



Dissolve with the Secretary of State or pay another \$800 tax

This article discusses corporations, but the same applies to LLCs except as noted.

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Publisher

Although December 31, 2015, was not the drop dead date to dissolve an entity and avoid the \$800 minimum/annual tax for 2016, now might be a good time to start preparing the paperwork if your client's entity wrapped up their business (liquidated) in 2015.

A corporation is dissolved when the corporation is dissolved under state law. A corporation that ceases business and meets the liquidation requirements of IRC §332 must dissolve with the Secretary of State (SOS) to stop the clock on the \$800 minimum tax.

For California purposes, you must dissolve the corporation by filing required documents with the SOS, or the corporation (and maybe the shareholder) will be liable for the annual \$800 minimum franchise tax until the dissolution is complete.

Note: California conforms to IRC §§336 and 337 for taxation of corporate liquidations, as well as §331 for shareholder tax treatment.¹

How to dissolve

The voluntary dissolution of a domestic stock corporation is initiated by an election to dissolve, which may be made by:

- The vote or written consent of at least 50% of the outstanding shares of the corporation;
- The board of directors if no shares have been issued; or
- In limited circumstances, by a majority of the incorporators if no directors were named in the original Articles of Incorporation and none have been elected.²

Following the dissolution election, the corporation must file documents with the SOS.

To dissolve, the corporation must file a Certificate of Election to Wind Up and Dissolve (Form ELEC STK) prior to or together with a Certificate of Dissolution (Form DISS STK). However, if the election to dissolve is made by the vote of all the outstanding shares, only the Certificate of Dissolution is required.

When to dissolve with the SOS

The FTB will not assess the \$800 minimum franchise tax or the \$800 annual tax if a business entity meets these three conditions:

- The entity files a timely final tax return on or before the extended due date for the preceding taxable year;
- The entity does not do business in California after the end of that year; and
- The entity files a Certificate of Dissolution, Surrender, or Cancellation with the SOS before the end of the 12-month period beginning with the date the final return was filed.³

If the corporation dissolves with the SOS mid-year, the corporation has a short year, and the return is due on the 15th day of the third month after the month of dissolution.⁴ However, there is a six-month extension. Failure to file the return on or before the extended due date could result in penalties.

EXAMPLE 2-1: Wrap-it-Up, Inc., a calendar-year S corporation, sold its assets and distributed cash to the shareholders on July 3, 2015. Wrap filed cancellation documents with the SOS on July 20, 2015. Wrap has a short year and must file its final California return on or before April 15, 2016, or be subject to late-filing penalties.

On the other hand, Wrap could file its final 2015 full-year return on or before October 15, 2016, and could then file dissolution paperwork within 12 months of filing the timely California final return.

Short-term dissolution

A domestic stock corporation can file a Short Form Certificate of Dissolution (Form DSF STK) if the following requirements are met:

- The Short Form Certificate of Dissolution is being filed within 12 months from the date the Articles of Incorporation were filed;
- The corporation has no debts and liabilities (other than tax liability);
- The tax liability will be satisfied on a taxes-paid basis, or the tax liability will be assumed;
- The final tax return has been or will be filed with the Franchise Tax Board;
- The corporation has not conducted any business;
- The corporation has not issued shares, and if the corporation has received payments for shares from investors, those payments have been returned to those investors;
- The majority of the directors (or incorporators, if directors were not named and none have been elected) authorized the dissolution and elected to dissolve the corporation; and
- The assets have been distributed to the persons entitled thereto, or no assets have been acquired.⁵

Comment

This process also applies to an LLC.⁶ An LLC qualified for this streamlined cancellation process is exempt from paying the annual tax during its first 12 months but is not allowed any refunds of taxes or fees already paid to the FTB.

LLC taxed as a corporation

If the LLC taxed as a corporation has made a valid check-the-box election, for SOS purposes, the entity is still an LLC. Thus, the final return will be done on a Form 100 or Form 100S. However, the entity will file LLC cancellation documents with the SOS.

Liquidating but not dissolving

The corporation itself may remain in existence in order to keep the name or to be used for another business at a later time. Thus, a corporation may be liquidated without being dissolved.⁷

EXAMPLE 2-2: Best Name Ever, Inc. ceased business in 2014 and liquidated under IRC §332. However, the owners of Best want to preserve the name so their son can start a new business in 2017 using the same name.

To do this, Best does not dissolve with the SOS. Best has no federal filing requirement but must file California corporate returns showing only the \$800 minimum tax because they are not dissolved.

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Information and forms are available from the SOS website at:

www.sos.ca.gov/business/business.htm

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Reasonable cause

There are no reasonable cause exceptions to these filing deadlines, and filing late paperwork will result in assessment of another year's minimum/annual tax.

The date of dissolution is not the date the SOS documents are mailed but the date they are stamped as received by the SOS.

Practitioner pointer

Use a service to have the documents delivered to the SOS so the documents are not lost in the mail and the date is not missed.



¹ R&TC §§24451, 24461

² Corp. Code §§1900, 1900.5

³ R&TC §23332

⁴ R&TC §18601(c)

⁵ Corp. Code §1900.5; R&TC §23331

⁶ R&TC §17947

⁷ Treas. Regs. §1.332-2(c)