

Nevada Incorporation Benefits for Out-of-Staters

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While the legal framework in Nevada is favorable to companies, one of its most appealing aspects is that a business entity doesn't have to be physically present to enjoy the benefits of incorporation here and many are doing so.

Estimated to account for 80 percent of the 71,036 new business entities incorporated here last year, out-of-state incorporations are fast becoming a boon to Nevada, contributing mightily to the nearly \$57 million total levied by the state through licensing and other fees for new companies as well as annual renewals for the 239,909 businesses in good standing with the Secretary of State's office.

Last week, the Business Press examined some of the misconceptions about incorporating in Nevada among out-of-state businesses, primarily the erroneous idea that incorporating a business in Nevada allows owners to avoid taxes in the state in which they reside and do business.

That fallacy is maintained and sometimes even encouraged by a few resident agents, who derive their income acting as an out-of-state corporation's official in the jurisdiction and are therefore the main beneficiaries of increased activity. The intense competition to register business entities here have lead to other practices among a small number of resident agents that skirt the ethical boundary.

Despite the actions of a few bad apples, out-of state incorporations are a legitimate and lucrative business, with Nevada becoming the third largest jurisdiction in terms of new incorporations per population density behind traditional leader Delaware as well as South Dakota. As the Legislature looks to beef up the state's attractiveness this legislative session by broadening the base of legal protection, the industry is only expected to grow.

"It all results in additional funding for the general fund," says Steve George, public information officer for Secretary of State Dean Heller's office, which licenses all businesses. "Not only is it a great industry, it is a growth industry."

The growth of the industry is marked. According to the Secretary of State's office, the 71,036 new business entities formed in 2004 represent a 25.1 percent increase over the 56,786 incorporations in 2003.

Revenue generated for Nevada though is measured according to the fiscal year which ends June 30. Including optional fees to expedite service, the \$57 million raised in fiscal year 2003-2004 is an 18.75 percent increase over the approximately \$48 million added in the previous fiscal year. While the Secretary of State's office does not register the jurisdiction of beneficiary owners, industry analysts estimate that 80 percent of all incorporations are for individuals and entities that are outside of Nevada.

Notwithstanding the misconception that Nevada is a tax haven, there are real tax benefits for companies incorporating in Nevada. With no corporate income tax as well as no franchise tax or taxes on corporate shares, Nevada companies with multi-jurisdictional sales that can be domiciled without a physical structure, such as Internet companies, can escape some state taxes, although any personal income derived, such as dividends, is subject to the laws of the home jurisdiction.

"State taxes are becoming an increasing liability to a company's operating expense," says Derek Rowley, a resident agent for Corporate Service Center in Reno and board member of Nevada Corporate Headquarters in Las Vegas. "Because of federal tax reform, the state slice of the tax pie has become the larger part [in some cases]. This draws attention to Nevada, particularly for a company that does business in a large number of states. For example, if you are a California company, all the income is taxable by California. If you incorporate in Nevada, only the California income is taxable [by California]."

The example is particularly poignant as Rowley estimates that 35 percent of out-of-state incorporations are by California entities. The total is down, however, from the 50 percent that was the norm only three to four years ago.

Part of the reason is a rise in international businesses and foreign individuals seeking to incorporate in Nevada. While the tax incentives are limited for domestic companies and federal taxes apply regardless of location, U.S. corporate tax rates are among the lowest in the world, making the country a tax haven in and of itself.

According to attorney Scott Swain, a tax and estate planning expert at law firm McDonald Carano Wilson, which owns a resident agency subsidiary, Sierra Corporate Services, resident agents, like law enforcement officials here, expect international clients to be playing by their home rules when they come here.

"What happens with foreign clients is that we've seen a reduction in [U.S. tax] rates and an increase of the U.S. as a tax haven," he says. "We think that attracts more [international incorporations] and Nevada seems to be as good a jurisdiction as any. We make clear to an overseas client that we expect them to have an advisor on their jurisdiction. We can only advise on local Nevada issues. We can't be tax experts in every jurisdiction."

Broader issues, however, limit the appeal to foreign clients. For instance, banks are loath to open accounts for foreign entities and the use of professional management companies to oversee foreign companies is fraught with pitfalls that have only grown in light of the country's current security situation.

"Since 9/11 and the Patriot Act, it is much more [difficult] for foreign nationals to use Nevada as an entity," Rowley notes.

While that leaves domestic entities as the primary source for any significant growth in the out-of-state incorporation business, the numerous advantages point to unrelenting growth. If the actual benefits depend on the type of business being served, one element common even to international offshore centers is the high degree of confidentiality afforded to companies registered here.

While Nevada offers businesses numerous features for maintaining privacy, such as minimal reporting and disclosure requirements, keeping shareholders out of public records, and no information sharing agreement with the IRS, it doesn't mean information on Nevada companies can't be obtained. More importantly, it doesn't mean the privacy is extended to cover criminal or other illegal behavior.

"If [any entity] wants records from a Nevada agent, they need a subpoena to do it," says Rowley. "And they can do it ... Don't get into fraudulent activity, because Nevada statutes keep in tandem [with other jurisdictions]."

Nevada also has enacted corporate governance statutes that favor business operations and minimize exposure. For instance, Nevada law limits the rights of minority shareholders, although recent court decisions have upheld those rights.

In addition, Nevada indemnifies corporate officers and directors from certain liability by limiting the amount of external factors, such as interest rate changes, which can be admitted in any legal proceedings.

"There may be bad businesses and there may be bad business people, but they are not doing something illegal," Rowley says. "[In other jurisdictions], judges allow external information to determine whether an officer acted reasonably and whether a reasonable person might have done differently. The standard in Nevada is that as long as the officer believes that what he or she was doing was for the good of the company, [it is acceptable]. In criminal acts, none of these standards apply."

Perhaps the greatest appeal of the Nevada jurisdiction is the protection provided to corporate assets from creditors. Nevada law prevents creditors from dismantling companies and liquidating assets to satisfy debt, but rather limits collections to charging orders. A charging order is a court order that allows creditors to receive payments on debts solely from any disbursements made to shareholders.

"In a charging order, when a distribution is made from an entity to an owner, the creditor will receive the distribution," said Swain. "But until the entity decides to make the distribution, the creditor receives nothing. Many jurisdictions have charging orders, but they are not the only remedy. They can also liquidate assets. Nevada is one of the few jurisdictions where the sole remedy for creditors is the charging order."

Applied initially to limited-liability companies and partnerships, the asset protection feature has seen an explosion in those entities, assumed to be driven by out-of-state registrants.

In 2000, the number of corporations formed in Nevada peaked at 35,550 and then fell to 33,465 in 2003, a decrease of 5.9 percent. Over the same period, the formation of LLCs went from 12,765 in 2000 to 21,011, a phenomenal 64 percent surge.

In the 2003 legislative session, the asset protection was extended to business trusts. This year, the Legislature will consider whether to expand the charging order protection to "S" corporations.

"S" corporations are entities which limit the number of shareholders to 75 and in which earnings are reported but go directly to shareholders and are taxed at one rate. Typically, "S" corporations are small businesses.

In comparison, the more well known "C" corporations have unlimited shareholders with shares that can be publicly traded on exchanges. "C" corporations pay corporate income tax and its dividends can also be liable.

"It prevents creditors from foreclosing [on "S" corporations], which can currently be done," says Rowley. "We think [the bill] will create the most significant change in incorporation over the next 20 to 30 years. If it gets passed, we will see a significant impact on the Nevada incorporation business."

While the proposed and current Nevada laws are attractive reason for incorporation here, Swain believes the effectiveness of asset protection and its extension to other entities has

yet to be tested fully. Because the U.S. Constitution requires jurisdictions to recognize the acts of other states, such as marriages and warrants as well as court orders, Swain argues that the future of the industry might not be as clear as some interpret it, until the law is clearly interpreted by the courts.

"The U.S Constitution requires us to give 'full faith and credit' to rulings made in sister states," the attorney says. "The problem is that we don't have a definition of what that means to say, trusts, here. It is a question of which state law applies. Is it Nevada law or, for example, Florida law, that says you can't have a trust that shields [your business assets] from creditors or a sheriff's auction? If you live in Florida, what does a Florida court care about your Nevada business? Sooner or later we are going to have a test case and that will tell us the answer. But as of now, we have to tell the client we don't know how it will play out."

SIZE: 239,909 businesses in good standing with the Secretary of State on 12/31/04

GROWTH: 71,036 new business entities registered in 2004 (56,786 in 2003)

REVENUES: Nearly \$57 million for state budget through registration fees

Article provided by Nevada Corporation Services Ltd (www.AssetProtection123.com)