DELAWARE FRANCHISE TAXES ARE AROUND THE CORNER

Startup? Organized in Delaware? Then you likely received a notice from the Secretary of State of Delaware saying you owe thousands (maybe even tens of thousands) in franchise taxes and have to file an Annual Report by March 1, 2020. DON'T PANIC!! There are two ways to calculate franchise taxes, and Delaware defaults to the one that is usually less favorable to startups.

Method 1 – The Authorized Shares Method (DEFAULT)

Under this method, franchise taxes are based on the number of ***shares*** a corporation is ***authorized*** to issue in its certificate of incorporation as of December 31st.

- If 5,000 **Authorized Shares** or less - $175.00 (minimum franchise tax)
- If 5,001 – 10,000 Authorized Shares - $250.00
- Add $85 for every additional 10,000 Authorized Shares (or portion thereof) until $200,000 (maximum franchise tax).

So, for example, under this method, a corporation with:

- 10,005 Authorized Shares, pays $335 in Franchise Taxes:
  1. First 10,000 shares = $250.
  2. 5 shares are a portion of the next 10,000, so 1 additional 10,000 shares = $85
  3. $250 + $85 = $335 (Total Franchise Tax Owed)
- 100,000 Authorized Shares, pays $1,015 in Franchise Taxes:
  1. First 10,000 shares = $250
  2. Each additional 10,000 shares = $765 (calculated as follows: (a) 100,000 shares minus 10,000 shares = 90,000 shares; divided by 10,000 shares = 9; (b) $85 × 9 = $765)
  3. $250 + $765 = $1015 (Total Franchise Tax Owed)

Or, more applicable to a typical startup corporation:

- 10,000,000 Authorized Shares, pays $85,165 in Franchise Taxes:
  1. First 10,000 shares = $250
  2. $\frac{10{,}000{,}000 - 10{,}000}{10{,}000}$ × $85 = (999 × $85) = $84,915
  3. $250 + $84,915 = $85,165 (Total Franchise Tax Owed)

Not very good for a startup that has no revenue, no customers, and limited funds (or whatever your company's particular situation may be). However, Delaware accepts another method of calculating franchise taxes that may reduce your company's franchise tax burden.

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Method 2 – The Assumed Par Value Capital Method

Under this method, franchise taxes are based on ***all Issued Shares***, ***Authorized Shares***, and ***Total Gross Assets*** (as reported on U.S. Form 1120, Schedule L).

STEP 1: $\frac{\text{Total Gross Assets}}{\text{Total Issued Shares}}$ = **Assumed Par Value**

STEP 2: Find **Real Par**: the actual or ***real*** par value of your corporation's shares as recorded in the company's certificate of incorporation.

STEP 3: (a) If Real Par < Assumed Par Value, then take:

$$\text{Assumed Par Value} \times \text{Authorized Shares} = \textbf{Assumed Par Value Capital}$$

or

(b) If Real Par ≥ Assumed Par Value, then take:

$$\text{Real Par Value} \times \text{Authorized Shares} = \textbf{Assumed Par Value Capital}$$

STEP 4: If Assumed Par Value Capital > $1,000,000 then round Assumed Par Value Capital up to the next million (leave as-is if not)

STEP 5: $\frac{\text{Assumed Par Value Capital}}{1{,}000{,}000}$ × $400 = **Franchise Tax Amount** (with a $400 minimum)

If different classes of shares have different par values, then, if and as applicable, you would calculate Steps 3(a) and 3(b) for each class of share, add the results in order to get the aggregated Assumed Par Value Capital Amount, and then proceed with the rest of steps as listed.

For example, a typical startup with 10,000,000 Authorized Shares of stock, with a par value of $0.0001, that has issued 9,000,000 shares, and has gross assets of $100,000, under this model, might have a franchise tax calculation look like:

STEP 1: $\frac{100{,}000}{9{,}000{,}000} = \mathbf{\$0.0\overline{11111}}$

STEP 2: Find **Real Par**: $0.0001

STEP 3: (a) If Real Par (**$0.0001**) < Assumed Par Value (**$0.01**), then take:

$$\$0.01 \times 10{,}000{,}000 = \$\mathbf{111{,}111.\overline{111}}$$

or

~~(b) If Real Par ≥ Assumed Par Value, then take:~~

$$\cancel{\text{Real Par Value} \times \text{Authorized Shares} = \textbf{Assumed Par Value Capital}}$$

STEP 4: If Assumed Par Value Capital ($111,111.11) > $1,000,000 then round Assumed Par Value Capital up to the next million (leave as-is if not)

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STEP 5: $\frac{\$111{,}111.11}{1{,}000{,}000} \times \$400 =$ **$44.44**

Because this amount in Step 5 ($44.44) is lower than the minimum tax allowed under this method, the franchise tax amount will be increased to **$400**.

As you can see, the Assumed Par Value Capital method is significantly more complicated than the Authorized Share method; however, it may drastically reduce your company's franchise tax obligation. In the examples above, the same company with 10,000,000 Authorized Shares is obligated to pay $85,165 under the Authorized Shares Method (default), compared to just $400 under the Assumed Par Value Capital Method.

Companies incorporated in Delaware should note that an annual report is due, along with your franchise tax payment, by **March 1, 2020**. Delaware requires the annual reports to be filed electronically.

Additionally, Delaware provides a Franchise Tax Calculator to assist you in estimating your franchise taxes.

If you are incorporated in Delaware, but conducting business in another state, you must be qualified to do business in that state – meaning, you might be subject to that state's franchise tax (if any) as well.