Caganco Incorporated

States of Incorporation Brief[1]

Two of the first things that any serious entrepreneur needs to do when forming their company is select the form of entity they wish for their company, and the state in which they wish to form it. The selection of the best suited entity – corporation (C), limited liability company (LLC), sub-chapter S corporation (S), beneficial corporation (B), partnership, sole proprietorship, etc. is not covered in this brief.

This brief deals with the relative comparison of benefits and costs in incorporating in the states of Delaware, Nevada, and Wyoming. Each state is different, and for many companies, especially those only intending to do business locally, it may just be best to simply incorporate in the state in which you intend to do business. For other companies, especially those intending to operate on a national or international scale, and those hoping for an eventual liquidity event, there are other things to consider.

For many years Delaware has been considered the gold standard. According to the Wall Street Journal[2], "The small state remained the legal home of just over two-thirds of Fortune 500 companies in 2023, up slightly from five years earlier, state records show. Nearly 80% of initial public offerings in 2022 were registered there, slightly below 2019 levels." In the last few years two states in particular have been vying for this business – Nevada and Wyoming. While this document focuses on comparing these two with Delaware, it is important to note that other states also have reputations in this area, ranging from Texas as excellent, and California as generally undesirable.

Here we present an itemized comparison between those states.[3]

	Delaware	Wyoming	Nevada
No state corporate income tax:		✓	✓
No tax on corporate shares:	✓	✓	✓
No franchise tax:		✓	✓
Minimal annual fees:		✓	
One-person corporation is allowed:	✓	✓	✓
Stockholders are not revealed to the State:	✓	✓	✓
No annual report is required until the anniversary of the incorporation date:		✓	
No Initial List of Officers/Members is filed with the state:	✓	✓	
No general Business License required:	✓	✓	
Unlimited stock is allowed, of any par value:	✓	✓	
Nominee shareholders are allowed:		✓	✓
Share certificates are not required:		✓	
Minimal initial filing fees:		✓	
No minimum capital requirements:	✓	✓	✓
Meetings may be held anywhere:	✓	✓	✓
Officers, directors, employees and agents are statutorily indemnified:		✓	✓
Continuance procedure (allows adoption of a corporation formed in another state):		✓	
Doesn't collect corporate income tax information to share with the IRS:		✓	✓

Note:

(a) Delaware Corporations who do NOT Conduct Business in Delaware are not required to file a Delaware Corporate Income Tax Return, regardless of being incorporated under the laws of Delaware.
(b) Delaware Corporations, while not statutorily indemnifying directors, employees, and agents, can easily do so within their Certificate of Incorporation and Bylaws.

In general, Delaware, through its developed legal system and laws protecting shareholder rights, is geared toward the large complex public corporations, whereas Nevada and Wyoming are more attractive to the small privately held corporations and LLCs. Delaware law tends to protect the rights of boards of directors and shareholders, while Nevada and Wyoming tend to favor management.

The choice of domiciles ultimately depends on your business model and the long-term goals of your company. Delaware has an excellent body of corporate case law spanning 232 years regarding such matters as management/shareholder issues and mergers & acquisitions, and that's precisely why the Fortune 500 are drawn to this state. Delaware laws tend to be "pro-management" when it comes to minority shareholder disputes.

If you are aiming to appeal to venture investors, or raise capital nationally, and grow your company to over $100M+, Delaware's case law offers better insights into what you can and cannot do, and what the likely consequences may be; and more investors and advisors are familiar with DE law.

Unfortunately, Delaware also has corporate income tax, personal income tax (corporate and personal income tax only apply to companies headquartered in and individuals living in DE), a state franchise tax, reporting requirements and regulations compelling disclosure of substantial amounts of information resulting in far less privacy for you. That makes Nevada and Wyoming much more attractive for small privately owned businesses.

Sharing Information: While Nevada is famed as the only state that does not share information with the IRS. Wyoming does share information with the IRS, but only the information given by companies with real assets inside the state. Be aware however that Nevada makes the IRS mad. That means if you are in Nevada the IRS may target you because you are in a non-friendly state.

Corporate veil: The corporate veil separates the assets and liabilities of the company from the assets and liabilities of its owners, thus protecting owners from business risk. Nevada offers the best corporate veil protection available. Wyoming also has well established criteria concerning the piercing of the corporate veil. Delaware is less secure.

State taxes: There are no state income taxes on individuals or companies both in Nevada and Wyoming. Delaware taxes company and individual revenue generated within the state. However, Nevada is now considered "the worst state to do business in" by the non-partisan Tax Foundation that has pointed to the new changes to Nevada taxation. Recently, annual list and business license fees which were already the 3rd highest in the nation were increased. Nevada also has a new "Commerce Tax" on your GROSS REVENUE if your combined gross revenue of all of your Nevada business entities is over $4 million per year! In other words, the state will combine the income of multiple corporations of any common owner and apply the Commerce Tax if the combined revenue reaches the $4 million threshold.

Generally, the reasons that Nevada is better than Delaware are not well founded, except in the context of small business corporations and corporations that want to limit stockholder rights, and therefore, threats of stockholder lawsuits. Despite their best efforts to create an environment more conducive to business incorporating, Nevada has largely failed to attract out-of-state and international incorporation business at levels as great as Delaware.

While Delaware is typically characterized as more protection for Shareholders/Owners, Nevada is considered the opposite - more Protection for Directors, Less Protection for Owners. There are many differences between Delaware and Nevada corporation liability law, which are all tailored to make directors and officers less liable in Nevada (this does not apply to LLCs). First, the corporation law in Nevada extends liability protection for breaches of the duty of care to officers, whereas Delaware corporation law only removes liability for these breaches from directors <u>if a firm opts to remove such liability in its Certificate of Incorporation</u> (by providing indemnification in the Certificate of Incorporation). In Delaware, directors and officers are liable for breaches of the duty of care (unless the firm opts-out); breaches of the duty of loyalty; actions done in bad faith; improper personal benefit; and intentional fraud, misconduct, or knowing violation of the law. However, Nevada corporations must only make directors and officers liable for behavior that is both a breach of the duty of loyalty and intentional fraud, misconduct, or knowing violation of the law. These firms can opt-in to make officers and directors liable for other violations, such as breaching a duty of loyalty or improper personal benefit, but the current Nevada corporation law does not mandate liability for things such as self-dealing with the company or conflicts of interest. Additionally, corporations organized in Nevada can choose to indemnify officers and directors from all actions, as well as choose to indemnify their legal expenses, which is more limited in Delaware. It is also impossible to indemnify acts of bad faith for Delaware corporations. This decreased Nevada liability is seen as the main benefit of incorporating in Nevada, rather than Delaware. This additional protection for management from shareholder lawsuits has not attracted much corporate business to Nevada.

The Wall Street Journal notes, "Delaware courts typically defer to a company's board on many kinds of decisions under the "business judgment" rule. A tougher standard applies when companies purse transactions that stand to disproportionately benefit a controlling shareholder. In lawsuits over those transactions, companies generally must show the transaction was "entirely fair" to other shareholders."

In theory, another main benefit to incorporating a corporation in Nevada is lower cost of litigation. Nevada's law is fairly clear on the limits of liability for corporate officers and directors, meaning that less litigation should be required. This will benefit corporations that either would not want to go through this extensive litigation or firms which already have strong internal controls in place to combat breaches that would lead to litigation. However, in the case of litigation, Delaware has a judiciary that is more skilled at adjudicating business disputes than that of Nevada, due to Delaware's history as the chief state of incorporations. Delaware also has a much more extensive history of case law than Nevada.

Statistical studies over the years have shown that incorporating in Delaware tends to provide a premium to the market value of a corporation in relation to its assets, whereas Nevada does not provide that same premium to corporation value. This is due to both the brand of Delaware as a state for incorporation and the difference in which group is favored by the laws of the states: Delaware law is pro-stockholder, while Nevada's law is more tailored to suit the wants and needs of directors and officers. As a result, institutional ownership of corporations tends to be higher in Delaware than in Nevada.

This preference for wants and needs of directors in Nevada also makes the composition of the Board of Directors for Nevada firms different than those in Delaware. Boards of Directors in Nevada tend to include many more insiders than their counterparts in Delaware, which could either be for private benefit through self-dealing with the corporation or to maintain more control over the operation of the firm, depending on the motivations of the Board of Directors.

The Nevada Board of Directors structure would lend itself much more to a smaller, closely held or family corporation, which appears to be one of the types of firms that incorporate in Nevada. These firms would also benefit from a lower cost in Nevada because they are not required to have independent directors, which are stressed in Delaware.

Advantages of incorporating in Nevada

1. Nevada has no state corporate income tax and no taxes on corporate shares.

2. Officers, directors, employees, and agents are statutorily indemnified, maintaining favorable limited liability protection for directors and officers of corporations.

3. Nevada doesn't collect corporate income tax information to share with the IRS.

4. Codified management-friendly standards of care for actions taken in response to takeover attempts.

5. During pending litigation, the Nevada business courts provide early comprehensive case management to prevent interruptions to business operations.

The four primary reasons that corporations often prefer incorporating in Delaware:

1. Brand: By virtue of its long history, significant investment, focus, and dedicated effort Delaware has achieved the single highest level of credibility for incorporation in the eyes of stockholders, investors, directors, regulators, analysts, and business observers.
2. The General Corporation Law: Changeable by design, this fine-tuned statue is biased against regulation. Nationwide, it led the way to limiting the liability of corporate directors and officers, providing relief from high-cost insurance. Many provisions also exist to ensure that companies run smoothly.
3. Delaware's Court of Chancery: Established in 1792, this jury-free court boasts a long, written history of decisional corporate law. Former Chief Justice William Rehnquist described the court as one that "allows business planners to order their affairs to avoid lawsuits." The Court of Chancery does not handle tort or criminal cases, which allows it to operate quickly.
4. The Division of Corporations: Run by the Delaware Secretary of State's office, this unique government agency actually makes a profit. One reason: It's set up to run much like the businesses it serves. Open until midnight, the agency handles one-hour, two-hour, same day and 24-hour turnarounds for important documents. <u>And, my personal favorite., when you call, someone answers the phone on the first few rings, and they can almost always answer your questions in that call.</u>

Note: FULL DISCLOSURE. In January 2024 Dennis Cagan with Caganco Incorporated posted the following message on LinkedIn.

> ***Incorporating in Delaware vs Nevada:*** *Hello colleagues. I have previously posted on the relative benefits of one domain over another for company incorporation. Here is one good reason NOT to do so in Nevada. Time for someone in the Office of the Secretary of State to answer the phone:*
>
> *Delaware - 2nd ring answers with a person who can answer your question.*

Nevada - Over 12 hours on hold and no sign of any answer. (BTW, I even called at the exact moment that the office opened in the morning.)

No reasonable excuse in my book. Yea DELAWARE, Boo NEVADA.

[I also posted this same message on Facebook; on my account and on the account for the Secretary of State of Nevada.]

Follow Up: About two weeks after posting the above message I received a call from Office of Secretary of State Francisco Aguilar (Nevada), Customer Engagement Manager. She was very apologetic, telling me that they had a variety of problems and were trying to work them out, and hoped to be caught up in the next few months. Oh, and by the way, she was able to answer my extremely simple question that I could not find anywhere on their website – which is why I called in the first place.

The following authoritative links are sources for the above summary and will help guide you through the process for evaluating your best option.

https://www.myusacorporation.com/articles/delaware-vs-nevada-vs-wyoming/.

https://www.incorporate.com/learning-center/delaware/incorporate-delaware-nevada/#:~:text=Delaware%20corporations%20require%20both%20a,for%20both%20LLCs%20and%20corporations.

https://www.wolterskluwer.com/en/expert-insights/why-incorporate-in-delaware-or-nevada

https://incorporationsolutions.com/nevada-delaware-comparison/

[1] We at Caganco Incorporated are not attorneys or accountants, we do not provide legal or financial advice, and we encourage clients to receive qualified consultation on all legal and accounting matters. This document contains only generally available public information obtained from the various sources, both private and government. We make no warranties of any kind with respect to accuracy of the information shown.
[2] Wall Street Journal, February 12, 2024, pp A1-2.
[3] MyUSACorporation.com
[4] Wall Street Journal, February 12,2024 edition, pp A1-2, *Frustrated Executives Look Past Delaware*.

Caganco Incorporated, a Texas corporation, is a management consulting firm, established in 1984, specializing in its trademarked Shadow CEO® service – working with private company leaders, from start-ups to $2 billion in annual revenue, guiding them and working with them hand-in-hand to expand their skills and performance in areas where they lack direct experience. Caganco provides actual working assistance – not just advice - in the execution of any decisions, and work challenges.

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