Corporate & LLC Statutory Changes

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During 2004, the legislature made a number of changes to the South Carolina Business Corporation Act and the LLC Act. A few of these changes are very significant and some may mislead the uniformed lawyer as to their effect. The following summarizes the main provisions of HB 4650, S.C. Gen. Assembly, 115 Session, 2003-2004.

Domestication.

A company incorporated in another state may move into South Carolina merely by filing articles of domestication and then filing dissolution papers in the former "home" state. A primary purpose of this legislation was to make it easier for companies, such as captive insurance companies, which wished to move "back" to South Carolina to have an expedited method of making the move. Prior to the adoption of this statute the foreign corporation which wanted to move to South Carolina would likely have had to go through a more cumbersome merger process.

The articles of domestication are very simple. They merely require the same information as is required of a company incorporating in South Carolina plus the following: (a) designation where previously incorporated; (b) the old and new name; and (c) certification that proper shareholder approval was obtained. The company is deemed to be the same entity as before domestication. Its assets, liabilities, outstanding shares, and pending actions remain the same. A filing with the Register of Deeds in each county where the company owns real property must be made.

In most domestications there should be no federal or state income tax consequences, merely as a result of the domestication.

Conversions.

The revisions now provide that any business entity may be "converted" into any other business entity merely by filing articles of conversion. (Also, a business corporation may now be converted into a public benefit nonprofit corporation.) Thus a corporation which wants to become an LLC merely files the conversion articles. Likewise a partnership or LLC which wants to become a corporation merely files articles of conversion. Although there are separate code sections covering each type of conversion, the process and effects for each are generally the same. For example, if a corporation wants to convert into an LLC the board adopts a plan, submits it to the shareholders for approval, and once approved articles of "organization" are filed. These articles will include the standard provisions required to form an LLC plus: (1) a designation that this is a conversion; (2) the former name; (3) recitation of the proper votes being cast; and (4) a statement cancelling the corporation's articles. The plan and documents may

provide that some former shareholders are being "cashed out" and will not receive membership interests in the new company. Shareholders who do not like the conversion idea have dissenters' rights. (However, if an LLC or partnership converts to another entity, there will be no dissenters' rights.)

Similar to domestication, the converted entity is deemed to be the same entity as before– just in a different form. All former property, liabilities, and pending actions remain with the converted entity. The owners of the converted business remain liable for old debts and become liable for new debts to the extent that an owner would otherwise be liable. In most of the conversions, county Register of Deeds filing is required if the business owns real property in a particular county. (There may be some question whether this filing is required if a corporation converts into a partnership or limited partnership. Consider the language in amended § 33-4-104. Making the filing would seem to be the better practice.)

Tax Risks with Conversions.

Warning! Many clients will probably want to take advantage of this conversion process and convert their existing corporation into the more popular LLC. There are typically serious tax risks with this.

As a general rule, the conversion of a corporation into a limited liability company will generate taxable gain at both the corporate level and the shareholder level. The transaction will be treated for federal and state income tax purposes as the complete liquidation of the corporation. The corporation will be deemed to have sold all of its property for its fair market value triggering gain or loss to the corporation. The shareholders upon distribution of the corporate assets to them in exchange for their stock will recognize gain or loss measured by the difference between the fair market value of the assets distributed by the corporation and the shareholders' basis in their stock.

The profit to nonprofit conversion process was included primarily to allow businesses with liquor licenses to take advantage of the more favorable liquor laws which apply to nonprofit organizations. There is an additional tax trap here. If the for-profit corporation converts into a nonprofit business the transaction may not qualify as a tax free reorganization, particularly where the nonprofit has no Members. Additionally, if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market value.

On the other hand if an LLC or partnership wants to convert into a corporation, there may be no negative income tax consequences caused merely by the act of converting.

A word to the wise. Before you assist a client with a conversion, you need to be certain that you know what the tax consequences will be. Often this will require consulting with a tax specialist.

Mergers.

Business corporations may now merge with nonprofit corporations, LLCs, partnerships, and limited partnerships. Assuming that they can meet existing restrictions, nonprofit corporations are also now permitted to merge with LLCs, partnerships and limited partnerships. It seems unlikely that there will be much demand for any of these procedures.

Transacting Business – Exemptions.

If a foreign business does business in South Carolina it must register with the Secretary of State. The bill clarifies that the following activities do not require the business to register in South Carolina. A foreign corporation is not transacting business in South Carolina merely because it is a *passive* investor in a South Carolina LLC. Likewise foreign limited partnerships and foreign LLCs are not transacting business in South Carolina merely because they own an interest in a South Carolina LLC.

Contingent and Post Dissolution Claims.

Claims that were contingent when a corporation dissolved and any claims based on an event occurring after the company dissolved continue to be barred if the dissolved corporation made proper public notifications of its dissolution and no action is taken on the claims within ten years after newspaper notice of the dissolution. Newspaper notification previously was not a requirement for barring the claim and the former language may have provided slightly more protection to the dissolved company and its former shareholders.

Fictitious Name Filing Abolished.

The prior requirement that unincorporated mercantile businesses must file the owners' names with the clerk of court and post the names near the door of the business has been repealed.

Certificateless Shares.

If shares without certificates are issued, the shareholder must now be furnished with the same information which would appear on the certificate.

Authority to Transfer Stock.

The buyer of stock may now demand that the seller demonstrate that he has authority to make the transfer. If the seller fails to comply the buyer may rescind the purchase.

No LLC Annual Reports.

LLCs are no longer required to file annual reports with the Secretary of State.

Sue LLC Managers.

An unhappy LLC member now has statutory authorization to not only sue another member, but also to now sue the manager(s) if it is asserted that the manager(s) breached a duty owed to the member or the LLC.

LLC Distributions.

Distributions from a dissolved LLC to its members shall be made in accord with the tax regulations, in accord with the members' positive capital account balances. This default provision may be modified by a contrary provision in the operating agreement.