign corporations to “qualify” if they transact business within the state.

Each state, through its statutes, determines the type of activity that triggers the qualification requirement. If a foreign corporation fails to qualify when required, it is barred from accessing the state courts and is subject to monetary sanctions. **What activities would give rise to a foreign corporation’s requirement to qualify in California? What are the qualification requirements of other major states where significant business is transacted?** Answers to those questions can also help in determining if your company will need to qualify as a foreign corporation or perhaps you can plan to keep future actions sufficiently limited so that you will not need to do so.

The Model Rules

Most qualification statutes have substantially adopted provisions of the Model Business Corporation Act Section 106 (“MBCA”) or the Revised Model Business Corporation Act Section 15.01 (“RMBCA”). Both model provisions include excluded activities which will not trigger a foreign corporation’s duty to qualify. Under the MBCA, such activities by a foreign corporation include:

1. Maintaining or defending any action or suit or any administrative or arbitration proceeding;
2. Holding shareholder or director meetings or carrying on other activities concerning internal affairs;
3. Maintaining bank accounts;
4. Maintaining offices or agencies for the transfer, exchange and registration of its securities or appointing and maintaining trustees or depositories with relation to its securities;
5. Effecting sales through independent contractors;
6. Soliciting or procuring orders that do not require this state’s acceptance before becoming binding contracts;

7. Creating evidences of debt, mortgages or liens on real or personal property;
8. Securing or collecting debts or enforcing any rights in property securing the same;
9. Transacting any business in interstate commerce; and
10. Conducting an isolated transaction completed within a period of 30 days and not in the course of a number of repeated transactions of like nature.

The RMBCA is essentially the same except it includes “owning, without more, real or personal property” as an excluded activity. Because these provisions leave it up to the state in question to determine what specific activities would trigger a foreign corporation’s duty to qualify, it is virtually impossible to state with certainty what activities, individually or collectively, will or will not require a foreign corporation to qualify. **However, if a company transacts a material part of its ordinary business in a state or states outside of its state of incorporation, it probably will be required to qualify as a foreign corporation.**

Qualifying in California

Section 191 of the California Corporation Code governs **when foreign corporations doing business in California must qualify**. Section 191 adopts the MBCA with these modifications:

1. Securing or collecting debts or enforcing any rights in property securing the same is not an excluded activity;
2. Transacting business in interstate commerce is not an excluded activity; and
3. The time period for completing an isolated transaction is 180 days instead of 30 days.

Additionally, a foreign corporation shall not be considered to be transacting business merely because its subsidiary transacts interstate business.

The most important difference is that Section 191 affirmatively requires a corporation to qualify if it enters into **repeated and successive transactions of its business within California**. When ruling on whether corporations must qualify, courts look beyond the mere frequency and volume of local activity alone. They look at the combination of local activities conducted, including the manner, extent and character of such activities. For example, if a foreign corporation solicits sales to a targeted group of wholesalers, it is not required to qualify, but if this same corporation maintained an office in California, staffed it with one or more employees, and mailed solicitations to local wholesalers, it would likely need to qualify.

To qualify in California, a foreign corporation must obtain a Certificate of Qualification. This can be done by filing a Statement of Designation by a Foreign Corporation with California’s Secretary of State along with a certificate of good standing issued from the state where the corporation is located. **The filing fees can outweigh the fines and repercussions:**

- A \$100 filing fee is assessed for foreign stock corporations and a \$30 filing fee is assessed for foreign nonprofit corporations.
- A foreign corporation that transacts intrastate business in California without qualifying is subject to a one-time \$250 penalty. Thereafter, the corporation must pay \$20 for each day unauthorized intrastate business is transacted.
- The corporation can also be found guilty of a misdemeanor and may be subject to an additional fine of \$500 to \$1,000.

- Additionally, the corporation will be barred from accessing California's courts, thereby preventing it from bringing or maintaining an action in the courts, such as an action enforcing a contract.

In assessing whether to qualify, it is important to consider that **California is one of eleven states where liability for failing to qualify may be imposed not only on the corporate entity but on individuals acting on its behalf.**

Ultimately, whether a foreign corporation must qualify in California requires a careful, case by case analysis of factual circumstances. **Please contact our corporate attorneys to assist your out-of-state corporation in determining whether it must qualify in California.**

Qualifying in Other States

Texas and New York have the highest gross state products outside of California. **California companies transacting business in these states should consider the following:**

Texas

Texas recently enacted Business Organizations Code Section 9.001 to replace its former statute governing the qualification of foreign corporations. The new statute does not have a laundry-list of excluded activities, but does **require all foreign corporations that transact business in Texas to qualify.** Neither the statute nor the state courts clarify what it means to "transact business." However, according to Texas' Attorney General, whether a corporation is transacting business in the state is a fact question that depends on the specific circumstances of the business.

If a foreign corporation fails to qualify in Texas when required to do so, a court may enjoin the corporation from transacting business in the state. Further, the corporation is denied access to all courts and it may be subject to monetary sanctions equal to all taxes and fees that would have been imposed on the corporation had it qualified. Due to the breadth of Section 9.001, and the severe consequences for failing to qualify, **foreign corporations should cautiously monitor the degree of business they conduct in Texas should they wish to avoid qualifying.**

New York

Section 1301 of New York's Business Corporation Law **provides limited guidance** for determining when a foreign corporation doing business in the state must qualify. There are only four excluded activities under this section:

1. Maintaining or defending legal actions or proceedings;
2. Holding director or shareholder meetings;
3. Maintaining bank accounts and
4. Maintaining offices or agencies for the transfer or maintenance of securities.

Unlike California's Corporation Code, Section 1301 does not define the nature of activities that will force a foreign corporation to qualify.

According to New York's courts, foreign corporations that conduct isolated transactions having no continuity or no profit motive or commercial significance do not need to qualify. Thus, **whether a**

corporation conducts systematic and regular business transactions in the state is an important factor in determining whether it must qualify. Another factor is whether the corporation maintains an office or place of business in the state. If a foreign corporation fails to qualify in New York when required to do so, a court may enjoin the corporation from doing any intrastate business and annul the corporation, requiring the corporation to forfeit its corporate rights, privileges and franchises. Additionally, the corporation may be required to pay monetary sanctions and special court costs.

Other States

State statutes governing when a foreign corporation must qualify general follow the MBCA or the RMBCA. For example:

- The statutes enacted in New Mexico, Rhode Island and South Dakota adopt the language cited in the **MBCA**.
- Substantial portions of the **MBCA's** language are incorporated into the statutes of Alaska, Georgia, Louisiana, Maryland, Minnesota, North Carolina, Pennsylvania and Washington.
- The statutes enacted in Arkansas, Connecticut, Hawaii, Idaho, Indiana, Iowa, Kentucky, Michigan, Mississippi, Nebraska, New Hampshire, Oregon, South Carolina and Wyoming adopt the language cited in the **RMBCA**.
- Substantial portions of the **RMBCA's** language have been incorporated into the statutes of Arizona, Colorado, Florida, Illinois, Maine, Missouri, Montana, Nevada, North Dakota, Utah, Vermont, Virginia, West Virginia and Wisconsin.

Virtually all state statutes have substantially adopted the language in Model Business Corporation Act Section 124. This section **prohibits unqualified foreign corporations transacting intrastate business from maintaining any action, suit or proceeding in any court of the state until the corporation qualifies.** This section also provides for **monetary penalties** equal to all fees and franchise taxes which would have been imposed on the violating corporation had the corporation qualified in addition to penalties assessed for failure to pay such fees and taxes. The sanctions and penalties for failing to qualify vary substantially from state to state.

Please contact our corporate attorneys to assist your company in determining if it has to qualify as a foreign corporation in any states it does business or if it can plan its activities in a manner to avoid having to do so.

The Fine Print.

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