



Mary Hanson



## About the Business Advisor

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

Mary Hanson has a law degree from the University of Wisconsin and an MBA from the University of Southern California. She has practiced business law exclusively for 30 years.

She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

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## CLOSING A BUSINESS

by Mary Hanson

**I**n the current economic environment, business closure is a threat and has become a reality for many more business owners.

Many businesses have seen drastic changes in their industries, from changes in credit to global competition to changing needs or expectations of customers. While some business owners and managers have been able to shift to different goods, services, or markets, other businesses have been forced to consider liquidation.

I am dealing with many more business closures now than at any time in the prior 32 years.

Having a plan for closure of a business is AT LEAST as important as having a plan for starting a business. The closure of a business can leave business owners with substantial liabilities.

The plan needs to identify the liabilities the business and business owner may face and list all issues to be addressed in the closure. A closure plan facilitates the cross-checking of the diverse aspects of closing the business, making sure the proposed steps work together, and making sure no important issue is overlooked.

A business owner's main concern should be liability. The closure plan needs to address all types of

potential and actual liability. It is important to identify all contracts, debts, and unpaid obligations of any nature. Serious planning is normally needed to avoid or reduce business and personal liability.

Here are some typical liabilities you might face as a business owner and what might be done to address them:

**Leases.** Is there another party that can take over your lease? Can you plan to close the business at the end of your lease? A lease can be the greatest potential liability in the closure of a business. The lease is likely to be personally guaranteed. In the current environment, the leased premises may not be leased to a new tenant for some time. The exposure can be significant. Try to negotiate a release from an existing lease. Paying an agreed upon amount for a release is usually preferable to not knowing what that liability will be and wondering if the landlord will pursue you for unpaid rent.

**Contractual obligations.** Is there another party willing to fulfill your contractual commitments? Will another business agree to fulfill orders and meet warranty obligations? Will customers agree to a cancellation of orders, services, or other unfulfilled commitments? Can you negotiate a partial payment on your accounts payable or other business obligations?

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“Unknown” potential liabilities. Does your business sell a product that might involve implied warranties and product liability? What types of risks were involved in the goods or services provided by the business? As part of closure planning, review your insurance policies with a knowledgeable insurance person. Consider getting a policy that will cover you in the future for liabilities arising from goods or services provided when the business was in operation.

If you are planning to dissolve your entity, make sure such a step is consistent with your plan for handling liabilities. Make sure the “insured” on your insurance policies is consistent with your closure plans.

Leased equipment. Try to negotiate a favorable termination of the lease with the lessor. Try to find someone who needs the equipment to take over the lease. Recently lessors have been more flexible and more willing to agree to a transfer of a lease. Seek an arrangement in which you are completely released from liability on the lease.

Payroll liability and the termination of employees. Remember that there are specific rules regarding payment of terminated employees and that there are penalties for failing to comply. Unless you have established that a different rule applies in your situation, assume that the regular rule applies to you and that employees must be paid all of their wages and accrued vacation pay immediately at the time of termination.

The penalty for failure to pay on the day of termination is a day’s pay for the employee for every day of delay – up to a maximum of 30 calendar days.

Review your plan for termination of employees with an employment attorney. He or she will likely suggest offering severance pay in exchange for a release from potential claims. In addition, an experienced employment attorney can make valuable recommendations on how to handle terminations in a manner that reduces your potential liability.

Even if you have few employees, and especially if you have any “issues” with employees (related to possible compensation claims, discrimination, or personal vendettas), get good advice before employees are terminated.

## Assets

Plan to get the most value out of the business assets. A slow and well-promoted sale of assets will bring in much more money than a last minute fire sale. There are now a number of firms available to help in liquidation sales. Their advice is helpful in planning sales, promotions, and the details of the liquidation, such as making sure the sales are “as is” and “final.”

Identify valuable intangible assets. Do you have a customer list or a recognized business name that may be valuable to another business?

Work hard to collect your accounts receivable. Expect greater resistance to payment after the doors are closed.

## CLOSING A BUSINESS

Don't forget to collect all deposits on accounts. If the business closure is at the end of a lease, you will get your security deposit refunded. You may have a number of other deposits on various accounts. If your review of your insurance requirements identified unneeded insurance policies, don't delay in cancelling unneeded policies and obtaining refunds of any unearned premiums.

If you have a pension plan, work with your pension advisors to plan the termination of the pension plan. A pension plan cannot survive without the employer sponsor, and termination of the plan will involve notices to employees, rolling over or distributing assets, and complying with reporting requirements.

Are you planning to distribute remaining funds to yourself or other shareholders? Were you planning to just take home some of the left over assets? Make sure your plan covers the tax consequences of all distributions, loan repayments, compensation, purchases, and any other transfers.

### Taxes

Payroll taxes must be paid and a final report and final statement must be submitted to EDD. The forms are required to be filed within 10 days of the closure of the business.

A final sales tax return must be filed. The individual responsible for paying sales tax can have personal liability for unpaid taxes and penalties.

Don't forget to use tax planning to minimize your taxes or optimize your entity and personal tax situation.

### Tax and Accounting Advice

There are a number of tax planning issues that most likely require your accountant's input and advice. Here are some of the questions you will want to ask your accountant:

- What is my entity's tax basis in the assets it's selling? Will the corporation (or I, if I don't have any entity) have depreciation recapture (taxed at ordinary rates)?
- Will I be able to take a loss on the closure of the business?
- Will I (or the entity) have taxes to pay on forgiveness of indebtedness?
- Do I have losses carried forward that I can use to offset income from liquidation sales?
- Do I have shareholder loans that I can repay with remaining cash (without taxes to me)?
- Can I just take some of the equipment that has been completely depreciated and has no book value?
- What is the best way to take a vehicle? Can I pay book value for it? Should I pay for it or take it as compensation or a final distribution of assets to shareholders?
- What is the amount of my "liquidating dividend" in exchange for my stock? Will you prepare a 1099 showing the distribution?

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## Publisher's Note

It's worth the effort to find another business willing to take over some parts of a closing business. Even if a buyer is unable or unwilling to pay much for business assets, having another business take over a portion of ongoing obligations can have significant value.

In the good old days, some arrangements would only be acceptable if the party taking over ongoing obligations was financially very strong. Now some business owners are willing to enter into assignments and other arrangements with the philosophy that any payments made by the assignee or subtenant reduces the departing business owner's total exposure.

The most troublesome business situation is one in which significant obligations are personally guaranteed. If this situation makes personal bankruptcy a possibility, get bankruptcy advice early on. A good business bankruptcy attorney has a wealth of knowledge and advice not only on bankruptcy, but on debts, creditors, personal liability, compromises on taxes and other obligations, and avoiding mistakes in handling financial obligations.

Mary Hanson  
Attorney/Publisher

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a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

## Disposition of Entity

Expect to keep the business entity open until the end of its tax year. There is no longer a need to rush to dissolve an entity. You can now take your time to dissolve the entity and still avoid tax liability for the \$800 annual franchise tax, as long as you don't have any business activity after the end of the "final" year for which a final tax return will be filed.

There is no "one size fits all" recommendation regarding dissolution of an entity. But don't rush to dissolve the entity. Once it is dissolved, there is no going back and undoing the dissolution. Without the entity,

you may miss some tax-planning possibilities as well as protection from personal liability.

Closing an entity does not terminate obligations. Many liabilities are moved to the individual owners. The cap on each shareholder's liability resulting from dissolution of a corporation is the amount received by the shareholder in liquidation of the entity. This is a valuable limitation, and care should be taken to document the amount of that distribution, even if it means having the entity send you a 1099 and paying tax on the distribution. **BA**

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