LEGISLATIVE PROPOSAL 06-01
EXECUTIVE SUMMARY

- **Title:** Abuse of the Child and Dependent Care Expenses Credit

- **Problem Statement:** Current tools available to prevent CDC credit abuse have proven ineffective.

- **Proposed Solution:** Amend the California Revenue & Taxation Code to enact stricter consequences for taxpayers who fraudulently or recklessly claim the CDC credit. The consequences should be similar to the disallowance enacted under federal law for the abuse of the EIC as follows:

  1. If a taxpayer claims the CDC credit and a final determination is made that the error is due to reckless or intentional disregard of the CDC rules, the taxpayer would not be allowed to take the credit for two years.

  2. If a final determination is made that a taxpayer claimed the CDC credit fraudulently, the taxpayer would not be allowed to take the credit for 10 years.

  When a taxpayer is denied the credit as a result of a final determination of a deficiency, the taxpayer would not be able to claim the credit until the taxpayer submitted adequate substantiation.

- **Major Concerns/Issues:** The CDC credit has been the subject of fraudulent claims since its inception in 2000.

- **Revenue:** This proposal would result in the following revenue gain in the initial three fiscal years:

Estimated Revenue Impact of LP 06-01 Assumed effective 1/1/2007, enactment after 6/30/2006 ($ Millions)		
2006/2007	2007/2008	2008/2009
+ 3	+ 5	+ 5

2006 Departmental Legislative Proposal
LP 06-01

Title

Abuse of the Child and Dependent Care Expenses Credit

Introduction

This proposal would create a disallowance period for taxpayers who fraudulently or recklessly file Child and Dependent Care Expenses Credit (CDC) claims.

Program History/Background

The purpose of the CDC credit is to defray expenses incurred by taxpayers who must pay for child or dependent care so that they can be gainfully employed or seek employment. The taxpayer must incur up to $3,000 in expenses for one child/dependent or up to $6,000 in expenses for two or more children/dependents to qualify for a CDC credit. The California credit is calculated as a percentage of the federal credit, which is based on the taxpayer's qualified expenses. The percentage decreases as income increases and is eliminated for taxpayers with AGI greater than $100,000. The maximum available credit for families with at least two children/dependents ranges from $1,050 for AGI less than $15,000 to $408 for AGI $70,000 - $100,000. Unlike the federal credit, the California credit is refundable. Thus, it is available to taxpayers who do not have a tax liability.

The number of taxpayers who claimed the CDC in 2002, 2003, and 2004 is as follows:

Tax Year	Number T/P's Claiming CDC	Total of All CDC Claims	Average CDC Claim
2002	682,668	$205 million	$300
2003	666,211	$205 million	$308
2004	590,052	$175 million	$297

The CDC credit has been significantly abused since its inception in 2000. There are many taxpayers that are claiming the credit when they know they do not qualify for it or are claiming an amount much greater than the amount to which they are entitled. These are not taxpayers who filed in error or used the wrong percentage; these taxpayers knowingly enter false information on their tax returns.

From the inception of this credit, a determination was made of a potential universe of 225,000 fraudulent returns based on the known fraud rate of 30% for the federal refundable Earned Income Credit (EIC). The Fraud Prevention and Detection (FPD) team has denied thousands of CDC credit claims over the last five years. Some denials were due to math errors and incomplete forms; however, about 95% of the denials were due to intentional disregard of the law. Each year the FPD has augmented its staff and has checked more claims than the year before, and each year more false claims are found.

FTB projects that over the next three years $51.3 million will be fraudulently claimed and that it will have over 100,000 personal accounts flagged as existing, ongoing, and future fraudulent CDC accounts.

The IRS estimates that the EIC, a federal refundable credit, had and continues to experience 30% fraud each year. Increasing the number of audits of CDC claims audited each year has limitations, namely space constraints and human resources.

Current Federal Law

A nonrefundable CDC credit is allowed for a portion of qualifying child and dependent care expenses paid for the purpose of allowing the taxpayer to be gainfully employed. To qualify for this credit, a taxpayer must pay more than half the cost of maintaining a household that includes as a member one or more qualifying individuals. The taxpayer must be gainfully employed and must also incur employment-related expenses for household services and expenses for the care of a qualifying individual.

A "qualifying individual" is: (1) a dependent of the taxpayer who is under the age of 13 and for whom the taxpayer is entitled to claim a dependent exemption, (2) the taxpayer's spouse who was physically or mentally unable to care for himself or herself, or (3) a dependent of the taxpayer who was physically or mentally unable to care for himself or herself and for whom the taxpayer is entitled to claim a dependent exemption credit.

Additionally, the taxpayer must provide information about the care provider (name, address, SSN, EIN, telephone number, and the amount paid to the provider) and information about the qualifying person: name, SSN, date of birth or that the person was disabled, part of the year the qualifying person lived in the taxpayer's home, and amount incurred and paid during the tax year for the qualifying individual.

The person who provided the care cannot be the taxpayer's spouse or a person for whom the taxpayer was entitled to claim a dependent exemption credit. The taxpayer and qualifying individual must live in the same home.

Internal Revenue Code section 32(h) provides that no credit shall be allowed for: (1) 10 years where a taxpayer is found to have made a fraudulent claim, (2) two years where a taxpayer is found to have made a claim due to reckless or intentional disregard of rules and regulations, and (3) for an indefinite period where the denial was made as part of a deficiency determination unless the taxpayer provides documentation of eligibility for the credit.

IRS SCA 200245051, September 30, 2002, holds that when a taxpayer fails to respond to information requests from the IRS, the taxpayer cannot be deemed to have acted with intentional or reckless disregard in claiming the credit.

Current State Law

California law is similar to federal law except that California's CDC credit is refundable. The CDC first became available for tax years beginning on or after January 1, 2000.

The California credit is calculated as a percentage of the federal credit as explained above under Program History/Background.

Problem

Current tools available to prevent CDC credit abuse have proven ineffective.

Proposed Solution

Amend the CDC to enact stricter consequences for taxpayers who intentionally abuse the CDC credit and conform to federal law by treating the CDC similar to the disallowance under federal law for the EIC as follows:

3. If a taxpayer claims the CDC credit and it is finally determined that the error is due to reckless or intentional disregard of the CDC rules, the taxpayer would not be allowed to take the credit for two years.

4. If it is finally determined that a taxpayer claimed the CDC credit fraudulently, the taxpayer would not be allowed to take the credit for 10 years.

When a taxpayer is denied the credit as a result of a final determination of a deficiency, the taxpayer would not be able to claim the credit until the taxpayer submitted adequate substantiation.

Effective/Operative Date

If enacted in the 2006 legislative session, the amendment would be effective and operative beginning January 1, 2007.

Justification

Denial of the CDC credit as the only enforcement tool obviously lacks adequate consequences to be effective. By prohibiting claims from ineligible or fraudulent filers in subsequent years, this proposal would prevent and discourage repeat false CDC claims.

Implementation

Departmental policies and procedures and taxpayer appeal rights would need to be developed and implemented. The Taxpayer Information System (TI) will require modification when coding the account to bar a taxpayer for the two- or 10-year credit disallowance period. FTB’s CDC unit would need to revise the current denial process because the department bears the burden of proving reckless conduct or fraud.

Fiscal Impact

The department's costs to administer this bill would be as follows:

PROGRAM AREA	FIRST YEAR PERSONAL SERVICES COSTS	SECOND YEAR PERSONAL SERVICES COSTS	TOTAL PERSONAL SERVICES COSTS
INFORMATION VALIDATION SECTION	$87,069	$67,726	$154,795
TAX SYSTEMS MANAGEMENT BUREAU	$77,316	N/A	$77,316
SUB-TOTAL	$164,385	$67,726	$232,111
ADMINISTRATIVE OVERHEAD @ 11.40%	$18,740	$7,721	$26,461
GENERAL OE&E @ 6.63%	$10,899	$4,490	$15,389
GRAND TOTAL	$194,024	$79,937	$273,961

Economic Impact

Revenue Impact

This proposal would result in the following revenue gain in the initial three fiscal years:

Estimated Revenue Impact of LP 06-01 Assumed effective 1/1/2007, enactment after 6/30/2006 ($ Millions)		
2006/2007	2007/2008	2008/2009
+ 3	+ 5	+ 5

This analysis does not consider the possible changes in investment activity, employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The Franchise Tax Board annually denies more than $6 million in child and dependent care refund claims. Due to a recent budget augmentation for auditing this issue, denials are projected to increase to approximately $17 million per year. The FPD staff suggests that approximately 30% of denials are for taxpayers with a history of claim denials. Thus, by the time this proposal would become effective, about $5 million per year of denied claims will be attributable to taxpayers subject to the provisions of this proposal.

Automatic denial of these credits to taxpayers with a denial history would free up audit resources to pursue additional claim disallowances. Assuming that the additional amount of disallowance resulting from this redirection is similar to the amount currently generated by these resources, this proposal would produce a revenue gain of $5 million per year. The estimates presented in the table above have been adjusted to represent fiscal year effects.

Policy Considerations

Historically, the department has had significant problems with refundable credits and fraud. These problems are aggravated if a refund is made that is later determined to be fraudulent. In such cases, the refund commonly cannot be recovered. The changes recommended by this proposal could substantially reduce the department’s concerns about fraud.

Other States

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by California. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

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FRANCHISE TAX BOARD'S
LEGISLATIVE PROPOSAL 06-1
As Introduced

AMENDMENT 1

Sec. 1 Revenue and Taxation Code Section 17052.6 is amended to read as follows:

17052.6. (a) For each taxable year beginning on or after January 1, 2000, there shall be allowed as a credit against the "net tax" (as defined in Section 17039) an amount determined in accordance with Section 21 of the Internal Revenue **Code**, as modified by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), except that the amount of the credit shall be a percentage, as provided in subdivision (b) of the allowable federal credit without taking into account whether there is a federal tax liability.

(b) For the purposes of subdivision (a), the percentage of the allowable federal credit shall be determined as follows:

(1) For taxable years beginning before January 1, 2003:

If the adjusted gross income is:	The percentage of credit is:
$40,000 or less	63%
Over $40,000 but not over $70,000................	53%
Over $70,000 but not over $100,000...............	42%
Over $100,000	0%

(2) For taxable years beginning on or after January 1, 2003:

If the adjusted gross income is:	The percentage of credit is:
$40,000 or less	50%
Over $40,000 but not over $70,000................	43%
Over $70,000 but not over $100,000...............	34%
Over $100,000	0%

(c) In the case of a taxpayer whose credits provided under this section exceed the taxpayer's tax liability computed under this part, the excess shall be credited against other amounts due, if any, from the taxpayer and the balance, if any, shall be paid from the Tax Relief and Refund Account and refunded to the taxpayer.

(d) For purposes of this section, adjusted gross income means adjusted gross income as computed for purposes of paragraph (2) of subdivision (h) of Section 17024.5.

(e) The credit authorized by this section shall be limited to employment-related expenses, within the meaning of Section 21 of the Internal Revenue **Code**, but only for child care services or care provided in this state and only to the extent of earned income (within the meaning of Section 21(d) of the Internal Revenue **Code**) from sources within this state.

(f) For purposes of this section, Section 21(b)(1) of the Internal Revenue **Code**, relating to a qualifying individual, is modified to additionally provide that a child (as defined in Section 151(c)(3) of the Internal Revenue **Code**) shall be treated, for purposes of Section 152 of the Internal Revenue **Code** (as applicable for purposes of this section), as receiving over one-half of his or her support during the calendar year from the parent having custody for a greater portion of the calendar year, that parent shall be treated as a "custodial parent" (within the meaning of Section 152(e) of the Internal Revenue **Code**, as applicable for purposes of this section), and the child shall be treated as a qualifying individual under Section 21(b)(1) of the Internal Revenue **Code**, as applicable for purposes of this section, if both of the following apply:

(1) The child receives over one-half of his or her support during the calendar year from his or her parents who never married each other and who live apart at all times during the last six months of the calendar year.

(2) The child is in the custody of one or both of his or her parents for more than one-half of the calendar year.

(g) The amendments to this section made by the act adding this subdivision shall apply only to taxable years beginning on or after January 1, 2002.

(h) No credit shall be allowed under this section for any taxable year in the disallowance period.

(1) For purposes of this subdivision, the disallowance period is either of the following:

(A) The period of ten taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to fraud.

(B) The period of two taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to reckless or intentional disregard of rules and regulation (but not due to fraud).

(2) In the case of a taxpayer who is denied the credit under this section for any taxable year as a result of the deficiency procedures under article 3 (commencing with Section 19031) of chapter 4 of part 10.2, no credit shall be allowed under this section for any subsequent taxable year unless the taxpayer provides such information as the Franchise Tax Board may require to demonstrate eligibility for the credit.

LEGISLATIVE PROPOSAL 06-04
EXECUTIVE SUMMARY

- **Title:** Limited Liability Company (LLC) Short Form Cancellation - Allow Annual Tax Refund

- **Problem Statement:** Current law that expressly prohibits a refund of the waived LLC annual tax deprives the LLC of the benefit of the short form cancellation.

- **Proposed Solution:** Amend the Revenue and Taxation Code to permit the refund of amounts paid if the underlying LLC annual tax liability is waived.

- **Major Concerns/Issues:** None.

- **Revenue:**

Estimated Revenue Impact of LP 06-04 For LLCs That Organize On Or After 01/01/2004 Operative for Transactions After January 1, 2005		
2005-06	2006-07	2007-08
a/	a/	a/

a/ A minor loss less than $150,000.

2006 Departmental Legislative Proposal
LP 06-04

Title

Limited Liability Company Short Form Cancellation - Allow Annual Tax Refund

Introduction

This proposal would allow Franchise Tax Board (FTB) to refund a payment of the limited liability company (LLC) annual tax after the liability for the tax is waived by another provision of the Revenue and Taxation Code (R&TC).

Program History/Background

The Beverly-Killea Limited Liability Company Act of 1994 authorized the formation of LLCs in California and recognized out-of-state LLCs doing business in California as business entities. LLCs combine traditional corporate and partnership characteristics.

Current State Law

An LLC not classified as a corporation is required to pay an annual tax on or before the fifteenth day of the fourth month of its taxable year.

A domestic LLC that files a certificate of cancellation with the California Secretary of State within one year of organization may do so without a tax clearance certificate from FTB if it did no business in California. This provision applies to LLCs that organize on or after January 1, 2004. This process is called a “short form” cancellation. The “short form” cancellation process for taxable years beginning on or after January 1, 2005, provides for the waiver of the LLC annual tax if the LLC never commences business during the first taxable year; however, if the annual tax is paid to FTB, present law expressly prevents FTB from refunding the payment.

Problem

Current law that expressly prohibits a refund of the waived LLC annual tax deprives the LLC of the benefit of the short form cancellation.

Proposed Solution

Amend the R&TC to permit the refund of amounts paid if the underlying LLC annual tax liability is waived.

Effective/Operative Date of Solution

If enacted in the 2006 legislative session as an administrative measure, this bill would be effective January 1, 2006; however, the specific terms of this proposal would make it operative for taxable years beginning on or after January 1, 2005.

Justification

The purpose of the initial legislation was to allow newly-formed LLCs the time to investigate going into business in California without a tax consequence. The current prohibition on refunds negates that purpose for LLCs that pay the annual tax and cancel their existence during the same taxable year. This proposal would fulfill the purpose of the initial legislation.

Implementation

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

Fiscal Impact

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

Economic Impact

This proposal is expected to impact income tax revenue as follows:

Estimated Revenue Impact of LP 06-4 For LLCs That Organize On Or After 01/01/2004 Operative for Transactions After January 1, 2005		
2005-06	2006-07	2007-08
a/	a/	a/

a/ A minor loss less than $150,000.

This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Departmental data for 2003 show that there were 116 LLCs that paid the annual tax, but did no business during the tax year and cancelled within 12 months of formation. The annual tax of $800 was multiplied by 116 LLCs for a revenue loss of $92,800.

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FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO LP 06-04

AMENDMENT 1

SEC.1. Section 17941 of the Revenue and Taxation Code is amended to read:

17941. (a) For each taxable year beginning on or after January 1, 1997, a limited liability company doing business in this state (as defined in Section 23101) shall pay annually to this state a tax for the privilege of doing business in this state in an amount equal to the applicable amount specified in paragraph (1) of subdivision (d) of Section 23153 for the taxable year.

(b) (1) In addition to any limited liability company that is doing business in this state and is therefore subject to the tax imposed by subdivision (a), for each taxable year beginning on or after January 1, 1997, a limited liability company shall pay annually the tax prescribed in subdivision (a) if articles of organization have been accepted, or a certificate of registration has been issued, by the office of the Secretary of State. The tax shall be paid for each taxable year, or part thereof, until a certificate of cancellation of registration or of articles of organization is filed on behalf of the limited liability company with the office of the Secretary of State.

(2) If a taxpayer files a return with the Franchise Tax Board that is designated as its final return, the Franchise Tax Board shall notify the taxpayer that the annual tax shall continue to be due annually until a certificate of cancellation is filed with the Secretary of State pursuant to Section 17356 or 17455 of the Corporations Code.

(c) The tax assessed under this section shall be due and payable on or before the 15th day of the fourth month of the taxable year.

(d) For purposes of this section, "limited liability company" means an organization, other than a limited liability company that is exempt from the tax and fees imposed under this chapter pursuant to Section 23701h or Section 23701x, that is formed by one or more persons under the law of this state, any other country, or any other state, as a "limited liability company" and that is not taxable as a corporation for California tax purposes.

(e) Notwithstanding anything in this section to the contrary, if the office of the Secretary of State files a certificate of cancellation pursuant to Section 17350.5 of the Corporations Code for any limited liability company, then paragraph (1) of subdivision

(f) of Section 23153 shall apply to that limited liability company as if the limited liability company were properly treated as a corporation for that limited purpose only, and paragraph (2) of subdivision (f) of Section 23153 shall not apply. ~~Nothing in this subdivision entitles a limited liability company to receive a reimbursement for any annual taxes or fees already paid.~~

(f) The amendments made by the act adding this subdivision shall apply to a limited liability company for which the office of the Secretary of State filed a certificate of cancellation pursuant to Section 17350.5 of the Corporations Code on or after January 1, 2005.

(g) Notwithstanding Section 19306, the period for filing a claim for refund on the basis of the amendment made to subdivision (e) by the act adding this subdivision shall not expire prior to one year after the effective date of that act.

AMENDMENT 2

SEC. 2. The Legislature finds and declares that the application of the amendments made by this act to taxable years beginning on or after January 1, 2005, serves a public purpose by allowing for remediation of inequities resulting from the prohibition on refunds of payments of the limited liability company annual tax when the tax liability is properly extinguished.

LEGISLATIVE PROPOSAL 06-05
EXECUTIVE SUMMARY

- **Title:** Elimination of Tax Clearance Process and Revise Liability for the Annual and Minimum Franchise Taxes

- **Problem Statement:** The tax clearance process results in inactive business entities failing to dissolve formally.

- **Proposed Solution:**

  - Amend both the Corporations Code and the Revenue and Taxation Code (R&TC) to eliminate the tax clearance certificate requirement, and
  - Amend the R&TC to provide that the annual tax or the minimum franchise tax would not be assessed for a taxable year after the year for which the final return is filed if two conditions are met: 1) the entity did not thereafter do business in California, and 2) the dissolution, surrender, or cancellation of the entity is completed before the end of the 12-month period following the date the tax return for the final year was filed.

- **Major Concerns/Issues:** None

Revenue: This proposal would result in a revenue loss of approximately $3 million dollars annually. The loss is attributable to the prospective relief of annual/minimum tax that would not be paid or incurred by the dissolving corporations.

2006 Departmental Legislative Proposal
LP 06-05

Title

Elimination of Tax Clearance Process and Revise Liability for the Annual and Minimum Franchise Taxes

Introduction

This proposal would make two important changes to the laws for certain business entities halting business:

1. It would eliminate the requirement to obtain a tax clearance certificate prior to dissolving or canceling the registration, and
2. It would suspend further liability for the annual or minimum franchise tax after a final return is filed.

Current State Law

Every corporation (including a limited liability company (LLC) classified as a corporation) incorporated or organized in, qualified to do business in, or doing business in California must annually pay to the state a minimum franchise tax of $800. The minimum franchise tax applies from the earlier of the date of incorporation or organization, qualification, or commencing to do business within California until the date of dissolution, surrender, or if later, the date the corporation ceases to do business in California. This liability exists regardless of whether the corporation is earning income.

Every limited partnership, LLC not classified as a corporation, and limited liability partnership (LLP) registered, organized, or doing business in California must pay to the state an annual tax in an amount equal to the minimum franchise tax until a Certificate of Cancellation or a Notice of Change of Status, as applicable, is filed with the Office of the Secretary of State (SOS). In addition, an LLC not classified as a corporation must also annually pay a fee determined by the total income of the LLC.

Generally, a corporation, an LLC regardless of how classified, and an LLP organized within the state or registered with SOS must receive a tax clearance certificate from the Franchise Tax Board (FTB) before SOS will file the appropriate termination documents to extinguish the existence of the entity or its qualification to conduct business operations in California. During the period between the filing of a certificate of dissolution with SOS and the issuance of a tax clearance certificate by FTB, a domestic corporation (organized in California) is considered "conditionally dissolved." A conditionally dissolved domestic corporation does not accrue liability for the minimum franchise tax.

To obtain a tax clearance certificate, a Request for Tax Clearance Certificate Form is completed and sent to FTB for review and resolution of the entity's tax liability. FTB is required within 30 days either to issue the certificate or to notify the person requesting the certificate of the conditions that must be met before the certificate will be issued.

If the taxpayer files a tax return marked "final return" without having previously filed the tax clearance request described above, FTB will treat the return as a request for a tax clearance certificate. The taxpayer will be provided with the forms, instructions, and other documents that are required to be filed with SOS or FTB to complete the withdrawal or dissolution process.

Before a tax clearance certificate can be issued, the entity must have filed all required tax returns and paid all fees, taxes, penalties, and interest associated with those returns. The tax clearance certificate may be issued based on one of the following:

- Taxes paid and returns filed,
- An assumption of tax liability by an individual who can prove satisfactory financial responsibility.
- A surety bond generally in the amount equal to twice the estimated tax plus interest, or
- A non-interest bearing cash deposit that is held by FTB as security.

Program History / Background

It is estimated that approximately 80% of new businesses fail within the first several years of operation. In 2003, approximately 106,000 new corporations registered with SOS. In the same year, only 20,000 corporations successfully completed the dissolution process with SOS. These numbers dramatically increased in 2004. 174,300 new business entities (corporations/LLCs) registered with SOS while only 36,900 successfully completed the dissolution process with SOS. During the first half of 2005, we have already seen 86,230 number of business entities form and 19,600 complete the dissolution.

Although a business entity may submit the appropriate paperwork to SOS for terminating a business before the end of the taxable year, delays occur at FTB and SOS due to the sizable workload. During the end of the calendar year, FTB receives requests for tax clearance from SOS well into the next year, generally about 27,000 annually. Historically, FTB receives information from SOS about six weeks after the business entity submits its termination request. As a result, a business entity, other than a domestic corporation, continues to accrue at least the annual minimum franchise tax or annual tax until the entity is formally dissolved or its registration is cancelled.

Since a business entity that is ceasing to do business is often insolvent, the entity lacks the ability to pay the tax accrued for the additional year. Instead of formally dissolving by obtaining a tax clearance certificate, many business entities just walk away. As a result, both FTB and SOS files currently contain hundreds of thousands of inactive business entities that failed to complete the dissolution process.

Problem

The tax clearance process results in inactive business entities failing to dissolve formally.

Proposed Solutions

- Amend both the Corporations Code and the Revenue and Taxation Code (R&TC) to eliminate the tax clearance certificate requirement, and
- Amend the R&TC to provide that the annual tax or the minimum franchise tax would not be assessed for a taxable year after the year for which the final return is filed if two conditions are met: 1) the entity did not thereafter do business in California, and 2) the dissolution, surrender, or cancellation of the entity is completed before the end of the 12-month period following the date the tax return for the final year was filed.

Effective/Operative Date of Solution

If enacted in the 2006 legislative session as an administrative measure, this proposal would be effective and operative for tax clearance requests and final returns filed on and after January 1, 2007.

Justification

Eliminating the tax clearance certificate requirement would streamline the dissolution and cancellation process, resulting in more business entities completing the process.

Eliminating the minimum franchise and annual tax on inactive business entities that have failed to dissolve formally or cancel their existence provides relief for taxpayers that erroneously believed their future year tax liabilities were extinguished when a final return was filed.

Implementation

Implementing this proposal would have a moderate impact on the department as discussed below under Fiscal Impact. Department staff anticipates implementing the proposal during the normal annual updates and would cease issuing tax clearance certificates to those business entities seeking to dissolve after January 1, 2007.

For entities that are conditionally dissolved pending issuance of a tax clearance certificate, including domestic entities that have been suspended after filing a certificate of dissolution, approximately 20,395 entities, the department will treat them as dissolved as of the effective date of the act.

Fiscal Impact

This proposal would eliminate the department workload of issuing tax clearance certificates, which costs the department approximately $1.2 million (31 PY's) each fiscal year to maintain. Existing staff would be needed until June 30, 2007 to eliminate the remaining inventory workload. Therefore, the department would be able to show a budget reduction beginning with the 2007/2008 fiscal year.

Economic Impact

Revenue Impact

This proposal would result in the following revenue losses:

Estimated Impact of LP 06-05 Assumed Effective On 1/1/2007 *($ In Millions)*			
Fiscal Year	**2006/2007**	**2007/2008**	**2008/2009**
Eliminate Tax Clearance Process	No impact	no impact	no impact
Prospective Relief of Annual/Minimum Tax	No impact	-$1.5	-$3
Transferee Liability	No impact	no impact	no impact

Revenue Discussion

Eliminating the tax clearance process would not impact the collection of the annual/minimum tax for entities that dissolve, surrender, withdraw, or merge. Data indicate that roughly 27,000 tax clearance certificates are issued in any given year.

For entities that file a final return on or after this proposal would relieve the annual/minimum tax prospectively if taxpayers complete the dissolution process within a 12-months. Data indicates that roughly 17% of tax clearance requests fall into this category, or 4,600 business entities, plus an additional 2,100 other entities that do not have to file a tax clearance certificate (limited partnerships and limited liability partnerships). Nearly all of these 6,700 entities incur an additional annual/minimum tax liability between the time they file a final return and the time the process to dissolve or surrender is completed. It is assumed the department collects about half of the additional annual/minimum tax liabilities incurred by this category of entity; therefore, the annual revenue loss is approximately $3 million (6,700 x $800 x 50%). Based on the timing of amounts otherwise collected under current law, the first full-year impact does not occur until 2008-09.

With respect to the transferee liability portion of this proposal, the new language is clarifying of existing law and therefore would have no revenue impact.

Other Agency/Industry Impacted

Department staff has been in contact with SOS while developing this proposal and the response has been positive.

Other States

The states surveyed include *Delaware, Florida, Illinois, Massachusetts, Michigan, Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

These states have similar provisions to FTB's existing provisions. For example, a dissolving or withdrawing entity that has a tax liability, interest, or penalty due is unable to formally dissolve until the revenue department receives payment. If the entity does not have the assets to pay the liability, the entity frequently walks away rather than formally dissolve. In the absence of fraud, individual shareholders and directors may be legally pursued for the tax liability, but only to the extent of their pro rata share of the claim or the assets distributed to the shareholder just prior to or at the time of the dissolution.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS FOR LP 06-05

AMENDMENT 1

Section 1103 of the Corporations Code is amended to read:

1103. After approval of a merger by the board and any approval of the outstanding shares (Section 152) required by Chapter 12 commencing with Section 1200), the surviving corporation shall file a copy of the agreement of merger with an officers' certificate of each constituent corporation attached stating the total number of outstanding shares of each class entitled to vote on the merger, that the principal terms of the agreement in the form attached were approved by that corporation by a vote of a number of shares of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, or that the merger agreement was entitled to be and was approved by the board alone under the provisions of Section 1201. If equity securities of a parent of a constituent corporation are to be issued in the merger, the officers' certificate of that constituent corporation shall state either that no vote of the shareholders of the parent was required or that the required vote was obtained. The merger and any amendment of the articles of the surviving corporation contained in the merger agreement shall thereupon be effective (subject to subdivision (c) of Section 110 and subject to the provisions of Section 1108) and the several parties thereto shall be one corporation. ~~The agreement shall not be filed, however, until there has been filed by or on behalf of each corporation taxed under the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code), the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by said law have been paid or secured.~~ The Secretary of State may certify a copy of the merger agreement separate from the officers' certificates attached thereto.

AMENDMENT 2

Section 1107.5 of Corporations Code is amended to read:

1107.5. (a) Upon merger pursuant to this chapter, a surviving domestic or foreign corporation or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign corporation or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:

(1) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.

(2) To pay any tax liability determined to be due.

(b) ~~Notwithstanding Sections 1103, 1108, 1110, 1113,6014, 6018, 6019.1, 8014, 8018, 8019.1, 12535, 12539, 12540.1, 15678.4, and 17552 of this code and Sections 17945, 17948.1, and 23334 of the Revenue and Taxation Code, i~~If the surviving entity is a domestic limited liability company, domestic corporation, or registered limited liability partnership or a foreign limited liability company, foreign limited liability partnership, or foreign corporation that is registered or qualified to do business in California, the Secretary of State shall~~ file the merger~~ ~~without the certificate of satisfaction of the Franchise Tax Board and~~ ~~shall~~ notify the Franchise Tax Board of the merger.

AMENDMENT 3

Section 1108 of the Corporations Code is amended to read:

1108. (a) The merger of any number of domestic corporations with any number of foreign corporations may be effected if the foreign corporations are authorized by the laws under which they are formed to effect the merger. The surviving corporation may be any one of the constituent corporations and shall continue to exist under the laws of the state or place of its incorporation.

(b) If the surviving corporation is a domestic corporation, the merger proceedings with respect to that corporation and any domestic disappearing corporation shall conform to the provisions of this chapter governing the merger of domestic corporations, but if the surviving corporation is a foreign corporation, then, subject to the requirements of subdivision (d) and of Section 407 and Chapters 12 (commencing with Section 1200) and 13 (commencing with Section 1300) (with respect to any domestic constituent corporations), the merger proceedings may be in accordance with the laws of the state or place of incorporation of the surviving corporation.

(c) If the surviving corporation is a domestic corporation, the agreement and the officers' certificate of each domestic or foreign constituent corporation shall be filed as provided in Section 1103, or the certificate of ownership shall be filed as provided in Section 1110, and thereupon, subject to subdivision (c) of Section 110, the merger shall be effective as to each domestic constituent corporation; and each foreign disappearing corporation that is qualified for the transaction of intrastate business shall by virtue of the filing, subject to subdivision (c) of Section 110, automatically surrender its right to transact intrastate business.

(d) If the surviving corporation is a foreign corporation, the merger shall become effective in accordance with the law of the jurisdiction in which it is organized, but, except as provided in subdivision (e), the merger shall be effective as to any domestic disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state as required by this subdivision. There shall be filed as to the domestic disappearing corporation or corporations the documents described in any one of the following paragraphs:

(1) A copy of the agreement, certificate or other document filed by the surviving foreign corporation in the state or place of its incorporation for the purpose of effecting the merger, which copy shall be certified by the public officer having official custody of the original.

(2) An executed counterpart of the agreement, certificate or other document filed by the surviving foreign corporation in the state or place of its incorporation for the purpose of effecting the merger.

(3) A copy of the agreement of merger with an officers' certificate of the surviving foreign corporation and of each constituent domestic corporation attached, which officers' certificates shall conform to the requirements of Section 1103.

(4) A certificate of ownership pursuant to Section 1110.

(e) If the date of the filing in this state pursuant to subdivision (d) is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of the domestic corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation or corporations as of the date of filing in this state. Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall, by virtue of the filing pursuant to subdivision (d), automatically surrender its right to transact intrastate business as of the date of filing in this state regardless of the time of effectiveness as to a domestic disappearing corporation.

(f) The provisions of the last two sentences of Section 1101 and Chapter 12 (commencing with Section 1200) and Chapter 13 (commencing with Section 1300) apply to the rights of the shareholders of any of the constituent corporations that are domestic corporations and of any domestic corporation that is a parent party of any foreign constituent corporation.

~~(g) A certificate of satisfaction of the Franchise Tax Board shall be filed when required by Section 1103 or 1110 or when required by Section 23334 of the Revenue and Taxation Code.~~

AMENDMENT 4

Section 1110 of the Corporations Code is amended to read:

1110. (a) If a domestic corporation owns all the outstanding shares, or owns less than all the outstanding shares but at least 90 percent of the outstanding shares of each class, of a corporation or corporations, domestic or foreign, the merger of the subsidiary corporation or corporations into the parent corporation or the merger into the subsidiary corporation of the parent corporation and any other subsidiary corporation or corporations, may be effected by a resolution or plan of merger adopted and approved by the board of the parent corporation and the filing of a certificate of ownership as provided in subdivision (e). The resolution or plan of merger shall provide for the merger and shall provide that the surviving corporation assumes all the liabilities of each disappearing corporation and shall include any other provisions required by this section.

(b) If the parent corporation owns less than all the outstanding shares but at least 90 percent of the outstanding shares of each class of the subsidiary corporation that is a party to the merger, the resolution or plan of merger also shall set forth the securities, cash, property, or rights to be issued, paid, delivered, or granted upon surrender of each outstanding share of the subsidiary corporation not owned by the parent corporation and the entire resolution or plan of merger as well as the consideration to be received for each share of the subsidiary corporation not owned by the parent corporation, shall be approved by the board of that subsidiary corporation.

(c) If the parent corporation is to be merged into one of its subsidiary corporations, the resolution or plan of merger also shall provide for the pro rata conversion of the outstanding shares of the parent corporation into shares of the surviving subsidiary corporation. In this case, the entire resolution or plan of merger shall be approved by the board of the surviving subsidiary corporation and, if the merger, but for the operation of this section, would be a merger reorganization (Section 181) the principal terms of which would be required to be approved by the outstanding shares (Section 152) of any class of the parent corporation pursuant to subdivision (d) of Section 1201, the principal terms of the resolution or plan of merger shall be approved by the outstanding shares (Section 152) of that same class of the parent corporation.

(d) In any merger pursuant to this section, the resolution or plan of merger may provide for the amendment of the articles of the surviving corporation to change its name, subject to Section 201, regardless of whether the name so adopted is the same as or similar to that of one of the disappearing corporations. The provision shall establish the wording of the amendment pursuant to paragraph (2) of subdivision (a) of Section 907 and the resolution or plan of merger shall not provide for the amendment of the articles of the surviving corporation other than to change its name.

(e) After the required approval or approvals of the resolution or plan of merger, a certificate of ownership consisting of an officers' certificate of the parent corporation shall be filed, and a copy thereof for each domestic subsidiary corporation and qualified foreign disappearing subsidiary corporation which is a party to the merger shall also be filed. The certificate of ownership shall:

(1) Identify the parent and subsidiary corporation or corporations.

(2) Set forth the share ownership by the parent corporation of each subsidiary corporation as 100 percent of the outstanding shares or as at least 90 percent of the outstanding shares of each class, as the case may be.

(3) Set forth the resolution or plan of merger.

(4) Set forth approval of the resolution or plan of merger by the board of the parent corporation.

(5) Set forth other approvals of the resolution or plan of merger as required under subdivision (b) or (c), if applicable.

~~(f) The certificate of ownership shall not be filed, however, until there has been filed by or on behalf of each corporation taxed under the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code), the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by that law have been paid or secured~~

(~~g~~f) Upon the filing of the certificate of ownership, the merger shall be effective and any amendment of the articles of the surviving corporation set forth in the certificate shall be effective.

(~~h~~g) A merger pursuant to this section may be effected if the parent corporation is a foreign corporation and if at least one subsidiary corporation is a domestic corporation but in such a case the certificate of ownership prepared as in subdivision (e) or the document required by subdivision (d) of Section 1108 shall be filed as to each domestic and qualified foreign subsidiary corporation, but no filing shall be made as to the foreign parent corporation. No merger into or with a foreign corporation may be effected as provided by this section unless the laws of the state or place of its incorporation permit that action.

(~~i~~h) In the event all of the outstanding shares of a subsidiary domestic corporation party to a merger effected under this section are not owned by the parent corporation immediately prior to the merger, the parent corporation shall, at least 20 days before the effective date of the merger, give notice to each shareholder of such subsidiary corporation that the merger will become effective on or after a specified date. The notice shall contain a copy of the resolution or plan of merger and the information required by subdivision (a) of Section 1301. The notice shall be sent by mail addressed to the shareholder at the address of the shareholder as it appears on the records of the corporation. The shareholder shall have the right to demand payment of cash for the shares of the shareholder pursuant to Chapter 13 (commencing with Section 1300).

(~~j~~i) If an agreement of merger is entered into between a parent corporation and one or more of its subsidiary corporations and the share ownership requirements of subdivision (a) are met, the agreement of merger may be filed as a plan of merger with a certificate of ownership in accordance with the requirements of this section, in which case Sections 1101, 1102, 1103, 1200, 1201, and 1202 shall not apply; or the agreement of merger may be filed pursuant to Section 1103, in which case this section shall not apply.

AMENDMENT 5

Section 1113 of the Corporations Code is amended to read:

1113. (a) Any one or more corporations may merge with one or more other business entities (Section 174.5). One or more domestic corporations (Section 167) not organized under this division and one or more foreign corporations (Section 171) may be parties to the merger. Notwithstanding the provisions of this section, the merger of any number of corporations with any number of other business entities may be effected only if:

(1) In a merger in which a domestic corporation not organized under this division or a domestic other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(2) In a merger in which a foreign corporation is a party, it is authorized by the laws under which it is organized to effect the merger.

(3) In a merger in which a foreign other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(b) Each corporation and each other party which desires to merge shall approve, and shall be a party to, an agreement of merger. Other persons, including a parent party (Section 1200), may be parties to the agreement of merger. The board of each corporation which desires to merge, and, if required the shareholders, shall approve the agreement of merger. The agreement of merger shall be approved on behalf of each party by those persons required to approve the merger by the laws under which it is organized. The agreement of merger shall state:

(1) The terms and conditions of the merger.

(2) The name and place of incorporation or organization of each party to the merger and the identity of the surviving party.

(3) The amendments, if any, subject to Sections 900 and 907, to the articles of the surviving corporation, if applicable, to be effected by the merger. If any amendment changes the name of the surviving corporation, if applicable, the new name may be, subject to subdivision (b) of Section 201, the same as or similar to the name of a disappearing party to the merger.

(4) The manner of converting the shares of each constituent corporation into shares, interests, or other securities of the surviving party. If any shares of any constituent corporation are not to be converted solely into shares, interests or other securities of the surviving party, the agreement of merger shall state (i) the cash, rights, securities, or other property which the holders of those shares are to receive in exchange for the shares, which cash, rights, securities, or other property may be in addition to or in lieu of shares, interests or other securities of the surviving party, or (ii) that the shares are canceled without consideration.

(5) Any other details or provisions required by the laws under which any party to the merger is organized, including, if a public benefit corporation or a religious corporation is a party to the merger, Section 6019.1, or, if a mutual benefit corporation is a party to the merger, Section 8019.1, or, if a consumer cooperative corporation is a party to the merger, Section 12540.1, or, if a domestic limited partnership is a party to the merger, Section 15678.2, or, if a domestic partnership is a party to the merger, Section 16911, or, if a domestic limited liability company is a party to the merger, Section 17551.

(6) Any other details or provisions as are desired, including, without limitation, a provision for the payment of cash in lieu of fractional shares or for any other arrangement with respect thereto consistent with the provisions of Section 407.

(c) Each share of the same class or series of any constituent corporation (other than the cancellation of shares held by a party to the merger or its parent, or a wholly owned subsidiary of either, in another constituent corporation) shall, unless all shareholders of the class or series consent and except as provided in Section 407, be treated equally with respect to any distribution of cash, rights, securities, or other property. Notwithstanding paragraph (4) of subdivision (b), the nonredeemable common shares of a constituent corporation may be converted only into nonredeemable common shares of a surviving corporation or a parent party (Section 1200) or nonredeemable equity securities of a surviving party other than a corporation if another party to the merger or its parent owns, directly or indirectly, prior to the merger shares of that corporation representing more than 50 percent of the voting power of that corporation, unless all of the shareholders of the class consent and except as provided in Section 407.

(d) Notwithstanding its prior approval, an agreement of merger may be amended prior to the filing of the agreement of merger or the certificate of merger, as is applicable, if the amendment is approved by the board of each constituent corporation and, if the amendment changes any of the principal terms of the agreement, by the outstanding shares (Section 152), if required by Chapter 12 (commencing with Section 1200), in the same manner as the original agreement of merger. If the agreement of merger as so amended and approved is also approved by each of the other parties to the agreement of merger, the agreement of merger as so amended shall then constitute the agreement of merger.

(e) The board of a constituent corporation may, in its discretion, abandon a merger, subject to the contractual rights, if any, of third parties, including other parties to the agreement of merger, without further approval by the outstanding shares (Section 152), at any time before the merger is effective.

(f) Each constituent corporation shall sign the agreement of merger by its chairperson of the board, president or a vice president and also by its secretary or an assistant secretary acting on behalf of their respective corporations.

(g) (1) If the surviving party is a corporation or a foreign corporation, or if a public benefit corporation (Section 5060), a mutual benefit corporation (Section 5059), a religious corporation (Section 5061), or a corporation organized under the Consumer Cooperative Corporation Law (Section 12200) is a party to the merger, after required approvals of the merger by each constituent corporation through approval of the board (Section 151) and any approval of the outstanding shares (Section 152) required by Chapter 12 (commencing with Section 1200) and by the other parties to the merger, the surviving party shall file a copy of the agreement of merger with an officers' certificate of each constituent domestic and foreign corporation attached stating the total number of outstanding shares or membership interests of each class entitled to vote on the merger (and identifying any other person or persons whose approval is required), that the agreement of merger in the form attached or its principal terms, as required, were approved by that corporation by a vote of a number of shares or membership interests of each class that equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class and, if applicable, by that other person or persons whose approval is required, or that the merger agreement was entitled to be and was approved by the board alone (as provided in Section 1201, in the case of corporations subject to that section). If equity securities of a parent party (Section 1200) are to be issued in the merger, the officers' certificate of that controlled party shall state either that no vote of the shareholders of the parent party was required or that the required vote was obtained. In lieu of an officers' certificate, a certificate of merger, on a form prescribed by the Secretary of State, shall be filed for each constituent other business entity. The certificate of merger shall be executed and acknowledged by each domestic constituent limited liability company by all managers of the limited liability company (unless a lesser number is specified in its articles or organization or operating agreement) and by each domestic constituent limited partnership by all general partners (unless a lesser number is provided in its certificate of limited partnership or partnership agreement) and by each domestic constituent general partnership by two partners (unless a lesser number is provided in its partnership agreement) and by each foreign constituent limited liability company by one or more managers and by each foreign constituent general partnership or foreign constituent limited partnership by one or more general partners, and by each constituent reciprocal insurer by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary, or, if a constituent reciprocal insurer has not appointed those officers, by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary of the constituent reciprocal insurer's attorney-in-fact, and by each other party to the merger by those persons required or authorized to execute the certificate of merger by the laws under which that party is organized, specifying for that party the provision of law or other basis for the authority of the signing persons. The certificate of merger shall set forth, if a vote of the shareholders, members, partners, or other holders of interests of the constituent other business entity was required, a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the agreement of merger in the form attached or its principal terms, as required, were approved by a vote of the number of interests of each class that equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and any other information required to be set forth under the laws under which the constituent other business entity is organized, including, if a domestic limited partnership is a party to the merger, subdivision

(a) of Section 15678.4, if a domestic partnership is a party to the merger, subdivision (b) of Section 16915, and, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17552. The certificate of merger for each constituent foreign other business entity, if any, shall also set forth the statutory or other basis under which that foreign other business entity is authorized by the laws under which it is organized to effect the merger. The merger and any amendment of the articles of the surviving corporation, if applicable, contained in the agreement of merger shall be effective upon filing of the agreement of merger with an officer's certificate of each constituent domestic and foreign corporation and a certificate of merger for each constituent other business entity, subject to subdivision (c) of Section 110 and subject to the provisions of subdivision (j), and the several parties thereto shall be one entity. ~~The agreement of merger shall not be filed, however, until there has been filed by or on behalf of each party to the merger taxed under the Bank and Corporation Tax Law, the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by that law have been paid or secured.~~ If a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance is a party to the merger, the agreement of merger or certificate of merger shall not be filed until there has been filed the certificate issued by the Insurance Commissioner approving the merger pursuant to Section 1555 of the Insurance Code. The Secretary of State may certify a copy of the agreement of merger separate from the officers' certificates and certificates of merger attached thereto.

(2) If the surviving entity is an other business entity, and no public benefit corporation (Section 5060), mutual benefit corporation (Section 5059), religious corporation (Section 5061), or corporation organized under the Consumer Cooperative Corporation Law (Section 12200) is a party to the merger, after required approvals of the merger by each constituent corporation through approval of the board (Section 151) and any approval of the outstanding shares (Section 152) required by Chapter 12 (commencing with Section 1200) and by the other parties to the merger, the parties to the merger shall file a certificate of merger in the office of, and on a form prescribed by, the Secretary of State. The certificate of merger shall be executed and acknowledged by each constituent domestic and foreign corporation by its chairperson of the board, president or a vice president and also by its secretary or an assistant secretary and by each domestic constituent limited liability company by all managers of the limited liability company (unless a lesser number is specified in its articles of organization or operating agreement) and by each domestic constituent limited partnership by all general partners (unless a lesser number is provided in its certificate of limited partnership or partnership agreement) and by each domestic constituent general

partnership by two partners (unless a lesser number is provided in its partnership agreement) and by each foreign constituent limited liability company by one or more managers and by each foreign constituent general partnership or foreign constituent limited partnership by one or more general partners, and by each constituent reciprocal insurer by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary, or, if a constituent reciprocal insurer has not appointed those officers, by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary of the constituent reciprocal insurer's attorney-in-fact. The certificate of merger shall be signed by each other party to the merger by those persons required or authorized to execute the certificate of merger by the laws under which that party is organized, specifying for that party the provision of law or other basis for the authority of the signing persons. The certificate of merger shall set forth all of the following:

(A) The name, place of incorporation or organization, and the Secretary of State's file number, if any, of each party to the merger, separately identifying the disappearing parties and the surviving party.

(B) If the approval of the outstanding shares of a constituent corporation was required by Chapter 12 (commencing with Section 1200), a statement setting forth the total number of outstanding shares of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of shares of each class entitled to vote and the percentage vote required of each class.

(C) The future effective date or time, not more than 90 days subsequent to the date of filing of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

(D) A statement, by each party to the merger which is a domestic corporation not organized under this division, a foreign corporation, or an other business entity, of the statutory or other basis under which that party is authorized by the laws under which it is organized to effect the merger.

(E) Any other information required to be stated in the certificate of merger by the laws under which each party to the merger is organized, including, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17552, if a domestic partnership is a party to the merger, subdivision (b) of Section 16915, and, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.4.

(F) Any other details or provisions that may be desired. Unless a future effective date or time is provided in a certificate of merger, in which event the merger shall be effective at that future effective date or time, a merger shall be effective upon the filing of the certificate of merger in the office of the Secretary of State and the several parties thereto shall be one entity. ~~The certificate of merger shall not be filed, however, until there has been filed by or on behalf of each party to the merger that is taxed under the Bank and Corporation Tax Law, the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by the Bank and Corporation Tax Law have been paid or secured.~~ The surviving other business entity shall keep a copy of the agreement of merger at its principal place of business which, for purposes of this subdivision, shall be the office referred to in Section 17057 if a domestic limited liability company, at the business address specified in paragraph (5) of subdivision (a) of Section 17552 if a foreign limited liability company, at the office referred to in subdivision (a) of Section 16403 if a domestic general partnership, at the business address specified in subdivision (f) of Section 16911 if a foreign partnership, at the office referred to in subdivision (a) of Section 15614 if a domestic limited partnership, or at the business address specified in paragraph (5) of subdivision (a) of Section 15678.4 if a foreign limited partnership. Upon the request of a holder of equity securities of a party to the merger, a person with authority to do so on behalf of the surviving other business entity shall promptly deliver to that holder, a copy of the agreement of merger. A waiver by that holder of the rights provided in the foregoing sentence shall be unenforceable. If a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance is a party to the merger the agreement of merger or certificate of merger shall not be filed until there has been filed the certificate issued by the Insurance Commissioner approving the merger in accordance with Section 1555 of the Insurance Code.

(h) (1) A copy of an agreement of merger certified on or after the effective date by an official having custody thereof has the same force in evidence as the original and, except as against the state, is conclusive evidence of the performance of all conditions precedent to the merger, the existence on the effective date of the surviving party to the merger and the performance of the conditions necessary to the adoption of any amendment to the articles, if applicable, contained in the agreement of merger.

(2) For all purposes for a merger in which the surviving entity is a domestic other business entity and the filing of a certificate of merger is required by paragraph (2) of subdivision (g), a copy of the certificate of merger duly certified by the Secretary of State is conclusive evidence of the merger of the constituent corporations, either by themselves or together with the other parties to the merger, into the surviving other business entity.

(i) (1) Upon a merger pursuant to this section, the separate existences of the disappearing parties to the merger cease and the surviving party to the merger shall succeed, without other transfer, to all the rights and property of each of the disappearing parties to the merger and shall be subject to all the debts and liabilities of each in the same manner as if the surviving party to the merger had itself incurred them.

(2) All rights of creditors and all liens upon the property of each of the constituent corporations and other parties to the merger shall be preserved unimpaired, provided that those liens upon property of a disappearing party shall be limited to the property affected thereby immediately prior to the time the merger is effective.

(3) Any action or proceeding pending by or against any disappearing corporation or disappearing party to the merger may be prosecuted to judgment, which shall bind the surviving party, or the surviving party may be proceeded against or substituted in its place.

(4) If a limited partnership or a general partnership is a party to the merger, nothing in this section is intended to affect the liability a general partner of a disappearing limited partnership or general partnership may have in connection with the debts and liabilities of the disappearing limited partnership or general partnership existing prior to the time the merger is effective.

(j) (1) The merger of domestic corporations with foreign corporations or foreign other business entities in a merger in which one or more other business entities is a party shall comply with subdivision (a) and this subdivision.

(2) If the surviving party is a domestic corporation or domestic other business entity, the merger proceedings with respect to that party and any domestic disappearing corporation shall conform to the provisions of this section. If the surviving party is a foreign corporation or foreign other business entity, then, subject to the requirements of subdivision (c), and of Section 407 and Chapter 12 (commencing with Section 1200) and Chapter 13 (commencing with Section 1300), and, if applicable, corresponding provisions of the Nonprofit Corporation Law or the Consumer Cooperative Corporation Law, with respect to any domestic constituent corporations, Chapter 13 (commencing with Section 17600) of Title 2.5 with respect to any domestic constituent limited liability companies, Article 6 (commencing with Section 16601) of Chapter 5 of Title 2 with respect to any domestic constituent general partnerships, and Article 7.6 (commencing with Section 15679.1) of Chapter 3 of Title 2 with respect to any domestic constituent limited partnerships, the merger proceedings may be in accordance with the laws of the state or place of incorporation or organization of the surviving party.

(3) If the surviving party is a domestic corporation or domestic other business entity, the certificate of merger or the agreement of merger with attachments shall be filed as provided in subdivision (g) and thereupon, subject to subdivision (c) of Section 110 or

paragraph (2) of subdivision (g), as is applicable, the merger shall be effective as to each domestic constituent corporation and domestic constituent other business entity.

(4) If the surviving party is a foreign corporation or foreign other business entity, the merger shall become effective in accordance with the law of the jurisdiction in which the surviving party is organized, but, except as provided in paragraph (5), the merger shall be effective as to any domestic disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state of a copy of the agreement of merger with an officers' certificate of each constituent foreign and domestic corporation and a certificate of merger of each constituent other business entity attached, which officers' certificates and certificates of merger shall conform to the requirements of paragraph (1) of subdivision (g). If one or more domestic other business entities is a disappearing party in a merger pursuant to this subdivision in which a foreign other business entity is the surviving entity, a certificate of merger required by the laws under which that domestic other business entity is organized, including subdivision (a) of Section 15678.4, subdivision (b) of Section 16915, or subdivision (a) of Section 17552, as is applicable, shall also be filed at the same time as the filing of the agreement of merger.

(5) If the date of the filing in this state pursuant to this subdivision is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of a domestic disappearing corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation as of the date of filing in this state.

(6) In a merger described in paragraph (3) or (4), each foreign disappearing corporation that is qualified for the transaction of intrastate business shall by virtue of the filing pursuant to this subdivision, subject to subdivision (c) of Section 110, automatically surrender its right to transact intrastate business in this state. The filing of the agreement of merger or certificate of merger, as is applicable, pursuant to this subdivision, by a disappearing foreign other business entity registered for the transaction of intrastate business in this state shall, by virtue of that filing, subject to subdivision (c) of Section 110, automatically cancels the registration for that foreign other business entity, without the necessity of the filing of a certificate of cancellation.

~~(7) A certificate of satisfaction of the Franchise Tax Board for each disappearing party to the merger shall be filed when required by subdivision (g) or when required by Section 23334 of the Revenue and Taxation Code.~~

AMENDMENT 6

Section 1155 of the Corporations Code is amended to read:

1155. (a) To convert a corporation:

(1) If the corporation is converting into a domestic limited partnership, a statement of conversion shall be completed on the certificate of limited partnership for the converted entity.

(2) If the corporation is converting into a domestic partnership, a statement of conversion shall be completed on the statement of partnership authority for the converted entity, or if no statement of partnership authority is filed then a certificate of conversion shall be filed separately.

(3) If the corporation is converting into a domestic limited liability company, a statement of conversion shall be completed on the articles of organization for the converted entity.

(b) Any statement or certificate of conversion of a converting corporation shall be executed and acknowledged by those officers of the converting corporation as would be required to sign an officers' certificate (Section 173), and shall set forth all of the following:

(1) The name and the Secretary of State's file number of the converting corporation.

(2) A statement of the total number of outstanding shares of each class entitled to vote on the conversion, that the principal terms of the plan of conversion were approved by a vote of the number of shares of each class which equaled or exceeded the vote required under Section 1152, specifying each class entitled to vote and the percentage vote required of each class.

(3) The name, form, and jurisdiction of organization of the converted entity.

(c) For the purposes of this chapter, the certificate of conversion shall be on a form prescribed by the Secretary of State.

(d) The filing with the Secretary of State of a statement of conversion on an organizational document or a certificate of conversion as set forth in subdivision (a) shall have the effect of the filing of a certificate of dissolution by the converting corporation and no converting corporation that has made the filing is required to file a certificate of election under Section 1901 or a certificate of dissolution under Section 1905 as a result of that conversion.

(e) ~~No statement or certificate of conversion shall be filed with the Secretary of State until there has been filed by or on behalf of the converting corporation the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code) have been paid or secured. Notwithstanding the foregoing, if the converted entity is a domestic partnership,~~

~~domestic limited partnership or domestic limited liability company, the~~ The Secretary of State shall ~~file the statement or certificate of conversion without the certificate of satisfaction of the Franchise Tax Board and shall~~ notify the Franchise Tax Board of the conversion. Upon the effectiveness of a conversion pursuant to this chapter, a converted entity that is a domestic partnership, domestic limited partnership or domestic limited liability company shall be deemed to have assumed the liability of the converting corporation (1) to prepare and file or cause to be prepared and filed all tax and information returns otherwise required of the converting corporation under the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code) and (2) to pay any tax liability determined to be due pursuant to that law.

AMENDMENT 7

Section 1808 of the Corporations Code is amended to read:

1808. (a) Upon the final settlement of the accounts of the directors or other persons appointed pursuant to Section 1805 and the determination that the corporation's affairs are in condition for it to be dissolved, the court may make an order declaring the corporation duly wound up and dissolved. The order shall declare:

(1) That the corporation has been duly wound up, that a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code ~~any tax or penalty due under the Bank and Corporation Tax Law has been paid or secured~~ and that its ~~other~~ known debts and liabilities have been paid or adequately provided for, or that such ~~taxes, penalties,~~ debts and liabilities have been paid as far as its assets permitted, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the order shall state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or such other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(2) That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(3) That the accounts of directors or such other persons have been settled and that they are discharged from their duties and liabilities to creditors and shareholders.

(4) That the corporation is dissolved.

The court may make such additional orders and grant such further relief as it deems proper upon the evidence submitted.

(b) Upon the making of the order declaring the corporation dissolved, corporate existence shall cease except for the purposes of further winding up if needed; and the directors or such other persons shall be discharged from their duties and liabilities, except in respect to completion of the winding up.

AMENDMENT 8

Section 1809 of Corporations Code is amended to read:

1809. Whenever a corporation is dissolved or its existence forfeited by order, decree or judgment of a court, a copy of the order, decree or judgment, certified by the clerk of court, shall forthwith be filed in the office of the Secretary of State. The Secretary of State shall notify the Franchise Tax Board of the dissolution. ~~Notwithstanding Section 23334 of the Revenue and Taxation Code, when the order is based on an action for involuntary dissolution brought by the Attorney General pursuant to Section 1801, there need not be filed in the office of the Secretary of State the certificate of satisfaction of the Franchise Tax Board that all taxes have been paid.~~

AMENDMENT 9

Section 1900.5 of the Corporations Code is amended to read:

1900.5 (a) Notwithstanding any other provision of this division, when a corporation has not issued shares, a majority of the directors, or, if no directors have been named in the articles or been elected, the incorporator or a majority of the incorporators may sign and verify a certificate of dissolution stating the following:

(1) That the certificate of dissolution is being filed within 12 months from the date the articles of incorporation were filed.

(2) That the corporation does not have any debts or other liabilities, except as provided in paragraph (3).

(3) That the tax liability will be satisfied on a taxes paid basis or that a person or corporation or other business entity assumes the tax liability, if any, of the dissolving corporation and is responsible for additional corporate taxes, if any, that are assessed and that become due after the date of the assumption of the tax liability.

(4) That a final franchise tax return, within the meaning of section 23332 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board as required under ~~the Corporation~~

~~Tax Law (~~Part ~~11~~10.2(commencing with Section ~~23001~~18401) of Division 2 of the Revenue and Taxation Code~~)~~.

(5) That the corporation has not conducted any business from the time of the filing of the articles of incorporation.

(6) That the known assets of the corporation remaining after payment of, or adequately providing for, known debts and liabilities have been distributed to the persons entitled thereto or that the corporation acquired no known assets, as the case may be.

(7) That a majority of the directors, or, if no directors have been named in the articles or been elected, the incorporator or a majority of the incorporators authorized the dissolution and elected to dissolve the corporation.

(8) That the corporation has not issued any shares, and if the corporation has received payments for shares from investors, those payments have been returned to those investors.

(9) That the corporation is dissolved.

(b) A certificate of dissolution signed and verified pursuant to subdivision (a) shall be filed with the Secretary of State. The Secretary of State shall~~ file the certificate of dissolution without the tax clearance certificate specified in Section 23334 of the Revenue and Taxation Code and shall ~~notify the Franchise Tax Board of the dissolution.

(c) Upon filing a certificate of dissolution pursuant to subdivision (b), a corporation shall be dissolved and its powers, rights, and privileges shall cease.

AMENDMENT 10

Section 1905 of the Corporations Code is amended to read:

1905. (a) When a corporation has been completely wound up without court proceedings therefor, a majority of the directors then in office shall sign and verify a certificate of dissolution stating:

(1) That the corporation has been completely wound up.

(2) That its known debts and liabilities have been actually paid, or adequately provided for, or paid or adequately provided for as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the certificate shall state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or any other information that may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(3) ~~That the tax liability will be satisfied on a taxes paid basis~~

~~or that a person or corporation or other business entity assumes the tax liability, if any, of the dissolving corporation as security for the issuance of a tax clearance certificate from the Franchise Tax Board and is responsible for additional corporate taxes, if any, that are assessed and that become due after the date of the assumption of the tax liability.~~

~~(4)~~ That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(~~5~~4) That the corporation is dissolved.

(~~6~~5) If no certificate of election is to be filed pursuant to subdivision (c) of Section 1901, that the election to dissolve was made by the vote of all the outstanding shares.

(6) That a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

~~(b) The assumption agreement specified in paragraph (3) of subdivision (a) shall be submitted to the Secretary of State for transmittal to the Franchise Tax Board. The statement provided for in paragraph (3) of subdivision (a) need not be set forth in the certificate if the assumption agreement specified therein is submitted to the Secretary of State with the certificate.~~

(~~c~~b) The certificate of dissolution shall be filed with the Secretary of State and thereupon the corporate powers, rights, and privileges of the corporation shall cease. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~The Secretary of State shall notify the Franchise Tax Board of the filing and shall forward to the Franchise Tax Board any statement of assumption of tax liability accompanying the certificate of dissolution. The Franchise Tax Board shall determine from the available evidence whether or not all taxes imposed on the corporation pursuant to Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code have been paid or secured and shall notify the taxpayer of any outstanding tax liability and the necessity of satisfying the liability. The Franchise Tax Board shall notify the Secretary of State when all taxes imposed on the corporation pursuant to Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code have been paid or secured, at which time the corporation shall be dissolved as of the date of filing the certificate of dissolution and thereupon its corporate existence shall cease.~~

~~(d) When a corporation files a certificate of dissolution the Secretary of State shall notify the corporation that the corporation will be dissolved as of the date of filing only if the Franchise Tax Board notifies the Secretary of State that all taxes imposed on the~~

~~corporation pursuant to Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code have been paid or secured.~~

AMENDMENT 11

Section 1905.1 of the Corporations Code is added as follows:

<u>1905.1 If a corporation has filed a certificate of dissolution with the Secretary of State on or after January 1, 1992, and before the effective date of the act adding this section, pursuant to Section 1905 (prior to its amendment by the act adding this section), and the Franchise Tax Board has not, as of that effective date, made the determination required by subdivision (c) of Section 1905 (prior to its amendment by the act adding this section), then the corporation shall be dissolved as of the date of filing the certificate of dissolution and thereupon its corporate existence shall cease.</u>

AMENDMENT 12

Section 2010 of the Corporations Code is amended to read:

2010. (a) A corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting and defending actions by or against it and enabling it to collect and discharge obligations, dispose of and convey its property and collect and divide its assets, but not for the purpose of continuing business except so far as necessary for the winding up thereof.

(b) No action or proceeding to which a corporation is a party abates by the dissolution of the corporation or by reason of proceedings for winding up and dissolution thereof.

(c) Any assets inadvertently or otherwise omitted from the winding up continue in the dissolved corporation for the benefit of the persons entitled thereto upon dissolution of the corporation and on realization shall be distributed accordingly.

(d) For the purpose of this section, a dissolved corporation includes a corporation that has filed a certificate of dissolution on or after January 1, 1992, pursuant to Section 1905~~, and for which the Franchise Tax Board has not yet, or never has, made the determination referred to in Section 1905 that all taxes have been paid or secured~~.

AMENDMENT 13

Section 2011 of the Corporations Code is amended to read:

2011. (a)(1) Causes of action against a dissolved corporation, whether arising before or after the dissolution of the corporation, may be enforced against any of the following:

(A) Against the dissolved corporation, to the extent of its undistributed assets, including, without limitation, any insurance assets held by the corporation that may be available to satisfy claims.

(B) If any of the assets of the dissolved corporation have been distributed to shareholders, against shareholders of the dissolved corporation to the extent of their pro rata share of the claim or to the extent of the corporate assets distributed to them upon dissolution of the corporation, whichever is less.

A shareholder's total liability under this section may not exceed the total amount of assets of the dissolved corporation distributed to the shareholder upon dissolution of the corporation.

(2) Except as set forth in subdivision (c), all causes of action against a shareholder of a dissolved corporation arising under this section are extinguished unless the claimant commences a proceeding to enforce the cause of action against that shareholder of a dissolved corporation prior to the earlier of the following:

(A) The expiration of the statute of limitations applicable to the cause of action.

(B) Four years after the effective date of the dissolution of the corporation.

(3) As a matter of procedure only, and not for purposes of determining liability, shareholders of the dissolved corporation may be sued in the corporate name of the corporation upon any cause of action against the corporation. This section does not affect the rights of the corporation or its creditors under Section 2009, or the rights, if any, of creditors under the Uniform Fraudulent Transfer Act, which may arise against the shareholders of a corporation.

(4) This subdivision applies to corporations dissolved on and after January 1, 1992. Corporations dissolved prior to that date are subject to the law in effect prior to that date.

(b) Summons or other process against such a corporation may be served by delivering a copy thereof to an officer, director or person having charge of its assets or, if no such person can be found, to any agent upon whom process might be served at the time of dissolution. If none of such persons can be found with due diligence and it is so shown by affidavit to the satisfaction of the court, then the court may make an order that summons or other process be served upon the dissolved corporation by personally delivering a copy thereof, together with a copy of the order, to the Secretary of State or an assistant or deputy secretary of state. Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State.

(c) Every such corporation shall survive and continue to exist indefinitely for the purpose of being sued in any quiet title action. Any judgment rendered in any such action shall bind each and all of its shareholders or other persons having any equity or other interest in such corporation, to the extent of their interest therein, and such action shall have the same force and effect as an action brought under the provisions of Sections 410.50 and 410.60 of the Code of Civil Procedure. Service of summons or other process in any such action may be made as provided in Chapter 4 (commencing with Section 413.10) of Title 5 of Part 2 of the Code of Civil Procedure or as provided in subdivision (b).

(d) Upon receipt of such process and the fee therefor, the Secretary of State forthwith shall give notice to the corporation as provided in Section 1702.

(e) For the purpose of this section, a dissolved corporation includes a corporation that has filed a certificate of dissolution on or after January 1, 1992, pursuant to Section 1905~~, and for which the Franchise Tax Board has not yet, or never has, made the determination referred to in Section 1905 that all taxes have been paid or secured~~.

(f) For purposes of Article 4 (commencing with Section 19071) of Chapter 4 of Part 10.2 of the Revenue and Taxation Code, the liability described in this section shall be considered a liability at law with respect to a dissolved corporation.

AMENDMENT 14

Section 2112 of the Corporations Code is amended to read:

2112.   (a) Subject to Section 2113, a foreign corporation which has qualified to transact intrastate business may surrender its right to engage in that business within this state by filing a certificate of surrender signed by a corporate officer stating:

(1) The name of the corporation as shown on the records of the Secretary of State, and the state or place of incorporation or organization.

(2) That it revokes its designation of agent for service of process.

(3) That it surrenders its authority to transact intrastate business.

(4) That it consents that process against it in any action upon any liability or obligation incurred within this state prior to the filing of the certificate of withdrawal may be served upon the Secretary of State.

(5) A post office address to which the Secretary of State may mail a copy of any process against the corporation that is served upon the Secretary of State, which address or the name to which the process should be sent may be changed from time to time by filing a statement signed by a corporate officer stating the new address or name or both.

(6) That a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been or will be

filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(b) The Secretary of State shall notify the Franchise Tax Board of the surrender.

~~(b) A tax clearance certificate issued by the Franchise Tax Board pursuant to Section 23334 of the Revenue and Taxation Code shall be filed with the certificate of surrender.~~

AMENDMENT 15

Section 6014 of the Corporations Code is amended to read:

6014. After approval of a merger by the board and any approval by the members (Section 5034) or other person or persons required by Section 6012, the surviving corporation shall file a copy of the agreement of merger with an officers' certificate of each constituent corporation attached stating the total number of memberships of each class entitled to vote on the merger, identifying any other person or persons whose approval is required, and stating that the principal terms of the agreement in the form attached were duly approved by the required vote of the members and (if applicable) such other person or persons. The merger and any amendment of the articles of the surviving corporation contained in the merger agreement shall thereupon be effective (subject to subdivision (c) of Section 5008 and subject to the provisions of Section 6018) and the several parties thereto shall be one surviving corporation. ~~The agreement shall not be filed, however, until there has been filed by or on behalf of each constituent corporation taxed under the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code), the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by such law have been paid or secured.~~ The Secretary of State may certify a copy of the merger agreement separate from the officers' certificates attached thereto.

AMENDMENT 16

Section 6018 of the Corporations Code is amended to read:

6018. (a) Subject to the provisions of Section 6010, the merger of any number of corporations with any number of foreign corporations may be effected if the foreign corporations are authorized by the laws under which they are formed to effect the merger. The surviving corporation may be any one of the constituent corporations and shall continue to exist under the laws of the state or place of its incorporation.

(b) If the surviving corporation is a public benefit corporation or a religious corporation, the merger proceedings with respect to that corporation and any disappearing corporation shall conform to the provisions of this chapter governing the merger of corporations, but if the surviving corporation is a foreign corporation, then, subject to the requirements of subdivision (d) and Section 6012, the merger proceedings may be in accordance with the laws of the state or place of incorporation of the surviving corporation.

(c) If the surviving corporation is a public benefit corporation or a religious corporation, the agreement and the officers' certificate of each constituent corporation shall be filed as provided in Section 6014 and thereupon, subject to subdivision (c) of Section 5008, the merger shall be effective as to each corporation; and each foreign disappearing corporation that is qualified for the transaction of intrastate business shall by virtue of the filing automatically surrender its right to transact intrastate business.

(d) If the surviving corporation is a foreign corporation, the merger shall become effective in accordance with the law of the jurisdiction in which it is organized, but shall be effective as to any disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state as required by this subdivision. There shall be filed as to the domestic disappearing corporation or corporations the documents described in any one of the following paragraphs:

(1) A copy of the agreement, certificate, or other document filed by the surviving foreign corporation in the state or place of its incorporation for the purpose of effecting the merger, which copy shall be certified by the public officer having official custody of the original.

(2) An executed counterpart of the agreement, certificate, or other document filed by the surviving corporation in the state or place of its incorporation for the purpose of effecting the merger.

(3) A copy of the agreement of merger with an officers' certificate of the surviving foreign corporation and of each constituent domestic corporation attached, which officers' certificates shall conform to the requirements of Section 6014.

(e) If the date of the filing in this state pursuant to subdivision (d) is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of the domestic corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation or corporations as of the date of filing in this state. Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall automatically by the filing pursuant to subdivision (d) surrender its right to transact intrastate business as of the date of filing in this state regardless of the time of effectiveness as to a domestic disappearing corporation.

~~(f) A certificate of satisfaction of the Franchise Tax Board shall be filed when required by Section 6014 or when required by Section 23334 of the Revenue and Taxation Code.~~

AMENDMENT 17

Section 6019.1 of the Corporations Code is amended to read:

6019.1 (a) Subject to the provisions of Sections 6010 and 9640, any one or more corporations may merge with one or more other business entities (Section 5063.5). One or more other domestic corporations and foreign corporations (Section 5053) may be parties to the merger. Notwithstanding the provisions of this section, such a merger may be effected only if:

(1) In a merger in which a domestic corporation or domestic other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(2) In a merger in which a foreign corporation is a party, it is authorized by the laws under which it is organized to effect the merger.

(3) In a merger in which a foreign other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(b) Each corporation and each other party which desires to merge shall approve an agreement of merger. The board and the members (Section 5034) of each corporation which desires to merge, and each other person or persons, if any, whose approval of an amendment of the articles of that corporation is required by the articles or bylaws shall approve the agreement of merger. The agreement of merger shall be approved on behalf of each other party by those persons authorized or required to approve the merger by the laws under which it is organized. The parties desiring to merge shall be parties to the agreement of merger and other persons, including a parent party (Section 5064.5), may be parties to the agreement of merger. The agreement of merger shall state all of the following:

(1) The terms and conditions of the merger.

(2) The name and place of incorporation or organization of each party and the identity of the surviving party.

(3) The amendments, if any, subject to Sections 5810 and 5816, to the articles of the surviving corporation, if applicable, to be effected by the merger. The name of the surviving corporation may be, subject to subdivision (b) of Section 5122 and subdivision (b) of Section 9122, the same as, or similar to, the name of a disappearing party to the merger.

(4) The manner, if any, of converting the memberships of each of the constituent corporations into shares, memberships, interests, or other securities of the surviving party; and, if any memberships of any of the constituent corporations are not to be converted solely into shares, memberships, interests, or other securities of the surviving party, the cash, rights, securities, or other property which the holders of those memberships are to receive in exchange for the memberships, which cash, rights, securities, or other property may be in addition to, or in lieu of, shares, memberships, interests, or other securities of the surviving corporation or surviving other business entity.

(5) Any other details or provisions required by the laws under which any party to the merger is organized, including, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.2, or, if a domestic general partnership is a party to the merger, subdivision (a) of Section 16911, or, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17551.

(6) Any other details or provisions as are desired.

(c) Notwithstanding its prior approval, an agreement of merger may be amended prior to the filing of the agreement of merger if the amendment is approved by each constituent corporation in the same manner as the original agreement of merger. If the agreement of merger as so amended and approved is also approved by each of the other parties to the agreement of merger, as so amended it shall then constitute the agreement of merger.

(d) The board of a constituent corporation may, in its discretion, abandon a merger, subject to the contractual rights, if any, of third parties, including other parties to the agreement of merger, without further approval by the members (Section 5034) or other persons, at any time before the merger is effective.

(e) Each constituent corporation shall sign the agreement of merger by its chairperson of the board, president or a vice president, and also by its secretary or an assistant secretary acting on behalf of their respective corporations.

(f) After required approvals of the merger by each constituent corporation and each other party to the merger, the surviving party shall file a copy of the agreement of merger with an officers' certificate of each constituent domestic and foreign corporation attached stating the total number of outstanding shares or membership interests of each class, if any, entitled to vote on the merger (and identifying any other person or persons whose approval is required), that the agreement of merger in the form attached or its principal terms, as required, were approved by that corporation by a vote of a number of shares or membership interests of each class entitled to vote, if any, which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and, if applicable, by that other person or persons whose approval is required.

If equity securities of a parent party (Section 5064.5) are to be issued in the merger, the officers' certificate or certificate of merger of the controlled party shall state either that no vote of the shareholders of the parent party was required or that the required vote was obtained. The merger and any amendment of the articles of the surviving corporation, if applicable, contained in the agreement of merger shall be effective upon the filing of the agreement of merger, subject to the provisions of subdivision (h). ~~The agreement of merger shall not be filed, however, until there has been filed by or on behalf of each party to the merger taxed under the Bank and Corporation Tax Law, the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by that law have been paid or secured.~~ If a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance is a party to the merger, the agreement of merger or certificate of merger shall not be filed until there has been filed the certificate issued by the Insurance Commissioner approving the merger pursuant to Section 1555 of the Insurance Code.

In lieu of an officers' certificate, a certificate of merger, on a form prescribed by the Secretary of State, shall be filed for each constituent other business entity. The certificate of merger shall be executed and acknowledged by each domestic constituent limited liability company by all of the managers of the limited liability company (unless a lesser number is specified in its articles of organization or operating agreement) and by each domestic constituent limited partnership by all general partners (unless a lesser number is provided in its certificate of limited partnership or partnership agreement) and by each domestic constituent general partnership by two partners (unless a lesser number is provided in its partnership agreement) and by each foreign constituent limited liability company by one or more managers and by each foreign constituent general partnership or foreign constituent limited partnership by one or more general partners, and by each constituent reciprocal insurer by the chairperson of the board, president, or vice president, and also by the secretary or assistant secretary, or, if a constituent reciprocal insurer has not appointed such officers, by the chairperson of the board, president, or vice president, and also by the secretary or assistant secretary of the constituent reciprocal insurer's attorney-in-fact, and by each other party to the merger by those persons required or authorized to execute the certificate of merger by the laws under which that party is organized, specifying for such party the provision of law or other basis for the authority of the signing persons.

The certificate of merger shall set forth, if a vote of the shareholders, members, partners, or other holders of interests of a constituent other business entity was required, a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the agreement of merger or its principal terms, as required, were approved by a vote of the number of interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and any other information required to be set forth under the laws under which the constituent other business entity is organized, including, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.4, if a domestic general partnership is a party to the merger, subdivision (b) of Section 16915, and, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17552. The certificate of merger for each constituent foreign other business entity, if any, shall also set forth the statutory or other basis under which that foreign other business entity is authorized by the laws under which it is organized to effect the merger.

The Secretary of State may certify a copy of the agreement of merger separate from the officers' certificates and certificates of merger attached thereto.

(g) A copy of an agreement of merger certified on or after the effective date by an official having custody thereof has the same force in evidence as the original and, except as against the state, is conclusive evidence of the performance of all conditions precedent to the merger, the existence on the effective date of the surviving party to the merger, the performance of the conditions necessary to the adoption of any amendment to the articles, if applicable, contained in the agreement of merger, and the merger of the constituent corporations, either by themselves or together with other constituent parties, into the surviving party to the merger.

(h) (1) The merger of domestic corporations with foreign corporations or foreign other business entities in a merger in which one or more other business entities is a party shall comply with subdivisions (a) and (f) and this subdivision.

(2) Subject to subdivision (c) of Section 5008 and paragraph (3), the merger shall be effective as to each domestic constituent corporation and domestic constituent other business entity upon filing of the agreement of merger with attachments as provided in

subdivision (f).

(3) If the surviving party is a foreign corporation or foreign other business entity, except as provided in paragraph (4), the merger shall be effective as to any domestic disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state of a copy of the agreement of merger with an officers' certificate of the surviving foreign corporation and of each constituent foreign and domestic corporation and a certificate of merger of each constituent other business entity attached, which officers' certificates and certificates of merger shall conform to the requirements of subdivision (f).

If one or more domestic other business entities is a disappearing party in a merger pursuant to this subdivision in which a foreign other business entity is the surviving entity, a certificate of merger required by the laws under which each domestic other business entity is organized, including subdivision (a) of Section 15678.4, subdivision (b) of Section 16915, or subdivision (a) of Section 17552, if applicable, shall also be filed at the same time as the filing of the agreement of merger.

(4) If the date of the filing in this state pursuant to this subdivision is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of a domestic disappearing corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation as of the date of filing in this state.

(5) Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall automatically by the filing pursuant to subdivision (f) surrender its right to transact intrastate business as of the date of filing in this state or, if later, the effective date of the merger. With respect to each foreign disappearing other business entity previously registered for the transaction of intrastate business in this state, the filing of the agreement of merger pursuant to subdivision (f) automatically has the effect of a cancellation of registration for that foreign other business entity as of the date of filing in this state or, if later, the effective date of the merger, without the necessity of the filing of a certificate of cancellation.

AMENDMENT 18

Section 6020.5 of the Corporations Code is amended to read:

6020.5. (a) Upon merger pursuant to this chapter, a surviving domestic or foreign corporation or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign corporation or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:

(1) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.

(2) To pay any tax liability determined to be due.

(b) ~~Notwithstanding Sections 1103, 1108, 1110, 1113, 6014, 6018, 6019.1, 8014, 8018, 8019.1, 12535, 12539, 12540.1, 15678.4, and 17552 of this code and Sections 17945, 17948.1, and 23334 of the Revenue and Taxation Code, i~~If the surviving entity is a domestic limited liability company, domestic corporation, or registered limited liability partnership or a foreign limited liability company, foreign limited liability partnership, or foreign corporation that is registered or qualified to do business in California, the Secretary of State shall ~~file the merger~~ ~~without the certificate of satisfaction of the Franchise Tax Board~~ ~~and~~ ~~shall~~ notify the Franchise Tax Board of the merger.

AMENDMENT 19

6518. (a) Upon the final settlement of the accounts of the directors or other persons appointed pursuant to Section 6515 and the determination that the corporation's affairs are in condition for it to be dissolved, the court may make an order declaring the corporation duly wound up and dissolved. The order shall declare:

(1) That the corporation has been duly wound up, that a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code ~~any tax or penalty due under the Bank and Corporation Tax Law has been paid or secured~~ and that its ~~other~~ known debts and liabilities have been paid or adequately provided for, or that such ~~taxes, penalties,~~ debts and liabilities have been paid as far as its assets permitted, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the order shall state what provision has been made, setting forth the name and address of the corporation,

person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or such other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(2) That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(3) That the accounts of directors or such other persons have been settled and that they are discharged from their duties and liabilities to creditors and members.

(4) That the corporation is dissolved.

(b) The court may make such additional orders and grant such further relief as it deems proper upon the evidence submitted.

(c) Upon the making of the order declaring the corporation dissolved, corporate existence shall cease except for the purposes of further winding up if needed; and the directors or such other persons shall be discharged from their duties and liabilities, except in respect to completion of the winding up.

AMENDMENT 20

Section 6519 of the Corporations Code is amended to read:

6519. Whenever a corporation is dissolved or its existence forfeited by order, decree or judgment of a court, a copy of the order, decree or judgment, certified by the clerk of court, shall forthwith be filed. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~Notwithstanding Section 23334 of the Revenue and Taxation Code, when the order is based on an action for involuntary dissolution brought by the Attorney General pursuant to Section 6511, there need not be filed the certificate of satisfaction of the Franchise Tax Board that all taxes have been paid or secured.~~

AMENDMENT 21

Section 6615 of the Corporations Code is amended to read:

6615. (a) When a corporation has been completely wound up without court proceedings, a majority of the directors then in office shall sign and verify a certificate of dissolution stating:

(1) That the corporation has been completely wound up.

(2) That its known debts and liabilities have been actually paid, or adequately provided for, or paid or adequately provided for as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be. If there are known debts or

liabilities for payment of which adequate provision has been made, the certificate shall state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(3) That the corporation is dissolved.

(4) That a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(b) One of the following documents issued by the Attorney General shall be attached to the certificate of dissolution:

(1) A written waiver of objections to the distribution of the corporation's assets pursuant to subdivision (c) of Section 6716.

(2) A written confirmation that the corporation has no assets.

(c) The certificate of dissolution and attachment described in subdivision (b) shall be filed with the Secretary of State who shall not accept a certificate of dissolution for filing without this attachment. The corporate existence shall cease upon the acceptance of the filing of the certificate of dissolution and attachment by the Secretary of State, except for the purpose of further winding up if needed. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~However, before any corporation may file a certificate of dissolution it shall file or cause to be filed the certificate of satisfaction of the Franchise Tax Board required by Section 23334 of the Revenue and Taxation Code that all taxes, if any, imposed under the Bank and Corporation Tax Law have been paid or secured.~~

AMENDMENT 22

Section 8014 of the Corporations Code is amended to read:

8014. After approval of a merger by the board and any approval by the members (Section 5034) required by Section 8012, the surviving corporation shall file a copy of the agreement of merger with an officers' certificate of each constituent corporation attached stating the total number of memberships of each class entitled to vote on the merger, identifying any other person or persons whose approval is required, and that the principal terms of the agreement in the form attached were duly approved by the required vote of the members and, if applicable, any other person or persons. The merger and any amendment of the articles of the surviving corporation contained in the merger agreement shall thereupon be effective (subject to subdivision (c) of Section 5008 and subject to the provisions of Section 8018) and the several parties thereto shall be one corporation. ~~The agreement shall not be filed, however, until there has been filed by or on behalf of each corporation taxed under the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code), the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by such law have been paid or secured.~~ The Secretary of State may certify a copy of the merger agreement separate from the officers' certificates attached thereto.

AMENDMENT 23

Section 8018 of the Corporations Code is amended to read:

8018. (a) Subject to the provisions of Section 8010, the merger of any number of corporations with any number of foreign corporations, foreign business corporations or domestic corporations may be effected if the foreign corporations are authorized by the laws under which they are formed to effect the merger. The surviving corporation may be any one of the constituent corporations and shall continue to exist under the laws of the state or place of its incorporation.

(b) If the surviving corporation is a mutual benefit corporation, the merger proceedings with respect to that corporation and any domestic disappearing corporation shall conform to the provisions of this chapter and other applicable laws of this state, but if the surviving corporation is a foreign corporation, then, subject to the requirements of subdivision (d) and Section 8012 the merger proceedings may be in accordance with the laws of the state or place of incorporation of the surviving corporation.

(c) If the surviving corporation is a mutual benefit corporation, the agreement and the officers' certificate of each constituent corporation shall be filed as provided in Section 8014 and thereupon, subject to subdivision (c) of Section 5008, the merger shall be effective as to each corporation; and each foreign disappearing corporation that is qualified for the transaction of intrastate business shall, by virtue of the filing, automatically surrender its right to transact intrastate business.

(d) If the surviving corporation is a foreign corporation, or foreign business corporation, the merger shall become effective in accordance with the law of the jurisdiction in which it is organized, but shall be effective as to any disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state as required by this subdivision. There shall be filed as to the domestic disappearing corporation or corporations the documents described in any one of the following paragraphs:

(1) A copy of the agreement, certificate, or other document filed by the surviving foreign corporation in the state or place of its incorporation for the purpose of effecting the merger, which copy shall be certified by the public officer having official custody of the original.

(2) An executed counterpart of the agreement, certificate, or other document filed by the surviving corporation in the state or place of its incorporation for the purpose of effecting the merger.

(3) A copy of the agreement of merger with an officers' certificate of the surviving foreign corporation and of each constituent domestic corporation attached, which officers' certificates shall conform to the requirements of Section 8014.

(e) If the date of the filing in this state pursuant to subdivision (d) is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of the domestic corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation or corporations as of the date of filing in this state. Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall automatically by the filing pursuant to subdivision (d) surrender its right to transact intrastate business as of the date of filing in this state regardless of the time of effectiveness as to a domestic disappearing corporation.

~~(f) A certificate of satisfaction of the Franchise Tax Board shall be filed when required by Section 8014 or when required by Section 23334 of the Revenue and Taxation Code.~~

AMENDMENT 24

Section 8019.1 of the Corporations Code is amended to read:

8019.1 (a) Subject to the provisions of Section 8010, any one or more corporations may merge with one or more other business entities (Section 5063.5). One or more other domestic corporations, foreign corporations (Sections 5053), and foreign business corporations (Section 5052) may be parties to the merger. Notwithstanding the provisions of this section, such a merger may be effected only if:

(1) In a merger in which a domestic corporation or domestic other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(2) In a merger in which a foreign corporation or foreign business corporation is a party, it is authorized by the laws under which it is organized to effect the merger.

(3) In a merger in which a foreign other business entity is a

party, it is authorized by the laws under which it is organized to effect the merger.

(b) Each corporation and each other party which desires to merge shall approve an agreement of merger. The board and the members (Section 5034) of each corporation which desires to merge, and each other person or persons, if any, whose approval of an amendment of the articles of that corporation is required by the articles or bylaws shall approve the agreement of merger. The agreement of merger shall be approved on behalf of each other constituent party by those persons authorized or required to approve the merger by the laws under which it is organized. The parties desiring to merge shall be parties to the agreement of merger and other persons, including a parent party (Section 5064.5), may be parties to the agreement of merger. The agreement of merger shall state all of the following:

(1) The terms and conditions of the merger.

(2) The name and place of incorporation or organization of each party and the identity of the surviving party.

(3) The amendments, if any, subject to Sections 7810 and 7816, to the articles of the surviving corporation, if applicable, to be effected by the merger. The name of the surviving corporation may be, subject to subdivisions (b) and (c) of Section 7122, the same as or similar to the name of a disappearing party to the merger.

(4) The manner, if any, of converting the memberships or securities of each of the constituent corporations into shares, memberships, interests, or other securities of the surviving party; and, if any memberships or securities of any of the constituent corporations are not to be converted solely into shares, memberships, interests, or other securities of the surviving party, cash, rights, securities, or other property which the holders of those memberships or securities are to receive in exchange for the memberships or securities, which cash, rights, securities, or other property may be in addition to or in lieu of shares, memberships, interests, or other securities of the surviving party.

(5) Any other details or provisions required by the laws under which any party to the merger is organized, including, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.2, or, if a domestic general partnership is a party to the merger, subdivision (a) of Section 16911, or, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17551.

(6) Any other details or provisions as are desired.

(c) Each membership of the same class of any constituent corporation (other than the cancellation of memberships held by a party to the merger or its parent or a wholly owned subsidiary of either in another constituent corporation) shall be treated equally with respect to any distribution of cash, property, rights, or securities unless (i) all members of the class consent or (ii) the commissioner has approved the terms and conditions of the transaction and the fairness of those terms pursuant to Section 25142.

(d) Notwithstanding its prior approval, an agreement of merger may be amended prior to the filing of the agreement of merger if the amendment is approved by each constituent corporation in the same manner as the original agreement of merger. If the agreement of merger as so amended and approved is also approved by each of the other parties to the agreement of merger, as so amended it shall then constitute the agreement of merger.

(e) The board of a constituent corporation may, in its discretion, abandon a merger, subject to the contractual rights, if any, of third parties, including other parties to the agreement of merger, without further approval by the members (Section 5034) or other persons, at any time before the merger is effective.

(f) Each constituent corporation shall sign the agreement of merger by its chairperson of the board, president, or a vice president and also by its secretary or an assistant secretary acting on behalf of their respective corporations.

(g) After required approvals of the merger by each constituent corporation and each other party to the merger, the surviving party shall file a copy of the agreement of merger with an officers' certificate of each constituent domestic corporation, foreign corporation, and foreign business corporation attached stating the total number of outstanding shares or membership interests of each class entitled to vote on the merger (and identifying any other person or persons whose approval is required), that the agreement of merger in the form attached or its principal terms, as required, were approved by that corporation by a vote of a number of shares or membership interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote required of each class, and, if applicable, by such other person or persons whose approval is required.

If equity securities of a parent party (Section 5064.5) are to be issued in the merger, the officers' certificate or certificate of merger of the controlled party shall state either that no vote of the shareholders of the parent party was required or that the required vote was obtained. The merger and any amendment of the articles of the surviving corporation, if applicable, contained in the agreement of merger shall be effective upon the filing of the agreement of merger, subject to the provisions of subdivision (i). ~~The agreement of merger shall not be filed, however, until there has been filed by or on behalf of each party to the merger taxed under the Bank and Corporation Tax Law, the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by that law have been paid or secured.~~ If a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance is a party to the merger, the agreement of merger or certificate of merger shall not be filed until there has been filed the certificate issued by the Insurance Commissioner approving the merger pursuant to Section 1555 of the Insurance Code.

In lieu of an officers' certificate, a certificate of merger, on a form prescribed by the Secretary of State, shall be filed for each constituent other business entity. The certificate of merger shall be executed and acknowledged by each domestic constituent limited liability company by all of the managers of the limited liability company (unless a lesser number is specified in its articles of organization or operating agreement) and by each domestic constituent limited partnership by all general partners (unless a lesser number is provided in its certificate of limited partnership or partnership agreement) and by each domestic constituent general partnership by two partners (unless a lesser number is provided in its partnership agreement) and by each foreign constituent limited liability company by one or more managers and by each foreign constituent general partnership or foreign constituent limited partnership by one or more general partners, and by each constituent reciprocal insurer by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary, or, if a constituent reciprocal insurer has not appointed such officers, by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary of the constituent reciprocal insurer's attorney-in-fact, and by each other party to the merger by those persons required or authorized to execute the certificate of merger by the laws under which that party is organized, specifying for such party the provision of law or other basis for the authority of the signing persons.

The certificate of merger shall set forth, if a vote of the shareholders, members, partners, or other holders of interests of a constituent other business entity was required, a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and any other information required to be set forth under the laws under which the constituent other business entity is organized, including, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.4, if a domestic general partnership is a party to the merger, subdivision (b) of Section 16915 and, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17552. The certificate of merger for each constituent foreign other business entity, if any, shall also set forth the statutory or other basis under which that foreign other business entity is authorized by the laws under which it is organized to effect the merger.

The Secretary of State may certify a copy of the agreement of merger separate from the officers' certificates and certificates of merger attached thereto.

(h) A copy of an agreement of merger certified on or after the effective date by an official having custody thereof has the same force in evidence as the original and, except as against the state, is conclusive evidence of the performance of all conditions precedent to the merger, the existence on the effective date of the surviving party to the merger, the performance of the conditions necessary to the adoption of any amendment to the articles, if applicable, contained in the agreement of merger, and of the merger of the constituent corporations, either by themselves or together with other constituent parties, into the surviving party to the merger.

(i) (1) The merger of domestic corporations with foreign corporations or foreign other business entities in a merger in which one or more other business entities is a party shall comply with subdivisions (a) and (g) and this subdivision.

(2) Subject to subdivision (c) of Section 5008 and paragraph (3), the merger shall be effective as to each domestic constituent corporation and domestic constituent other business entity upon filing of the agreement of merger with attachments as provided in subdivision (g).

(3) If the surviving party is a foreign corporation or foreign business corporation or foreign other business entity, except as provided in paragraph (4), the merger shall be effective as to any domestic disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state of a copy of the agreement of merger with an officers' certificate of the surviving foreign corporation or foreign business corporation and of each constituent foreign and domestic corporation and a certificate of merger of each constituent other business entity attached, which officers' certificates and certificates of merger shall conform to the requirements of subdivision (g).

If one or more domestic other business entities is a disappearing party in a merger pursuant to this subdivision in which a foreign other business entity is the surviving entity, a certificate of merger required by the laws under which each domestic other business entity is organized, including subdivision (a) of Section 15678.4, subdivision (b) of Section 16915, or subdivision (a) of Section 17522, if applicable, shall also be filed at the same time as the filing of the agreement of merger.

(4) If the date of the filing in this state pursuant to this subdivision is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of a domestic disappearing corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be

effective as to the domestic disappearing corporation as of the date of filing in this state.

(5) Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall automatically by the filing pursuant to subdivision (g) surrender its right to transact intrastate business as of the date of filing in this state or, if later, the effective date of the merger. With respect to each foreign disappearing other business entity previously registered for the transaction of intrastate business in this state, the filing of the agreement of merger pursuant to subdivision (g) automatically has the effect of a cancellation of registration for that foreign other business entity as of the date of filing in this state or, if later, the effective date of the merger, without the necessity of the filing of a certificate of cancellation.

AMENDMENT 25

Section 8020.5 of the Corporations Code is amended to read:

8020.5. (a) Upon merger pursuant to this chapter, a surviving domestic or foreign corporation or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign corporation or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:

(1) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.

(2) To pay any tax liability determined to be due.

(b) ~~Notwithstanding Sections 1103, 1108, 1110, 1113, 6014, 6018, 6019.1, 8014, 8018, 8019.1, 12535, 12539, 12540.1, 15678.4, and 17552 of this code and Sections 17945, 17948.1, and 23334 of the Revenue and Taxation Code, i~~If the surviving entity is a domestic limited liability company, domestic corporation, or registered limited liability partnership or a foreign limited liability company, foreign limited liability partnership, or foreign corporation that is registered or qualified to do business in California, the Secretary of State shall ~~file the merger~~ ~~without the certificate of satisfaction of the Franchise Tax Board and~~ ~~shall~~ notify the Franchise Tax Board of the merger.

AMENDMENT 26

Section 8518 of the Corporations Code is amended to read:

8518. (a) Upon the final settlement of the accounts of the directors or other persons appointed pursuant to Section 8515 and the determination that the corporation's affairs are in condition for it to be dissolved, the court may make an order declaring the corporation duly wound up and dissolved. The order shall declare:

(1) That the corporation has been duly wound up, that a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation code, has been filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code ~~any tax or penalty due under the Bank and Corporation Tax Law has been paid or secured~~ and that its ~~other~~ known debts and liabilities have been paid or adequately provided for, or that such ~~taxes, penalties,~~ debts and liabilities have been paid as far as its assets permitted, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the order shall state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or such other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(2) That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(3) That the accounts of directors or such other persons have been settled and that they are discharged from their duties and liabilities to creditors and members.

(4) That the corporation is dissolved.

(b) The court may make such additional orders and grant such further relief as it deems proper upon the evidence submitted.

(c) Upon the making of the order declaring the corporation dissolved, corporate existence shall cease except for the purposes of further winding up if needed; and the directors or such other persons shall be discharged from their duties and liabilities, except in respect to completion of the winding up.

AMENDMENT 27

Section 8519 of the Corporations Code is amended to read:

8519. Whenever a corporation is dissolved or its existence forfeited by order, decree or judgment of a court, a copy of the order, decree or judgment, certified by the clerk of court, shall forthwith be filed. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~Notwithstanding Section 23334 of the Revenue and Taxation Code, when the order is based on an action for involuntary dissolution brought by the Attorney General pursuant to Section 8511, there need not be filed the certificate of satisfaction of the Franchise Tax Board that all taxes have been paid or secured.~~

AMENDMENT 28

Section 8615 of the Corporations Code is amended to read:

8615. (a) When a corporation has been completely wound up without court proceedings therefor, a majority of the directors then in office shall sign and verify a certificate of dissolution stating:

(1) That the corporation has been completely wound up.

(2) That its known debts and liabilities have been actually paid, or adequately provided for, or paid or adequately provided for as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the certificate shall state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or such other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(3) That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(4) That the corporation is dissolved.

(5) That a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(b) The certificate of dissolution shall be filed and thereupon the corporate existence shall cease, except for the purpose of further winding up if needed. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~before any corporation may file~~

~~a certificate of dissolution it shall file or cause to be filed the certificate of satisfaction of the Franchise Tax Board required by Section 23334 of the Revenue and Taxation Code that all taxes, if any, imposed under the Bank and Corporation Tax Law have been paid or secured.~~

AMENDMENT 29

Section 12535 of the Corporations Code is amended to read:

12535. After approval of a merger by the board and any approval by the members under Section 12533, the surviving corporation shall file a copy of the agreement of merger with an officers' certificate of each constituent corporation attached stating the total number of memberships of each class entitled to vote on the merger, and that the principal terms of the agreement in the form attached were duly approved by the required vote of the members. The merger and any amendment of the articles of the surviving corporation contained in the merger agreement shall thereupon be effective (subject to subdivision (c) of Section 12214 and subject to the provisions of Section 12539) and the several parties thereto shall be one corporation. ~~The agreement shall not be filed, however,~~ ~~until there has been filed by or on behalf of each corporation taxed under the Bank and Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code), the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by such law have been paid or secured.~~ The Secretary of State may certify a copy of the merger agreement separate from the officers' certificates attached thereto.

AMENDMENT 30

Section 12539 of the Corporations Code is amended to read:

12539. (a) Subject to the provisions of Section 12530, the merger of any number of corporations with any number of foreign corporations, foreign business corporations, or domestic corporations may be effected if the foreign corporations are authorized by the laws under which they are formed to effect the merger. The surviving corporation may be any one of the constituent corporations and shall continue to exist under the laws of the state or place of its incorporation.

(b) If the surviving corporation is a cooperative corporation, the merger proceedings with respect to that corporation and any domestic disappearing corporation shall conform to the provisions of this chapter and other applicable laws of this state, but if the surviving corporation is a foreign corporation, then, subject to the requirements of subdivision (d) and Section 12533, the merger proceedings may be in accordance with the laws of the state or place of incorporation of the surviving corporation.

(c) If the surviving corporation is a cooperative corporation, the agreement and the officers' certificate of each constituent corporation shall be filed as provided in Section 12535 and thereupon, subject to subdivision (c) of Section 12214, the merger shall be effective as to each corporation; and each foreign disappearing corporation that is qualified for the transaction of intrastate business shall, by virtue of the filing, automatically surrender its right to transact intrastate business.

(d) If the surviving corporation is a foreign corporation, the merger shall become effective in accordance with the law of the jurisdiction in which it is organized, but shall be effective as to any disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state as required by this subdivision. There shall be filed as to the domestic disappearing corporation or corporations the documents described in any one of the following paragraphs:

(1) A copy of the agreement, certificate, or other document filed by the surviving corporation in the state or place of its incorporation for the purpose of effecting the merger, which copy shall be certified by the public officer having official custody of the original.

(2) An executed counterpart of the agreement, certificate, or other document filed by the surviving corporation in the state or place of its incorporation for the purpose of effecting the merger.

(3) A copy of the agreement of merger with an officers' certificate of the surviving foreign corporation and of each constituent domestic corporation attached.

(e) If the date of the filing in this state pursuant to subdivision (d) is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of the domestic corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation or corporations as of the date of filing in this state. Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall automatically by the filing pursuant to subdivision (d) surrender its right to transact intrastate business as of the date of the filing in this state regardless of the time of effectiveness as to a domestic disappearing corporation.

~~(f) A certificate of satisfaction of the Franchise Tax Board shall be filed when required by Section 23334 of the Revenue and Taxation Code.~~

AMENDMENT 31

Section 12540.1 of the Corporations Code is amended to read:

12540.1 (a) Any one or more corporations may merge with one or more other business entities (Section 12242.5). Subject to the provisions of Section 12530, one or more other domestic corporations or foreign corporations (Section 12237) may be parties to the merger.

Notwithstanding the provisions of this section, such a merger may be effected only if:

(1) In a merger in which a domestic corporation or domestic other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(2) In a merger in which a foreign corporation is a party, it is authorized by the laws under which it is organized to effect the merger.

(3) In a merger in which a foreign other business entity is a party, it is authorized by the laws under which it is organized to effect the merger.

(b) Each corporation, other domestic corporation, foreign corporation, and other business entity which desires to merge shall approve an agreement of merger. The board and the members of each corporation which desires to merge shall approve (Sections 12222 and 12224) the agreement of merger. The agreement of merger shall be approved on behalf of each other constituent party by those persons authorized or required to approve the merger by the laws under which it is organized.

The parties desiring to merge shall be parties to the agreement of merger and other persons, including a parent party (Section 12242.6), may be parties to the agreement of merger. The agreement of merger shall state all of the following:

(1) The terms and conditions of the merger.

(2) The name and place of incorporation or organization of each party and the identity of the surviving party.

(3) The amendments, if any, subject to Sections 12500 and 12507, to the articles of the surviving corporation, if applicable, to be effected by the merger. The name of the surviving corporation may be, subject to subdivisions (b) and (c) of Section 12302, the same as, or similar to, the name of a disappearing party to the merger.

(4) The manner, if any, of converting the memberships or securities of each of the constituent corporations into shares, memberships, interests, or other securities of the surviving party and, if any memberships or securities of any of the constituent corporations are not to be converted solely into shares, memberships, interests, or other securities of the surviving party, the cash, rights, securities, or other property which the holders of those memberships or securities are to receive in exchange for the

memberships or securities, which cash, rights, securities, or other property may be in addition to or in lieu of shares, memberships, interests, or other securities of the surviving party.

(5) Any other details or provisions required by the laws under which any party to the merger is organized, including, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.2, or, if a domestic general partnership is a party to the merger, subdivision (a) of Section 16911, or, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17551.

(6) Any other details or provisions as are desired.

(c) Each membership of the same class of any constituent corporation (other than the cancellation of memberships held by a party to the merger or its parent or a wholly owned subsidiary of either in another constituent corporation) shall be treated equally with respect to any distribution of cash, property, rights, or securities unless (i) all members of the class consent or (ii) the commissioner has approved the terms and conditions of the transaction and the fairness of those terms pursuant to Section 25142.

(d) Notwithstanding its prior approval, an agreement of merger may be amended prior to the filing of the agreement of merger if the amendment is approved by each constituent corporation in the same manner as the original agreement of merger. If the agreement of merger as so amended and approved is also approved by each of the other parties to the agreement of merger, as so amended it shall then constitute the agreement of merger.

(e) The board of a constituent corporation may, in its discretion, abandon a merger, subject to the contractual rights, if any, of third parties, including other parties to the agreement of merger, without further approval by the members (Section 12224), at any time before the merger is effective.

(f) Each constituent corporation shall sign the agreement of merger by its chairperson of the board, president, or a vice president and also by its secretary or an assistant secretary acting on behalf of their respective corporations.

(g) After required approvals of the merger by each constituent corporation and each other party to the merger, the surviving party shall file a copy of the agreement of merger with an officers' certificate of each constituent domestic and foreign corporation attached stating the total number of outstanding shares or membership interests of each class entitled to vote on the merger (and identifying any other person or persons whose approval is required), that the agreement of merger in the form attached or its principal terms, as required, were approved by that corporation by a vote of a number of shares or membership interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and, if applicable, by that other person or persons whose approval is required.

If equity securities of a parent party (Section 12242.6) are to be issued in the merger, the officers' certificate or certificate of merger of the controlled party shall state either that no vote of the shareholders of the parent party was required or that the required vote was obtained. The merger and any amendment of the articles of the surviving corporation, if applicable, contained in the agreement of merger shall be effective upon the filing of the agreement of merger, subject to the provisions of subdivision (i). ~~The agreement of merger shall not be filed, however, until there has been filed by or on behalf of each party to the merger taxed under the Bank and Corporation Tax Law, the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by that law have been paid or secured.~~ If a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance is a party to the merger, the agreement of merger or certificate of merger shall not be filed until there has been filed the certificate issued by the Insurance Commissioner approving the merger pursuant to Section 1555 of the Insurance Code.

In lieu of an officers' certificate, a certificate of merger, on a form prescribed by the Secretary of State, shall be filed for each constituent other business entity. The certificate of merger shall be executed and acknowledged by each domestic constituent limited liability company by all of the managers of the limited liability company (unless a lesser number is specified in its articles of organization or operating agreement) and by each domestic constituent limited partnership by all general partners (unless a lesser number is provided in its certificate of limited partnership or partnership agreement) and by each domestic constituent general partnership by two partners (unless a lesser number is provided in its partnership agreement) and by each foreign constituent general partnership or foreign constituent limited liability company by one or more managers and by each foreign constituent limited partnership by one or more general partners, and by each constituent reciprocal insurer by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary, or, if a constituent reciprocal insurer has not appointed such officers, by the chairperson of the board, president, or vice president, and by the secretary or assistant secretary of the constituent reciprocal insurer's attorney-in-fact, and by each other party to the merger by those persons required or authorized to execute the certificate of merger by the laws under which that party is organized, specifying for such party the provision of law or other basis for the authority of the signing persons.

The certificate of merger shall set forth, if a vote of the shareholders, members, partners, or other holders of interests of the constituent other business entity was required, a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the agreement of merger or its principal terms, as required, were approved by a vote of the number of interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and any other information required to be set forth under the laws under which the constituent other business entity is organized, including, if a domestic limited partnership is a party to the merger, subdivision (a) of Section 15678.4, if a domestic general partnership is a party to the merger, subdivision (b) of Section 16915, and, if a domestic limited liability company is a party to the merger, subdivision (a) of Section 17552. The certificate of merger for each constituent foreign other business entity, if any, shall also set forth the statutory or other basis under which that foreign other business entity is authorized by the laws under which it is organized to effect the merger.

The Secretary of State may certify a copy of the agreement of merger separate from the officers' certificates and certificates of merger attached thereto.

(h) a copy of an agreement of merger certified on or after the effective date by an official having custody thereof has the same force in evidence as the original and, except as against the state, is conclusive evidence of the performance of all conditions precedent to the merger, the existence on the effective date of the surviving party to the merger, the performance of the conditions necessary to the adoption of any amendment to the articles, if applicable, contained in the agreement of merger, and of the merger of the constituent corporations, either by themselves or together with other constituent parties, into the surviving party to the merger.

(i) (1) The merger of domestic corporations with foreign corporations or foreign other business entities in a merger in which one or more other business entities is a party shall comply with subdivisions (a) and (g) and this subdivision.

(2) Subject to subdivision (c) of Section 12214 and paragraph (3), the merger shall be effective as to each domestic constituent corporation and domestic constituent other business entity upon filing of the agreement of merger with attachments as provided in subdivision (g).

(3) If the surviving party is a foreign corporation or foreign other business entity, except as provided in paragraph (4), the merger shall be effective as to any domestic disappearing corporation as of the time of effectiveness in the foreign jurisdiction upon the filing in this state of a copy of the agreement of merger with an officers' certificate of the surviving foreign corporation and of each constituent foreign and domestic corporation and a certificate of merger of each constituent other business entity attached, which officers' certificates and certificates of merger shall conform to

the requirements of subdivision (g).

If one or more domestic other business entities is a disappearing party in a merger pursuant to this subdivision in which a foreign other business entity is the surviving entity, a certificate of merger required by the laws under which each domestic other business entity is organized, including subdivision (a) of Section 15678.4, subdivision (b) of Section 16915 or subdivision (a) of Section 17552, if applicable, shall also be filed at the same time as the filing of the agreement of merger.

(4) If the date of the filing in this state pursuant to this subdivision is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of a domestic disappearing corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger shall be effective as to the domestic disappearing corporation as of the date of filing in this state.

(5) Each foreign disappearing corporation that is qualified for the transaction of intrastate business shall automatically by the filing pursuant to subdivision (g) surrender its right to transact intrastate business as of the date of filing in this state or, if later, the effective date of the merger. With respect to each foreign disappearing other business entity previously registered for the transaction of intrastate business in this state, the filing of the agreement of merger pursuant to subdivision (g) automatically has the effect of a cancellation of registration for that foreign other business entity without the necessity of the filing of a certificate of cancellation.

AMENDMENT 32

Section 12550.5 of the Corporations Code is amended to read:

12550.5. (a) Upon merger pursuant to this chapter, a surviving domestic or foreign corporation or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign corporation or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:

(1) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.

(2) To pay any tax liability determined to be due.

(b) ~~Notwithstanding Sections 1103, 1108, 1110, 1113, 6014, 6018, 6019.1, 8014, 8018, 8019.1, 12535, 12539, 12540.1, 15678.4, and 17552 of this code and Sections 17945, 17948.1, and 23334 of the Revenue~~

~~and Taxation Code, i~~If the surviving entity is a domestic limited liability company, domestic corporation, or registered limited liability partnership or a foreign limited liability company, foreign limited liability partnership, or foreign corporation that is registered or qualified to do business in California, the Secretary of State shall ~~file the merger~~ ~~without the certificate of satisfaction of the Franchise Tax Board~~ ~~and~~ ~~shall~~ notify the Franchise Tax Board of the merger.

AMENDMENT 33

Section 12628 of the Corporations Code is amended to read:

12628. (a) Upon the final settlement of the accounts of the directors or other persons appointed pursuant to Section 12625 and the determination that the corporation's affairs are in condition for it to be dissolved, the court may make an order declaring the corporation duly wound up and dissolved. The order shall declare:

(1) That the corporation has been duly wound up, that a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code ~~any tax or penalty due under the Bank and Corporation Tax Law has been paid or secured~~ and that its ~~other~~ known debts and liabilities have been paid or adequately provided for, or that such ~~taxes, penalties,~~ debts and liabilities have been paid as far as its assets permitted, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the order shall state what provision has been made, setting forth the name and address of the corporation, person, or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or such other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(2) That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(3) That the accounts of directors or such other persons have been settled and that they are discharged from their duties and liabilities to creditors and members.

(4) That the corporation is dissolved.

(b) The court may make such additional orders and grant such further relief as it deems proper upon the evidence submitted.

(c) Upon the making of the order declaring the corporation dissolved, corporate existence shall cease except for the purposes of further winding up if needed; and the directors or such other persons shall be discharged from their duties and liabilities, except in respect to completion of the winding up.

AMENDMENT 34

Section 12629 of the Corporations Code is amended to read:

12629. Whenever a corporation is dissolved or its existence forfeited by order, decree, or judgment of a court, a copy of the order, decree or judgment, certified by the clerk of court, shall forthwith be filed. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~Notwithstanding Section 23334 of the Revenue and Taxation Code, when the order is based on an action for involuntary dissolution brought by the Attorney General pursuant to Section 12621, there need not be filed the certificate of satisfaction of the Franchise Tax Board that all taxes have been paid or secured.~~

AMENDMENT 35

Section 12635 of the Corporations Code is amended to read:

12635. (a) When a corporation has been completely wound up without court proceedings therefor, a majority of the directors then in office shall sign and verify a certificate of dissolution stating:

(1) That the corporation has been completely wound up.

(2) That its known debts and liabilities have been actually paid, or adequately provided for, or paid or adequately provided for as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the certificate shall state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or such other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

(3) That its known assets have been distributed to the persons entitled thereto or that it acquired no known assets, as the case may be.

(4) That the corporation is dissolved.

(5) That a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(b) The certificate of dissolution shall be filed and thereupon the corporate existence shall cease, except for the purpose of further winding up if needed. The Secretary of State shall notify the Franchise Tax Board of the dissolution.~~However, before any corporation may file a certificate of dissolution it shall file or cause to be filed the certificate of satisfaction of the Franchise Tax Board required by Section 23334 of the Revenue and Taxation Code that all taxes, if any, imposed under the Bank and Corporation Tax Law have been paid or secured.~~

AMENDMENT 36

Section 15678.4 of the Corporations Code is amended to read:

15678.4 (a) If the surviving entity is a limited partnership or an other business entity (other than a corporation in a merger in which a domestic corporation is a constituent party), after approval of a merger by the constituent limited partnerships and any constituent other business entities, the constituent limited partnerships and constituent other business entities shall file a certificate of merger in the office of, and on a form prescribed by, the Secretary of State. The certificate of merger shall be executed and acknowledged by each domestic constituent limited partnership by all general partners (unless a lesser number is provided in the certificate of limited partnership of the domestic constituent limited partnership) and by each foreign constituent limited partnership by one or more general partners, and by each constituent other business entity by those persons required to execute the certificate of merger by the laws under which the constituent other business entity is organized. The certificate of merger shall set forth all of the following:

(1) The names and the Secretary of State's file numbers, if any, of each of the constituent limited partnerships and constituent other business entities, separately identifying the disappearing limited partnerships and disappearing other business entities and the surviving limited partnership or surviving other business entity.

(2) If a vote of the limited partners was required under Section 15678.2, a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class.

(3) If the surviving entity is a limited partnership and not an other business entity, any change required to the information set forth in the certificate of limited partnership of the surviving limited partnership resulting from the merger, including any change

in the name of the surviving limited partnership resulting from the merger. The filing of a certificate of merger setting forth any such changes to the certificate of limited partnership of the surviving limited partnership shall have the effect of the filing of a certificate of amendment by the surviving limited partnership, and the surviving limited partnership need not file a certificate of amendment under Section 15622 to reflect those changes.

(4) The future effective date or time (which shall be a date or time certain not more than 90 days subsequent to the date of filing) of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

(5) If the surviving entity is an other business entity or a foreign limited partnership, the full name, type of entity, legal jurisdiction in which the entity was organized and by whose laws its internal affairs are governed, and the address of the principal place of business of the entity.

(6) Any other information required to be stated in the certificate of merger by the laws under which each constituent other business entity is organized, including, if a domestic corporation is a party to the merger, paragraph (2) of subdivision (g) of Section 1113.

If the surviving entity is a foreign limited partnership in a merger in which a domestic corporation is a disappearing other business entity, a copy of the agreement of merger and attachments as required under paragraph (1) of subdivision (g) of Section 1113 shall be filed at the same time as the filing of the certificate of merger.

(b) If the surviving entity is a domestic corporation or a foreign corporation in a merger in which a domestic corporation is a constituent party, after approval of the merger by the constituent limited partnerships and constituent other business entities, the surviving corporation shall file in the office of the Secretary of State a copy of the agreement of merger and attachments required under paragraph (1) of subdivision (g) of Section 1113. The certificate of merger shall be executed and acknowledged by each domestic constituent limited partnership by all general partners, unless a lesser number is provided in the certificate of limited partnership of the domestic constituent limited partnership.

(c) A certificate of merger or the agreement of merger, as is applicable under subdivision (a) or (b), shall have the effect of the filing of a certificate of cancellation for each disappearing limited partnership, and no disappearing limited partnership need file a certificate of dissolution or a certificate of cancellation under Section 15623 as a result of the merger.

(d) ~~If a disappearing other business entity is a foreign corporation qualified to transact intrastate business in this state, a certificate of satisfaction of the Franchise Tax Board as required by~~

~~Section 23334 of the Revenue and Taxation Code shall be filed with the certificate of merger or agreement of merger, as is applicable under subdivision (a) or (b)~~ By the filing of the certificate of merger or agreement of merger, as is applicable, the foreign corporation shall automatically surrender its right to transact intrastate business.

AMENDMENT 37

Section 15678.10 of the Corporations Code is amended to read:

15678.10 <u>(a)</u> Upon merger pursuant to this article, a surviving domestic or foreign limited partnership or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign limited partnership or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:
(~~a~~<u>1</u>) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.
(~~b~~<u>2</u>) To pay any tax liability determined to be due.
<u>(b) The Secretary of State shall notify the Franchise Tax Board of the merger.</u>

AMENDMENT 38

Section 16915.5 of the Corporations Code is amended to read:

16915.5. (a) Upon merger pursuant to this article, a surviving domestic or foreign partnership or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign partnership or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:

(1) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.

(2) To pay any tax liability determined to be due.

(b) ~~Notwithstanding Sections 1103, 1108, 1110, 1113, 6014, 6018, 6019.1, 8014, 8018, 8019.1, 12535, 12539, 12540.1, 15678.4, and 17552 of this code and Sections 17945, 17948.1, and 23334 of the Revenue and Taxation Code, i~~<u>If</u> the surviving entity is a domestic limited liability company, domestic corporation, or registered limited liability partnership or a foreign limited liability company, foreign limited liability partnership, or foreign corporation that is registered or qualified to do business in California, the Secretary of State shall ~~file the merger~~ ~~without the certificate of satisfaction of the Franchise Tax Board~~ ~~and~~ ~~shall~~ notify the Franchise Tax Board of the merger.

AMENDMENT 39

Section 16954 of the Corporations Code is amended to read:

16954. (a) The registration of a registered limited liability partnership may be amended by an amended registration executed by one or more partners authorized to execute an amended registration and filed with the Secretary of State, as soon as reasonably practical after any information set forth in the registration or previously filed amended registration becomes inaccurate or to add information to the registration or amended registration.

(b) If a registered limited liability partnership ceases to be a registered limited liability partnership, it shall file with the Secretary of State a notice, executed by one or more partners authorized to execute the notice, that it is no longer a registered limited liability partnership. ~~A tax clearance certificate issued by the Franchise Tax Board pursuant to Section 17948.1 of the Revenue and Taxation Code shall be filed with the notice.~~The notice shall state that a final annual tax return, within the meaning of Section 17948.3 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(c) An amendment pursuant to subdivision (a) and a notice pursuant to subdivision (b) shall each be accompanied by a fee as set forth in subdivision (c) of Section 12189 of the Government Code.

(d) The Secretary of State shall provide forms for an amended registration under subdivision (a) and a notice under subdivision (b).

(e) A notice of cessation signed and verified pursuant to subdivision (b) shall be filed with the Secretary of State. The Secretary of State shall notify the Franchise Tax Board of the cessation.

AMENDMENT 40

Section 16960 of the Corporations Code is amended to read:

16960. (a) The registration of a foreign limited partnership may be amended by an amended registration executed by one or more partners authorized to execute an amended registration and filed with the

Secretary of State, as soon as reasonably practical after any information set forth in the registration or previously filed amended registration becomes inaccurate, to add information to the registration or amended registration or to withdraw its registration as a foreign limited liability partnership.

(b) If a foreign limited partnership ceases to be a limited liability partnership, it shall file with the Secretary of State a notice, executed by one or more partners authorized to execute the notice, that it is no longer a foreign limited liability partnership. ~~A tax clearance certificate issued by the Franchise Tax Board pursuant to Section 17948.1 of the Revenue and Taxation Code shall be filed with the notice.~~ The notice shall state that a final annual tax return, within the meaning of Section 17948.3 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(c) A foreign limited liability partnership that is, but is no longer required to be, registered under Section 16959 may withdraw its registration by filing a notice with the Secretary of State, executed by one or more partners authorized to execute the notice.

(d) The Secretary of State shall provide forms for an amended registration under subdivision (a) and notices under subdivisions (b) and (c).

(e) The filing of amended registration forms pursuant to subdivision (a) and a notice pursuant to subdivision (b) or (c) shall each be accompanied by a fee as set forth in subdivision (d) of Section 12189 of the Government Code.

(f) A notice of cessation signed pursuant to subdivision (b) shall be filed with the Secretary of State. The Secretary of State shall notify the Franchise Tax Board of the cessation.

AMENDMENT 41

Section 17350.5 of the Corporations Code is amended to read:

17350.5 (a) Notwithstanding any other provision of this division, if a domestic limited liability company has not conducted any business, only a majority of the members, or, if there are no members, the majority of the managers, if any, or if no members or managers, the person or a majority of the persons signing the articles of organization, may execute and acknowledge a certificate of cancellation of articles of organization, on a form prescribed by the Secretary of State, stating all of the following:

(1) The name of the domestic limited liability company and the Secretary of State's file number.

(2) That the certificate of cancellation is being filed within 12

months from the date the articles of organization were filed.

(3) That the limited liability company does not have any debts or other liabilities, except as provided in paragraph (4).

(4) ~~That the tax liability of the limited liability company will be satisfied on a taxes-paid basis or that a person, limited liability company, or other business entity assumes the tax liability, if any, of the dissolving limited liability company as security for the issuance of a tax clearance certificate from the Franchise Tax Board and is responsible for additional taxes or fees, if any, that are assessed under the Revenue and Taxation Code and become due after the date of the assumption of tax liability.~~

~~(5)~~ That ~~the~~ a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, or a final annual tax return, within the meaning of Section 17947 of the Revenue and Taxation Code has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(~~6~~5) That the known assets of the limited liability company remaining after payment of, or adequately providing for, known debts and liabilities have been distributed to the persons entitled thereto or that the limited liability company acquired no known assets, as the case may be.

(~~7~~6) That the limited liability company has not conducted any business from the time of the filing of the articles of organization.

(~~8~~7) That a majority of the managers or members voted, or, if no managers or members, the person or a majority of the persons signing the articles of organization, voted to dissolve the limited liability company.

(~~9~~8) If the limited liability company has received payments for interests from investors, that those payments have been returned to those investors.

(b) A certificate of cancellation executed and acknowledged pursuant to subdivision (a) shall be filed with the Secretary of State within 12 months from the date that the articles of organization were filed. The Secretary of State shall ~~file the certificate of cancellation without the tax clearance certificate specified in Section 17945 of the Revenue and Taxation Code, and shall~~ notify the Franchise Tax Board of the cancellation.

(c) Upon filing a certificate of cancellation pursuant to subdivision (a), a limited liability company shall be cancelled and its powers, rights, and privileges shall cease.

(d) A domestic limited liability company that filed articles of organization on or after January 1, 2004, and that meets all of the conditions described in subdivision (a) may file a certificate of cancellation under this section.

AMENDMENT 42

Section 17355 of the Corporations Code is amended to read:

17355. (a) (1) Causes of action against a dissolved limited liability company, whether arising before or after the dissolution of the limited liability company, may be enforced against any of the following:

(A) Against the dissolved limited liability company, to the extent of its undistributed assets, including, without limitation, any insurance assets held by the limited liability company that may be available to satisfy claims.

(B) If any of the assets of the dissolved limited liability company have been distributed to members, against members of the dissolved limited liability company to the extent of the limited liability company assets distributed to them upon dissolution of the limited liability company.

Any member compelled to return distributed assets in an amount that exceeds the sum of the member's pro rata share of the claim and the amount for which the member could otherwise be held liable under Section 17254 or 17255 may seek contribution for the excess from any other member or manager, up to the sum of that other person's pro rata share of the claim and that other person's liabilities under Section 17254 or 17255.

(2) Except as set forth in subdivision (c), all causes of action against a member of a dissolved limited liability company arising under this section are extinguished unless the claimant commences a proceeding to enforce the cause of action against that member of a dissolved limited liability company prior to the earlier of the following:

(A) The expiration of the statute of limitations applicable to the cause of action.

(B) Four years after the effective date of the dissolution of the limited liability company.

(3) As a matter of procedure only, and not for purposes of determining liability, members of the dissolved limited liability company may be sued in the name of the limited liability company upon any cause of action against the limited liability company. This section does not affect the rights of the limited liability company or its creditors under Sections 17254 and 17255, or the rights, if any, of creditors under the Uniform Fraudulent Transfer Act, that may arise against the member of a limited liability company.

(b) Summons or other process against a limited liability company may be served by delivering a copy thereof to a manager, member, officer, or person having charge of its assets or, if no such person can be found, to any agent upon whom process might be served at the time of dissolution. If none of those persons can be found with due diligence and it is so shown by affidavit to the satisfaction of the court, then the court may make an order that summons or other process be served upon the dissolved limited liability company by personally delivering a copy thereof, together with a copy of the order, to the Secretary of State or an assistant or deputy Secretary of State. Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State. Upon receipt of process and the fee therefor, the Secretary of State shall give notice to the limited liability company as provided in Section 1702

(c) Every limited liability company shall survive and continue to exist indefinitely for the purpose of being sued in any quiet title action. Any judgment rendered in any such action shall bind each and all of its members or other persons having any equity or other interest in the limited liability company, to the extent of their interest therein, and the action shall have the same force and effect as an action brought under the provisions of Sections 410.50 and 410.60 of the Code of Civil Procedure. Service of summons or other process in any action may be made as provided in Chapter 4 (commencing with Section 413.10) of Title 5 of Part 2 of the Code of Civil Procedure or as provided in subdivision (b).

(d) For purposes of Article 4 (commencing with Section 19071) of Chapter 4 of Part 10.2 of the Revenue and Taxation Code, the liability described in this section shall be considered a liability at law with respect to a dissolved limited liability company.

AMENDMENT 43

Section 17356 of the Corporations Code is amended to read:

17356. (a)(1) The managers shall cause to be filed in the office of, and on a form prescribed by, the Secretary of State, a certificate of dissolution upon the dissolution of the limited liability company pursuant to Chapter 8 (commencing with Section 17350), unless the event causing the dissolution is that specified in subdivision (c) of Section 17350, in which case the managers or members conducting the winding up of the limited liability company's affairs pursuant to Section 17352 shall have the obligation to file the certificate of dissolution.

(2) The certificate of dissolution shall set forth all of the following:

(A) The name of the limited liability company and the Secretary of State's file number.

(B) Any other information the managers or members filing the certificate of dissolution determine to include.

(3) If a dissolution pursuant to subdivision (b) of Section 17350 is made by the vote of all of the members and a statement to that effect is added to the certificate of cancellation of articles of

organization pursuant to subdivision (b), the separate filing of a certificate of dissolution pursuant to this subdivision is not required.

(b) (1) The managers or members who filed the certificate of dissolution shall cause to be filed in the office of, and on a form prescribed by, the Secretary of State, a certificate of cancellation of articles of organization upon the completion of the winding up of the affairs of the limited liability company pursuant to Chapter 8 (commencing with Section 17350), unless the event causing the dissolution is that specified in subdivision (c) of Section 17350, in which case the managers or members conducting the winding up of the limited liability company's affairs pursuant to Section 17352 shall have the obligation to file the certificate of cancellation of articles of organization.

(2) The certificate of cancellation of articles of organization shall set forth all of the following:

(A) The name of the limited liability company and the Secretary of State's file number.

(B) That a final franchise tax return, within the meaning of Section 23332 of the Revenue and Taxation Code, or a final annual tax return, within the meaning of Section 17947 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

~~(B) A statement that the tax liability will be satisfied on a taxes paid basis or that a person, limited liability company, or other business entity assumes the tax liability, if any, of the dissolving limited liability company as security for the issuance of a tax clearance certificate from the Franchise Tax Board and is responsible for additional taxes or fees, if any, that are assessed under the Revenue and Taxation Code and become due after the date of the assumption of tax liability.~~

(C) Any other information the managers or members filing the certificate of cancellation of articles of organization determine to include.

(3) The Secretary of State shall notify the Franchise Tax Board of the filing. ~~and shall forward to the Franchise Tax Board. any statement of assumption of tax liability accompanying the certificate of cancellation. The Franchise Tax Board shall determine from the available evidence whether or not all taxes and fees imposed on the limited liability company under the Revenue and Taxation Code have been paid or secured and shall notify the taxpayer of any outstanding tax or fee liability and the necessity of satisfying that liability.~~

~~(4) The Franchise Tax Board shall notify the Secretary of State when all taxes and fees imposed on the limited liability company under the Revenue and Taxation Code have been paid or secured, at which time the limited liability company shall cease to exist as of~~

~~the date of filing its certificate of cancellation of articles of organization.~~

~~(5) When a limited liability company files a certificate of cancellation of articles of organization, the Secretary of State shall notify the limited liability company that the limited liability company will be dissolved as of the date of filing only if the Franchise Tax Board notifies the Secretary of State that all taxes and fees imposed on the limited liability company pursuant to Chapter 1.6 of Part II (commencing with Section 23091) of Division 2 of the Revenue and Taxation Code have been paid or secured.~~

AMENDMENT 44

Section 17552 of the Corporations Code is amended to read:

17552. (a) If the surviving entity is a limited liability company or an other business entity (other than a corporation in a merger in which a domestic corporation is a constituent party), after approval of a merger by the constituent limited liability companies and any constituent other business entities, the constituent limited liability companies or constituent other business entities shall file a certificate of merger in the office of, and on a form prescribed by, the Secretary of State. The certificate of merger shall be executed and acknowledged by each domestic constituent limited liability company by all of the managers of the limited liability company, unless a lesser number is specified in the articles of organization or the operating agreement of the constituent limited liability company, and by each constituent foreign limited liability company and each constituent other business entity by those persons required to execute the certificate or agreement of merger by the laws under which the constituent foreign limited liability company or other business entity is organized. The certificate of merger shall set forth all of the following:

(1) The names and the Secretary of State's file numbers, if any, of each of the constituent limited liability companies and constituent other business entities, separately identifying the disappearing limited liability companies and disappearing other business entities and the surviving limited liability company or surviving other business entity.

(2) If a vote of the members was required under Section 17551, a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class that equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class.

(3) If the surviving entity is a limited liability company and not

an other business entity, any change required to the information set forth in the articles of organization of the surviving limited liability company resulting from the merger, including any change in the name of the surviving limited liability company resulting from the merger. The filing of a certificate of merger setting forth any changes to the articles of organization of the surviving limited liability company shall have the effect of the filing of an amendment to the articles of organization by the surviving limited liability company, and the surviving limited liability company need not file a certificate of amendment under Section 17054 to reflect those changes.

(4) The future effective date or time (which shall be a date or time certain not more than 90 days subsequent to the date of filing) of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

(5) If the surviving entity is an other business entity or a foreign limited liability company, the full name, type of entity, legal jurisdiction in which the entity was organized and by whose laws its internal affairs are governed, and the address of the principal place of business of the entity.

(6) Any other information required to be stated in the certificate of merger by the laws under which each constituent other business entity is organized, including, if a domestic corporation is a party to the merger, paragraph (2) of subdivision (g) of Section 1113.

If the surviving entity is a foreign limited liability company in a merger in which a domestic corporation is a disappearing other business entity, a copy of the agreement of merger and attachments as required under paragraph (1) of subdivision (g) of Section 1113 shall be filed at the same time as the filing of the certificate of merger.

(b) If the surviving entity is a domestic corporation or a foreign corporation in a merger in which a domestic corporation is a constituent party, after approval of the merger by the constituent limited liability companies and constituent other business entities, the surviving corporation shall file in the office of the Secretary of State a copy of the agreement of merger and attachments required under paragraph (1) of subdivision (g) of Section 1113. The certificate of merger shall be executed and acknowledged by each domestic constituent limited liability company by all of the managers of the limited liability company unless a lesser number is specified in the articles of organization or the operating agreement of the domestic constituent limited liability company.

(c) A certificate of merger, or the agreement of merger, as is applicable under subdivisions (a) or (b), shall have the effect of the filing of a certificate of cancellation of articles of organization for each disappearing limited liability company and no disappearing limited liability company need file a certificate of cancellation of articles of organization under Section 17356 as a result of the merger.

(d) If a disappearing other business entity is a foreign corporation qualified to transact intrastate business in this state~~, a certificate of satisfaction of the Franchise Tax Board as required by Section 23334 of the Revenue and Taxation Code shall be filed with the certificate of merger or the agreement of merger, as is applicable under subdivision (a) or (b). By~~ the filing of the certificate of merger or the agreement of merger, ~~the foreign corporation~~ shall automatically surrender its right to transact intrastate business.

~~(e) No certificate of merger shall be filed, however, until there has been filed on behalf of each constituent entity that is taxed under the Bank and Corporation Tax Law, the existence of which is terminated by the merger, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by that law have been paid or secured.~~

AMENDMENT 45

Section 17554.5 of the Corporations Code is amended to read:

17554.5. (a) Upon merger pursuant to this chapter, a surviving domestic or foreign limited liability company or other business entity shall be deemed to have assumed the liability of each disappearing domestic or foreign limited liability company or other business entity that is taxed under Part 10 (commencing with Section 17001) of, or under Part 11 (commencing with Section 23001) of, Division 2 of the Revenue and Taxation Code for the following:

(1) To prepare and file, or to cause to be prepared and filed, tax and information returns otherwise required of that disappearing entity as specified in Chapter 2 (commencing with Section 18501) of Part 10.2 of Division 2 of the Revenue and Taxation Code.

(2) To pay any tax liability determined to be due.

(b) ~~Notwithstanding Sections 1103, 1108, 1110, 1113, 6014, 6018, 6019.1, 8014, 8018, 8019.1, 12535, 12539, 12540.1, 15678.4, and 17552 of this code and Sections 17945, 17948.1, and 23334 of the Revenue and Taxation Code, i~~If the surviving entity is a domestic limited liability company, domestic corporation, or registered limited liability partnership or a foreign limited liability company, foreign limited liability partnership, or foreign corporation that is registered or qualified to do business in California, the Secretary of State shall ~~file the merger without the certificate of satisfaction of the Franchise Tax Board and shall~~ notify the Franchise Tax Board of the merger.

AMENDMENT 46

Section 3126 of the Financial Code is amended to read:

3126. (a) When the commissioner has completed the liquidation of the bank, he or she shall petition the court for an order declaring the bank duly wound up and dissolved.

(b) After such notice as the court may direct and a hearing, the court may make an order declaring the bank duly wound up and dissolved. Such order shall declare:

(1) That the bank has been duly wound up;

(2) That any tax or penalty due under the Bank and Corporation Tax Law has been paid or secured and that the bank's other known debts and liabilities have been paid or adequately provided for, or that such taxes, penalties, debts, and liabilities have been paid so far as the bank's assets permitted, as the case may be. If there are known debts or liabilities for the payment of which adequate provision has been made, the order shall describe such provision, setting forth such information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability;

(3) That all known assets of the bank have been distributed to its shareholders or wholly applied on account of the bank's debts and liabilities; and

(4) That the bank is dissolved.

(c) The court may make such additional orders and grant such further relief as it deems proper upon the evidence submitted.

(d) Upon the making of the order declaring the bank dissolved, the corporate existence of the bank shall cease, except for the purposes of any necessary further winding up.

(e) Upon the making of the order declaring the bank dissolved, the commissioner shall forthwith file with the Secretary of State a copy of such order, certified by the clerk of the court. ~~Notwithstanding the provisions of Section 23334 of the Revenue and Taxation Code, there need not be filed with the Secretary of State any certificate of satisfaction of the Franchise Tax Board that all taxes due from the bank have been paid or secured.~~

AMENDMENT 47

Section 5758 of the Financial Code is amended to read:

5758. The executed agreement, or an executed counterpart of it and the respective certificate of each constituent association or any other corporation and of the surviving association shall be filed with the Secretary of State. Neither the agreement nor any certificate shall be filed, however, unless the commissioner's written approval is attached~~and until there has been filed with the Secretary of State, by or on behalf of each association or any other corporation taxed under the provisions of Chapter 2 (commencing with Section 23101) of Part 11 of Division 2 of the Revenue and Taxation Code, the existence of which is terminated by the merger or consolidation, the certificate of satisfaction of the Franchise Tax Board that all taxes imposed by the act have been paid or secured~~. The effective date of the merger or consolidation under this article shall be the date of the filing with the Secretary of State of the copy of the approved agreement of merger or consolidation. A copy of the approved agreement certified by the Secretary of State shall be filed with the commissioner.

If the resulting association is a federal association, the effective date of merger shall be the date the merger is effective under regulations of the Office of Thrift Supervision.

AMENDMENT 48

Section 5760 of the Financial Code is amended to read:

5760. (a) Any association, owning all the outstanding stock of any corporation, may merge its wholly owned subsidiary corporation if the laws under which the subsidiary corporation exists permit a merger as this section provides. The association shall submit to the commissioner for approval a certificate of ownership in its name signed by its president or a vice president, and its secretary or an assistant secretary, which shall be verified by their affidavit, stating, in effect, that the matters set forth in the certificate are true of their own knowledge. The certificate shall set forth:

(1) That it owns all the outstanding stock of the merged corporation.

(2) A copy of the resolution adopted by its board of directors to merge the corporation, and to assume all of its obligations.

(3) The time and place of the meeting of the board of directors at which the resolution was adopted, and the vote by which it was adopted.

(b) If an association owns less than all the outstanding stock but at least 90 percent of the outstanding shares of stock of each class of a corporation or corporations, domestic or foreign, the merger of the subsidiary corporation or corporations into the parent association may be effected by resolutions adopted by the boards of the parent and each subsidiary corporation, and the filing of a certificate of ownership as provided in subdivision (d). The resolution of the board of the parent association shall provide for the merger, shall provide that the parent association assumes all the liabilities of each subsidiary corporation and shall set forth the securities, cash property or rights to be issued, paid, delivered or granted by the parent association upon surrender of each share of stock of each subsidiary corporation not owned by the parent association. The resolution of the board of each subsidiary corporation shall approve the fairness of the consideration to be received for each share of stock of the subsidiary corporation not owned by the parent association.

(c) Notwithstanding any other provision of law, in any merger pursuant to this section, the parent association may change its name regardless of whether the name so adopted is the same or similar to that of one of the disappearing associations. In this case the resolution shall provide for the amendment of articles to change the name.

(d) After adoption of the resolution or resolutions of merger, as provided under subdivision (b), the association shall submit to the commissioner for approval a certificate of ownership in its name signed by its president or a vice president, and its secretary or an assistant secretary, which shall be verified by their affidavit, stating, in effect, that the matters set forth in the certificate are true of their own knowledge. The certificate shall set forth:

(1) That the association owns at least 90 percent of the outstanding stock of the merged corporations.

(2) A copy of the resolution adopted by the association's board of directors to merge the corporation, to assume all of its obligations, and including the resolution for a change of name if applicable.

(3) A copy of the resolution or resolutions adopted by the board of each subsidiary corporation, if required.

(4) The time and place of the meeting of the boards of directors of the parent and the subsidiary at which the resolutions were adopted, and the vote by which they were adopted.

(e) In the event all of the outstanding shares of stock of a subsidiary domestic corporation party to a merger effected under this section are not owned by the parent association immediately prior to the merger, the parent association shall, at least 20 days before the effective date of the merger, give notice to each stockholder of the subsidiary corporation that the merger will become effective on or after a specific date, which notice shall contain (1) a copy of the resolutions of the boards of directors of the parent and the subsidiary required by subdivision (b) above and (2) the information which must accompany the notice required by subdivision (a) of Section 1301 of the Corporations Code. The notice shall be sent by mail addressed to the stockholder at the address of the stockholder as it appears on the records of the corporation. The stockholder shall have the right to demand payment of cash for the shares of stock of the stockholder pursuant to the provisions of Chapter 13 (commencing with Section 1300) of Division 1 of Title 1 of the Corporations Code.

(f) If a merger authorized by this section is approved, the commissioner shall attach to the certificate written approval, and the certificate shall be filed with the Secretary of State. A copy of the approved certificate certified by the Secretary of State shall be filed with the commissioner. Thereupon, all of the estate, property, rights, privileges, and franchises of the merged corporation shall vest in and be held and enjoyed by the parent association as fully as the same were before held and enjoyed by the merged corporation, but subject to all the liabilities and obligations of the merged corporation and the rights of all creditors. The parent association shall not, however, thereby acquire the right to engage in any business or to exercise any right, privilege, or franchise of a kind which it could not lawfully engage in or exercise under the provisions of this division. The parent association shall be deemed to have assumed all the liabilities and obligations of the merged corporation, and shall be liable in the same manner as if it had itself incurred the liabilities and obligations.

(g) If the merged subsidiary is a domestic corporation, a copy of the certificate shall be filed in the office of the Secretary of State on behalf of the subsidiary corporation. If the merged subsidiary is a foreign corporation qualified for the transaction of intrastate business in this state there shall be filed in the office of the Secretary of State on behalf of the foreign subsidiary a certificate of surrender and right to transact intrastate business as provided in Section 2112 of the Corporations Code. ~~No copy of the certificate shall be filed unless there is also filed with the Secretary of State the certificate of satisfaction of the Franchise Tax Board that all taxes imposed upon the subsidiary corporation by the Bank and Corporation Tax Law, Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code, have been paid or secured.~~

AMENDMENT 49

Section 17937 is added to the Revenue and Taxation Code to read:

17937. (a) A limited partnership shall not be subject to the tax imposed by this chapter for a taxable year if the limited partnership does all of the following:

(1) Files with the Franchise Tax Board a timely final annual tax return for a taxable year.

(2) Does not do business in this state after the end of the taxable year for which the final annual tax return was filed.

(3) Files a certificate of cancellation with the Secretary of State pursuant to Section 15623 or 15696 of the Corporations Code before the end of the twelve-month period beginning with the date the final annual tax return described in paragraph (1) was filed.

(b) For purposes of this section, a "final annual tax return" is a return described in Section 18633 that is filed on or before the due date of the return (as extended) that the taxpayer designates in the manner prescribed by the Franchise Tax Board as the taxpayer's final annual tax return for purposes of the tax imposed under this chapter. A final annual tax return for purposes of the tax imposed under this chapter is a return filed pursuant to Section 18633 where the taxpayer is not required to file a subsequent return to reflect the imposition of tax under this chapter.

AMENDMENT 50

Section 17945 of the Revenue and Taxation Code is repealed.

~~17945. No decree of dissolution, withdrawal, or cancellation shall be made and entered by any court, nor shall the county clerk of any county or the Secretary of State file any decree of dissolution, withdrawal, or cancellation or any other document by which the term of existence of the limited liability company shall be reduced or terminated, except as provided in subdivision (b) of Section 17350.5 of the Corporations Code, nor shall the Secretary of State file any certificate of the surrender or cancellation by a foreign limited liability company of its rights to do intrastate business in this state unless the limited liability company obtains from the Franchise Tax Board and files with the court, county clerk, or Secretary of State, as the case may be, a tax clearance certificate indicating that the Franchise Tax Board is satisfied from the available evidence that all taxes and fees imposed by this chapter or all taxes imposed by Part 11 (commencing with Section 23001) have been paid or are secured by bond, deposit, or otherwise. Within 30 days after receiving a request for a certificate, the Franchise Tax Board shall either issue the certificate or notify the person requesting the certificate of the amount of tax or fees that must be paid or the amount of bond, deposit, or other security that must be furnished as a condition of issuing the certificate. The issuance of the certificate shall not relieve the taxpayer or any individual, bank, or corporation from liability for any taxes, fees, penalties, or interest imposed by this part or Part 11 (commencing with Section 23001). The Franchise Tax Board shall furnish a copy of the tax clearance certificate to the Secretary of State.~~

AMENDMENT 51

Section 17947 is added to the Revenue and Taxation Code to read:

17947. (a) A limited liability company shall not be subject to the tax and fee imposed by this chapter for a taxable year if the limited liability company does all of the following:

(1) Files with the Franchise Tax Board a timely final annual tax return for a taxable year.

(2) Does not do business in this state after the end of the taxable year for which the final annual tax return was filed.

(3) Files a certificate of cancellation with the Secretary of State pursuant to Section 17356 or 17455 of the Corporations Code before the end of the twelve-month period beginning with the date the final annual tax return described in paragraph (1) was filed.

(b) For purposes of this section, a "final annual tax return" is a return described in Section 18633.5 that is filed on or before the due date of the return (as extended) that the taxpayer designates in the manner prescribed by the Franchise Tax Board as the taxpayer's final annual tax return for purposes of the tax imposed under this chapter. A final annual tax return for purposes of the tax imposed under this chapter is a return filed pursuant to Section 18633.5 where the taxpayer is not required to file a subsequent return to reflect the imposition of tax under this chapter.

AMENDMENT 52

Section 17948.1 of the Revenue and Taxation Code is repealed.

~~17948.1 No decree of dissolution, withdrawal, or cancellation shall be made and entered by any court, nor shall the county clerk of any county or the Secretary of State file any decree of dissolution, withdrawal, or cancellation or any other document by which the term of existence of the registered limited liability partnership shall be reduced or terminated, nor shall the Secretary of State file any amended registration or notice by a foreign limited liability partnership that its rights to do intrastate business in this state have ceased or of its dissolution and winding up, unless the registered limited liability partnership or foreign limited liability partnership obtains from the Franchise Tax Board and files with the court, county clerk, or Secretary of State, as the case may be, a tax clearance certificate indicating that the Franchise Tax Board is satisfied from the available evidence that all taxes imposed by this chapter have been paid or are secured by bond, deposit, or otherwise. Within 30 days after receiving a request for a certificate, the Franchise Tax Board shall either issue the certificate or notify the person requesting the certificate of the amount of tax or fees that~~

~~must be paid or the amount of bond, deposit, or other security that must be furnished as a condition of issuing the certificate. The issuance of the certificate shall not relieve the taxpayer or any individual, bank, or corporation from liability for any taxes, fees, penalties, or interest imposed by this code. The Franchise Tax Board shall furnish a copy of the tax clearance certificate to the Secretary of State.~~

AMENDMENT 53

Section 17948.3 is added to the Revenue and Taxation Code to read:

17948.3. (a) A registered limited liability partnership shall not be subject to the tax imposed by this chapter for a taxable year if the registered limited liability partnership does all of the following:

(1) Files with the Franchise Tax Board a timely final annual tax return for a taxable year.

(2) Does not do business in this state after the end of the taxable year for which the final annual tax return was filed.

(3) Files a notice of cessation or withdrawal with the Secretary of State pursuant to Section 16954 or 16960 of the Corporations Code before the end of the twelve-month period beginning with the date the final annual tax return described in paragraph (1) was filed.

(b) For purposes of this section, a “final annual tax return” is a return described in Section 18633 that is filed on or before the due date of the return (as extended) that the taxpayer designates in the manner prescribed by the Franchise Tax Board as the taxpayer’s final annual tax return for purposes of the tax imposed under this chapter. A final annual tax return for purposes of the tax imposed under this chapter is a return filed pursuant to Section 18633 where the taxpayer is not required to file a subsequent return to reflect the imposition of tax under this chapter.

AMENDMENT 54

Section 23153 of the Revenue and Taxation Code is amended to read:

23153. (a) Every corporation described in subdivision (b) shall be subject to the minimum franchise tax specified in subdivision (d) from the earlier of the date of incorporation, qualification, or commencing to do business within this state, until the effective date of dissolution or withdrawal as provided in Section 23331 or, if later, the date the corporation ceases to do business within the limits of this state.

(b) Unless expressly exempted by this part or the California Constitution, subdivision (a) shall apply to each of the following:

(1) Every corporation that is incorporated under the laws of this

state.
(2) Every corporation that is qualified to transact intrastate business in this state pursuant to Chapter 21 (commencing with Section 2100) of Division 1 of Title 1 of the Corporations Code.
(3) Every corporation that is doing business in this state.
(c) The following entities are not subject to the minimum franchise tax specified in this section:
(1) Credit unions.
(2) Nonprofit cooperative associations organized pursuant to Chapter 1 (commencing with Section 54001) of Division 20 of the Food and Agricultural Code that have been issued the certificate of the board of supervisors prepared pursuant to Section 54042 of the Food and Agricultural Code. The association shall be exempt from the minimum franchise tax for five consecutive taxable years, commencing with the first taxable year for which the certificate is issued pursuant to subdivision (b) of Section 54042 of the Food and Agricultural Code. This paragraph only applies to nonprofit cooperative associations organized on or after January 1, 1994.
(d) (1) Except as provided in paragraph (2), paragraph (1) of subdivision (f) of Section 23151, paragraph (1) of subdivision (f) of Section 23181, and paragraph (1) of subdivision (c) of Section 23183, corporations subject to the minimum franchise tax shall pay annually to the state a minimum franchise tax of eight hundred dollars ($800).
(2) The minimum franchise tax shall be twenty-five dollars ($25) for each of the following:
(A) A corporation formed under the laws of this state whose principal business when formed was gold mining, which is inactive and has not done business within the limits of the state since 1950.
(B) A corporation formed under the laws of this state whose principal business when formed was quicksilver mining, which is inactive and has not done business within the limits of the state since 1971, or has been inactive for a period of 24 consecutive months or more.
(3) For purposes of paragraph (2), a corporation shall not be considered to have done business if it engages in other than mining.
(e) Notwithstanding subdivision (a), for taxable years beginning on or after January 1, 1999, and before January 1, 2000, every "qualified new corporation" shall pay annually to the state a minimum franchise tax of five hundred dollars ($500) for the second taxable year. This subdivision shall apply to any corporation that is a qualified new corporation and is incorporated on or after January 1, 1999, and before January 1, 2000.
(1) The determination of the gross receipts of a corporation, for purposes of this subdivision, shall be made by including the gross receipts of each member of the commonly controlled group, as defined in Section 25105, of which the corporation is a member.

(2) "Gross receipts, less returns and allowances reportable to this state," means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of Section 25120, and the gross receipts from the production of nonbusiness income, as defined in subdivision (d) of Section 25120.

(3) "Qualified new corporation" means a corporation that is incorporated under the laws of this state or has qualified to transact intrastate business in this state, that begins business operations at or after the time of its incorporation and that reasonably estimates that it will have gross receipts, less returns and allowances, reportable to this state for the taxable year of one million dollars ($1,000,000) or less. "Qualified new corporation" does not include any corporation that began business operations as a sole proprietorship, a partnership, or any other form of business entity prior to its incorporation. This subdivision shall not apply to any corporation that reorganizes solely for the purpose of reducing its minimum franchise tax.

(4) This subdivision shall not apply to limited partnerships, as defined in Section 17935, limited liability companies, as defined in Section 17941, limited liability partnerships, as defined in Section 17948, charitable organizations, as described in Section 23703, regulated investment companies, as defined in Section 851 of the Internal Revenue Code, real estate investment trusts, as defined in Section 856 of the Internal Revenue Code, real estate mortgage investment conduits, as defined in Section 860D of the Internal Revenue Code, financial asset securitization investment trusts, as defined in Section 860L of the Internal Revenue Code, qualified Subchapter S subsidiaries, as defined in Section 1361(b)(3) of the Internal Revenue Code, or to the formation of any subsidiary corporation, to the extent applicable.

(5) For any taxable year beginning on or after January 1, 1999, and before January 1, 2000, if a corporation has qualified to pay five hundred dollars ($500) for the second taxable year under this subdivision, but in its second taxable year, the corporation's gross receipts, as determined under paragraphs (1) and (2), exceed one million dollars ($1,000,000), an additional tax in the amount equal to three hundred dollars ($300) for the second taxable year shall be due and payable by the corporation on the due date of its return, without regard to extension, for that year.

(f) (1) Notwithstanding subdivision (a), every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, shall not be subject to the minimum franchise tax for its first taxable year.

(2) This subdivision shall not apply to limited partnerships, as defined in Section 17935, limited liability companies, as defined in Section 17941, limited liability partnerships, as defined in Section 17948, charitable organizations, as described in Section 23703,

regulated investment companies, as defined in Section 851 of the Internal Revenue Code, real estate investment trusts, as defined in Section 856 of the Internal Revenue Code, real estate mortgage investment conduits, as defined in Section 860D of the Internal Revenue Code, financial asset securitization investment trusts, as defined in Section 860L of the Internal Revenue Code, and qualified Subchapter S subsidiaries, as defined in Section 1361(b)(3) of the Internal Revenue Code, to the extent applicable.

(3) This subdivision shall not apply to any corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax.

(g) Notwithstanding subdivision (a), a domestic corporation, as defined in Section 167 of the Corporations Code, that files a certificate of dissolution in the office of the Secretary of State pursuant to subdivision (c) of Section 1905 of the Corporations Code <u>(prior to its amendment by the act amending this subdivision)</u> and that does not thereafter do business shall not be subject to the minimum franchise tax for taxable years beginning on or after the date of that filing.

(h) The minimum franchise tax imposed by paragraph (1) of subdivision (d) shall not be increased by the Legislature by more than 10 percent during any calendar year.

AMENDMENT 55

Section 23332 of the Revenue and Taxation Code is amended to read:

23332. (a) Except in the case of a taxpayer subject to the provisions of Section 23222a, any taxpayer which is dissolved or withdraws from the state during any taxable year shall pay a tax only for the months of the taxable year which precede the effective date of the dissolution or withdrawal, according to or measured by (1) the net income of the preceding income year or (2) a percentage of net income determined by ascertaining the ratio which the months of the taxable year, preceding the effective date of dissolution or withdrawal, bears to the months of the income year, whichever is the lesser amount. The taxes levied under this chapter shall not be subject to abatement or refund because of the cessation of business or corporate existence of any taxpayer pursuant to a reorganization, consolidation, or merger (as defined by Section 23251). In any event, each corporation shall pay a tax not subject to offset for the period in an amount equal to the minimum tax prescribed by Section 23153.

(b) The provisions of subdivision (a) shall be applied only with respect to taxpayers which dissolve or withdraw before January 1, 1973. On and after that date, the tax for the taxable year in which the taxpayer ceases doing business, dissolves or surrenders shall be determined under the appropriate provisions of Section 23151.1, 23153, 23181, or 23183, whichever is applicable. ~~However, if all of the following conditions are satisfied, a minimum franchise tax shall not be imposed with respect to the taxable year in which a tax clearance certificate is issued by the Franchise Tax Board:~~

~~(1) The taxpayer does not do business in this state at any time during that taxable year.~~

~~(2) The taxpayer files a certificate of dissolution with the Secretary of State prior to the beginning of that taxable year, in accordance with Section 1905 of the Corporations Code.~~

(c)(1) A corporation shall not be subject to the minimum franchise tax imposed by this chapter for a taxable year if the corporation does all of the following:

(A) Files with the Franchise Tax Board a timely final franchise tax return for a taxable year.

(B) Does not do business in this state after the end of the taxable year for which the final franchise tax return was filed.

(C)(i) In the case of a corporation other than a corporation described in clause (ii), files a certificate of dissolution or surrender with the Secretary of State in accordance with Section 1905 or 2112 of the Corporations Code before the end of the twelve-month period beginning with the date the final franchise tax return described in subparagraph (A) was filed.

(ii) In the case of a limited liability company that is a corporation pursuant to subdivision (c) of Section 23038, files a certificate of cancellation with the Secretary of State in accordance with Section 17356 or 17455 of the Corporations Code before the end of the twelve-month beginning with the date the final franchise tax return described in subparagraph (A) was filed.

(2) For purposes of this subdivision, a final franchise tax return is a return filed pursuant to Section 18601 on or before the due date of the return (as extended) that the taxpayer designates in the manner prescribed by the Franchise Tax Board as the taxpayer's final franchise tax return for purposes of the tax imposed under this chapter. A final franchise tax return for purposes of the tax imposed under this chapter is a return filed pursuant to Section 18601 where the taxpayer is not required to file a subsequent return to reflect the imposition of tax under this chapter.

AMENDMENT 56

Section 23334 of the Revenue and Taxation Code is repealed.

~~23334. No decree of dissolution shall be made and entered by any court, nor shall the Secretary of State file a decree of dissolution, or file in the case of a credit union incorporated under the California Credit Union Law a certificate of election to dissolve, or in the case of any other taxpayer file a certificate of dissolution,~~

~~except as provided in subdivision (c) of Section 1905 of the Corporations Code and subdivision (b) of Section 1900.5 of the Corporations Code, or any other document by which the term of existence of the taxpayer shall be reduced or terminated, nor shall the Secretary of State file any certificate of the surrender by a foreign corporation of its right to do intrastate business in this state unless the taxpayer obtains from the Franchise Tax Board and files with the court or Secretary of State, as the case may be, a tax clearance certificate indicating that the Franchise Tax Board is satisfied from the available evidence that all taxes imposed by this chapter have been paid or are secured by bond, deposit, or otherwise. Within 30 days after receiving a request for a certificate, the Franchise Tax Board shall either issue the certificate or notify the person requesting the certificate of the amount of tax that must be paid or the amount of bond, deposit, or other security that must be furnished as a condition of issuing the certificate. The issuance of the certificate shall not relieve the taxpayer or any individual or corporation from liability for any taxes, penalties, or interest imposed by this part, nor shall the issuance of the certificate in the case of any credit union which revokes its election to wind up and dissolve, relieve that credit union of any taxes or interest that would have been imposed under this part had the election not been filed.~~

~~The Franchise Tax Board shall furnish a copy of the tax clearance certificate to the Secretary of State.~~

AMENDMENT 57

Section 23335 of the Revenue and Taxation Code is amended to read:

23335. (a) Any return filed pursuant to Section 18601 that the taxpayer designates in the appropriate place on the form provided by the Franchise Tax Board as the taxpayer's final franchise tax return as the result of a dissolution or withdrawal shall be treated as a request for information on how to properly dissolve or withdraw.~~a certificate issued by the Franchise Tax Board pursuant to Section 23334 unless the taxpayer has otherwise filed a request with the Franchise Tax Board for that certificate.~~

(b) If a taxpayer has filed a return ~~that is a request for a tax clearance certificate~~ as described in subdivision (a), the Franchise Tax Board shall provide the taxpayer with information ~~, including forms and instructions,~~ regarding all documents that are required by this article to be filed with the Franchise Tax Board and the Secretary of State.

AMENDMENT 58

Section 23561 of the Revenue and Taxation Code is amended to read:

23561. No decree of dissolution shall be made and entered by any court, nor shall the county clerk of any county or the Secretary of State file any such decree, or file any other document by which the term of existence of any taxpayer shall be reduced or terminated, nor shall the Secretary of State file any certificate of the surrender by a foreign corporation of its right to do intrastate business in this State if the corporate powers, rights and privileges of the corporation have been suspended or forfeited by the Franchise Tax Board for failure to pay ~~until~~ the tax, penalties, or~~and~~ interest due under this ~~chapter~~ part or Part 10.2 (commencing with Section 18401).~~shall have been paid or are secured by bond, deposit, or otherwise~~.

LEGISLATIVE PROPOSAL 06-06
EXECUTIVE SUMMARY

- **Title:** Limitations/Exclusions Applied On A Post-Apportionment Basis

- **Problem Statement:** For corporations earning income in multiple states, tax disputes between these taxpayers and the department result because state tax law is silent on whether the rules listed below regarding usage of certain tax benefits are applied before or after apportionment:
  - the limitation on the amount of certain losses and tax credits from acquired corporations, and
  - the amount of tax benefits required to be reduced as a result of cancellation of indebtedness income.

- **Proposed Solution:** Amend Section 24451 to provide that the limitations on the usage of NOLs and tax credits from acquired corporations are determined by taking the federal limitation on acquired NOLs and multiplying it by the average of the acquired corporation's California apportionment percentage. In addition, amend Section 24307 to provide that the apportionment and allocation rules would be applied to the excluded cancellation of indebtedness income to determine the amount of tax attributes required to be reduced for California.

- **Major Concerns/Issues:** None

- **Revenue:** This proposal would result in estimated revenue gains for the following fiscal years:

Estimated Revenue Impact of LP 06-06			
Fiscal Year Impact (millions)			
2005-06	**2006-07**	**2007-08**	**2008-09**
$5	**$23**	**$17**	**$9**

The method being proposed relating to the cancellation of indebtedness income is current practice among taxpayers and would not, therefore, impact income tax revenues.

The method being proposed relating to the limitations on NOLs and tax credits from acquired corporations results in the estimated revenue gains shown above. This proposal delays (not disallows) the usage of NOLs and tax credits. To the extent that the usage of NOLs and tax credits that are limited each year can be used in later years, the revenue impact is an "acceleration" rather than a long-term revenue gain. The revenue estimate is based on the analysis of prior years' tax returns and the usage of NOLs and tax credits by corporations acquired during the tax year and their respective apportionment percentages. The data for determining the amount of the federal NOL limitation on acquired corporations with California NOLs was not available.

Title

Limitations/Exclusions Applied On A Post-Apportionment Basis

Introduction

This proposal would specify that the California apportionment percentage is to be applied to the federal limitation[1] and exclusion[2] amounts that are conformed to by California in order to calculate the California limitations and exclusions. This proposal is consistent with the concept of apportionment that is currently used by California and many other states that apply an apportionment percentage to federal taxable income after state adjustments to "divide up" the taxable income for each state. This proposal would apply the same concept to the federal limitations and exclusions and "divide up" the limitation and the exclusion by using the apportionment percentage.

Background

A corporation files or is included in one federal tax return, but a corporation may file or be included in numerous state tax returns. To divide up the federal taxable income among the states, many states use an apportionment percentage to determine how much of the federal taxable income, i.e., business income, is taxable in each state. The California apportionment percentage is determined on the basis of a formula. This formula measures relative levels of business activity in the state using the amounts of the taxpayer's property, payroll, and sales in California. These measures of activities are commonly called "factors."

California conforms to the federal provisions that allow a corporation to exclude from taxable income the amount of the corporation's indebtedness that is cancelled as long as the corporation reduces certain tax benefits called "tax attributes" by the same amount as the debt cancelled. Examples of tax attributes are NOLs and tax credits. California law does not specify whether the apportionment percentage is applied to the corresponding federal exclusion of cancellation of indebtedness income to arrive at the amount of tax attributes that are required to be reduced for California. See Appendix A for examples showing the effects of applying the apportionment percentage to the federal exclusion of cancellation of indebtedness income. Also see the Program History portion of this proposal for a discussion of a court case that ruled that the apportionment percentage is applied to the exclusion of cancellation of indebtedness income to determine the amount of tax attributes required to be reduced.

California conforms to the federal provisions relating to corporations that acquire other corporations with NOLs and tax credits and the limitation on the amount of acquired NOLs and tax credits that may be taken each year. California law does not specify whether the corporation's apportionment percentage is applied to the federal limitations on acquired NOLs or tax credits. See Appendix A for examples showing the effects of applying the apportionment percentage to these federal limitations.

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[1] Limitations on the usage of net operating losses and tax credits under Internal Revenue Code (IRC) Sections 382 and 383.
[2] Exclusion of cancellation of indebtedness under IRC Section 108.

Current Law

1. **Internal Revenue Code (IRC) Section 382 – Limitation On NOL Deductions Following An Ownership Change**

Federal Law

When a corporation has a net taxable loss for the tax year, the net taxable loss is called an NOL. An NOL may be carried forward to future tax years and taken as a deduction to reduce taxable income or carried back to prior tax years and deducted to reduce taxable income for the prior year.

When a corporation acquires another corporation with NOLs, IRC Section 382 limits the amount of acquired NOL the buyer may deduct on its tax return each year. Specifically, the "Section 382 limitation" does not allow the buyer to use the NOLs at a faster rate than the acquired corporation could have used them if it had sold its assets and invested the proceeds in tax-exempt government obligations. The purpose of this rule is to make NOLs a neutral factor in a corporate acquisition. Prior to the limitation, corporations with large NOLs were being purchased by corporations with large taxable incomes simply because the acquired corporation's NOLs could be used to reduce the buyer's taxable income.

The "Section 382 limitation" is calculated by multiplying the fair market value of the stock of the acquired corporation immediately prior to the change in ownership by the federal long-term tax-exempt rate. The Internal Revenue Service publishes this rate monthly.

For example:

Buyer corporation purchases at fair market value all of the stock of Target corporation for $1,000,000. Target has a $500,000 NOL. The long-term tax-exempt bond rate is 10%. The amount of Target's NOL that Buyer may deduct each year is limited to $100,000 ($1,000,000 x 10%) until the total acquired $500,000 NOL is used up.

State Law

California generally determines its NOL in accordance with the federal rules but has several differences. One difference is that the California NOL is calculated by taking the corporation's federal net taxable loss, after applying certain state adjustments, and multiplying this number by the California apportionment percentage to calculate the California NOL.

For example, if a corporation has a federal net taxable loss after state adjustments of $1,000,000 and has a California apportionment percentage of 20%, the corporation's NOL for California is $200,000. ($1,000,000 x 20%). For federal purposes the NOL is $1,000,000, but for California purposes an additional step of multiplying the NOL by an apportionment percentage is necessary to determine the corporation's proper or proportionate NOL for California.

California conforms to the IRC Section 382 limitation on NOLs.

2. IRC Section 383 – Limitation On Tax Credits Following An Ownership Change

Federal Law

When a corporation acquires another corporation that has unused carryover tax credits, IRC Section 383 limits the amount of the acquired tax credits the buyer may claim on its tax return each year. This limitation is referred to as the IRC Section 383 limitation. As with the IRC Section 382 limitation, the purpose of this rule is to make tax credits a neutral factor in a corporate acquisition and prevent corporations with large taxable income from purchasing corporations with large tax credits in order to reduce their tax liability.

The IRC Section 383 limitation is calculated using the IRC Section 382 limitation. The IRC Section 383 limitation is calculated by taking the excess IRC Section 382 limitation, if any, and multiplying this number by the acquired corporation's federal marginal tax rate. For example:

Corporation A is acquired and subject to the IRC Section 382 limitation. The IRC Section 382 limitation is $25,000, and Corp A's acquired NOLs equal $20,000. After applying the IRC Section 382 limitation, Corp A's acquired NOLs may be fully deducted, and there is an excess of $5,000 available for the IRC Section 383 limitation ($25,000 - 20,000). Corp A's marginal tax rate is 15%, so the IRC Section 383 limitation is calculated to be $750 ($5,000 x 15%). If Corp A had unused carryover tax credits that were acquired, only $750 of these credits could be taken in the acquisition tax year. This calculation is performed each year until Corp A's acquired tax credits are used up.

State Law

California conforms to the IRC Section 383 limitation on tax credits.

3. IRC Section 108 – Cancellation of Indebtedness

Federal Law

When a borrower has its debt repayment obligation cancelled that borrower must include in federal taxable income the amount of debt cancelled. Various exceptions to this immediate income recognition rule are contained in IRC Section 108. One exception provides that instead of including the amount of cancellation of indebtedness in taxable income, the corporation may instead reduce certain tax attributes that could have been used to reduce the tax liability of that corporation in the future. These tax attributes include NOLs, tax credits, capital losses, and the depreciable basis of property. Tax attributes such as NOLs, capital losses, and "depreciable basis" are reduced dollar for dollar, while tax credits are reduced at 33 1/3 cents per dollar income not recognized.

For example:

A corporation has $500,000 of its debt cancelled and excludes this income under IRC Section 108[3]. The corporation has an NOL carryforward of $600,000. The corporation may exclude the $500,000 of cancelled debt from taxable income, but must reduce its NOL carryforward to $100,000 ($600,000 - $500,000).

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[3] IRC Section 108(a)

<u>State Law</u>

California conforms to IRC Section 108 with modifications.[4] One modification is that tax credit attributes are reduced at 11.1 cents per dollar rather than the 33 1/3 cents for federal law.

Program History

On January 9, 2003, in an unpublished opinion, *Appeal of Wilshire Restaurant Group, Inc.*, the California State Board of Equalization allowed, under IRC Section 108, a reduction to the taxpayer's tax attributes on a post-apportionment basis. This opinion is consistent with this proposal's recommendation. However, because the opinion is unpublished, it is not precedent for any other similar case nor is it precedent with respect to application of similar principles with respect to the NOL limitation in IRC Section 382 or the tax credit limitation in IRC Section 383.

Legislative Proposal 03-25 was submitted to the three-member Franchise Tax Board at their meeting of November 26, 2002, for consideration. The proposal requested that the Legislature grant the department rulemaking authority to write regulations to clarify the issue on the impact of apportionment in the application of IRC Sections 382 and 108. The proposal also provided that taxpayers' input into the regulation process would be considered in deciding if IRC Sections 108 and 382 would be applied on a pre-apportionment or post-apportionment basis. This proposal was not approved by the three-member Franchise Tax Board.

Problem

For corporations earning income in multiple states, tax disputes between these taxpayers and the department result because state tax law is silent on whether the rules listed below regarding usage of certain tax benefits are applied before or after apportionment:

- the limitation on the amount of certain losses and tax credits from acquired corporations, and
- the amount of tax benefits required to be reduced as a result of cancellation of indebtedness income.

Proposed Solution

<u>IRC Section 382/383 NOL and Tax Credit Limitation</u>

Amend Revenue & Taxation Code (R&TC) Section 24451 to provide that the limitations on the usage of NOLs and tax credits from acquired corporations are determined by taking the federal limitation on acquired NOLs and multiplying it by the average of the acquired corporation's California apportionment percentages for the year of the acquisition and the two immediately preceding tax years.

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[4] R&TC Section 24307

IRC Section 108 Cancellation of Debt

Amend R&TC Section 24307 to provide that the apportionment and allocation rules would be applied to the excluded cancellation of indebtedness income to determine the amount of tax attributes required to be reduced for California. This would be done first by reducing the depreciable basis of property as determined under federal law, as basis is not a post-apportioned amount, but simply cost determined in conformity with federal law. Any remaining excluded income from cancellation of indebtedness would be determined as follows:

1. determine if the excluded income is business or nonbusiness income,
    a. if business income, the amount would be apportioned to California, reflecting the apportionment percentage of the taxpayer,
    b. if nonbusiness income, that amount would be allocated to California if attributable to California nonbusiness income, and
2. apply the excluded income apportioned or allocated to California against the taxpayer's California tax attributes, reflecting a dollar-for-dollar reduction of California net operating losses and capital losses. Tax credits would be reduced using the same 11.1 cents per dollar as under current California law.

Justification

This proposal would assure that the California method of taxing multistate corporations by apportioning income among the states where a corporation does business is likewise applied to adjustments to income and tax.. Namely, this proposal would apply the apportionment and allocation rules to the cancellation of indebtedness exclusion similar to the current practice of taxpayers; and applies these same rules consistently to the federal limitations on NOLs and tax credits. This proposal delays (not disallows) the usage of NOLs and tax credits from acquired corporations, which was a significant reason the federal limitation was originally enacted into law.

Effective/Operative Date of Solution

If enacted during the 2006 legislative session as a tax levy, these amendments would apply to taxable years beginning on or after January 1, 2006.

Implementation

Implementing this proposal would not significantly impact the department's programs and operations.

Economic Impact

Revenue Estimate

Based on data and assumptions discussed below, the revenue impact from this proposal would be as follows:

Estimated Revenue Impact of LP 06-06 Effective for taxable years on or after 1/1/2006 Fiscal Year Impact (millions)			
2005-06	**2006-07**	**2007-08**	**2008-09**
$5	**$23**	**$17**	**$9**

Revenue Discussion

Federal NOL and Tax Credit Limitations

This proposal would apply the apportionment and allocation rules to the federal limitations relating to NOLs and tax credits from acquired corporations to determine the limitation for California. This may result in a reduction in the amount of NOLs and tax credits the acquired corporation is allowed to deduct in the first taxable year after the acquisition and also in each subsequent tax year until the NOLs and tax credits are "used up." To the extent that the NOLs and tax credits that are limited each year can be used in later years, the revenue impact is an "acceleration" rather than a long-term revenue gain.

The data for determining the amount of the federal NOL limitation on acquired corporations with California NOLs is not available. The revenue estimate was based on data available on California NOLs and the apportionment percentage of the acquired corporations.

In 2001, corporations reported approximately $2.1 billion more in available California NOL carryovers than would have been predicted from their available California NOL carryovers reported at the end of 2000. Based on audit data, it is estimated that 47% of the $2.1 billion of excess NOLs ($987 million) can be attributed to acquisitions. Using the apportionment factors from the acquired corporations with excess NOLs, it was determined that 46% of the $987 million of excess NOLs from acquired corporations, or $454 million, may not be able to be used immediately because of the proposal's new California limitation. Of this $454 million, it is estimated that 50%, or $227 million, of the NOLs would not be allowed immediately but may be used in subsequent tax years. Applying an average tax rate of 5.3%, it is estimated that this limitation would result in increased revenues by approximately $12 million ($227 million x 5.3%) for calendar year 2001. Adjusting for growth of NOLs generated and the effects due to the suspension of NOLs for taxable years 2002 and 2003, the revenue impact for 2006 is estimated to be $22 million. The estimate assumes that 95% of the limited NOLs will be used in the following three tax years.

In 2003, corporations reported on their tax returns approximately $385 million more in California tax credits than the tax credit carryovers reported on their tax returns at the end of 2002. It is estimated that 70% of the $385 million of excess tax credits, or $270 million, can be attributed to acquisitions. Using the apportionment factors from the acquired corporations with excess tax credits, it was determined that approximately 18% of the $270 million of excess tax credits from acquired corporations, or $48 million, may not be able to be used immediately because of the proposal's new California limitation. Of this $48 million, it is estimated that 50%, or $24 million, of the tax credits would not be allowed immediately but may be used in subsequent tax years and result in a $24 million revenue impact for tax year 2003. Adjusting for the sunset of the Manufactures' Investment Credit, the revenue impact is estimated to approximate $9 million for calendar year 2006.

In the table above, the NOL and tax credit revenue impacts were combined and then converted to a fiscal-year basis. As discussed above, the estimated revenue impact for the federal NOL limitation is $22 million, and the revenue impact for the federal credit limitation is $9 million for a total revenue impact of $31 million. This total was spread to the following fiscal years: $5 million to 2005-06, $23 million to 2006-07, and $3 million to 2007-08. Starting with 2007, the estimated revenue gain is reduced to reflect delayed usage of NOLs and tax credits that were limited by this proposal in earlier years.

Section 108-Cancellation of Debt Income

Current law does not specifically address apportioning of debt cancellation for the purposes regulated by this proposal. According to audit contacts, the method being proposed is current practice among taxpayers and would not, therefore, impact income tax revenues.

Other States

The laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York* were reviewed because their tax laws are similar to California's income tax laws. One similarity is that these states use an apportionment percentage to assign income for state purposes.

IRC Section 382 NOL limitation

Florida, Illinois, and *New York* generally conform to IRC Section 382, but it could not be determined whether the NOL limitation is calculated before apportionment or after apportionment.

Massachusetts determines its IRC Section 382 NOL limitation by multiplying the federal limitation by *Massachusetts* taxable net income divided by federal taxable income.

Michigan does not conform to IRC Section 382, and *Minnesota* issued a revenue notice explaining that the federal "Section 382 limitation" is multiplied by the *Minnesota* apportionment factor to determine the NOL limitation for *Minnesota*. This method is similar to this proposal.

IRC Section 383 Tax Credit Limitation

Illinois, Michigan, Minnesota, and *Massachusetts* generally conform to IRC Section 383, but research did not confirm that *Florida* and *New York* conform to this provision.

<u>IRC Section 108 Cancellation of Debt</u>

The states reviewed generally conform to IRC Section 108, but it could not be determined whether the amount determined to reduce tax attributes is calculated before apportionment or after apportionment.

A general search of all states showed that *Oregon* implemented a regulation to address the reduction of tax attributes for the IRC Section 108 exclusion of cancellation of indebtedness income. The regulation provides that:

- tax credits are not subject to tax attribute reduction,
- the excluded cancellation of indebtedness income is first multiplied by the Oregon apportionment factor to determine the amount of reduction required for tax attributes, and
- the tax attribute "basis of property" is reduced before apportionment.

Oregon's regulation is similar to this proposal in that it applies the apportionment percentage to the amount of excluded cancellation of indebtedness income before determining the amount of tax attributes to be reduced.

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APPENDIX A
Pre- and Post-Apportionment Examples

The following examples illustrate the effects of applying the apportionment percentage to the federal limitations on acquired NOLs and tax credits and to the amount of tax attributes that are required to be reduced as a result of an exclusion of cancellation of indebtedness income.

Example: Section 108 Cancellation of Debt

Corporation X

Cancellation of Debt = $600,000
Federal NOL = $1,000,000
Federal R & D Credit = $150,000
California Apportionment % = 20%
California NOL = $200,000
California Research & Development (R&D) Credit = $45,000
Illinois Apportionment % = 80%
Illinois NOL = $800,000
Illinois R & D Credit = $105,000

Corporation X elects to exclude $600,000 of cancellation of indebtedness income under IRC Section 108 and must reduce its tax attributes by $600,000; therefore, Corporation X must reduce its federal NOL to $400,000 ($1,000,000 - $600,000). The federal R&D credit carryover to subsequent years remains unaffected since the NOL was able to absorb the total amount of the excluded cancellation of indebtedness income.

Scenario #1: Post-apportionment (Recommended By This Proposal)

If the reduction of tax attributes were applied to California post-apportionment, Corporation X would be required to reduce its California tax attributes by $120,000 ($600,000 x 20%), and Corporation X would reduce its California NOL to $80,000 ($200,000 - $120,000).

If the $600,000 reduction of tax attributes were applied to Illinois post-apportionment, Corporation X would be required to reduce its Illinois tax attributes by $480,000 ($600,000 x 80%), and Corporation X would reduce its Illinois NOL to $320,000 ($800,000 - $480,000).

The reduction of tax attributes for both states would total $600,000 ($120,000 for California and $480,000 for Illinois), which is equal to the amount of cancellation of indebtedness income. Thus, the policy of reducing a corporation’s tax attributes by the amount of cancellation of indebtedness income is achieved for state purposes.

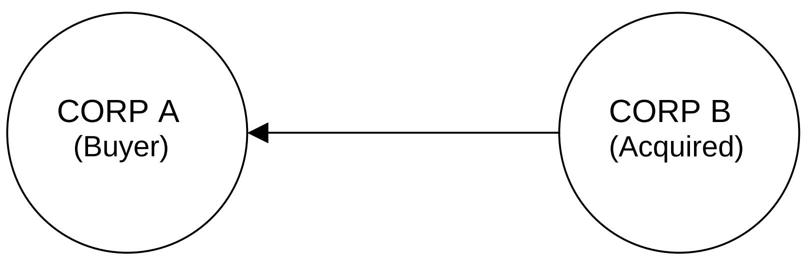
<u>Scenario #2: Pre-apportionment</u>

If the $600,000 reduction of tax benefits were applied to California pre-apportionment, Corporation X would reduce its $200,000 California NOL to zero, leaving an additional $400,000 of tax benefits that would need to be reduced ($600,000 - $200,000). The remaining $400,000 would be applied to reduce tax credits at a rate of 11.1 cents on the dollar, or $44,400 ($400,000 x 11.1%). The California R & D credit would be reduced to $600 ($45,000 - $44,400).

If the $600,000 reduction of tax benefits were applied to Illinois pre-apportionment, Corporation X must reduce its $800,000 Illinois NOL to $200,000 ($800,000 - $600,000). The Illinois R & D credit carryover of $105,000 remains unaffected because its NOL was able to absorb the full $600,000 required reduction of tax attributes.

The total reduction of tax benefits in both states would equal $1,200,000 ($600,000 for California and $600,000 for Illinois), which is twice the amount of the $600,000 cancellation of indebtedness income. Thus, the policy of reducing the corporation's tax benefits by the amount of cancellation of debt income is not achieved for state purposes.

<u>Example: Section 382 NOL limitation</u>



FMV B Stock = $5,000,000
California's Apportionment % = 20%
Illinois's Apportionment % = 80%
Corp B's Federal Loss = $(1,000,000)

CORP A purchases all of the stock of CORP B for $5,000,000. The federal long-term tax-exempt rate is 5%. The "Section 382 limitation" is $250,000 ($5,000,000 x 5%) meaning CORP A may only deduct $250,000 of CORP B's $1,000,000 NOL each year until the NOL carryforward is zero.

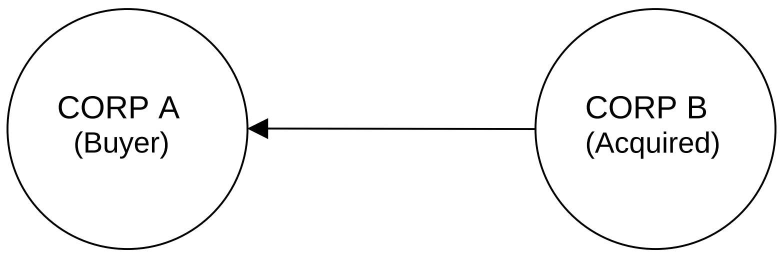
<u>Scenario #1: Post-apportionment – (Recommended By This Proposal)</u>

If the $250,000 limitation were applied post-apportionment to California, California's limitation would be $50,000 ($250,000 x 20%), and Illinois's limitation would be $200,000 ($250,000 x 80%). California's and Illinois' limitations would equal the federal limitation of $250,000 ($50,000 + $200,000). Thus, the policy of IRC Section 382 to limit the annual benefit of acquired NOLs to 5% of the value of the stock is accomplished for state purposes.

<u>Scenario #2: Pre-apportionment</u>

If the $250,000 “Section 382 limitation” were applied to California pre-apportionment, California’s NOL would be limited to $250,000, and Illinois’s NOL would be limited to $250,000 for a total limitation for both states of $500,000, which is twice as much as the federal “Section 382 limitation.” Thus the policy of IRC Section 382 to limit the annual benefit of acquired NOLs to 5% of the value of the stock is substantially avoided for state purposes.

<u>Example: Section 383 Acquired Tax Credit Limitation</u>



FMV B Stock = $2,000,000
California’s Apportionment % = 20%
Illinois’s Apportionment % = 80%
Corp B’s Federal Tax Credits =$120,000
Corp B’s CA Tax Credits = $15,000
Corp B’s Illinois Tax Credits = $105,000
Federal Tax Rate = 15%
California Tax Rate = 8.84%
Illinois Tax Rate = 6%

CORP A purchases all of the stock of CORP B for $2,000,000. The federal long-term tax-exempt rate is 5%. The “Section 382 limitation” is $100,000 ($2,000,000 x 5%). The federal limitation on the amount of acquired tax credits that may be taken in this tax year is $15,000 ($100,000 x 15%).

<u>Scenario #1: Post-apportionment – (Recommended By Proposal)</u>

If the $100,000 “Section 382 limitation” were applied to California post-apportionment, California’s tax credit would be limited to $1,768 ($100,000 x 20% x 8.84%), and Illinois’s tax credit would be limited to $4,800 ($100,000 x 80% x 6%) for a total tax credit limitation for both states of $6,568, which is about half of the federal limitation on acquired tax credits and is reasonable because the state tax rates are about half of the federal tax rate. Thus, the policy of IRC Section 383 to limit the annual benefit of acquired tax credits is achieved for state purposes.

<u>Scenario #2: Pre-apportionment</u>

If the $100,000 limitation were applied pre-apportionment, California’s limitation would be $8,840 ($100,000 x 8.84%), and Illinois’ limitation would be $6,000 ($100,000 x 6%) for a total limitation for both states of $14,840. California’s and Illinois’ limitations would almost equal the federal limitation of $15,000 even though the federal tax rate is twice as much as each state’s tax rate. Thus, the policy of IRC Section 383 to limit the annual benefit of acquired tax credits is not achieved for state purposes.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO LP 06-06

AMENDMENT 1

24451. (a) Subchapter C of Chapter 1 of Subtitle A of the Internal Revenue **Code**, relating to corporate distributions and adjustments, shall apply, except as otherwise provided.

(b)(1) The allocation and apportionment provisions of article 2 (commencing with Section 25120) of chapter 17 shall apply to any adjustment required to be made under Sections 382 and 383 of the Internal Revenue Code.

(2) The Internal Revenue Code Sections 382 and 383 limitations shall be determined by applying the average apportionment percentage (utilizing the proper apportionment formula as described in paragraph (1) above) of the old loss corporation for the year of acquisition and the two immediately preceding taxable years, if applicable.

AMENDMENT 2

24307. (a) Section 108 of the Internal Revenue **Code**, relating to income from discharge of indebtedness, shall apply, except as otherwise provided.

(b)(1) Section 108(b)(2)(B) of the Internal Revenue **Code**, relating to general business credit, is modified by substituting "this part" in lieu of "Section 38 (relating to general business credit)."

(2)~~(c)~~ Section 108(b)(2)(G) of the Internal Revenue **Code**, relating to foreign tax credit carryovers, shall not apply.

(3)~~(d)~~ Section 108(b)(3)(B) of the Internal Revenue **Code**, relating to credit carryover reduction, is modified by substituting "11.1 cents" in lieu of "33 1/3 cents" in each place in which it appears. In the case where more than one credit is allowable under this part, the credits shall be reduced on a pro rata basis.

(4)(A) Except as provided in paragraph (2), for purposes of reducing tax attributes under Section 108(b) of the Internal Revenue Code as modified by the section, the amount excluded from gross income shall be the amount determined after the application of the apportionment and allocation provisions of article 2 (commencing with Section 25120) of chapter 17.

(B) For purposes of reducing the basis of property pursuant to Section 108(b)(2)(E) of the Internal Revenue Code, if income from discharge of indebtedness is business income or nonbusiness income allocable to this state, the amount excluded from gross income shall not be reduced by the application of the apportionment and allocation provisions of article 2 (commencing with Section 25120) of chapter 17.

(5)(A) If a taxpayer makes an election for federal income tax purposes under Section 108(b)(5) of the Internal Revenue Code, relating to applying the reduction of tax attributes first against depreciable property, a separate election shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5 and the federal election shall be binding for purposes of this part.

(B) If a taxpayer has not made an election for federal income tax purposes under Section 108(b)(5) of the Internal Revenue Code, relating to applying the reduction of tax attributes first against depreciable property, then the taxpayer shall not be allowed to make that election for purposes of this part.

(6) In lieu of the order of reduction of tax attributes prescribed by Section 108(b), the reduction in tax attributes shall be made in the following order:

(A) To the extent the basis of property of a taxpayer is reduced for federal purposes by application of Section 108(b)(2)(E), the basis of that property shall be reduced by the same amount for purposes of this part.

(B) The reduction in tax attributes required by Section 108(b)(1) shall be made as described in Sections 108(b)(2) (A), (B) (as modified by this section), (C), and (D), in the order prescribed therein.

(C) Any amount remaining after the application of subparagraphs (A) and (B) of this paragraph shall be applied to reduce the basis of property in accordance with Section 108(B)(2)(E). To the extent an amount remaining after the application of subparagraphs (A) and (B) consists of an amount from the discharge of indebtedness that would give rise to business income, that amount shall be increased to an amount determined by dividing that amount by the fraction determined under Section 25128 for apportioning business income to this state.

(7)~~(e)~~ Section 108(g)(3)(B) of the Internal Revenue **Code**, relating to adjusted tax attributes, is modified by substituting "$9" in lieu of "$3."

(8) The Franchise Tax Board is authorized to prescribe any regulations as may be necessary or appropriate to carry out the purposes of this subdivision.

(c~~f~~) (1) The amendments to Section 108 of the Internal Revenue **Code** made by Section 13150 of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to exclusion from gross income for income from discharge of qualified real property business indebtedness, shall apply to discharges occurring on or after January 1, 1996, in taxable years beginning on or after January 1, 1996.

(2) If a taxpayer makes an election for federal income tax purposes under Section 108(c) of the Internal Revenue **Code**, relating to treatment of discharge of qualified real property business indebtedness, a separate election shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5 and the federal election shall be binding for purposes of this part.

(3) If a taxpayer has not made an election for federal income tax purposes under Section 108(c) of the Internal Revenue **Code**, relating to treatment of discharge of qualified real property business indebtedness, then the taxpayer shall not be allowed to make that election for purposes of this part.

(d~~g~~) The amendments to Section 108 of the Internal Revenue **Code** made by Section 13226 of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to modifications of discharge of indebtedness provisions, shall apply to discharges occurring on or after January 1, 1996, in taxable years beginning on or after January 1, 1996.

(e~~h~~) The amendments made to Section 108(d)(7)(A) of the Internal Revenue **Code**, relating to certain provisions to be applied at the corporate level by Section 402 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), shall apply to discharges of indebtedness after December 31, 2001, in taxable years ending after that date. This subdivision shall not apply to any discharge of indebtedness made before March 1, 2002, pursuant to a plan of reorganization filed with a bankruptcy court on or before October 11, 2001.

LEGISLATIVE PROPOSAL 06-12
EXECUTIVE SUMMARY

- **Title**: Use of Last Known Address For Mailing Notices

- **Problem Statement:** California law lacks a statutory standard for mailing various notices to taxpayers to satisfy the reasonable notice element of due process.

- **Proposed Solution:** Amend Section 18416 of the Revenue and Taxation Code to conform to federal law by defining “last known address” as the address that appears on the taxpayer’s last return filed with the Franchise Tax Board, unless the taxpayer provides clear and concise written notification of a different address.

- **Major Concerns/Issues:** This proposal would eliminate any uncertainty surrounding the proper address to be used in mailing notices to taxpayers. This proposal would bring California law into conformity with federal law regarding the use and definition of last known address. Conforming to the federal statute would provide the benefit of an already established body of case law and would provide taxpayers with consistent procedures when dealing with both federal and California income tax agencies.

- **Revenue:** This proposal would not impact the state’s income tax revenues.

Title

Use Of Last Known Address For Mailing Notices

Introduction

This proposal would provide a definition of "last known address" for purposes of sending required notices.

Current Federal Law

The fourteenth amendment of the United States Constitution guarantees to individual specific rights, including the right to due process of law before property can be taken from the individual by the government. The essential elements of due process include reasonable notice.

Under current federal law, the due process element of reasonable notice is met when the IRS mails a required notice to the taxpayer at the taxpayer's last known address. Federal regulations require that unless the IRS has been given clear and concise notice of a different address, the address that appears on the taxpayer's most recently filed federal tax return is the taxpayer's last known address. The regulation also provides that under certain conditions, updated address information received from the United States Postal Service (USPS) National Change of Address (NCOA) database will be considered the taxpayer's last known address unless the IRS is given clear and concise notification of a different address.

The purpose of the "last known address rule" is to place the responsibility on the taxpayer to notify the taxing agency of any change of address. This rule absolves the taxing agency in instances where the taxing agency does not have the taxpayer's correct address because of the failure of the taxpayer to notify the agency of a change. The rationale for this rule is that with the transient nature of many taxpayers the taxing agency does not have sufficient resources to track the movements of several hundred thousand taxpayers each year. When the tax agency has reason to believe that the address previously provided by the taxpayer is no longer correct, the agency does have a duty to exercise reasonable diligence to ascertain the correct address.

Current State Law

Current state law does not define "last known address" nor does state law specify the address to which required notices must be sent to satisfy the reasonable notice element of due process. In practice, FTB has generally followed the federal "last known address" law and procedures. The department mails notices to the taxpayer's last known address as shown on the taxpayer's last filed return, unless the taxpayer provides clear and concise notice of a different address.

Department policy requires staff to exercise reasonable diligence to ascertain and utilize the current address when mailing correspondence and notices to taxpayers. Department policy is similar to the federal regulation requiring use of information from the USPS NCOA database to update a taxpayer's address for sending notices taxpayers.

In addition, the department may receive taxpayer address information from sources, such as Employment Development Department, 1099 Information Returns, and interest income statements from financial institutions. If FTB determines that an address provided by such a third party source is the current address over the address in departmental records, the new address will be used. In accordance with this policy, the department's Integrated Non Compliance system (INC) uses the address with the most recent date to send a notice to a taxpayer.

Tax appeal decisions of the State Board of Equalization (BOE) interpreting "last known address" generally follow the federal "last known address" definition when determining the sufficiency of FTB notices.

Problem

California law lacks a statutory standard for mailing various notices to taxpayers to satisfy the reasonable notice element of due process.

Proposed Solution

Amend Section 18416 of the Revenue and Taxation Code to conform to federal law by defining "last known address" as the address that appears on the taxpayer's last return filed with the Franchise Tax Board, unless the taxpayer provides clear and concise written notification of a different address.

Effective/Operative Date of Solution

If enacted in the 2006 legislative session, this proposal would be effective January 1, 2007, and be operative as of that date.

Justification

This proposal would eliminate any uncertainty surrounding the proper address to be used in mailing notices to taxpayers. This proposal would bring California law into conformity with federal law regarding the use and definition of last known address. Conforming to federal statute would provide the benefit of an already established body of case law and would provide taxpayers with consistent procedures when dealing with both federal and California income tax agencies.

Implementation

Implementing this proposal will not significantly impact the department's programs or operations.

Fiscal Impact

This proposal would not impact the department's costs since it would codify current practice.

Economic Impact

This proposal would not impact the state's income tax revenues.

Other States

Laws from the states of *Michigan, Minnesota, Illinois, New York,* and *Massachusetts* were reviewed due to their similarities to California's economy, business entity types, and tax laws. *Michigan* defines the term “last known address” to mean the place of a taxpayer’s residence or abode. *Minnesota* does not define “last known address” in its statutes, although the term “last known address” is used based on the address from the last filed return, similar to California’s practice. The definition of “last known address” was not apparent in the review of the laws of the states of *New York, Illinois,* and *Florida.*

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO LP06-12

AMENDMENT 1

Amend Revenue and Taxation Code Section 18416 as follows:

18416. (a) Unless expressly otherwise provided in this part, any notice may be given by first-class mail postage prepaid.
(b) For purposes of this part, any notice mailed to a taxpayer shall be sufficient if mailed to the taxpayer's last known address.
(c) The last known address shall be the address that appears on the taxpayer's last return filed with the Franchise Tax Board, unless the taxpayer has provided to the Franchise Tax Board clear and concise written or electronic notification of a different address, or the Franchise Tax Board has an address it has reason to believe is the most current address for the taxpayer.

LEGISLATIVE PROPOSAL 06-14

EXECUTIVE SUMMARY

- **Title:** Repeal of Interest Offset Provision

- **Problem Statement:** Continued use of Revenue and Taxation Code (RTC) Section 24344(b), the interest offset provision that was declared unconstitutional by the U.S. Supreme Court, appears to discriminate in favor of California based corporations by providing them a tax deduction for 100% of a portion of their interest expense while non-California based corporations receive a deduction for only a portion of their interest expense based upon the portion of their business done in California.

- **Proposed Solution:** Amend Section 24344 of the RTC to repeal the interest offset provision.

- **Major Concerns/Issues:** Repeal of the interest offset provision would reflect the determination of the U. S. Supreme Court decision in *Hunt-Wesson, Inc. v. FTB*. If repealed prospectively, the repeal would not unduly impact taxpayers that may have used the provision in past returns.

  Repealing the interest offset provision would remove grounds for constitutional challenges that the provision discriminates in favor of corporations domiciled in California.

- **Revenue:** The revenue impact of this proposal would accelerate from an estimated revenue gain of $1 million in 2005-06 to an ongoing revenue gain of $6 million by 2007-08.

Estimated Revenue Impact of LP06-14 Operative for Taxable Years BOA 1/1/06 [$ In Millions]		
2005-06	2006-07	2007-08
$1	$5	$6

2006 Departmental Legislative Proposal
LP 06-14

Title

Repeal of Interest Offset Provision/*Hunt-Wesson*

Introduction

This proposal would repeal a section of the Revenue and Taxation Code (R&TC) that has been held unconstitutional by the U.S. Supreme Court.

Background

Corporations that do business both within and without California determine their net income attributable to California by dividing income into two classes:

1. business income that is subject to apportionment by formula, and
2. nonbusiness income that is allocated to a specific state.

Corporations are allowed to deduct from gross income the interest expense incurred on indebtedness to determine the net income of that corporation.

Subdivision (b) of Revenue and Taxation Code (RTC) Section 24344, provides a method for corporations to follow when allocating (or assigning) interest expense to specified types of gross income. Interest expenses allocated to a specified type of income reduces that income and the resulting tax liability of the corporation. Whether the income is classified as business income or nonbusiness income, determines to what extent the income is considered by California in determining the corporation's California tax liability.

Hunt-Wesson

On February 22, 2000, the U.S. Supreme Court in *Hunt-Wesson, Inc.* v. *Franchise Tax Board* (2000) 528 U.S. 458, held that the interest offset provision of Section 24344(b) is unconstitutional on facts specific to a non-California domiciliary corporation. The Court found that the interest offset provision was not based upon a rational relationship between the taxpayer’s expenses and the income generated by those expenses, and resulted in the impermissible taxation of income outside California’s jurisdictional reach in violation of the Due Process and Commerce Clauses.

In light of the court decision in *Hunt-Wesson*, the Franchise Tax Board (FTB) applied the statute as follows:

- because the Court did not consider the first clause of the interest offset provision (allowing a deduction to the extent of apportionable "business" interest income), the FTB continued to apply that portion to all taxpayers;
- because the *Hunt- Wesson* Court did not reach the constitutionality of Section 24344(b) as it applies to allocable "nonbusiness" interest and dividend income that is allocable to California, the FTB continued to apply Section 24344(b) in those circumstances; and
- because the *Hunt-Wesson* Court held that to the extent that Section 24344(b) would assign interest expense to interest and dividends allocable to another state the section is unconstitutional, that provision will not be applied. As a consequence, such interest expense is to be taken into account in determining net apportionable, or business, income.

No statutory changes were made by the Legislature to section 24344 as a result of the *Hunt-Wesson* decision. In addition, Legislative Counsel has opined that the consequence of the *Hunt-Wesson* decision is that section 24344(b) is void.

Current Federal Law

Federal law generally allows a deduction for interest paid or accrued during the taxable year on a corporation's indebtedness. That deduction is reduced to the extent such interest expense is attributable to the production of tax-exempt income (e.g., interest incurred on a loan where the funds are used to purchase or carry tax-exempt obligations that generate tax-exempt interest).

Federal law does not contain business/nonbusiness income concepts because those concepts were developed by the states in response to constitutional limitations on state taxation. Therefore, there are no requirements under federal law to make expense allocations between business and nonbusiness income. Federal law does make expense allocations between foreign (non-U.S.) and domestic income and, by regulation, uses methods similar to those provided for in Regulation 25120(d) of title 18 of the California Administrative Code.

Current State Law

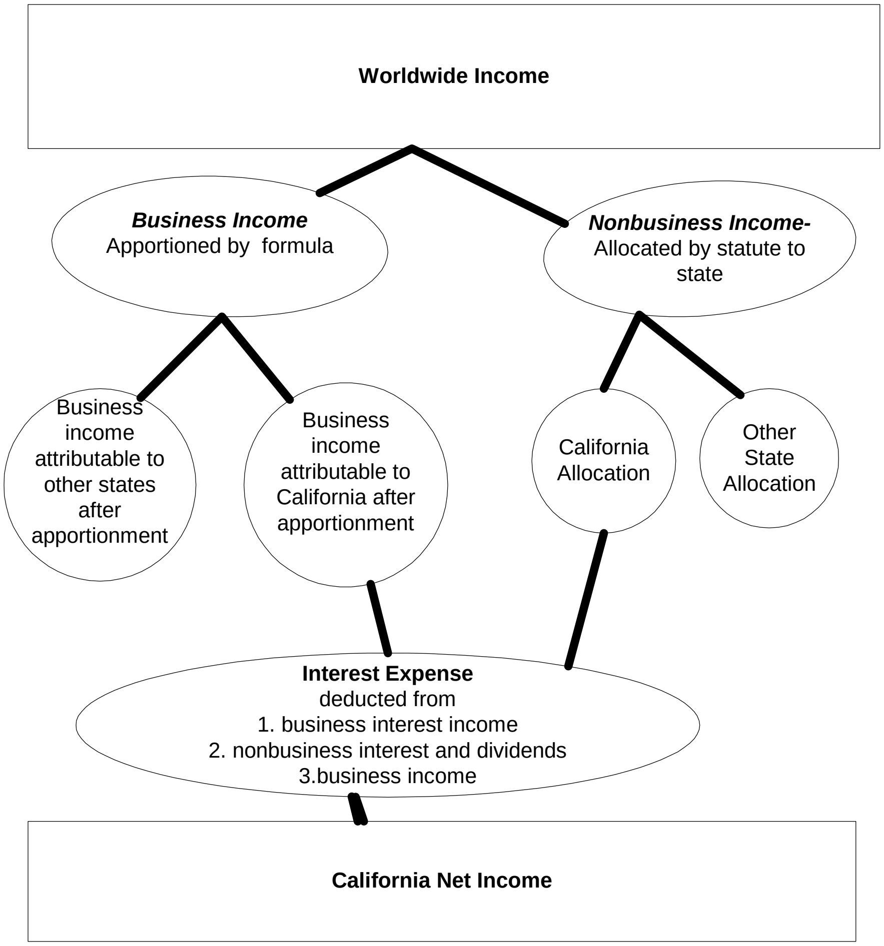
Under California law, a corporation deriving income from sources both within and outside California is required to measure its California tax liability by reference to income derived from or attributable to sources within California. The amount of income derived from California is calculated by first characterizing income as *business* and *nonbusiness.*

Business income is defined as income arising from transactions and activities in the regular course of the corporation's trade or business. To determine the portion of *business* income that is attributable to California, an apportionment formula is used. For most corporations, this formula is worldwide income multiplied by the average of the factors of property, payroll, and double-weighted sales. Each of these factors is the ratio of in-state activity to worldwide activity. *Business income* assigned to California is determined by multiplying total *business income* by the California apportionment percentage.

Nonbusiness income is all income that is not *business income*, and it is assigned by statute to a specific state. *Nonbusiness* income from intangible property is generally allocated to the taxpayer's commercial domicile. *Nonbusiness* income from tangible property is generally allocated to the physical location of the property.

Current state law provides a deduction for all interest paid or accrued on the indebtedness of a corporation. Generally, all expenses are to be assigned between various classes of income which include business income and nonbusiness income. The interest offset provisions provide special rules for the assignment of interest expense between business and nonbusiness income.

The interest offset provision requires interest expense to be deducted, first from business interest income and then, to the extent that interest expense exceeds business interest income, interest expense is deducted against nonbusiness interest and dividends. Any remaining interest expense is then allowed as a deduction in computing net business income. The following diagram illustrates how net income is calculated for corporations and how interest expense is deducted.



Since California determines business income by apportionment, only a part of business income is used to compute California income. Consequently, a corporation can only receive a deduction for a portion of its interest expense against business interest income.

For interest expense allocated to nonbusiness interest and dividends, a California company would receive a deduction for 100% of that expense, since all of that nonbusiness interest and dividend income is used in determining its California tax. A non-California based company on the other hand, would receive no deduction for the interest expense against nonbusiness interest and dividend income since it is not used in the computation of California tax.

Under FTB's application of *Hunt-Wesson*, a non-California company has the option to have none of its interest expense assigned to nonbusiness interest and dividend income. Therefore, a portion of all of it would be considered in determining its net income upon which its California tax is based.

Additionally, a California trial court recently held that the interest offset provision, because it provides a rule for a specific expense, applies prior to the application of the general statutory provision requiring that expenses be allocated between taxable and nontaxable income.

Problem

Continued use of Section 24344(b), the interest offset provision that was declared unconstitutional by the U.S. Supreme Court, appears to discriminate in favor of California-based corporations by providing a tax deduction for 100% of a portion of their interest expense while non-California-based corporations receive a deduction for only a portion of their interest expense based upon the portion of their business done in California.

Proposed Solution

Amend Section 24344 of the RTC to repeal the interest offset provision.

Effective/Operative Date of Solution

As a tax levy, this proposal would become effective upon enactment and operative for taxable years beginning on or after January 1, 2006.

Justification

Repeal of the interest offset provision would reflect the determination of the U. S. Supreme Court. If repealed prospectively, the repeal would not unduly impact taxpayers that may have used the provision in past returns.

Repealing the interest offset provision would remove grounds for constitutional challenges that the provision discriminates in favor of corporations domiciled in California. The Supreme Court indicated that an allocation method based on direct tracing and proportional allocation was in general use by the states and the federal government and was rationally based. California uses direct tracing and proportional allocation for all other expenses in determining net income and uses direct tracing and proportional allocation for allocating expenses between taxable and nontaxable income. The direct tracing and proportional allocation method is provided for by RTC Section 24425 and Regulation section 25120 (d).

Repealing the interest offset section would also conform California law more closely to federal law since federal law attributes interest expense to the income it generated.

Implementation

Implementation of this proposal would occur during the department’s normal annual system update.

Fiscal Impact

This proposal would not significantly impact the department’s operations or programs.

<u>Economic Impact</u>

Tax Revenue Estimate

This proposal would generate the following revenue gains.

Estimated Revenue Impact of LP06-14 Operative for Taxable Years BOA 1/1/06 [$ In Millions]		
2005-06	2006-07	2007-08
$1	$5	$6

Revenue Discussion

The revenue impact of this proposal would be determined by the amount of interest expense assigned to business income under the proposal that otherwise would be assigned to non-business income under current departmental practice and the average apportionment percentage for corporations with such interest expense.

Using the most recent corporate sample data (2002), interest offset allocated to non-business income allocable to California was identified on Schedule R-Apportionment and Allocation of Income. Under the proposal, these amounts would be assigned to business income and apportioned rather than fully deducted under current departmental practice. Identified interest-offset amounts were multiplied by the average apportionment percentage of each corporation reporting such interest offset and multiplied by the franchise tax rate. This methodology derived a revenue gain of $6 million grown from the 2002 level.

The annual taxable year gain of $6 million was converted to the fiscal year cash flow estimate indicated in the table.

The California Legislative Counsel offered an opinion concerning the question of whether the FTB should continue to enforce any portion of RTC 24344 in light of the US Supreme Court decision in Hunt-Wesson. The role of the Legislative Counsel is to provide legal advice to the Legislature.
It was the opinion of the Legislative Counsel that the Franchise Tax Board may not continue to enforce any portion of R&TC 24344(b). Based on the Legislative Counsel's opinion, there would be no revenue change, since it is an unenforceable provision.

<u>Other States</u>

The states surveyed include *Florida, Michigan*, *Massachusetts, Illinois, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. No comparable provisions were located for *Florida, Massachusetts*, or *Michigan*.

Illinois treats the interest expense deduction as an itemized deduction and does not include it in the calculation of adjusted gross income.

Minnesota does not allow deductions for expenses associated with income that is not taxed by *Minnesota*. If an expense is attributable to both taxable and non-taxable income, taxpayers must make a reasonable allocation to prorate the expense.

New York allows for interest expense adjustments attributable to interest not previously deducted from the federal taxable income.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO LP 06-14

AMENDMENT 1

SECTION 1. Section 24344 of the Revenue and Taxation Code is amended to read:

24344. (a) Section 163 of the Internal Revenue Code, relating to interest, shall apply, except as otherwise provided.

(b) ~~If income of the taxpayer which is derived from or attributable to sources within this state is determined pursuant to Section 25101 or 25110, the interest deductible shall be an amount equal to interest income subject to apportionment by formula, plus the amount, if any, by which the balance of interest expense exceeds interest and dividend income (except dividends deductible under Section 24402 and dividends subject to the deductions provided for in Section 24411 to the extent of those deductions) not subject to apportionment by formula. Interest expense not included in the preceding sentence shall be directly offset against interest and dividend income (except dividends deductible under Section 24402 and dividends subject to the deductions provided for in Section 24411 to the extent of those deductions) not subject to apportionment by formula.~~

~~(c)~~(1) ~~Notwithstanding subdivision (b) and subject~~ Subject to paragraph (2), interest expense allowable under Section 163 of the Internal Revenue Code that is incurred for purposes of foreign investments may be offset against dividends deductible under Section 24411.

(2) For taxable years beginning on or after January 1, 1997, the amount of interest computed pursuant to paragraph (1) shall be multiplied by the same percentage used to determine the dividend deduction under Section 24411 to determine that amount of interest that may be offset as provided in paragraph (1).

~~(d)~~ (c) Section 7210(b) of Public Law 101-239, relating to the effective date for limitation on deduction for certain interest paid to a related person, shall apply.

~~(e)~~ (d) Section 163(j) (6)(C) of the Internal Revenue Code, relating to treatment of an affiliated group, is modified to apply to all members of a combined report filed under Section 25101.

SEC. 2. The amendments made by this act to Section 24344 of the Revenue and Taxation Code shall apply to taxable years beginning on or after January 1, 2006.

LEGISLATIVE PROPOSAL 06-16a
EXECUTIVE SUMMARY

- **Title:** Treat Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) Similar to Federal Law

- **Problem Statement:** Lack of conformity between federal and California dividend elimination provisions and between federal and California requirements for how corporations report income on a tax return result in income earned by RICs and REITs escaping tax whereas income earned in a similar manner by other business entity types are subject to tax.

- **Proposed Solution:**

  1. Prohibit a RIC or REIT from participating in a combined report unless FTB determines that filing a combined report is necessary to reflect income clearly. Prohibiting combination follows the federal tax law policy of not permitting a RIC or REIT to be included in a consolidated return.

  2. Prohibit REITs from using the dividend elimination provisions for dividends received from corporations.

- **Revenue:** This proposal would eliminate tax planning opportunities for corporations owning RICs or REITs. The revenue impact of the proposal would be determined by (1) the amount of RIC and REIT income that is retained as California income under the proposal that otherwise would escape tax under present law, and (2) the amount of dividends paid to a REIT that are ineligible for deduction under the proposal that otherwise are eliminated under present law.

  Potential revenue from the proposal is uncertain. Under current taxpayer practices, it will bring in perhaps a few million dollars annually. If the loopholes remain open and are more widely used, revenue at risk could reach tens of millions annually if the number of taxpayer’s employing such tax reducing strategies grows unabated. To date, relatively few taxpayers have been identified as employing such strategies.

2006 Departmental Legislative Proposal
LP 06-16a

Title

Treat Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) Similar to Federal Law

Introduction

This proposal would make the following changes to the rules regarding reporting dividends for RICs and REITs:

- Prohibit both RICs and REITs from being included on a combined return, and
- Make dividends received by a REIT from a corporation ineligible for dividend elimination.

Current Federal Law

The Internal Revenue Code allows quasi-pass-through entity treatment for special purpose corporations that operate pursuant to a prescribed set of rules. Two of these special entity types are regulated investment companies (RICs) and real estate investment trusts (REITs). Both types of entities can only be involved in and derive most of their income from certain prescribed passive activities and must distribute most of their earnings and profits to their shareholders. RICs, generally, can only invest in stocks and other securities. Mutual funds are the most common type of RIC. A REIT invests in real estate for leasing and appreciation purposes. Only the characteristics that are germane to this proposal will be discussed.

Federal law generally allows corporations that are at least 80% owned by another corporation to file a consolidated return. Federal law provides that dividends paid and received between corporations filing a consolidated return are not included in income. RICs and REITS are prohibited from being included in a consolidated return; thus, a dividend exclusion, similar to the state's dividend elimination discussed below, under the consolidated return rules is prohibited. RICs and REITs are not permitted to participate in a consolidated return because of their quasi-pass-through attributes and the double benefit that would arise from dividend exclusion and a DPD.

For federal purposes, RICs and REITs are allowed a "dividends paid deduction" (DPD). The DPD allows the RIC or REIT to deduct the amount of dividends paid to its shareholders from its income. Thus, a RIC or REIT is not taxed to the extent it distributes as dividends its current profits to shareholders. Corporations that do not qualify as RICs and REITs are not allowed a DPD.

Current State Law

California law generally conforms to the federal treatment of RICs and REITs. RICs and REITs are treated as quasi pass-through entities, and they are allowed a DPD.

Generally, California does not conform to the federal consolidated return regime. Instead, California law requires the use of a combined report for most unitary groups of corporations. Under the unitary method, all of the activities comprising a single trade or business are viewed as a single unit, irrespective of whether those activities are conducted by divisions of a single corporation or by commonly owned or controlled corporations. The business income from all of the unitary business activities is combined into a single report (the combined report). An apportionment formula is then applied to the combined business income to determine the portion attributable to California. By statute, California law prohibits S corporations from participating in a combined report unless the Franchise Tax Board (FTB) determines that it is necessary to clearly reflect income.

California law does not prohibit a RIC or REIT from being included in a combined report with other general and apportioning corporations if the RIC or REIT is part of the group's unitary business.

Members of a combined reporting group that have income from sources within and without the state may have both business and nonbusiness income. Each taxpayer member is required to apportion the total group combined report business income to California based on its respective California apportionment percentage. The nonbusiness income of each member is allocated between California and other states based upon specific rules. The apportioned business income and allocated non-business income is added together to arrive at the member's California taxable income.

California law provides that to the extent a dividend is paid between members of a combined reporting group out of income from the unitary business of that combined reporting group be eliminated from the income of the recipient member. In the case of RICs, California law specifically provides that the dividends <u>received from or paid to</u> a RIC are not eliminated[1]. The law for REITs provides that the dividends <u>received from</u> REITs are not eliminated. State law fails to prohibit the elimination of dividends <u>paid to</u> REITs, which as outlined above, is contrary to federal RIC and REIT law and inconsistent with state RIC law.

<u>Problem</u>

Lack of conformity between federal and California dividend elimination provisions and between federal and California requirements for how corporations report income on a tax return result in income earned by RICs and REITs escaping tax whereas income earned in a similar manner by other business entity types are subject to tax.

For a detailed example of the problem please see Appendix I.

<u>Proposed Solution</u>

3. Prohibit a RIC or REIT from participating in a combined report unless FTB determines that filing a combined report is necessary to reflect income clearly. Prohibiting combination follows the federal tax law policy of not permitting a RIC or REIT to be included in a consolidated return.

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[1] The Commerce Clearing House (CCH) January 1, 2004, and 2005 publications of the income tax laws of California's Revenue and Taxation Code (R&TC) contain an error. CCH's printed version of the law does not prohibit the dividend deduction/elimination to and from RICs. The prohibition is contained in R&TC 24871(b)(3) and (e).

4. Prohibit REITs from using the dividend elimination provisions for dividends received from corporations.

Effective/Operative Date of Solution

If the proposed solution were enacted into law during the 2006 legislative session, it would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2006.

Justification

Prohibiting a RIC or REIT from participating in a combined report or return follows the federal tax law policy of not permitting a RIC or REIT to be included in a consolidated return. Prohibiting a REIT from eliminating dividends received also follows federal law and the state and federal treatment of dividends received by a RIC.

This proposal would eliminate a difference in tax treatment based solely on an entity's classification or form of organization.

Implementation

Implementing this proposal would not significantly impact the department's programs and operations.

Fiscal Impact

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

Economic Impact

This proposal would eliminate tax planning opportunities for corporations owning RICs or REITs. The revenue impact of the proposal would be determined by (1) the amount of RIC and REIT income that is retained as California income under the proposal that otherwise would escape tax under present law, and (2) the amount of dividends paid to a REIT that are ineligible for deduction under the proposal that otherwise are eliminated under present law.

Potential revenue from the proposal is uncertain. Under current taxpayer practices, it will bring in perhaps a few million dollars annually. If the loopholes remain open and are more widely used, revenue at risk could reach tens of millions annually if the number of taxpayer's employing such tax reducing strategies grows unabated. To date, relatively few taxpayers have been identified as employing such strategies.

Legislative History

SB 103 (Alpert, Chap. 655, Stats. 2003) prohibited dividends paid to or received from a RIC from being deducted or eliminated in a combined report.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Michigan and *New York* treat RICs and REITs the same as any other corporation and thus do not have the loophole. *Massachusetts* treats REITS the same as any other corporation and allow RICs a DPD and thus only have the loophole for RICs . *Florida* and *Illinois* treat RICs and REITs the same as under federal law except they do not permit a dividend paid deduction for capital gains paid out as dividends, and thus only have the loophole for non-capital gains dividends.

In addition to the above, Mississippi recently enacted a statute that would curtail most applications of the DPD that result in a loophole. Texas and New Jersey have pending legislation that would also address the DPD loophole.

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APPENDIX I
Treat RICs and REITs Similar to Federal Law
LP 06-16

Assume Parent REIT corporation owns 100% of the voting stock of a general corporation called Sub A and the two corporations are unitary. Parent REIT has income of $100 from its own passive business operations. Sub A also has income of $100 from its own active business operations and distributes that income to Parent REIT as a dividend. Parent REITs earnings and profits are $200 ($100 from its own operations and $100 dividend from Sub A). Parent REIT pays a dividend of $200 to its shareholders.

Under federal law, Parent REIT would have $200 of income and a DPD of $200, which results in Parent REIT having no taxable income and no tax liability. The shareholders pay tax on the REIT distribution in the same manner as any other corporate dividend. Tax is paid on the $100 earned by Sub A, and at the shareholder level on the $200 earned by Parent REIT. The passive income of the REIT is taxed only once at the shareholder level.

Under California law, the business income of the two corporations is combined and the dividend deduction or elimination rule for the Sub A dividend paid to Parent REIT would be applicable. Parent REITs separate income is $200 ($100 operational income and $100 dividend income) and Sub A's separate income is $100 for a total $300 unitary group income. The group is entitled to a $200 DPD and a $100 dividend deduction or elimination to arrive at zero taxable income for the unitary group. Regardless of the California apportionment percentage, the California taxable income would be zero because the unitary business income is zero. The shareholders receiving the $200 dividend from Parent REIT would pay tax on this amount.

The intention of the preferential treatment of REITs is that only the passive income of the REIT be taxed once at the shareholder level.

This proposal would prevent the REIT and Sub A from filing a combined report and disqualify the REIT from using the dividend deduction or elimination provisions, resulting in the dividend income from the operating subsidiary being taxed in substantially the same manner as under federal law.

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FRANCHISE TAX BOARD
PROPOSED AMENDMENTS FOR LP 06-16a

AMENDMENT 1

Section 24871 of the Revenue and Taxation Code is amended to read:

24871. (a) (1) Section 852(b)(1) of the Internal Revenue Code, relating to imposition of tax on regulated investment companies, does not apply.

(2) Every regulated investment company shall be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except that its "net income" shall be equal to its "investment company income," as defined in subdivision (b).

(b) "Investment company income" means investment company taxable income, as defined in Section 852(b)(2) of the Internal Revenue Code, modified as follows:

(1) Section 852(b)(2)(A) of the Internal Revenue Code, relating to an exclusion for net capital gain, does not apply.

(2) Section 852(b)(2)(B) of the Internal Revenue Code, relating to net operating losses, is modified to deny the deduction allowed under Sections 24416 and 24416.1, in lieu of denying the deduction allowed by Section 172 of the Internal Revenue Code.

(3) In lieu of the provision of Section 852(b)(2)(C) of the Internal Revenue Code, relating to special deductions for corporations, no deduction shall be allowed under Sections 24402, 24406, 24410, and 25106.

(4) The deduction for dividends paid, under Section 852(b)(2)(D) of the Internal Revenue Code, is modified to allow capital gain dividends and exempt interest dividends (to the extent that interest is included in gross income under this part) to be included in the computation of the deduction.

(c) Section 852(b)(3)(A) of the Internal Revenue Code, relating to capital gains, does not apply.

(d) Section 852(b)(5)(B) of the Internal Revenue Code, relating to treatment of exempt interest dividends by shareholders, does not apply.

(e) Section 854 of the Internal Revenue Code, relating to limitations applicable to dividends received from regulated investment companies, is modified to refer to Sections 24402, 24406, 24410, and 25106, in lieu of Section 243 of the Internal Revenue Code.

(f)(1) Except as provided in paragraph (2), a corporation that is a "regulated investment company" for purposes of this part may not be included in a combined report pursuant to Chapter 17 (commencing with Section 25101).

(2)(A) In cases where the Franchise Tax Board determines that the reported income or loss of a group of commonly owned or controlled corporations (within the meaning of Section 25105), that includes one or more corporations treated as a "regulated investment company" under Chapter 14.5 (commencing with Section 24870), does not clearly reflect income (or loss) of a member of that group or represents an evasion of tax by one or more members of that group, and the Franchise Tax Board determines that the comparable uncontrolled price method prescribed by regulations promulgated under Section 482 of the Internal Revenue Code cannot practically be applied, the Franchise Tax Board may, in lieu of other methods prescribed by regulations promulgated under Section 482 of the Internal Revenue Code, apply methods of unitary combination, pursuant to Article 1 (commencing with Section 25101) of Chapter 17, to properly reflect the income or loss of the members of the group.

(B) The application of the provisions of this subdivision shall not otherwise affect the treatment of any corporation as a "regulated investment company."

Section 24872 of the Revenue and Taxation Code is amended to read:

24872. (a) A real estate investment trust shall be deemed to have satisfied the distribution requirements of Section 857(a)(1) of the Internal Revenue Code for purposes of this part if it satisfies the distribution requirements of Section 857(a)(1) of the Internal Revenue Code for federal purposes.

(b) (1) Section 857(b)(1) of the Internal Revenue Code, relating to imposition of tax on real estate investment trusts, shall not apply.

(2) Every real estate investment trust shall be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except that its "net income" shall be equal to its "real estate investment trust income," as defined in subdivision (c).

(c) "Real estate investment trust income" means real estate investment company taxable income, as defined in Section 857(b)(2) of the Internal Revenue Code, modified as follows:

(1) In lieu of Section 857(b)(2)(A) of the Internal Revenue Code, relating to special deductions for corporations, no deduction shall be allowed under Section ~~24402.~~ 24402, 24406, 24410, and 25106.

(2) Section 857(b)(2)(D) of the Internal Revenue Code, relating to an exclusion for an amount equal to the net income from foreclosure property, shall not apply.

(3) Section 857(b)(2)(E) of the Internal Revenue Code, relating to a deduction for an amount equal to the tax imposed in the case of failure to meet certain requirements for the taxable year, shall not apply.

(4) Section 857(b)(2)(F) of the Internal Revenue Code, relating to an exclusion for an amount equal to any net income derived from prohibited transactions, shall not apply.

(d) Section 857(b)(3) of the Internal Revenue Code, relating to an alternative tax in case of capital gains, shall not apply.

(e) Section 857(b)(4)(A) of the Internal Revenue Code, relating to the imposition of tax on income from foreclosure property, shall not apply.

(f) Section 857(b)(5) of the Internal Revenue Code, relating to the imposition of tax in case of failure to meet certain requirements, shall not apply.

(g) Section 857(b)(6)(A) of the Internal Revenue Code, relating to the imposition of tax on income from prohibited transactions, shall not apply.

(h) (1) Sections 541 through 547 of Public Law 106-170 shall apply unless otherwise provided.

(2) Section 857(b)(7) of the Internal Revenue Code, as added by Section 545 of Public Law 106-170, relating to income from redetermined rents, redetermined deductions, and excess interest, shall not apply.

(i) Section 857(c) of the Internal Revenue Code, relating to restrictions applicable to dividends received from real estate investment trusts, is modified to refer to Sections 24402, 24406, 24410, and 25106, in lieu of Section 243 of the Internal Revenue Code.

(j)(1) Except as provided in paragraph (2), a corporation that is a "real estate investment trust" for purposes of this part may not be included in a combined report pursuant to Chapter 17 (commencing with Section 25101).

(2)(A) In cases where the Franchise Tax Board determines that the reported income or loss of a group of commonly owned or controlled corporations (within the meaning of Section 25105), that includes one or more corporations treated as a " real estate investment trust” under Chapter 14.5 (commencing with Section 24870), does not clearly reflect income (or loss) of a member of that group or represents an evasion of tax by one or more members of that group, and the Franchise Tax Board determines that the comparable uncontrolled price method prescribed by regulations promulgated under Section 482 of the Internal Revenue Code cannot practically be applied, the Franchise Tax Board may, in lieu of other methods prescribed by regulations promulgated under Section 482 of the Internal Revenue Code, apply methods of unitary combination, pursuant to Article 1 (commencing with Section 25101) of Chapter 17, to properly reflect the income or loss of the members of the group.

(B) The application of the provisions of this subdivision shall not otherwise affect the treatment of any corporation as a " real estate investment trust.”

~~(j) The amendments to this section by Chapter 878 of the Statutes of 1993 are clarifications of legislative intent and shall apply to taxable years beginning on or after January 1, 1987.~~

LEGISLATIVE PROPOSAL 06-16b
EXECUTIVE SUMMARY

- **Title:** Require Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) to be Treated Similarly to Partnerships for Combined Reporting.

- **Problem Statement:** California's lack of conformity to federal tax treatment regarding ECI results in a loophole based on entity type, namely an out-of-state or foreign parent corporation can use a RIC or a REIT to convert income earned by activity in California into dividend income that escapes California tax.

- **Proposed Solution:** Require a corporation that owns 10% or more of a RIC or REIT to treat that interest as if it were an interest in a partnership. Namely, the corporation owning the RIC or REIT would be treated as having received California source income from the RIC or REIT. In the above example, the Grand Cayman Corporation would be taxable on the California real estate rental income earned by the REIT and distributed to that corporation.

- **Major Concerns/Issues:** A REIT can transform rental income, which is taxed under California law where the property is located, to dividend income, which is taxed where the shareholder corporation is commercially domiciled. This tax planning loophole is not available under federal law because both the rental income and dividend income are taxed. Similar results can happen with a RIC.

- **Revenue:** This proposal would block potential tax loopholes for corporations owning RICs or REITs that earned income in California. The revenue impact of the proposal would be determined by (1) the amount of RIC and REIT income that is retained as California income under the proposal that otherwise would escape tax under present law, and (2) the amount of dividends paid to a REIT that are ineligible for deduction under the proposal that otherwise are eliminated under present law.

  Potential revenue from the proposal is uncertain. To date, relatively few taxpayers have been identified as employing such strategies. If the loophole is exploited, revenue at risk could reach tens of millions annually.

2006 Departmental Legislative Proposal
LP 06-16b

Title

Require Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) to be Treated Similarly to Partnerships for Combined Reporting.

Introduction

This proposal would, for Corporation Tax Law purposes, treat a RIC and a REIT similar to a partnership.

Current Federal Law

The Internal Revenue Code allows quasi-pass-through entity treatment for special purpose corporations that operate pursuant to a prescribed set of rules. Two of these special entity types are RICs and REITs. Both types of entities can only be involved in and derive most of their income from certain prescribed passive activities and must distribute most of their earnings and profits to their shareholders. RICs, generally, can only invest in stocks and other securities. Mutual funds are the most common type of RIC. A REIT invests in real estate for leasing and appreciation purposes. Only the characteristics that are germane to this proposal will be discussed.

These entities are commonly called *quasi-pass-through* entities because they share some of the same pass-through characteristics as a partnership or an S corporation. A partnership is not taxed on its income and its income is passed through to its partners. The income of a partnership passed-through to a partner keeps its character as ordinary, capital gain, or tax exempt. A partnership's income is taxed at the partner level, regardless of whether the partnership actually distributed the profits.

For federal purposes, RICs and REITs are allowed a "dividends paid deduction" (DPD). The DPD allows the RIC or REIT to deduct the amount of dividends paid to its shareholders from its income. Thus, a RIC or REIT is not taxed to the extent it distributes as dividends its current profits to shareholders.

In addition, certain dividends (i.e., capital gains dividends and exempt interest dividends) in the hands of a shareholder generally have the same tax treatment as when the dividends were earned by the RIC or REIT. Thus, if a RIC or REIT has a capital gain and pays out the capital gain as a capital gain dividend to its shareholders, the RIC or REIT will not pay any tax, and the shareholders will pay tax at the capital gain rate. Corporations that do not qualify as RICs and REITs are not allowed a DPD, and the tax treatment of the dividend is generally not passed to the shareholder.

Federal law generally allows corporations that are at least 80%-owned by another corporation to file a consolidated return. Federal law provides that dividends paid and received between corporations filing a consolidated return are not included in income. RICs and REITs are prohibited from being included in a consolidated return; thus, a dividend exclusion under the consolidated return rules is prohibited. RICs and REITs are not permitted to participate in a consolidated return because of their quasi-pass-through attributes and the double benefit that would arise from dividend exclusion and a DPD.

Federal law taxes income that is "effectively connected income" (ECI) to a United States trade or business as if it were U.S.-source income. ECI is determined by the activities conducted that earned the income. If the primary activity is in the U.S., the income is ECI. Dividends received from a U.S. corporation are ECI and taxed regardless of where the shareholder is located. Rents received on property located in the U.S. are also ECI and are taxed regardless of where the owner is located.

Current State Law

How income is sourced and therefore taxable to California depends on whether the income is from tangible or intangible property. Tangible property is sourced to California if the tangible property is located in California; thus, rental income, derived from real property, is sourced to California. For intangible property income, the general rule is to source the income to the state where the corporation is commercially domiciled or headquartered. Dividends, which are a type of intangible income, are sourced to the corporation's place of commercial domicile. Therefore, generally dividends received by California domiciled corporations are sourced to California. Dividends received from a RIC or REIT generally follow this general rule.

The treatment of partnership income under the California's Corporation Tax Law is similar to federal law. That is, the income of the partnership passes through to the partner both as to amount <u>and character</u>. Thus, rental income from California real property remains taxable by California even if the corporate partner receiving the distribution is domiciled in another state or country. In addition, under California law a corporate partner is required to include its proportionate share of the partnership's activities in the apportionment factors. Thus, a corporate partner is required to include the partnership's sales, property, and payroll in the corporate partner's apportionment factors. This is consistent with partnership law and follows the pass-through of various items of income and loss. A corporation, located outside of California, is taxable in California if the corporation is a partner in a partnership that conducts business within California. Intangible income of a partnership is generally sourced to the corporate partner's state or country of domicile.

California law generally also conforms to the federal treatment of RICs and REITs. RICs and REITs are treated as quasi pass-through entities, and they are allowed a DPD.

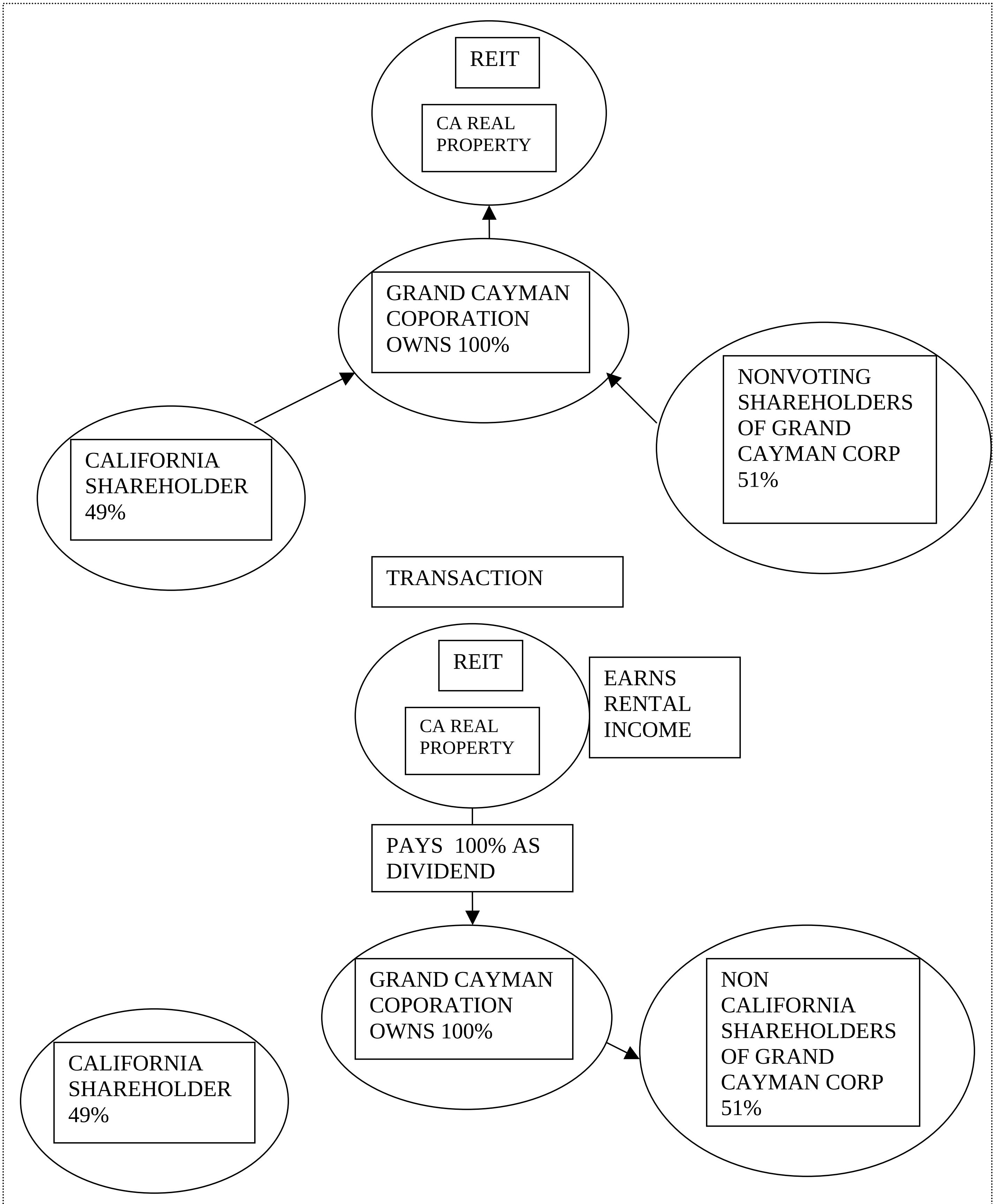
Unlike the federal prohibition on filing consolidated returns by a RIC or REIT and the California prohibition on an S corporation filing a combined report, California allows a RIC or REIT to be included in a combined report with other general and apportioning corporations if the RIC or REIT is part of the group's unitary business.

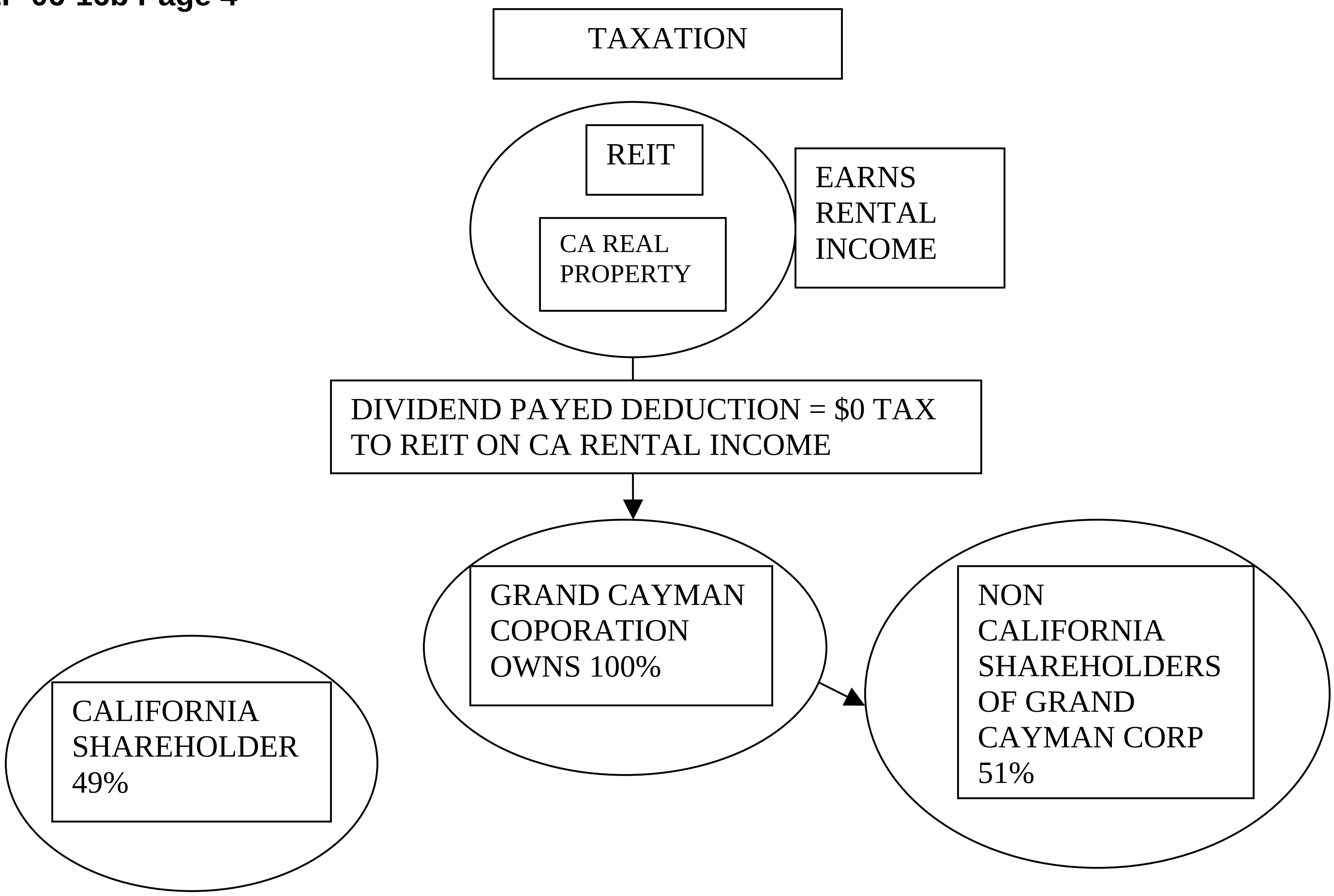
Since California does not conform to the ECI rules contained in federal law, the income of the RIC or REIT does not retain its character as California source income taxable to the RIC or REIT shareholder regardless of that shareholder's state or country of domicile and the general sourcing rules would apply.

Problem

California's lack of conformity to federal tax treatment regarding ECI results in a loophole based on entity type, namely an out-of-state or foreign parent corporation can use a RIC or a REIT to convert income earned by activity in California into dividend income that escapes California tax.

CORPORATE STRUCTURE





The Grand Cayman Corporation pays no tax on the dividends received from the REIT because dividend income is sourced in the state or country where the corporation receiving the dividend is domiciled. In this example, the corporation is domiciled outside of the state.

Proposed Solution

Require a corporation that owns 10% or more of a RIC or REIT to treat that interest as if it were an interest in a partnership. Namely, the corporation owning the RIC or REIT would be treated as having received California source income from the RIC or REIT. In the above example, the Grand Cayman Corporation would be taxable on the California real estate rental income earned by the REIT and distributed to that corporation.

Effective/Operative Date of Solution

If the proposed solution were enacted into law during the 2006 legislative session, it would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2006.

Justification

A REIT can transform rental income, which is taxed under California law where the property is located, to dividend income, which is taxed where the shareholder corporation is commercially domiciled. This tax planning loophole is not available under federal law because both the rental income and dividend income are taxed. Similar results can happen with a RIC. For a detailed example of the problem please Appendix I.

Implementation

Implementing this proposal would not significantly impact the department's programs and operations.

Fiscal Impact

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

Economic Impact

This proposal would block potential tax loopholes for corporations owning RICs or REITs that earned income in California. The revenue impact of the proposal would be determined by (1) the amount of RIC and REIT income that is retained as California income under the proposal that otherwise would escape tax under present law, and (2) the amount of dividends paid to a REIT that are ineligible for deduction under the proposal that otherwise are eliminated under present law.

Potential revenue from the proposal is uncertain. To date, relatively few taxpayers have been identified as employing such strategies. If the loophole is exploited, revenue at risk could reach tens of millions annually.

Legislative History

SB 103 (Alpert, Chap. 655, Stats. 2003) prohibited dividends paid to or received from a RIC from being deducted or eliminated in a combined report.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Michigan and *New York* treat RICs and REITs the same as any other corporation and thus do not have the loopholes. *Massachusetts* treats REITs the same as any other corporation and allows RICs a DPD and thus only have the loophole for RICs. *Florida* and *Illinois* treat RICs and REITs the same as under federal law except they do not permit a dividend paid deduction for capital gains paid out as dividends, and thus only have the loophole for non-capital gains dividends. In addition to the above, Mississippi recently enacted a statute that would curtail most applications of the DPD that result in a loophole. Texas and New Jersey have pending legislation that would also address the DPD loophole.

LEGISLATIVE STAFF CONTACT

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APPENDIX I
RICs and REITs to be Treated Similar to Partnerships for Combined Reporting.
LP 06-16b

The effects of an out-of-state or foreign parent corporation using a RIC or a REIT to convert income earned in California into dividend income that escapes California tax is illustrated as follows.

> Corporation P has a substantial taxable presence in California, including a large amount of real property. Corporation P contributes cash to a Grand Cayman subsidiary corporation, Corporation GCS, retaining 49% of the voting stock. Other investors acquire the remaining 51% of the stock. Corporation GCS and other investors form a REIT, with Corporation GCS holding all of the voting stock of the REIT, and the other investors holding non-voting and non-dividend paying preferred stock. The REIT then enters into a contract with Corporation P to purchase its high basis California property. The contract allows corporation P an option to repurchase the property at a future date at a specified price. That price guarantees the preferred investors a specified rate of return, higher than many prevailing investments, but the investors cannot enjoy the benefits of substantial amounts of appreciation in the real property, should the value dramatically increase. The REIT charges Corporation P market rate rent for the use of the property. The REIT pays all current earnings and profits out as dividends to Corporation GCS.
>
> With less than 50% ownership of voting stock, Corporation P cannot be combined with Corporation GCS and the REIT. Thus, Corporation P, Corporation GCS, and the REIT are prohibited from filing a combined report. As a result, the high basis California real property is removed from Corporation P’s property factor and replaced with an eight times multiple of the rent paid to the REIT. This significantly reduces Corporation P’s California property factor percentage. Additionally, Corporation P’s taxable income is reduced by the amount of rent paid to the REIT. Although the REIT has California real property and collects California rental income, the REIT will not pay any tax to California because the REIT has the DPD for the dividend paid to Corporation GCS. Corporation GCS purportedly has no California source income because its only income received is dividends from the REIT. Even though the dividend may be derived 100% from California rents, dividend income is taxed to the state of commercial domicile. By passing the income through a REIT, the rental income, which is taxed where the property is located, is changed to dividend income, which is taxed where the corporation receiving the dividend is commercially domiciled. The net effect of the scheme is that Corporation P’s net income is reduced by a rent expense, which is more than the corresponding decrease in depreciation deductions (due to "sale" of the property to the REIT), and the California apportionment factor is also reduced due to the decrease in the property factor. The end result is that Corporation P, essentially without changing any of its business practices except for its form of ownership over one of its assets, owes significantly less tax to California.
>
> Under the federal “effectively connected income” rules, the dividends the REIT paid to the Grand Cayman Corporation, GCS, is taxed by the United States.

The above scheme is the issue highlighted in the Louisiana Supreme Court case of *Bridges v. Autozone Properties* (March 24, 2005). In that case, a foreign corporation, which in turn was owned by a domestic corporation doing business in Louisiana, was established as the holder of the REIT. It claimed that its receipt of REIT dividends were not Louisiana source income. The effect was a dramatic loss of Louisiana income, and the corresponding rental income could not be taxed to the REIT, as a result of its DPD zeroing out its income. The court there held that the state of Louisiana had due process nexus over the offshore shareholder and that the dividend income earned by the foreign corporation was properly considered attributable to Louisiana. However, in its denial of a petition for rehearing, one of the justices questioned the constitutionality of the court's prior conclusion and suggested a better solution lied with the Legislature.

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FRANCHISE TAX BOARD
PROPOSED AMENDMENTS FOR LP 06-16b

AMENDMENT 1

Section 24871.9 is added to the Revenue and Taxation Code to read:

24871.9. (a) Notwithstanding any other provision of law, dividends received by a shareholder owning more than ten percent of the voting stock of a regulated investment company (determined by reference to the regulated investment company as a whole, and not to an investment series) shall be treated as subject to apportionment and allocation under Chapter 17 in the same manner as distributive income from a partnership.

(b) Notwithstanding any other provision of law, the dividends described in subdivision (a) shall be considered distributions for purposes of this part.

(c) The constructive ownership provisions of Section 318 of the Internal Revenue Code shall apply for purposes of determining the ownership of stock under this section.

Section 24872.9 is added to the Revenue and Taxation Code to read:

24872.9. (a) Notwithstanding any other provision of law, dividends received by a shareholder that owns more than ten percent of the voting stock of a real estate investment trust shall be treated as subject to apportionment and allocation under Chapter 17 in the same manner as distributive income from a partnership.

(b) Notwithstanding any other provision of law, the dividends described in subdivision (a) shall be considered distributions for purposes of this part.

(c) The constructive ownership provisions of Section 318 of the Internal Revenue Code shall apply for purposes of determining the ownership of stock under this section.