

## New Law Streamlines Dissolution for Dormant Nonprofit Corporations in California

**The Problem.** Of the 150,000 nonprofit corporations in California, many are dormant. If these inactive corporations fail to make routine filings with the Secretary of State (SOS) and Franchise Tax Board (FTB), they risk triggering a series of increasingly unfortunate events. First, they risk losing their good standing for failing to file a simple Statement of Information. If this filing is not attended to, they will lose any tax exemption they have with the FTB. Minimum franchise taxes (\$800), penalties and interest will start to accrue and will continue indefinitely until the corporation dissolves. The rub, however, is that nonprofit corporations must reinstate their good standing with the SOS and FTB (including paying all accrued fees, penalties and interest) before they have the privilege of dissolving in California. Furthermore, even if they pay back taxes, interest and penalties, many dormant corporations need to reappoint boards of directors and convene meetings simply to dissolve. They need to build the system up just to break it down.

Because of these powerful disincentives, many nonprofit corporations simply walk away, neither reinstating their good standing nor paying a compounding bill to the State. Predictably, the State's system has become choked with inactive corporations with no intention of reinstating and no desire (or ability) to pay back taxes or dissolve.

Recognizing this perverse situation, Assembly Member Jacqui Irwin introduced AB 557 earlier this year. The bill passed the Senate and Assembly in August and was signed into law by Governor Brown on September 30th. The bill will take effect in 2016. This email alert highlights the key changes effected by AB 557.

**Administrative Dissolution or Surrender.** Under current California law, nonprofit corporations that have been suspended by the FTB cannot dissolve until they reinstate their good standing with the FTB. Under the new law, any domestic nonprofit corporation that has been suspended by the FTB for *48 continuous months* will be "administratively dissolved" by the SOS. Likewise, any foreign nonprofit corporation qualified to do business in California whose corporate powers have been forfeited for 48 continuous months will have its qualification to do business in California "administratively surrendered."

by Pamela S. Kaufmann & Payam A. Saljoughian



Before administrative dissolution or administrative surrender takes effect, the FTB will notify the affected corporation. While most of these notices will likely go to corporations that have no interest in being resurrected, corporations that wish to remain in existence may object to the administrative dissolution or surrender. The corporation will have 60 days to object, and another 90 days from the date of the objection to resolve all outstanding requirements with the FTB. If the corporation files no objection, or if the outstanding requirements are not met, the corporation will be administratively dissolved or will have its qualification to do business in California administratively surrendered.

**Tax Amnesty.** Upon administrative dissolution or surrender, the nonprofit corporation's liabilities for qualified taxes, interest, and penalties will be abated. Qualified taxes include the minimum franchise tax but not taxes imposed on an organization's unrelated business taxable income. Qualified penalties include those assessed for failure to file a Statement of Information with the SOS. This is perhaps the most attractive feature of the bill and likely reflects the FTB's realization that continuing to invoice dormant corporations or to send them past-due notices is sending good money after bad. One could argue that this program will reward inaction; however, the administrative dissolution/surrender process will help clean up the State's records by removing numerous inactive corporations.

Importantly, this bill will *not* discharge nonprofit corporations' liabilities to creditors other than the FTB.

**Short-Form Dissolution.** AB 557 will also allow nonprofit corporations to enjoy a benefit already available to their for-profit counterparts. California law requires both nonprofit and for-profit corporations to file a Certificate of Dissolution with the SOS when they seek to dissolve; however, in lieu of this certificate, for-profit corporations that meet certain requirements may file a Short-Form Certificate of Dissolution within 12 months of filing of their articles of incorporation. AB 557 will make this option available to nonprofit corporations, as well, but the filing period will be 24 months from the date of filing. This period will give nonprofit corporations a reasonable time to determine that a new corporation does not really need to exist.

**Abatement of Taxes, Interest, and Penalties Upon Loss of Exemption.** Under AB 557, nonprofit corporations that had their state or federal tax exempt status revoked, or that never did business in California, may request an abatement of unpaid qualified taxes, interest, and penalties for taxable years in which they did no business. "Doing business" is defined as "engaging in any transaction for the purpose of financial or pecuniary gain or profit." To take advantage of this abatement, the corporation must (1) show that it has ceased all business operations; and (2) dissolve within 12 months from the date of filing the request for abatement.

**Housecleaning Time.** Nonprofit corporations can be formed at the drop of a hat. Often, they are created to make an offer on a property, compete for a contract, or introduce a new program. When the property is not purchased, the contract is not awarded, or the program falls through, the corporation often remains on the books but is not properly maintained. Other times, a corporation outlives its usefulness because a contract ends, a property is sold, or funds run out. If you have any such corporations, AB 557 may afford you a great opportunity to clean house at the State's expense.

**Questions?** Feel free to contact the authors.

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