



Mary Hanson



About the Business Advisor

The Business Advisor is written and published by Mary Hanson, a business attorney in Torrance, California.

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DISSOLUTIONS OF ENTITIES: Significant Changes in California Law

by Mary Hanson

California law on the dissolution of legal entities changed dramatically in 2006. The new law¹ affects dissolutions of entities after January 1, 2006.

Under the new law there is no need to file a Certificate of Dissolution or similar document with the Secretary of State by the end of the final tax year in order to avoid the \$800 minimum franchise tax (or annual tax) for the following year, provided that business has ceased and a final tax return is filed.² There is now no need to rush to file with the Secretary of State before year end. In addition, for corporations, a major change is that a tax clearance certificate is no longer required from the Franchise Tax Board before a dissolution is final.

Now an entity can take its time and file a Certificate of Dissolution (or other document appropriate for the type of entity) with the Secretary of State in 2007, for example, and NOT owe \$800 for the year 2007 if:

- The entity files a timely (including extension) final franchise or annual tax return for 2006; and
- The entity does not conduct any business in 2007; and
- The entity files the Certificate of Dissolution (or the document appropriate for the type of

entity) with the California Secretary of State within 12 months of the (timely) filing of the final tax return, including any extension.

At the time of the filing of dissolution documents with the Secretary of State, the entity cannot be suspended by the Franchise Tax Board for failure to pay taxes, penalties, or interest due.³

The entities affected by the new law are:

Corporations,

Limited liability companies (LLCs),

Limited liability partnerships (LLPs),

Limited partnerships, and

Not-for-profit corporations and exempt entities.

Since the new law is based upon the inactivity of an entity and the filing of a final return, the decision whether or not to dissolve a corporation or entity is really a decision of whether or not a particular tax return should be filed as a final return.

If the entity has not ceased business, it cannot dissolve. After a corporation has filed a Certificate of Dissolution it no longer has legal authority to transact business, although it can continue to take all actions appropriate as part of the

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process of winding up the business. After a final tax return has been filed for an entity, there can be no additional income and expenses reported for that entity.

The new law makes much more sense, making the decision to dissolve an entity turn on whether business activities have ceased and whether a final tax return can be filed. However, the process of dissolution still requires preparation and co-ordination.

There are a number of benefits to the dissolution of an entity after it has ceased business. One is the saving of expenses related to maintaining the entity. The yearly costs in California of maintaining a corporation or LLC include an \$800 minimum franchise tax for corporations or an \$800 annual fee for limited liability companies, and also the cost of preparation of an entity tax return. There are time and cost involved in maintaining corporate or other entity formalities (such as the annual meetings of the shareholders and the Board of Directors for corporations, or minutes of meetings for other entities), the fee of \$25 for the yearly filing of the Statement of Information with the Secretary of State (showing the address and other information on the entity), and the costs of maintaining a bank account and any other accounts, contracts, policies, or activities that are continued for the entity.

An additional benefit of dissolution of a corporation or LLC is that, under California law, after the formal dissolution of a corporation

or an LLC, a shareholder's or LLC member's liability is limited to the total value of assets distributed to that shareholder or member upon dissolution. Even that liability ceases after four years from the dissolution (or the statute of limitations for the claim, if that expires earlier).⁴

A liability concern that should motivate owners to dissolve a defunct entity is that an inactive business is likely to have limited funds and no insurance. If there are claims against the business, claims against an inactive, asset-less, uninsured entity are likely to become attempts to “pierce the corporate veil” (to hold the shareholders or owners liable for obligations of the entity). The limited liability of shareholders and members under California law after dissolution of an entity is far preferable to the liability exposure resulting from the piercing of the entity veil.

The Dissolution Process

What are the legal steps for the voluntary dissolution of a California corporation?

- (1) Shareholders representing 50% or more of the outstanding shares of the corporation must vote in favor of the dissolution.
- (2) The action of the shareholders must be evidenced by the minutes of a meeting or a Consent to Action signed by shareholders representing 50% or more of the outstanding shares.
- (3) A Certificate of Dissolution must

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be signed by a majority of the directors of the corporation.

(4) A Certificate of Election must also be prepared and signed by the officers or directors verifying the required shareholder vote in favor of the dissolution if the vote for dissolution is less than 100% of the outstanding shares. If the dissolution is being done by the shareholders, certain shareholders must be authorized to sign the Certificate of Election.

(5) A notice of commencement of dissolution proceedings must be sent to creditors or claimants of the corporation as well as shareholders who did not vote in favor of the dissolution.⁵

(6) The Board of Directors adopts a plan of dissolution. Funds or assets cannot be distributed to shareholders unless creditors have been paid or arrangements for payment have been made.⁶

Preparing for Dissolution

If you are planning to close your business, or have sold your business and plan to dissolve your corporation, there are a number of things you can do to be “ready” for the dissolution to avoid problems and minimize the effort required.

(1) Resolve any problems that may keep your entity from being in good standing with the state. Make sure your annual Statement of Information is filed and make sure taxes are paid and tax returns are filed when due.

(2) Keep a copy of your most recent Statement of Information to use in

preparing dissolution documents. It will be important for you to be certain that the information at the Secretary of State’s office matches the information and signatures on your dissolution and documents.

(3) Plan ahead. If you are still transacting business, plan when the “doors will close” and no further business will be transacted. Plan how you will sell assets, let employees go, pay bills, discontinue services, collect receivables, close out your sales tax permit, close out accounts, and give notice of closing and of dissolution as necessary. The business details of closing a business will be far more difficult than the legal steps.

(4) If the business has been closed, keep corporate finances separate from your personal finances as you finalize the corporation’s business, pay bills, taxes, and claims, and deposit refunds and payments. Keep your corporate bank account open until all “winding up” activity is complete.

(5) Make sure your corporate information and records are correct. Know who your officers, directors, and shareholders are. Know the percentage interest of each shareholder.

(6) Work with your tax advisor on your plan to liquidate and dissolve. Remember that any money or other assets you take out of your corporation could be as compensation, a dividend, a distribution of S corporation profits, repayment of debt, or for redemption of stock. Unless you are an



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Publisher's Note

The entire process of dissolution has changed in California. There is no longer any need to rush to file a Certificate of Dissolution in order to avoid additional yearly fees. The cost of dissolution has dropped, because the process can be done in a more logical, orderly fashion.

Since so much time is allowed to file the Certificate of Dissolution (without a risk that the annual taxes for the next year will apply if the Certificate is not filed by the end of the year), a corporation can take the risk of submitting a Certificate of Dissolution that does not meet the Secretary of State requirements. A corrected document can be resubmitted – without worry about missing a critical year-end deadline.

Mary Hanson
Attorney/Publisher

experienced tax and accounting professional, you will probably make incorrect assumptions about the corporation's tax basis in its assets, your tax basis in your stock, and the different types of tax consequences from the transfer of assets from the corporation to the

shareholders. A typical liquidation of a corporation involves a sale of the corporation's assets and then the distribution of remaining corporate cash and assets to the shareholders. Funds and assets distributed may be subject to two levels of tax. **BA**

FOOTNOTES

¹ Assembly Bill 2341, which was signed into law on September 29, 2006 affects tax years beginning on or after January 1, 2006. To view the entire bill and all amendments to the Corporations Code, Financial Code, and the Revenue and Taxation Code, go to: http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_2301-2350/ab_2341_bill_20060929_chaptered.html

² See Rev & Tax Code Sec. 23332 (c) for corporations, Sec. 17947 for limited liability companies, Sec. 17948.3 for limited liability partnerships, and Sec. 17937 for limited partnerships.

³ See Rev & Tax Code Sec. 23561

⁴ Sec. 17355 of the Corporations Code for LLCs; Sec. 2011 for corporations.

⁵ Corporations Code Sec. 1903

⁶ Corporations Code Sec. 2004

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