

15.2: Foreign Corporations

Learning Objectives

By the end of this section, you will be able to:

- Discuss state-imposed conditions on the admission of foreign corporations.
- Discuss state court jurisdiction over foreign corporations.
- Explain how states may tax foreign corporations.
- Apply the US Constitution to foreign corporations.

A foreign corporation is a company incorporated outside the state in which it is doing business. A Delaware corporation, operating in all states, is a foreign corporation in forty-nine of them.

Conditions on Admission to Do Business

States can impose on foreign corporations conditions on admission to do business if certain constitutional barriers are surmounted. One potential problem is the Privileges and Immunities Clause in Article IV, Section 2, of the Constitution, which provides that “citizens shall be entitled to all privileges and immunities of citizens in the several states.” The Supreme Court has interpreted this murky language to mean that states may not discriminate between their own citizens and those of other states. For example, the Court voided a tax New Hampshire imposed on out-of-state commuters on the grounds that “the tax falls exclusively on the incomes of nonresidents.” *Austin v. New Hampshire*, 420 U.S. 656 (1975). However, corporations are uniformly held not to be citizens for purposes of this clause, so the states may impose burdens on foreign corporations that they do not put upon companies incorporated under their laws. But these burdens may only be imposed on companies that conduct intrastate business, having some level of business transactions within that state.

Other constitutional rights of the corporation or its members may also come into play when states attempt to license foreign corporations. Thus when Arkansas sought to revoke the license of a Missouri construction company to do business within the state, the Supreme Court held that the state had acted unconstitutionally (violating Article III, Section 2, of the US Constitution) in conditioning the license on a waiver of the right to remove a case from the state courts to the federal courts. *Terral v. Burke Construction Co.*, 257 U.S. 529 (1922).

Typical Requirements for Foreign Corporations

Certain preconditions for doing business are common to most states. Foreign corporations are required to obtain from the secretary of state a certificate of authority to conduct business. The foreign corporation also must maintain a registered office with a registered agent who works there. The registered agent may be served with all legal process, demands, or notices required by law to be served on the corporation. Foreign corporations are generally granted every right and privilege enjoyed by domestic corporations.

These requirements must be met whenever the corporation transacts business within the state. As mentioned previously, some activities do not fall within the definition of transacting business and may be carried on even if the foreign corporation has not obtained a certificate of authority. These include filing or defending a lawsuit, holding meetings of directors or shareholders, maintaining bank accounts, maintaining offices for the transfer of the company’s own securities, selling through independent contractors, soliciting orders through agents or employees (but only if the orders become binding contracts upon acceptance outside the state), creating or acquiring security interests in real or personal property, securing or collecting debts, transacting any business in interstate commerce, and “conducting an isolated transaction that is completed within 30 days and that is not one in the course of repeated transactions of a like nature” (Revised Model Business Corporation Act, Section 15.01).

Penalties for Failure to Comply with a Statute

A corporation may not sue in the state courts to enforce its rights until it obtains a certificate of authority. It may defend any lawsuits brought against it, however. The state attorney general has authority to collect civil penalties that vary from state to state. Other sanctions in various states include fines and penalties on taxes owed; fines and imprisonment of corporate agents, directors, and officers; nullification of corporate contracts; and personal liability on contracts by officers and directors. In some states, contracts made by a corporation that has failed to qualify are void.

Jurisdiction over Foreign Corporations

Whether corporations are subject to state court jurisdiction depends on the extent to which they are operating within the state. If the corporation is qualified to do business within the state and has a certificate of authority or license, then state courts have jurisdiction and process may be served on the corporation's registered agent. If the corporation has failed to name an agent or is doing business without a certificate, the plaintiff may serve the secretary of state on the corporation's behalf.

Even if the corporation is not transacting enough business within the state to be required to qualify for a certificate or license, it may still be subject to suit in state courts under long-arm statutes. These laws permit state courts to exercise personal jurisdiction over a corporation that has sufficient contacts with the state.

The major constitutional limitation on long-arm statutes is the Due Process Clause. The Supreme Court upheld the validity of long-arm statutes applied to corporations in *International Shoe Co. v. Washington*. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). But the long-arm statute will only be constitutionally valid where there are minimum contacts—that is, for a state to exercise personal jurisdiction over a foreign corporation, the foreign corporation must have at least “minimum contacts” with the state. That jurisdictional test is still applied many years after the *International Shoe* decision was handed down. *Judas Priest v. District Court*, 104 Nev. 424; 760 P.2d 137 (Nev. 1988); *Pavlovich v. Superior Court*, 29 Cal. 4th 262; 58 P.3d 2 (Cal. 2002). Since *International Shoe*, the nationalization of commerce has given way to the internationalization of commerce. This change has resulted in difficult jurisdictional questions that involve conflicting policy considerations. *Asahi Metal Industry v. Superior Court of California*, 480 U.S. 102, 107 S.Ct. 1026, 94 L. Ed. 92 (1987).

Taxing Authority

May states tax foreign corporations? Since a state may obviously tax its domestic corporations, the question might seem surprising. Why should a state ever be barred from taxing foreign corporations licensed to do business in the state? If the foreign corporation was engaged in purely local, intrastate business, no quarrel would arise. The constitutional difficulty is whether the tax constitutes an unreasonable burden on the company's interstate business, in violation of the Commerce Clause. The basic approach, illustrated in *D. H. Holmes Co., Ltd. v. McNamara* (see Section 25.4.2 “Constitutional Issues Surrounding Taxation of a Foreign Corporation”), is that a state can impose a tax on activities for which the state gives legal protection, so long as the tax does not unreasonably burden interstate commerce.

State taxation of corporate income raises special concerns. In the absence of ground rules, a company doing business in many states could be liable for paying income tax to several different states on the basis of its total earnings. A company doing business in all fifty states, for example, would pay five times its earnings in income taxes if each state were to charge a 10 percent tax on those earnings. Obviously, such a result would seriously burden interstate commerce. The courts have long held, therefore, that the states may only tax that portion of the company's earnings attributable to the business carried on in the state. To compute the proportion of a company's total earnings subject to tax within the state, most states have adopted a formula based on the local percentage of the company's total sales, property, and payroll.

Key Takeaway

A foreign corporation is a company incorporated outside of the state in which it is doing business. States can place reasonable limitations upon foreign corporations subject to constitutional requirements. A foreign corporation must do something that is sufficient to rise to the level of transacting business within a state in order to fall under the jurisdiction of that state. These transactions must meet the minimum-contacts requirement for jurisdiction under long-arm statutes. A state may tax a foreign corporation as long as it does not burden interstate commerce.

Exercises

1. What are some typical requirements that a corporation must meet in order to operate in a foreign state?
2. Provide examples of business activities that rise to the level of minimum contacts such as that a state may exercise jurisdiction over a foreign corporation.
3. What are some possible jurisdictional problems that arise from increasing globalization and from many corporations providing input for a particular product? For more information, see the *Asahi Metal* and *Pavlovich* court cases, cited in endnotes 13 and 14 below.

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