SMALL BUSINESS

What to Know When Your Clients Want to Expand Their Businesses to Another State

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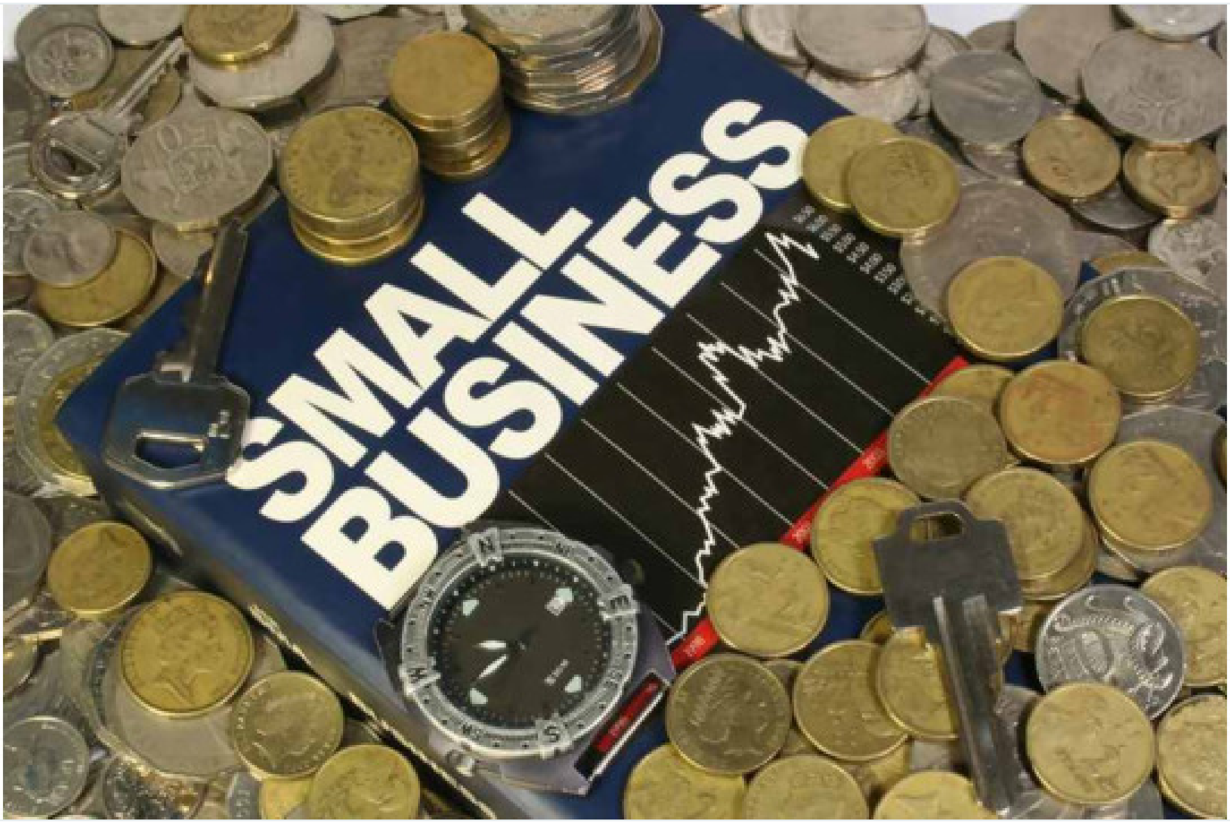

Are your clients looking to expand their businesses to another state or states? If so, that's a great indication of success and they'll probably turn to you for financial guidance to help them make the move. However, they're also likely to need your advice about how to legally operate their business in a state different from their home base. Here's what you need to know.

When to Register

Foreign qualification is the process of registering a business in another state in order to conduct business. Whether or not your business clients need to register depends on a number of factors, and unfortunately most states won't specify exactly which activities constitute doing business. In general:

- Will your clients have a physical presence (office space, warehouse or retail store) in the state?
- Will your clients conduct in-person meetings with clients or customers in the state?
- Is the business structured as limited liability company (LLC), corporation or limited partnership (LP)?
- Will the business have any employees living/working in the state?

If the answer to any of these questions is yes, your clients need to file a foreign qualification in the states they intend to conduct business in.

When Not to Register

Not all business activities require foreign qualification, however. For example, if your clients are freelancers or consultants and most of the work performed is conducted online, they do not need to file a foreign qualification. E-commerce businesses are different because there are sales of products involved and often a warehouse with products located in the state.

In most states, the following business activities also do not constitute transacting business in a state:

- Defending or settling a lawsuit
- Dealing with internal LLC or corporate business such as member meetings
- Having a bank account in the state
- Selling through independent contractors
- Securing or collecting debts

- Conducting an isolated transaction that is completed within 180 days and not repeated

How to Register

Most states have similar procedures to file a foreign qualification and it starts at the Secretary of State's office in the state you want to register. Your clients need to submit a Certificate of Authority application form and pay the fees. The client might also have to show the business is in good standing in its home state, which may require official documentation.

Next, the client needs to do a name search in each state to make sure the business name is legally available. If not, they will need to use a "fictitious name" (or Doing Business As/DBA) in that state.

Once your client has foreign qualification, they will need to appoint a registered agent. A registered agent (also known as statutory agent or registered agent) is a person or company with the authority to accept service of process (legal documents and government notices) on behalf of a business. A registered agent can handle in-state responsibilities such as:

- Official federal and state correspondence
- Subpoenas for information
- Tax notices from the IRS and local tax authorities
- Lawsuits
- Summonses to appear in court
- Corporate filing notifications

To find a registered agent, check the website of the state you're expanding to. Many list businesses offering registered agent services in their state.

The Risks of Not Filing for Foreign Qualification

Failing to foreign qualify when it's required can cause significant issues for your business clients, including being penalized for operating illegally in the states where business is conducted.

Some of the penalties include:

- Fines and interest for the time the company was conducting business in the state and was not foreign qualified
- Payment for missing filing fees the company should have paid.

- Payment of back taxes for the time the company was doing business without being foreign qualified.
- Ineligibility to sue in the state, because an entity can't bring suit in a state where it isn't registered.

Hiring Out-of-State Employees

California's new AB5 law has made it harder to classify workers as independent contractors and soon other states may follow. Consequently, your clients may find they need to hire out-of-state employees—and that means paying employer taxes in other states.

Your clients will need to register with the employee's state tax agency, obtain a state income tax withholding number (and unemployment insurance number) and withhold income taxes for that state. If the employee lives in one of the states without a state income tax (AK, FL, NV, NH, SD, TN, TX, WA, WY), your client will still need to pay the federal income tax.

The business will also need to be registered with that state's labor department and be compliant with rules for employees in the state including minimum wage, labor laws, disability insurance, worker's compensation and more. Have your clients contact their payroll provider when they are ready to hire out-of-state as these companies are familiar with handling multi-state workforces and know the regulations in each state.

Collecting Sales Tax

Whether or not you have a physical presence such as a warehouse in another state, having an out-of-state employee signifies enough presence you need to collect and pay sales tax in that state. Having "nexus" in a state means having a connection and when it comes to having sales tax nexus in a state, the law considers whether the business has a physical location in the state, resident employees in the state, property (including intangible property) or regular sales people. In addition, in 2018 the Supreme Court determined states can now base sales tax collection requirements on economic activity alone (dollar amount or number of transactions).

Once your client has determined they have sales tax nexus in a particular state, they will be required to collect sales tax for all taxable transactions from that state and will pay sales tax to the state's department of revenue. Sales tax return forms declaring all transactions will also need to be filed.

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