



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 more than 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.

Her interests include flying and World War II.

Her law office is located in the Del Amo Financial Center, 21515 Hawthorne Blvd. #885, Torrance, California. She can be reached at (310) 543-1355 or by e-mail at mhanson@bizadvisor.com

STEPS FOR DISSOLUTION OF CORPORATIONS AND LLCs

by Mary Hanson

The key documents for dissolution of California corporations and LLCs are the Certificate of Dissolution for corporations and the Certificate of Cancellation for LLCs. The key step in the dissolution of either of these entities is wrapping up the business activity of the entity so that the entity can be terminated. A step that is important for most businesses is getting tax advice on the tax consequences arising from the actions involved in the winding up and from the filing of a dissolution certificate. If the tax consequences from the filing of a certificate ending an entity's existence are significant, then an additional tax question is whether one year is better than the other for the filing of the dissolution document.

Under California law it is no longer necessary to file a Certificate of Dissolution or Certificate of Cancellation by year-end in order to finalize the entity and avoid taxes and tax return requirements for the next year. Now a certificate to formally end the entity's existence can be filed months after the year for which a final tax return is filed, without having to pay minimum taxes for years after the final tax year. Now dissolution planning focuses on concluding all business activity, capturing all financial activity in the entity's last year, and determining that the tax return will be a final return. These steps are done before the filing of documents that terminate the existence of the entity, which can be done much later.

The filing of a Certificate of Dissolution or Certificate of Cancellation is typically done after the end of the final tax year. After the tax year has ended and the business's financial activities have been successfully concluded and captured in the final year tax return, the dissolution documents can be filed with confidence that the entity can be terminated.

If an entity continues to have contractual obligations, debt to collect, disputes to pursue, or ongoing taxable financial matters, the entity will need to continue its existence. Even if all business and tax-related activity has ceased and assets of the entity have been sold it may still be necessary or desirable to maintain the entity for some period of time. If the entity continues into the next tax year, the tax planning then revolves around concluding the entity activity in the new tax year. Coordinating the tax termination and legal termination is important.

If the business and financial activities of an entity have ceased and most assets have been sold, the typical liquidation of an entity involves a sale or distribution of any remaining assets, payment of all remaining obligations, and the distribution of the cash (including the proceeds from the sale of the business assets) to the shareholders or members.

Tax advice is needed for most dissolutions. A dissolution will often involve the distribution of some asset such as a personal vehicle to one person, and that distribution needs to be

▼

“The filing of a Certificate of Dissolution or Certificate of Cancellation is typically done after the end of the final tax year.”

treated as compensation, repayment of debt, or part of the final distribution to shareholders or members. Compensation or debt owed to different shareholders or members must be paid before distribution of the assets in final liquidation. And shareholders and members of flow-through entities may have different capital accounts which need to be evened up prior to the final liquidating distribution.

Because the dissolution of an entity ends its existence for contract purposes and tax purposes, there are often unanticipated tax consequences at both the entity and shareholder level. Even for flow-through entities where taxes are paid by the shareholders or members, the termination of the entity often triggers tax issues at two levels.

The business planning and tax planning for liquidation of the entity are far more challenging than the legal steps, which are defined by statute for California corporations and LLCs.

Dissolution of a California Corporation

Shareholders representing 50% or more of the outstanding shares of the corporation must vote in favor of the dissolution. This shareholder vote is documented in minutes of a meeting or a Consent to Action signed by shareholders representing 50% or more of the outstanding shares.

The Board of Directors adopts a plan of dissolution. A corporation with significant assets, obligations, or shareholders needs a detailed plan of dissolution. An inactive corporate shell distributing funds to one or two shareholders after the sale of a business doesn't need much of a plan.

A Certificate of Dissolution signed by a majority of the directors of the corporation is filed with the California Secretary of State. If the vote in favor of dissolution is 100%, the Certificate of Dissolution is the only form required. Since this filing terminates the existence of the corporation, it should only be filed after all financial activity has ended, tax planning has been done, and the filing of the final tax return has been confirmed. This form and the other California dissolution forms are one page check-the-box forms. There is no filing fee. It is very easy to file the dissolution forms.

A Certificate of Election signed by the officers or directors must also be filed with the California Secretary of State if the shareholder vote for dissolution is less than 100% of the outstanding shares. This form can be filed early in the dissolution process or with the final Certificate of Dissolution.

California law requires a notice of commencement of dissolution proceedings be sent to creditors or claimants of the corporation and to shareholders who did not vote in favor of the dissolution. A corporation that has concluded its business and financial activity often has no creditors and no shareholders requiring notice.

The dissolving corporation must be in good standing with state agencies. The Statement of Information due annually must have been filed and the officers and directors signing dissolution documents must be the officers and directors identified on the corporation's current Statement of Information. California dissolutions no longer require a tax clearance certificate from the Franchise Tax Board and a Certificate of Dissolution

STEPS FOR DISSOLUTION OF CORPORATIONS AND LLCs

can be filed without payment of state taxes. However, the Certificate of Dissolution contains a statement that a final state tax return has been or will be filed, and all state taxes need to be paid as part of winding up of the entity.

California law on corporate dissolution sets out mechanisms for a corporation to provide for payment of problematic debts and liabilities after dissolution so that the corporation can be wound up and dissolved.

The statutory language on a dissolving corporation's distribution of assets provides that "After determining that all known debts and liabilities... have been paid or adequately provided for..." a corporation's "board shall distribute all the remaining corporate assets among the shareholders according to their respective rights and preferences..."

Dissolution of a California LLC

The dissolution of a California LLC is triggered by the first to occur of:

- An event identified in the LLC's Articles of Organization or Operating Agreement as an event causing dissolution;
- The vote of 50% or more of the voting interest of the members (or higher percentage if provided in the Articles of Organization or Operating Agreement);
- The passage of 90 days with the LLC having no members; or
- A judicial dissolution.

When the dissolution of an LLC is triggered by an event of dissolution identified in the Articles of Organization or Operating Agreement or by the vote of less than all the members

of the LLC, a form LLC-3 "Certificate of Dissolution" must be filed. The form can be filed upon commencement of the dissolution process or with the filing of the Certificate of Cancellation when the process is concluded and the LLC is completely wound up.

The form LLC-4/7 "Certificate of Cancellation" is the document that ends the existence of a California LLC. Like the other California dissolution forms, it is a check-the-box form and there is no filing fee.

California law also requires that LLCs with creditors or claimants send a notice of commencement of dissolution proceedings to creditors or claimants in the records of the LLC.

The dissolving LLC must be in good standing with state agencies. The Statement of Information due biennially must have been filed, and the managers signing dissolution documents must be identified on the LLC's current Statement of Information. The LLC should have filed all state tax returns due and paid all taxes. The Certificate of Cancellation form contains a statement that a final state tax return has been or will be filed.

The California statute on distribution of assets upon dissolution of an LLC is more detailed than the statutory provision for corporations. LLCs are very flexible and members of an LLC may have a variety of differing rights as well as different capital account balances, so California law covers the priorities that are likely to be needed when liquidating the assets of an LLC. The provisions of the California LLC law apply if an LLC's operating agreement does not cover the distribution of the LLC's assets.



“The business planning and tax planning for liquidation of the entity are far more challenging than the legal steps...”

RETURN SERVICE REQUESTED



Publisher's Note

The tax advisor calculating the tax consequences of an entity dissolution may recommend an earlier filing of a final dissolution document before the end of the final tax year (e.g., filing in 2021 when the final tax year will be the year ended 12/31/2021) if the dissolution happens to have a major tax consequence (income, loss, gain, etc. from some recent or long-forgotten distribution, payable, receivable, capital contribution, shareholder loan, etc.) either at the entity level or for a shareholder or member AND there is an offsetting tax-related event or optimizing low or high marginal rate in the particular year (2021 in the this example).

An entity's tax advisor will play an important role in the dissolution of a typical California corporation or LLC. The tax consequences are far from one-size-fits-all. Unanticipated tax consequences can be triggered at two levels and by both federal and state tax law. The California time periods for filing dissolution documents with the Secretary of State but treating the year of the final tax return as the final year of obligations to the Franchise Tax Board are in the California Revenue and Tax Code.

Mary Hanson
Attorney/Publisher

Business Advisor

a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

California law provides:

The first step is determining that all known debts and liabilities of the LLC including debts and liabilities to members who are creditors of the LLC have been paid or adequately provided for.

The next priority is payment to members of the LLC in satisfaction of outstanding rights to distributions.

The third item is payment to members of the LLC for return of their contributions to the LLC.

The last item is distribution to the members according to their percentage rights to distributions set out in the LLC operating agreement or as established in California statutory provisions that set distribution rights in the absence of coverage in the LLC operating agreement.

The law on dissolution of LLCs also sets out a mechanism for payment of unresolved debt or liability after dissolution of an LLC.

After dissolution of a California corporation or LLC, the former shareholders of a corporation and members of an LLC can be sued for entity claims or obligations. California law sets out procedures for creditors and claimants of dissolved corporations or LLCs to pursue their claims by suing either the entity or the shareholders or members on behalf of the dissolved entity. For both corporations and LLCs the period of time is the shorter of four years or the statute of limitations on the underlying claim. The liability of both members and shareholders is limited to the amount received in the dissolution of the entity.

BA