

Reincorporating a California corporation to a Delaware corporation

If you formed your startup in California or another state, and in any format other than a Delaware C corporation, you will at some point consider whether to reincorporate your business venture into a Delaware corporation. If your startup is based in California, then this can be a particularly elaborate undertaking.

Why would you convert your business from a California entity to a Delaware entity?

You may be about to raise a financing round, and your venture capital investors may require that you "re-incorporate" in Delaware prior to the financing. You may be in the middle of an exit, and the buyer may want you to become a wholly-owned subsidiary operating in the form of a Delaware C corporation.

Why do venture capital investors and buyers prefer for business ventures to be organized as Delaware C corporations? As our article on [where to incorporate](#) explains, Delaware has a well established set of corporate laws: compared to all other US states, the Delaware General Corporation Law (DGCL) is more modern, flexible and business-friendly, while the Delaware courts are consistent, predictable and generally lead the development of business law in the country. In addition, the C corporation entity in Delaware presents certain preferred tax treatments for investors. Find more details on the tax treatment of an S corporation compared to a C corporation in our article [here](#).

A corporation may wish to reincorporate in Delaware for a number of business reasons that address the needs of a growing national or international business. The purpose of the corporation's reincorporation will in many ways drive the process of reincorporation.

What is the problem you need to address?

"Reincorporation" is a categorical term for various transactions that result in a business entity moving to a different state and/or switching entity types. In most cases, a reincorporation involves a simple and quick statutory mechanism – generally involving the filing of certain forms – called a "conversion." However, in order for a conversion to occur, both states must accept the process – the state where you are already incorporated must allow the corporation to move to the new state, and the new state must accept the corporation moving into that state.

Unfortunately for many corporations, California is one of a handful of states that does not recognize the concept of conversion and thus will not allow a domestic corporation to convert into what it deems a "foreign" corporation. That means that to reincorporate a California corporation, we need to get creative.

How do you reincorporate your business from a California entity to a Delaware entity?

If a California corporation decides to reincorporate in Delaware, there are three basic methods to combine the Delaware corporation and the California corporation, all of which are subject to a multitude of variations. These are a merger, an asset sale, and a stock-for-stock exchange.

How do I reincorporate via merger?

If the reincorporation is to be effectuated using a merger, then specific and detailed statutory requirements must be followed. A technique frequently employed when a corporation desires to reincorporate in another jurisdiction is called a "downstairs merger."

A downstairs merger occurs when, for example, the converting California corporation creates a new, wholly owned Delaware subsidiary. This subsidiary is merely a shell corporation which has no business or assets. The converting California corporation then merges into its Delaware subsidiary, with the Delaware corporation as the surviving entity. The stock and other securities of the Delaware subsidiary will have rights, preferences, privileges and restrictions identical to the outstanding stock and other securities of the California corporation and is exchanged for all of such outstanding stock and other securities of the California corporation.

Under the California Corporations Code (the CCC), the board of directors of the California corporation and the Delaware subsidiary must approve an agreement of merger. The constituent corporations to the merger must be party to the agreement of merger, and the agreement of merger must contain the terms and conditions of the merger, the amendments (if any) to the articles of the surviving corporation, and the manner of converting the shares of each of the constituent corporations into shares or other securities of the surviving corporation, among other items. The shareholders of the California corporation also must approve the merger and agreement of merger.

Thereafter, the surviving corporation must file with the Secretary of State of California a copy of the agreement of merger, along with an officers' certificate of each constituent corporation attached stating the total number of outstanding shares of each class entitled to vote on the merger and that the principal terms of the agreement in the form attached were approved by that corporation by a vote of a number of shares of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class.

Through this method, the California corporation is turned into a Delaware corporation without any other change whatever in its business or assets or in the rights of its security holders. This is a "clean" transfer.

How do I reincorporate via asset sale?

An asset sale can also be employed whereby the California corporation sells all of its assets to the Delaware corporation and then liquidates and dissolves. The new Delaware corporation to which the assets are transferred will first need to be formed, with all the desired securities, interests, and stockholder rights and privileges. The shareholders of the California corporation will then receive stock in the Delaware corporation as payment for the assets. Thereafter, the Delaware corporation owns all of the California corporation's former assets, and the shareholders of the California corporation are stockholders of the Delaware corporation.

This method provides the corporation with a fresh start. For a large corporation with many stakeholders, replicating the rights of owners, creditors, and debtors in a newly formed Delaware corporation may be more difficult.

How to reincorporate via stock-for-stock exchange?

A stock-for-stock exchange occurs when the Delaware corporation, which was first formed, issues and exchanges shares of its authorized and unissued common stock to the shareholders of the California corporation in exchange for all of the outstanding shares of the California corporation stock. This method can only be employed if the California corporation is relatively closely held and all of its shareholders are willing to make the exchange. The Delaware corporation may continue to operate the business of the California corporation through its new wholly owned subsidiary – the California corporation – or it may effect a merger. This may be the most flexible of the reorganization techniques, because it is entirely a matter of private contract and is not governed by statutory requirements and regulations.

Key takeaway

Depending on the form the transaction takes, different corporate and tax issues may arise. Reorganization structures may also trigger one or more change-of-control provisions in the corporation's existing contracts, and it is advisable to review and identify them at the outset. Additionally, each of the above vehicles may have different obligations regarding stockholder voting and dissenters rights.

The absence of a statutory method for converting a California corporation into a foreign entity is, in a way, an opportunity for the corporation to reorganize its structure through the reincorporation. The method of reincorporation will depend on your purpose for reincorporation and the nature of ownership and business of the corporation in question.

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