

Are You “Doing Business” in California?

For companies not based in California, a determination that they are “doing business” in California, even without a physical presence, can trigger registration, reporting and tax obligations. Therefore, companies with exposure or connection to California, even what may look like mild or remote links, should carefully evaluate whether they are subject to California law requirements.

While California law requires non-California companies to “qualify” (i.e., get a certificate of authority) as a condition to doing business in the state, there is no clear definition of what it means to “do business.” Different California agencies view “doing business” differently, largely based on the business activity involved, and it is important for companies to be mindful of compliance with multiple regulatory considerations.

What Qualifies as “Doing Business” in California?

The two main sources of law that are relevant are: California’s business entity laws, under the California Corporations Code (Corporations Code), and tax laws, under the California Revenue and Taxation Code (Tax Code).

CALIFORNIA CORPORATIONS CODE

The Corporations Code describes doing business as “entering into repeated and successive transactions of its business in [the] state, other than interstate or foreign commerce.”¹

While it does not list what activities constitute doing business, the statute provides a “nonexclusive” list of activities that do not

constitute doing business in California, including (a) maintaining, defending or settling any action or suit or any administrative or arbitration proceeding; (b) effecting sales through independent contractors; (c) transacting any business in “interstate” commerce (i.e., between or across states); and (d) 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.² The law also states that merely being a shareholder, member or manager, or limited partner of a California corporation, limited liability company or limited partnership (or a similar non-California entity transacting intrastate business) does not constitute “doing business.”³

However, other forms of even indirect contact with California could trigger a “doing business” qualification requirement. For example, an online business that engages in ongoing transactions in California would be required to qualify and pay taxes to enjoy the benefits of doing business in California.

Registering with the California Secretary of State

A non-California corporation “doing business” in California must register in California by filing a Statement and Designation by Foreign Corporation (or a Form-LLC 5, if a limited liability company). The entity must be in good standing in its place of organization at the time of the filing. Once registered, a Statement of Information must be filed with the California secretary of state within 90 days and each year thereafter (or every two years in the case of a

limited liability company), or the entity risks being assessed a penalty, suspension or forfeiture of its qualification (see “Penalties” below).⁴

Registering with the California Attorney General (for Charities)

In addition to qualifying with the Secretary of State, entities found to be “doing business” in California that are holding property for charitable purposes must register with the California Attorney General within 30 days of first receiving charitable assets, and renew their registrations annually thereafter.⁵

CALIFORNIA REVENUE AND TAXATION CODE

Under California’s tax laws, the concept of doing business can be more sweeping and technical than the corporate law approach described above. For taxation purposes, the Tax Code defines “doing business” as “actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.”⁶ The Tax Code further provides that a company is viewed as “doing business” if it is commercially domiciled in California (i.e., has a principal place of business in California from which the business is conducted) or the company’s California sales, property or payroll exceed the following amounts (current as of the date of this writing):

- Sales in California: the lesser of \$610,395 and 25% of the entity’s total sales;
- Property in California: the lesser of \$61,040 and 25% of the entity’s total real and tangible property; or
- Payroll in California: the lesser of \$61,040 and 25% of the total compensation paid.⁷

Taxation

Any entity that is “doing business” within the scope of the tax laws in California, or that has registered under the corporate regime described above with the California secretary of state, must file an annual franchise tax return and pay a minimum annual tax

(currently \$800 and commonly called a “franchise tax”) “for the privilege of doing business in California,” even if the company operates at a loss.⁸ Failure to comply with these requirements can result in interest and penalties, including an annual \$2,000 failure-to-file penalty under certain circumstances.

Different rules apply with respect to California sales tax. A retailer making sales in California must register for, collect and remit California sales tax when its combined sales in California exceed \$500,000 in the current or preceding year. This applies without regard to whether the retailer has a physical presence in California or is below the thresholds described above, with respect to California franchise tax.

TAX-EXEMPT ENTITIES

Certain entities may seek an exemption from the California franchise and income tax. While most nonprofit entities are tax-exempt, such exemption is not automatic, and entities seeking tax-exempt status must apply for and receive an “exempt status” letter from the California Franchise Tax Board (FTB), even if it has already received federal tax exemption. California tax-exempt status may be obtained by submitting an FTB 3500 (Exemption Application) form or an FTB 3500A (Submission of Exemption Request) form (applicable to entities that have received a federal tax exemption under the Internal Revenue Code Section 501(c)(3), (c)(4), (c)(5), (c)(6), (c)(7) or (c)(19)) to the FTB.

Penalties

California has statutory provisions imposing fines on non-California companies and individuals acting on behalf of non-California companies that have not complied with qualification or taxation requirements. For example, a person who does “intrastate” business in California on behalf of a non-California company that has not qualified to transact business in California can be guilty of a misdemeanor and may be subject to penalties

of up to \$600, regardless of the title or position held by the individual.⁹ A company transacting business in California without having properly registered (i.e., qualified) is subject to a penalty of \$20 for each day (up to \$1,000) that unauthorized intrastate business is conducted and is denied access to state courts for purposes of maintaining an action or proceeding upon any intrastate business conducted in the state. In other words, and quite importantly, an unqualified company cannot enforce contracts it made in the state of California, and its failure to so qualify may be used as a defense against a suit brought by the unqualified company in California. This can have particularly serious consequences from an operational and risk perspective.

Conclusion

As there is no easy legal definition for what constitutes “doing business,” it is important for companies and businesses to carefully evaluate their connections—even indirect—to California, whether based on employees, sales, real estate or other commercial activities. The failure to do so can be costly, both from a non-compliance penalty perspective and operationally in terms of being able to legally enforce contracts.

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Endnotes

- ¹ Cal. Corp. Code § 191(a).
- ² Cal. Corp. Code § 191(c) and (d).
- ³ Cal. Corp. Code § 191(a) and (b).
- ⁴ Cal. Corp. Code § 2117; see also, <https://www.sos.ca.gov/business-programs/business-entities/faqs#form>
- ⁵ Cal. Gov't Code § 12585.
- ⁶ Cal. Rev. & Tax. Code § 23101(a).
- ⁷ Cal. Rev. & Tax. Code § 23101(b); see also, <https://www.ftb.ca.gov/file/business/doing-business-in-california.html> The threshold amounts are adjusted annually by the California Franchise Tax Board (FTB) and represent the current amounts shown on the FTB website.
- ⁸ Cal. Rev. & Tax. Code § 17935 (limited partnerships); id. § 17941 (LLCs); id. § 23153 (C corporations); id. § 23802 (S corporations).
- ⁹ Cal. Corp. Code § 2259.

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