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NOTE: (***) = Indicates confidential and/or proprietary information has been deleted. **Rev. 7/17**

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**21.1 GENERAL
INFORMATION**

A domestic or foreign corporation, which has been incorporated or qualified with the Office of the Secretary of State (SOS), must formally dissolve or withdraw through the SOS. To do this, all returns must be filed with the Franchise Tax Board (FTB) and all liabilities paid in full.

In accordance with AB 2341, effective 09/29/06 dissolving corporations no longer need to request a Tax Clearance Certificate from FTB or supply a valid assumer in order to complete their dissolution or withdrawal process with SOS.

After a qualified corporation has formally dissolved through SOS, a magnetic tape is sent from the SOS to FTB reporting all the newly dissolved corporations. FTB runs this SOS tape on a monthly basis against BETS, which updates the corporation's SOS Status Code and SOS Status Date in BETS conversation ****.

The Post Dissolution (PD) unit receives a Quarterly BETS report called the Dissolved Corporation Report that lists all newly dissolved qualified corporations. PD also receives a daily report listing the nonqualified corporations that have filed final returns. The PD technicians use these lists to request the corporation folders from Receiving and Data Storage Section (RDSS).

As a result of the AB 2341 legislation, PD will be receiving final returns directly from Business Entities Section (BES) after the returns have been processed in BETS. The PD technicians will retain the final returns until they have done an initial review to determine if the account warrants further review. If a referral criterion, or another possible audit issue, has been determined, then they will request the corporate folders from RDSS.

When the folders are received from RDSS, the PD technicians will review the corporations' tax returns still within statute and determine if the specific referral criteria is met to warrant audit review. PD will also make sure that all available returns are in the folder prior to referral to audit. The PD technician will stamp, sign, and date the corporation folder being referred.

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	<p>The PD technician will route the referred corporate folders to the MSA PD Lead, who is responsible for logging in the number of folders received and logging out referred folders on the MSA Excel spreadsheet.</p> <p>When the referred folders have been reviewed by audit and are returned to PD, the PD technicians verify that no other BETS account clean up needs to be done prior to returning the folder to files (RDSS).</p> <p>For more information, please see Public Service Bulletin 06-27.</p> <p style="text-align: right;">Rev. 7/17</p>
21.2 AUDIT CONTROL OF DISSOLVED CORPORATIONS	<p>When the folders of dissolved corporations are received, the PD tax technician assumes full responsibility for control of the folder by entering their initials in the PD Audit box of the folder. Upon completion of their review, or audit review, the PD tax technician initials and dates (mm/yy) the top of the PD Audit box. Any folder received by RDSS with an open PD Audit box will be forwarded to the PD Unit for appropriate action.</p> <p>When a corporation folder is referred for audit review, the PD technician places a cover sheet on the folder indicating what audit referral criterion are met.</p> <p>The MSA PD Lead maintains a monthly inventory report to keep track of the volume of S corporations and C corporations, and how many folders are completed (returned to PD Unit) or referred to other sections for resolution. This MSA PD Inventory is reported on the Lead's Monthly report to supervision.</p> <p>The MSA PD team auditors will scope the returns in the folder that are within statute, and determine if there are any audit worthy issues.</p> <p>If no audit is warranted, the auditor will return the folder to the MSA PD Lead after surveying each return and putting an S and their initials in the upper right hand margin of the returns.</p>

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	<p>If the auditor determines that any BETS account corrections are needed, such as outstanding liabilities or credits, or that an additional return is needed, the auditor should make note of the tax year and the BETS issue that needs to be resolved on the PD cover sheet. If there are no further issues, the auditor should initial and date the cover sheet and return it to PD with the folder.</p> <p>The MSA PD Lead is responsible for routing the PD folders back to the PD Unit when the folders are completed. If a folder is retained, or referred, by MSA for further action, the auditor should notify the PD Lead via email or telephone. The PD technician will then log the folder out in CDTs to the appropriate party, thereby, relinquishing responsibility of the folder to the auditor.</p> <p style="text-align: right;">Rev. 7/17</p>
21.3 RELATED FOLDERS	<p>Before any audit action is taken, folders for all related corporations that are dissolved should be requested so that the entire file can be audited at the same time.</p> <p>Example: If the dissolving corporation is a subsidiary within a California combined group, and there are no returns available for review for the entity, then you should request the return of the parent corporation in order to verify the dissolved corporation had been included in the filing group up to the date of dissolution/withdrawal.</p> <p style="text-align: right;">Rev. 7/17</p>
21.4 LATEST RETURN NOT IN FOLDER	<p>The Post Dissolution Unit should have reviewed the account(s) to determine that all returns have been filed, and that all returns within statute are in the folder, prior to sending it for audit review.</p> <p>However, if the latest return is not in the folder:</p> <ol style="list-style-type: none">1. You may request the folder by completing Form FTB 6237 (Request for Corporation Folders) that is used to request missing return(s).2. Request the missing return on BETS using Conversation ****, after first checking PASS to make sure the return is not already in the audit section, and the CDTs database for most current location information.

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3. If you have tried steps one and two, and a reasonable amount of time has passed, then you should either re-request the return or call RDSS to initiate an Outsearch request to locate the return.

We are no longer sending folders back to PD when returns are missing from the folder.

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21.5 RETURNS IN FIELD

Contact the Field Office Audit Supervisor to determine if a field auditor or the MSA PD auditor should conduct the audit. If the audit is to be conducted by the field auditor, send the returns to the field using form FTB 7024 (Request for Field Action). Special instructions may be given, if needed.

Due to PASS modeling projects being initiated periodically, it is essential to check PASS as part of your initial review. By utilizing the **Find** function on PASS and inputting the corporation ID information into the **Taxpayer Information** tab, you will be able to locate any existing case units.

If a case unit is located in PASS for a tax year within statute, after checking the Event Log for recent activity, contact the responsible owner either by telephone or email. Ask if the corporation folder/returns are still needed for their review. If they need the folder, please send using the information above. If the folder/returns are not needed, continue your review.

If you find case units on PASS for the returns and these returns were previously audited or surveyed, you should indicate the date and initials of the auditor who reviewed the return. There should be very few reason(s) to review those returns again.

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21.6 REQUESTING CORPORATE FOLDERS

Follow these procedures when requesting corporate folders:

Rush cases	Folders may be requested by telephone if needed for telephone replies or other priority cases. RDSS Outsearch requests: Call 916.845.7911
Special cases	Requests should be made on form FTB 6237 (Request for Corporation Folder) marked Rush in red. If RDSS cannot locate the requested folder in files, the requestor will be notified immediately and if further search is

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		<p>required, the requestor will request an outsearch. If more than one corporate folder is needed, a separate form FTB 6237 should be prepared for each corporation and the forms staggered for easy identification.</p>
	<p>Routine cases</p>	<p>Requests should be made on form FTB 6237. The requested corporations should be listed numerically. If the RDSS cannot locate the folders in file, the request will be returned to the requestor showing out information. If after two requests RDSS is still unable to locate the file the requestor may request an outsearch. To request an outsearch you must call RDSS at 916.845.7911 and give them all the pertinent information. If DSS is unable to locate the folders by the search date, they will return the request to the requestor as UTL (Unable to Locate). If the folder is still needed, another search date should be provided. If DSS is unable to locate the folders after the second outsearch, the request will be referred to the Corporation Search Supervisor only if it is imperative that the folders be located.</p>
	<p>Dead by Merger</p>	<p>The transferee folder should be requested.</p>
	<p>Rev. 7/17</p>	
<p>21.7 DISSOLUTION OF A CREDIT UNION</p>	<p>The effective date of dissolution for credit unions is the date they file their Election to Wind-up and Dissolve in the office of SOS (CCR Section 23331).</p>	
	<p>Rev. 7/17</p>	
<p>21.8 REORGANIZATIONS</p>	<p>R&TC Section 23251 conforms to IRC Section 368 regarding reorganizations.</p> <p>If a determination of reorganization cannot be made based on all the related folders, complete the audit of all returns in the dead folder and send a letter requesting the information necessary to make a determination.</p> <p>If problems are encountered while auditing the returns, (1) include these items in a request for additional information, or (2) send the returns to the field with instructions to audit the returns and to determine if a reorganization has occurred.</p>	

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	<p>Since one prerequisite for reorganization is a continuation of the transferor's business, it can be assumed that an inactive corporation will not transfer its assets pursuant to reorganization.</p> <p>For state purposes, a transfer of assets and liabilities to a corporation that has been granted an exemption from tax under the California Revenue and Taxation Code or the state or federal constitutions cannot be reorganization.</p> <p style="text-align: right;">Rev. 7/17</p>
21.9 RETURN FILING REQUIREMENTS AS A RESULT OF A MERGER	<p>R&TC Section 23253 conforms to IRC Section 381(b) which provides that except in the case of an acquisition in connection with a reorganization described in IRC Section 368(a)(1)(F), the taxable year of the distributor or transfer or corporation shall end on the date of the distribution or transfer.</p> <p>In the case of a merger, verify the merger date reported on the disappearing corporation's final return by comparing it to the date reported on the SOS. If there is a lapse of time of more than 15 days between the end of the taxable period covered by the disappearing corporation's final return and the date of the merger, the disappearing corporation may be required to file an additional return if the corporation was still actively doing business in California. In this case, you should also request the folder for the surviving corporation to determine if the disappearing corporation reported its income for that time period between the end of the taxable period reported on the final return and prior to the merger date. If the merging corporation reports income on the surviving corporation's return, then the merging corporation is not required to file a return for that period.</p> <p style="text-align: right;">Rev. 7/17</p>
21.10 PROCESSING A FINAL RETURN	<p>When a final return as well as the appropriate corporate folder is received, determine whether to audit the return as follows:</p> <ol style="list-style-type: none">1. Review the balance sheet. If the balance sheet reports an ending balance, look at assets and liabilities. You may need to request a complete schedule of assets and liabilities distributed in liquidation to determine the disposition of assets likely to have appreciated in value such as land, buildings, or investments. Remember to ask for the book value and the fair market value of these assets. 2. Review accounts receivable. A cash basis taxpayer must report all ending accounts receivable balance into income in the year of dissolution. Therefore, if a

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corporation had accounts receivable from services completed prior to liquidation, it should be included in income on the corporation's final return. See MAP 21.14.2 Accounts Receivable.

3. Review the final return for deferred income. Unreported income from an installment obligation must be included in income for the corporation's final year. California R&TC Section 24672 provides for the accelerated recognition of income on an installment note during a corporation's final year of operation. The total amount of income from the sale should be accelerated on the corporation's final tax return. This legislation does not apply to shareholders, so it may be necessary to track the shareholder accounts on TI to verify that the unrealized gain is included when the final installment payments are paid. See MAP 21.14.1 Deferred Installment Sale Income.
4. If the corporation is an S-Corporation, review the return for Schedules K-1 and verify the shareholders filed returns on TI. If an amended return has been filed for the corporation, verify that the shareholders have also amended their returns.
5. Review the Net Operating Loss (NOL) deduction. Verify that the amount of NOL claimed is available. Remember that the NOL deduction was suspended for tax years 1991, 1992, 2002, 2003, 2010 and 2011. This is a common taxpayer error.
6. Review tax credits for reasonableness. Audit them if there is a history of abuse.
7. Review for possible Tax Shelter issues.
8. Check for previous audits on PASS, this could alert you to other audit issues.
9. Verify the account status on BETS and SOS files.

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<p>21.11 DISSOLVED PARENT OR "KEY" CORPORATION</p>	<p>If you are reviewing the dissolved parent corporation's returns, verify the dissolution information on the SOS file. It may give you an idea of the circumstances of the dissolution. Check the final return for dissolution information within attached correspondence. Make a note on the folder's PD cover sheet requesting that the cross-referencing in BETS Conversation **** be brought up to date.</p> <p>Whenever the parent or key corporation dissolves or withdraws from doing business in California, and a new key corporation has not been designated, call the taxpayer or send a letter inquiring as to which California subsidiary is to be designated the key corporation.</p> <p>Usually when the parent dissolves or withdraws from California, it is due to a reorganization. You should find the new parent for cross-referencing purposes. However, if the dissolved or withdrawn parent previously made an election to file a single return and pay the tax for a unitary group, you must call or write and ask the new parent to file an election form FTB 4523B, Authorization For Single Notices, if it wishes to continue to file in the same manner. See MAP 13.4.1 Authorization for Single Notices (FTB Form 4523B).</p> <p style="text-align: right;">Rev. 7/17</p>
<p>21.12 MINIMUM TAX AND COMPUTATION OF FINAL TAX</p>	<p>Effective September 29, 2006 dissolving entities can avoid paying the minimum franchise tax or annual tax for the current taxable year if all the following requirements are met (R&TC Section 23332(c)):</p> <ul style="list-style-type: none">Files a timely final return, including extensions, for the preceding taxable year.Does not conduct business after the preceding taxable year.Files the appropriate paperwork with the SOS within 12 months of the timely filing of the entity's final return. <p>More detailed examples on applying the above please see Public Service Bulletin 06-27.</p>

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	<p>The taxable year is terminated at the end of the month of dissolution or withdrawal, and a final return is due two and one half months later. The tax on the final return is based on the tax measured by net income for the year of dissolution or withdrawal, plus the tax based on net income for the preceding taxable year (but cannot be less than the minimum tax). The tax rate in effect during the month of dissolution/withdrawal is used to measure the final tax.</p> <p>For financial corporations, tax for the year of dissolution is to be computed at the corporate rate plus 2%.</p> <p style="text-align: right;">Rev. 7/17</p>
21.13 REFUNDS	<p>You may receive folders asking that a determination be made and the amount of tax or payments be refunded when the folder has not been stamped with the PD Audit box and date of dissolution.</p> <p>If the corporation has an overpayment and a claim number has been assigned and a determination has not or cannot be made, send a letter requesting the required information.</p> <p>Using form FTB 6213A, Accounting Instructions/Entity, will make any adjustment to the final return or account due to a first year credit, year change, cancellation, refund, etc.</p> <p>Generally, refunds will be based on first year credit or credit balance from estimated payments.</p> <p style="text-align: right;">Rev. 7/17</p>
21.14 AUDIT ISSUES	<p>Check ownership information on page 1 of the return, the percent of corporation stock owned on Schedule E, and Compensation of Officers on Schedule E. A review of the balance sheets on all available returns may indicate a change of ownership (i.e., fluctuation of investments in capital stock section).</p>

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	<p>If the final return indicates dissolution but there is a large net income and/or the balance sheet indicates a large amount of assets and there is no indication of the disposition, initiate an IDR for additional information.</p> <p>MAP 21.14.1 Deferred Installment Sale Income MAP 21.14.2 Accounts Receivable MAP 21.14.3 Gain on Distribution of Assets MAP 21.14.4 Subchapter S Corporation MAP 21.14.5 Bad Debt Reserve MAP 21.14.6 Net Operating Loss</p> <p style="text-align: right;">Rev. 7/17</p>
<p>21.14.1 Deferred Installment Sale Income</p>	<p>If no reorganization occurred, R&TC Section 24672 requires a corporation to include in its measure of tax the unreported income from an installment obligation it holds at the time the corporation is no longer subject to the tax imposed by Chapter 2 or 3.</p> <p>The installment note's basis is then increased to its face amount pursuant to the acceleration of R&TC Section 24672. In accordance with R&TC Section 24667 and IRC Section 453B, the corporation should recognize gain or loss on the difference between the fair market value of the note and its basis.</p> <p>If a corporation has sold property on the installment basis in prior years, the deferred gain may not be shown on its ending balance sheet. Care must be taken to check prior year returns for installment sales. This item is particularly important if no reorganization occurred.</p> <p>If the corporation merges with a California corporation, the income remains deferred. However, if the California corporation merges with an out of state corporation, R&TC Section 24672 applies and we can accelerate the income.</p> <p style="text-align: right;">Rev. 7/17</p>

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21.14.2 Accounts Receivable	<p>Accounts receivable that were earned by a cash basis corporation, before the distribution in liquidation, are taxable under R&TC Section 24651(b).</p> <p>If a final return reports zero gross receipts, but the balance sheet reports accounts receivable on the beginning balance, a statutory NPA may be issued. It may be necessary to write to the corporation and request the amount of accounts receivable not previously reported as income by the corporation, which was distributed to the shareholders.</p> <p style="text-align: right;">Rev. 7/17</p>
21.14.3 Gain on Distribution of Assets	<p>IRC Section 336 provides for gain or loss to be recognized by the liquidating corporation on the distribution of property as if the property were sold at its fair market value.</p> <p>If the corporation has assets remaining in the ending balance of the balance sheet or it cannot be determined if there is a gain or loss on the distribution of assets, it may be necessary to write to the corporation and request a schedule showing the gain or loss on the distribution of property in complete liquidation. The gain or loss is determined as if the property had been sold at its fair market value as of the date of distribution.</p> <p style="text-align: right;">Rev. 7/17</p>
21.14.4 Subchapter S Corporation	<p>When an S Corporation sells or distributes property in liquidation, the gain may be subject to a higher tax rate as provided in IRC Section 1374. The same rules apply to S Corporations as for C Corporations regarding the recognition of gain or loss on distribution of assets.</p> <p>IRC Section 453(h) provides that, except for purposes of any tax imposed by subchapter S, no gain or loss is recognized by the distributing S Corporation with respect to the distribution of installment obligations. This section does not apply for California</p>

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	<p>corporation purposes since California imposes not only IRC Section 1374 (tax on certain gains and built-in gains tax), but also an entity level tax.</p> <p>However, R&TC Section 24672 provides for the accelerated recognition of income on an installment note during the S corporation's final year of operation. The total amount of income from an installment sale should be accelerated on the corporation's final tax return. The shareholders are not subject to this statute and therefore not responsible for taxes on the unrealized income portion of the installment note until it is paid.</p> <p style="text-align: right;">Rev. 7/17</p>
21.14.5 Bad Debt Reserve	<p>If an amount is received by the corporation through the sale or other disposition of its account receivable, in excess of their net tax basis, such income is taxable in the last year that the corporation is subject to tax. Net tax basis equals face value less the bad debt reserve.</p> <p>When there is a reorganization or merger, bad debts need not be included in income.</p> <p style="text-align: right;">Rev. 7/17</p>
21.14.6 Net Operating Loss	<p>Common errors include claiming expired NOLs or incorrect percentage of NOLs.</p> <p>For more information on NOLs, see MATM 8000.</p> <p style="text-align: right;">Rev. 7/17</p>
21.15 DEFINITIONS	<ul style="list-style-type: none">• Liquidation: Corporation disposes of its assets and liabilities.

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	<ul style="list-style-type: none">• Incorporation and Dissolution: Formal action of domestic corporations through • Qualification and Withdrawal: Formal action of foreign corporations through the Office of the Secretary of State. • Transferor: Corporation that transfers its assets and liabilities to another corporation. • Transferee: Corporation that receives the assets and liabilities of another corporation. • Reorganization: A transaction in which a corporation combines or transfers assets and liabilities or stock and whose business is continued by another corporate entity or management. • No Reorganization: A transaction in which a corporation distributes its assets and liabilities to stockholders and whose business is not continued by another corporate entity. The corporation is not considered a party to reorganization. <p style="text-align: right;">Rev. 7/17</p>
21.16 NON-QUALIFIED CORPORATIONS	<p>Corporations that are not qualified or incorporated through the SOS are not required to dissolve or surrender. However, these corporations are required to do the following:</p> <ul style="list-style-type: none">• File a final return. • Check the final return box on side 1 of the return. • Attach a statement saying that they are no longer doing business in California.

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	The nonqualified corporations will be considered Closed when the above requirements have been completed.
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