



Legal Risk Management Tip January 2009

CALIFORNIA AGENCIES COME TOGETHER TO SUSPEND NON-COMPLIANT LLCs

In a time of current economic hardships, governmental agencies are working together to ensure compliance with applicable regulations. This is particularly evident in the securities industry with the recent enhanced efforts by the SEC, FTC and U.S. Department of Treasury, to name a few. California officials are taking notice, especially when the state is currently without a budget and forecasts an even larger deficit for years to come. As a result, state agencies are combining resources to crack-down on non-compliant limited liability companies (“LLCs”). The LLC has become an increasingly popular choice of entity due to its general protection of an owner’s (commonly referred to as a “member”) personal assets from any liability incurred by the LLC, and the favorable tax treatment provided by state and federal law. Registration with the state for an LLC is complete once it has filed its Articles of Organization and an information statement within 90 days thereafter. LLCs are required to meet certain ongoing filing and payment requirements in order to retain the status as an LLC. In its October 2008 edition of *Tax News for Tax Professionals*, the State of California Franchise Tax Board (“FTB”) released a notification that the FTB and the California Office of the Secretary of State (“SOS”) “are currently working together to implement a suspension/forfeiture process for Limited Liability Companies”¹ that are registered with California.

This suspension/forfeiture program is the first time LLCs have been the focus of any compliance regulations since their introduction as a business entity by California’s Beverly-Killea Limited Liability Company Act in 1994. Though the FTB and SOS have joined resources, the FTB is in charge of this program with help from the SOS behind the scenes. The main goals of this program are to help the FTB reduce the tax gap and to bring non-compliant LLCs into regulatory compliance.² Examples of non-compliance may include, but are not limited to: not filing state income tax returns, owing income fees, owing the minimum \$800 annual LLC tax, or failing to file an information statement that is required every two years and carries a penalty fee of \$250.³ With respect to this program, there are two areas of focus for a member of an LLC, notification and ramifications.

Notification: Already in effect, notices are being sent out monthly to any LLC registered with the state of California that has failed to meet its filing and/or payment obligations. In-state and out-of-state LLCs that have registered with California are subject to suspension whether or not they are currently doing business in the state. Although an LLC may cancel its registration with California at any time by filing a Certificate of Dissolution with the SOS, the LLC is still responsible for any and all outstanding payments and required filings. An LLC should expect to receive such a notice if it has failed to pay any outstanding fees, taxes, penalties or interest and/or failed to file a tax return.⁴ Notices will be mailed to the last known address for the LLC 60 days

¹ Franchise Tax Board, *Gearing Up for LLC Suspension Program*, TAX NEWS, Oct. 2008, at 2, <http://www.ftb.ca.gov/professionals/taxnews/2008/1008/1008.pdf> [hereinafter *Suspension Program*].

² *Id.*

³ Cyndia Zwahlen, *California Officials Going After Noncompliant LLCs*, L.A. TIMES, Jan. 12, 2009, at C4, available at <http://www.latimes.com/business/la-fi-smallbiz12-2009jan12,0,4595527.story?track=rss>.

⁴ *Id.*



prior to any suspension or forfeiture is imposed.⁵ This allows the LLC time to complete the filing of required tax returns and pay any outstanding fees, taxes, penalties or interest to avoid suspension/forfeiture.

Ramifications: There are severe ramifications once an LLC has been suspended or forfeited from registration. Upon suspension/forfeiture, an LLC will no longer retain its authority as a “natural person” in conducting its business activities as defined by California statute. As a result, the suspended/forfeited LLC will lose its authority to:

- Enter into any contract (and contracts entered into during the period of suspension/forfeiture will be void)
- Assume obligations and incur liabilities as a separate person from its member(s)
- Borrow or lend out money
- Purchase or sell property
- File a lawsuit, respond to a lawsuit or be represented in court⁶

In addition, the suspended/forfeited LLC will lose all rights to its business name. Once the LLC is suspended/forfeited, its business name immediately becomes available for use by the general public making no guarantees that the suspended/forfeited LLC will retain its original business name. When the LLC is no longer suspended/forfeited, it may be forced to choose another business name which could be costly in reputation and recognition, new marketing materials, client loyalty and other areas.

For securities firms formed as an LLC, its member(s) should review the firm’s corporate books and tax records for any outstanding filings or payments. If a firm discovers any missed filings or payments, it should take proactive steps to bring its firm into compliance as soon as possible. Additionally, the SOS is expecting to conduct its own suspension program beginning next year when the FTB suspension/forfeiture program ends.⁷ For more information, please contact us at (619) 298-2880.

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⁵ *Suspension Program*, *supra* note 1.

⁶ Steven R. Harmon, *Avoid the Suspense of Corporate Suspension*, Morgan Miller Blair HomeBase News, July 15, 2002, available at <http://www.mmlblaw.com/newsevents.php?NewsID=36>.

⁷ Zwahlen, *supra* note 3.