

ANALYSIS OF AMENDED BILL

Author: Harman Analyst: Norman Catelli Bill Number: AB 241
 Related Bills: See Legislative History Telephone: 845-5117 Amended Date: March 30, 2005
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT:	Corporation & Other Business Entity Mergers/Certificate of Satisfaction
-----------------	---

SUMMARY

This bill would streamline certain business entity mergers by eliminating the requirement that Franchise Tax Board (FTB) certify that the franchise and income tax obligations of a disappearing entity have been satisfied.

SUMMARY OF AMENDMENTS

The March 30, 2005, amendments make several nonsubstantive, technical changes that do not impact the department.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to reduce the administrative complexity of merger transactions and eliminate delays in completing such transactions.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2006, and would apply to certificates of mergers filed by the Secretary of State (SOS) after that date.

POSITION

Pending.

ANALYSIS

Existing state law requires that owners of a business seeking to be recognized as a legal distinct entity file articles of incorporation or organization with SOS. Once SOS accepts the filing, the business entity is recognized as a domestic entity until the date it files a certificate of dissolution, or cancellation, with SOS.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

For foreign business entities seeking to transact intrastate business in this state, the business entity must file a certificate of qualification with SOS. Once SOS accepts the certificate of qualification, the foreign business entity is recognized as qualified to transact intrastate business from the date of qualification until the date it files a certificate of withdrawal with SOS.

Existing state law provides that two or more corporations may be merged into one corporation (i.e., the surviving corporation). To accomplish the merger, among other things, the surviving corporation is required to submit a copy of the agreement of merger to the SOS, and the SOS must file the agreement of merger. Once the SOS files the agreement of merger, the parties to the merger are immediately treated as one corporation, and the merger is deemed effective on the date the agreement of merger was originally submitted by the surviving corporation to the SOS. However, before the SOS can file the merger agreement, it must request and receive a certificate of satisfaction from FTB unless the surviving corporation is a domestic corporation or a foreign corporation qualified to do business in California and the disappearing entity is a domestic corporation.

A public benefit, religious, or nonprofit corporation may merge with any domestic or foreign corporation, or other business entity. Unless first receiving prior written consent from the California Attorney General's Office, a public benefit, religious, or nonprofit corporation may only merge with another public benefit, religious corporation, or a foreign nonprofit corporation whose articles provide its assets are irrevocably dedicated to charitable, religious, or public purposes.

The certificate of satisfaction certifies that FTB is satisfied from the available evidence that all taxes imposed on the disappearing corporation have been paid or are secured by bond, deposit, or otherwise. Currently, FTB requires that the disappearing corporation file all returns due and that any outstanding tax liabilities be paid or secured by bond before the certificate be issued.

State law also provides that upon the merger of two or more domestic corporations (defined as incorporated under California corporation law, as distinguished from foreign corporations, which are incorporated under the corporation laws of some other jurisdiction), the separate existence of the disappearing corporation(s) ceases. Furthermore, the surviving corporation assumes all of the debts and liabilities (including tax debts and liabilities) of each disappearing corporation in the same manner as if the surviving corporation had incurred those debts and liabilities directly. There is also an explicit statutory requirement for the surviving corporation to prepare and file tax and information returns and to pay any state tax liability of the domestic disappearing corporation(s).

For a surviving foreign corporation the merger becomes effective in accordance with the law of its jurisdiction. The surviving foreign corporation is required to file with SOS a copy of the merger agreement, certificate, or other documents filed with the state of its incorporation. In addition, the disappearing corporation is required to obtain from FTB a certificate of satisfaction as described above.

If the articles of incorporation of a domestic disappearing corporation were filed less than 60 days before the date of filing the agreement of merger, the SOS can file the merger without the certificate of satisfaction from the FTB if two conditions are met. First, the surviving corporation must be a domestic corporation. Second, a certificate of satisfaction must be received from FTB.

THIS BILL

This bill would allow the SOS to file an agreement of merger of two or more business entities without receipt of the certificate of satisfaction from FTB if the surviving entity is a: (1) domestic limited liability company, (2) domestic corporation, or (3) registered limited liability partnership; or (4) a foreign limited liability company, (5) foreign limited liability partnership, (6) or foreign corporation that is registered or qualified to do business in California.

The disappearing entity must be: (1) a foreign or domestic limited partnership, (2) a domestic or foreign limited liability company, (3) a registered or foreign limited liability partnership, or (4) a domestic or foreign corporation.

The assumption of liability is accomplished by creating a statutory requirement that the surviving entity assume any liability of the disappearing entity for the preparation of any necessary tax returns and the payment of any tax liability that may be determined to be due.

IMPLEMENTATION CONSIDERATIONS

Currently, a surviving entity is required to “assume” or take responsibility for the disappearing entity’s tax liability upon merger. By replacing the term “assume” with the term “subject to,” this bill would reduce the clarity of a surviving entity’s responsibility for a disappearing entity’s tax liability, which could ultimately leave the tax liability unpaid. Because “subject to” could be interpreted as speculative rather than certain, the department could be required to take legal action against any surviving entity to compel it to pay the disappearing entity’s tax liability.

Currently, FTB reviews the proposed merger of exempt organizations for two principal issues: (1) assets are properly disposed of, and (2) the surviving entity continues to qualify for exemption, assuming it is an exempt entity. Under this bill, if an unacceptable merger occurs, in terms of tax-exemption, FTB will not discover that fact until after the merger is final.

Implementing this bill would require some changes to existing tax forms, instructions, and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

This bill appears to use certain terms interchangeably, i.e., “domestic disappearing corporation” and “disappearing domestic corporation.” The author may wish to use one term to describe disappearing domestic corporations to reduce potential confusion of the author’s intent.

In numerous sections of this bill, reference is made to the filing requirements by citing the R&TC chapter relating to the taxation of the disappearing entity. However, since the adoption of the “check-the-box” regulations in 1997, certain unincorporated business entities may elect to be taxed as corporations. For example, LLCs, may elect to file corporation tax returns and be subject to corporation tax rather than the LLC provisions. Therefore, the preparation and filing requirements should be for the “appropriate” return and tax for the entity’s tax classification.

The Corporation Code (Section 1113(g)(1)) would still require that a certificate of satisfaction be filed with FTB before the filing of a merger certificate could be accepted. This code section needs to be amended to remove this requirement if the objectives of this bill are to be accomplished.

LEGISLATIVE HISTORY

SB 324 (Ackerman, Stats. 2001, Ch. 50) allowed the SOS to file an agreement of merger of two or more corporations without receipt of the certificate of satisfaction from FTB if the surviving corporation is a domestic or qualified foreign corporation and the disappearing corporation is a domestic corporation, for mergers after January 1, 2002.

OTHER STATES' INFORMATION

The laws of *Florida, Illinois, Massachusetts, Michigan, and Minnesota* were reviewed because their tax laws are similar to California's income tax laws.

For all states described above, the general rule is to require the surviving corporation to assume all liabilities of the disappearing corporation including income tax liabilities before the merger will be recognized by the state's proper authority.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Because the tax liability of each disappearing entity would shift to the surviving entity, this proposal would not change the amount of personal income tax or corporate income or franchise tax due.

LEGAL IMPACT

Mergers of foreign business entities qualified to do business in California are governed under the laws of the state in which they are incorporated or organized. If the laws of those jurisdictions do not reflect reciprocity with the California process, FTB may not be able to collect a tax liability from a foreign surviving business entity incorporated or organized in a nonconforming state.

LEGISLATIVE STAFF CONTACT

Norman Catelli
Franchise Tax Board
845-5117
Norm.Catelli@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov