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**FEDERAL AND STATE TAXATIONS OF NEW CORPORATIONS**

*(Business Advisory No. 13)*

This Advisory will explore the facts behind federal and state taxations as they apply to California corporations.

This Advisory is neither exhaustive nor tailored to your specific situation. You should discuss your personal situation with us or with your own attorney. Our representation is only undertaken through a written engagement letter and not by the mere distribution of this Advisory.

**I. FEDERAL TAXES**

**A. Generally.** Federal law imposes a graduated tax on a corporation's taxable income in the following manner, IRC, Section 11 (b):

| Taxable Income |              | Tax       |               |                    |
|----------------|--------------|-----------|---------------|--------------------|
| Over           | But Not Over | Pay       | + % on Excess | Of the amount over |
| 0              | 50,000       | 0         | 15%           | 0                  |
| 50,000         | 75,000       | 7,500     | 25%           | 50,000             |
| 75,000         | 100,000      | 13,750    | 34%           | 75,000             |
| 100,000        | 335,000      | 22,250    | 39%           | 100,000            |
| 335,000        | 10,000,000   | 113,900   | 34%           | 335,000            |
| 10,000,000     | 15,000,000   | 3,400,000 | 35%           | 10,000,000         |
| 15,000,000     | 18,333,333   | 5,150,000 | 38%           | 15,000,000         |
| 18,333,333     |              | 6,416,667 | 35%           | 18,333,333         |

**B. Exceptions.** The following types of corporations are subject to different taxes. Please consult your tax advisor as this list is not all inclusive.

- (1) Personal Service Corporations. Taxed at a flat rate of 35%.

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(2) Personal Holding Companies. In addition to the standard corporate rates above, an additional tax is imposed on personal holding companies equal to 39.6% of undistributed personal holding company income.

(3) S Corporations. As a pass-through entity, S corporations are generally not subject to federal income taxes. However, an S corporation may be liable for (i) tax imposed on built-in gains or capital gains, (ii) tax on excess net passive income, (iii) tax from the recapture of a prior year's investment credit, or (iv) the LIFO recapture tax.

(4) Other Federal Taxes. In addition to the corporate income tax, a corporation may be subject to the following taxes as well, depending upon its tax circumstances: (i) alternative tax on net capital gains, (ii) alternative minimum tax, (iii) environmental tax, (iv) tax on accumulated earnings, (v) personal holding company income, (vi) S corporations' built-in gains, and (vii) passive investment income.

## II. STATE TAXES

**A. California Corporate Franchise Taxes.** California corporations as well as foreign corporations qualified to do business in California are subject California Franchise Taxes. (See Part II.B. for a discussion of California Corporate Income Taxes.)

(1) Minimum Franchise Tax. For corporations incorporated (or qualified) or doing business in California, there is a minimum of \$800 of tax owed, irrespective of income, on an annual basis which is generally due by the first quarter of each accounting period. If an entity is formed before March 15<sup>th</sup> of any year, the \$800 franchise fee/tax is due upon incorporation; otherwise, it is deferred until the filing of the tax return for the year of incorporation or March 15<sup>th</sup> of the following year, whichever is first.

Please note that this same tax/franchise fee applies to limited partnerships, limited liability companies, limited liability partnerships, real estate investment trusts, regulated investment companies, real estate mortgage investment conduits, financial assts securitization investment trusts and qualified Subchapter S subsidiaries.

Actual franchise taxes are measured based on income for the year, as described below.

(2) Actual Franchise Tax Rates. Depending upon the type of corporation, the following rates apply for income years 1997 to current. As you will note, unlike under federal law, S corporations are subject to California franchise taxes.

| <b>S Corporation</b> | <b>C Corporation</b> | <b>Bank/Financial C corporation</b> | <b>Financial S corporation</b> |
|----------------------|----------------------|-------------------------------------|--------------------------------|
| 1.5%                 | 8.84%                | 10.84%                              | 3.5%                           |

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**B. California Corporate Income Taxes.** This tax is imposed only to corporations that are not subject to the corporate franchise tax – generally foreign corporations deriving income from California sources that are not doing business in California. The corporate income tax rates are similar to the corporate franchise tax rates, except there is no minimum tax. Another difference with the corporate income taxes are that it is imposed on the net income for the immediately preceding year, an after-the-fact assessment on earned income.

As always, additional legislation may have been enacted that would change the above advisements. This Advisory is neither exhaustive nor is it tailored to your specific situation. You should discuss your individual situation with us or your own attorney. We look forward to being of assistance to you.

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Business and Tax Attorney

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*This Advisory is one of a series of business, real estate and tax advisories prepared by the attorneys at Buynak, Fauver, Archbald & Spray, LLP. Should you have further questions regarding the information provided in this Advisory, please contact the author at the number listed above.*

*Buynak, Fauver, Archbald & Spray, LLP provides business legal services to individuals, business entities and nonprofit organizations from entity formation and start up, through day-to-day operations and exit strategies.*

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