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NOTE: This TAM was initially started in 2003, therefore was given a 2003 TAM number. You can find this TAM in the 2004 TAM folder as well.

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Technical Advice Memorandum: 20030301

Requested By: Dave Quinn
Requested Date: 10/08/2003
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QUESTIONS PRESENTED

1. Does Section 1905 of the California Corporations Code prevent the audit and assessment of additional tax of a corporation that has been issued a tax clearance certificate on a taxes paid basis?
2. If FTB is authorized to conduct an audit after a tax clearance certificate is issued, to whom should the audit be directed?
3. If after audit a Notice of Proposed Assessment (NPA) is issued, who has litigation rights for protest and appeal purposes?
4. Will the answer to question 1 be different for C-Corporations and S-Corporations when considering the flow-through characteristics of the S-Corporation?

CONCLUSIONS

For the reasons expressed below, Corporations Code section 1905 does not prevent the FTB from either issuing an NPA or auditing a dissolved corporation that received a tax clearance certificate issued on a taxes paid basis.

ANALYSIS AND DISCUSSION

QUESTION 1: Corporations Code section 1905 deals with the voluntary dissolution of corporations and what the requirements are to dissolve a corporation. In your request for technical assistance, you specifically referred to the area of section 1905 that dealt with the tax clearance certificate issued by the FTB.

Corporations Code 1905 (a)..."(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. ..."

Based on this section of 1905, you questioned if the FTB could audit or issue proposed assessments against a dissolved corporation that the FTB had previously issued a tax clearance certificate to on a taxes paid basis. The question arises, because section 1905 does not indicate who is responsible for any subsequently assessed or due taxes when a tax clearance certificate has been issued on a taxes paid basis, while it does explicitly provide that the assumer is liable when the certificate is issued on an assumer basis.

While section 1905 is silent on this issue, Revenue and Taxation Code section 23334 is not. It specifically provides that the issuance of a tax clearance certificate (on either a taxes paid or assumer basis) "... shall not relieve the taxpayer or any individual or corporation from liability for any taxes, penalties, or interest imposed by this part, ..." (Emphasis added.)

Due to the FTB's practice of rarely issuing assessments to dissolved corporations who received a tax clearance on a taxes paid basis, there are few decisions by the State Board of Equalization (SBE) that analyze the relationship of Corporations Code section 1905 with the Revenue and Taxation Code section 23334. There is, however, one SBE decision that evaluated a similar factual situation as presented by your request.

In the *Appeal of United Oil Company*, 47-SBE-017, December 17, 1947, the SBE reviewed whether the FTB could assess additional tax against a dissolved corporation that had received a tax clearance certificate on a taxes paid basis. In that case, the corporation dissolved in 1938 after it had received a Tax Clearance Certificate on a taxes paid basis.

At that time section 403(c) of the Civil Code (current Corporations Code section 1905) provided that before a corporation was dissolved, a majority of the directors or trustees were required to sign and acknowledge a certificate stating that the corporation had either provided or paid for any tax or penalty due under the Bank and Corporation Franchise Tax Act. The certificate that was required was issued by the FTB under the provisions of section 29 of the Bank and Corporation Franchise Tax Act, which in 1938 read:

"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 until the tax, penalties, and interest shall have been paid."

Section 29 of the Bank and Corporation Franchise Tax Act was amended in 1939, omitting "until the tax, penalties, and interest shall have been paid," and substituting:

"... unless the taxpayer obtains from the commissioner and files with said court, county clerk or Secretary of State as the case may be, a certificate to the effect that all taxes imposed by this act upon the taxpayer which have become payable, have been paid, and that all taxes which may become due are secured by bond, deposit or otherwise. Within thirty days after receiving a request for a certificate, the commissioner 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 the 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, penalties, or interest imposed by this act.*" (Emphasis added.)

United Oil's (the appellant) argument was that before the addition of this last sentence, when a tax clearance certificate was issued on a taxes paid basis, it prevented the FTB from issuing any further assessments. The SBE rejected United Oil's argument and held that even prior to the addition of this sentence, the FTB could issue proposed tax assessments against a dissolved corporation as long as the assessments were made within the applicable statute of limitations. Section 29 of the Bank and Corporation Franchise Tax Act is now Revenue and Taxation Code section 23334, and it still provides:

"... *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,* ..." (Emphasis added.)

Therefore, the SBE has already held that a tax clearance certificate issued on a taxes paid basis does not prevent the FTB from issuing subsequent assessments against the dissolved corporation.

Since this decision, there have been several revisions and renumbering of the relevant statutes. The most significant revision (in relation to this issue) in section 1905 of the Corporations Code took place in 1999. Prior to this revision (in 1998) Corporations Code section 1905 (a)(3) required that a majority of the directors sign and verify a certificate that included the following:

"That a person or corporation 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."

Prior to 1999, section 1905 did not specifically state that the directors could verify that the taxes had been paid (rather than assumed or provided for), even though Revenue and Taxation Code section 23334 (in 1998) allowed the FTB to issue a tax clearance certificate when it determined that all taxes have "been paid or are secured by bond, deposit, or otherwise."

Because of this ambiguity between Corporations Code section 1905 and Revenue and Taxation Code section 23334, SB 284 in 1999 modified section 1905 and included the language "taxes paid." The legislative analysis for SB 284 indicated that the change "makes it explicit that tax liabilities can be satisfied on a "taxes paid basis." Also, it clarifies that any business entity can assume the tax liability of a dissolving corporation in addition to corporations and individuals."

There was no discussion or analysis documented in SB 284 to indicate that its purpose was to relieve a dissolved corporation of any subsequent tax assessment, nor did SB 284 modify Revenue and Taxation Code section 23334, which explicitly provided that the issuance of a tax clearance certificate did not relieve a corporation or assumer from a any subsequent assessment.

ANSWER: It is clear from a review of the SBE decisions and the applicable statutes that the FTB is able to audit and issue assessments against a dissolved corporation even if the corporation received a tax clearance certificate on a taxes paid basis.

QUESTIONS 2 AND 3: In regards to your second and third questions, Corporations Code section 2009 provides that when assets of the corporation have been distributed during the winding up or dissolution process, and there has not been prior payment or adequate provision for payment of any of the debts and liabilities of the corporation, any amount so improperly distributed to any shareholder may be recovered by the corporation. Any of such shareholders may be joined as defendants in the same action or brought in on the motion of any other defendant. A suit may also be brought in the name of the corporation to enforce the liability by any one or more creditors of the corporation, whether or not they have reduced their claims to judgment.

Corporations Code section 2011 provides that a cause of action against a dissolved corporation can be enforced against the corporation to the extent that any assets remain and to the shareholders to the extent of their pro rata share. There is a statute of limitations of the earlier of four years from the date of dissolution or the expiration of the statute of limitations for the cause of action.

ANSWER: Therefore, when a tax clearance certificate is issued on a taxes paid basis to a corporation still in existence (outside California), then the assessment should be issued to the corporation. If the corporation is dissolved, then the assessment should be issued against both the corporation and any shareholder who received a distribution, similar to transferee liability. The main distinction being that the requirements of Corporations Code section 2009 are not exactly the same as transferee liability. Section 2009 does not require that the transfer leave the corporation insolvent, rather the requirement is that the debt not have been provided for.

QUESTION AND ANSWER 4: The final question is in regards to whether the answers to questions 1-3 are different if the corporation is an S-corporation instead of a C-corporation. There is no major difference. The audit or assessment is first issued to the S-corporation like any other assessment against an S-corporation. When the assessment is final, the adjustment is flowed through to the individual and an additional assessment is made to the individual.

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