



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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She received her private pilot's license in 1996 and became a Special Member of the Second Air Division Association, an organization of World War II veterans of the U.S. Air Force.

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TERMINATING AN LLC OR CORPORATION

by Mary Hanson

Beginning in 2024 the Corporate Transparency Act requires corporations, LLCs, and other entities owned by individuals to file a new “Beneficial Ownership Information Report” with the Financial Crimes Enforcement Network (FinCEN), a federal agency within the Department of the Treasury. Entities formed before 2024 have until January 1, 2025 to make their filings. One consequence of the new requirement is likely to be the closure of corporations and LLCs that are no longer active in business.

Shareholders of corporations and members of LLCs should start planning now if termination in 2024 is desired. While “closure” sounds easy, entities with assets or liabilities or ongoing contracts or payments may need a long time to dispose of assets, address liabilities, get advice on minimizing taxes, and make final distributions to shareholders or LLC members.

Key advice is to start the process early, address issues that could create problems, and avoid hasty termination of an entity. Once an entity is terminated it can no longer make sales, make some transfers, modify contracts, or defer the tax consequences of the termination. An entity that has some financial activity may have many issues to address. Even an entity that has been inactive for some time can present challenging issues upon termination. Some entities are tax time-bombs that may be set off upon termination.

Here are a few topics that should be addressed before pulling the trigger on entity termination:

Assets

Disposition of physical assets, such as vehicles, furniture, computer equipment, machinery, tools, and supplies presents the challenge of identifying methods of disposition and potential buyers for diverse types of assets. Finding buyers can take time.

Intangible assets, such as trademarks, domain names, customer lists, customer information, websites, and other intellectual property should also be considered.

If maximizing value is important the entity needs a well-crafted plan with good advice and capable management to implement the plan for a sale of assets.

Typical Contracts

Leases for business premises. Any plans for the closure of an entity with an on-going lease must consider the terms of the lease. It is important to know when the lease expires, what the total lease liability is, and whether the lessor will be willing to extend the term of the lease or agree to an early termination.

Equipment leases. The final payment date for each lease and the total amount of all payments – or the payoff amount from the lessor or lender – is required to determine the total liability for equipment leases in the event of a transfer or closure of the business. The alternatives for the transfer of leases or return of equipment need to be identified early on. It should not be surprising if lessors require full payoff of the entire lease in order to transfer or close out an equipment lease.

Software licenses. All software licenses

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need to be identified. A closure plan needs to consider the expiration dates of current licenses, the terms for renewal or termination, the requirements for transfer of licenses, and the total cost to resolve all licenses. Financial software may be needed long after the business is transferred or closed.

Customer contracts. Contractual obligations to customers need to be reviewed to determine whether on-going obligations can be completed, transferred, terminated, or negotiated. Long-term contract obligations, such as warranty or support obligations, need to be identified and addressed.

Other contracts. Agreements with vendors, subcontractors, independent contractors, distributors, and others must be reviewed for on-going payment obligations, old payment obligations, termination requirements, and remaining contract obligations.

Review of existing contracts should include identification of any unresolved claims under any of the contracts.

Other obligations

Various sources of information should be checked to identify all obligations, commitments, contracts, and assets that should be addressed in order to terminate an entity with confidence that potential problems have been addressed. Checking account and banking information is typically useful for identifying sources of income and elements of obligation, since every entry of a payment received or payment made in a checking account program reflects either a one-time or an on-going business relationship. Reviewing payment information from prior years may also pick up infrequent but potentially significant obligations.

Debt obligations and liens. A business may have a bank line of credit and debt financing from various sources, as well as equipment loans, SBA loans, PPP loans related to a Covid-19 shutdown, and credit card balances. Each obligation needs to be identified and addressed. If a business’s loan information is not up-to-date, payoff information must be obtained from lenders. Many such loans are secured (collateralized) with assets of the business, with financing statements (UCC-1s) on file with state agencies to record liens on the business assets. A buyer of assets will check publicly available records for filings with the state agency (typically the Secretary of State in California) and will require that the lien filings be terminated before the buyer will purchase the assets. Business owners need to plan to pay off or resolve loans and get the filings terminated to be able to transfer assets to buyers. Public records may contain outdated or erroneous information that must be corrected. It can take time to resolve debt issues, negotiate payment, or correct erroneous filings.

An entity cannot unilaterally resolve debt obligations, records of liens, contract obligations, and other matters involving third parties. Old unresolved matters may present the challenge of finding the appropriate party to confirm, sign, file, terminate, agree, or otherwise resolve the matter.

Payroll and employee termination.

When a business is closed or sold employees are terminated and the business must comply with state and federal laws regarding termination of employees. Any termination requires compliance with the requirements for prompt payment of final wages and other compensation. Failure to comply with requirements can unnecessarily

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increase liability for the entity and the individuals responsible for payroll obligations. A business that has “issues” with employees needs advice from an employment attorney regarding potential employee claims, as well as compliance with requirements related to the business closure.

Taxes. A closure plan requires an estimate of the tax liability for both the entity and its shareholders or members. Taxes are likely to be very different from prior years and the assistance of a business’s tax advisor may be essential to capture all tax aspects of the termination of the entity. In addition to the usual income taxes, the business may owe taxes on capital gains, depreciation recapture, and other aspects of the sale of assets.

A business that does not have a sales tax permit and normally does not collect sales tax may become subject to sales tax on the sale of assets if assets are sold in several sales rather than in one sale to one buyer.

Personal guaranties. In the review of all obligations, business owners will want to determine whether they have personal liability arising from the business activities or obligations of their entities. Personal guaranties are often signed by business owners for leases, bank lines of credit, credit cards, and vendor contracts.

In addition, state laws impose personal liability on business owners for some unpaid taxes. Such personal liability exists and continues without regard to the status of the entity.

Personal liability after entity dissolution. After an entity is terminated, claims can still be pursued against the entity and its shareholders or members for a number of years after the termination. The typical statutory liability continues for a

period of 4 years after the termination of the entity but is limited to the extent of distributions to the individual from the terminated entity.

In addition to personal liability based on personal guaranties and shareholder or member post-termination liability, an individual may have personal liability for his or her own actions, negligence, or failure to act related to the business activity of the entity. The termination of an entity may increase a claimant’s interest in the personal liability of the individual. Termination of an entity does create an obstacle to pursuing claims, but claimants with significant claims may find it worthwhile to make the effort and incur the expense of pursuing former shareholders or LLC members after termination of an entity.

Insurance policies. It is important for businesses to review insurance policies for coverage of the remaining activities of an entity being wound down and to plan for post-closure protection. Assumptions about coverage should be avoided and insurance requirements should be confirmed. While it may be tempting to drop insurance policies as business activities are reduced, careful planning is needed to make sure appropriate insurance coverage is continued.

If the business, a portion of the business, or some of the assets of a business will be transferred to a buyer, the buyer will want to know that appropriate insurance coverage is in place until the buyer takes possession and provides coverage through the buyer’s insurance.

If the entity to be closed harbors potential liability, such as product liability, the shareholders or members should want to obtain a policy for protection from post-closure liability

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RETURN SERVICE REQUESTED



Publisher's Note

Beneficial Ownership Information ("BOI") Reports required under the Corporate Transparency Act ("CTA") must provide the names, residential street addresses, dates of birth, and images of U.S. passports, drivers' licenses, or similar IDs for all individuals owning 25% or more of an entity or somehow controlling the entity. The entity has an obligation to obtain and file the required information regarding its shareholders or members and the penalties for failing to file the reports are quite high.

Entities formed prior to 2024 have until January 1, 2025 to make the required filings. Entities formed in 2024 have 90 days to file the BOI report with FinCEN.

Despite anticipation that accountants and attorneys would add this burden to existing filing requirements, many accountants, attorneys, and other professionals are leery of bearing responsibility for securely collecting sensitive information, hounding clients for correct information, and timely filing the information with an unfamiliar government agency on a new electronic filing portal.

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following the termination of the entity. Insurance covering post-closure liability (often called a "tail" policy) may protect the shareholders and members of a terminated entity.

Termination of the Entity

Legal termination of an entity is a simple filing of a form or two forms with the Secretary of State in California (or the agency that handles entities in the state where the entity was formed). The termination must be filed in the same state in which the entity was formed.

California corporations and LLCs are both subject to state law requiring the vote of shareholders or LLC members for termination of corporations and LLCs. State statutes must be checked for requirements regarding voting rights, notices, and shareholder or LLC

member approval for the termination of the entity and disposition of assets as planned by the entity. In addition, a California LLC may have unique requirements related to termination of the entity, disposition of assets, or other actions related to winding up the business of the entity. The flexibility under California law allows an LLC to have requirements that can only be determined by review of the particular LLC's operating agreement.

Keeping a corporation or LLC active is usually a better choice than incautiously closing out a business entity. The best choice may be deferring the termination to a later tax year or to a time when the assets, liabilities, contracts, and other issues can be addressed in an orderly winding up, liquidation, and termination of the entity. Good planning pays off. **BA**