Corporate Alert

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Reminder: Why You Should Dissolve an Inactive New Jersey Corporation

We are often asked, "Why not let the State revoke a corporation's charter for failure to file an annual report rather than formally dissolving a New Jersey corporation?" The short answer is because the individual directors and officers could be personally liable for corporation taxes that accrue after the corporation stops operating.

Pursuant to Sections 14A:6-12 and 54:50-18 of the New Jersey Statutes, directors, and in certain cases officers, can be personally liable for a corporation's taxes after the complete liquidation of a corporation and the distribution of all of its assets to shareholders if the corporation fails to dissolve and adequately provide for the payment of its fees and taxes. In some instances, shareholders can also be liable up to the amount of the distributions they received. These taxes include not only the New Jersey Corporation Business Tax, which continues to accrue at a minimum of $500 annually until the corporation formally dissolves, but also trust fund tax liabilities (e.g., various taxes that the

corporation is under a duty to collect and remit to the state) as well as any related interest and penalties. Therefore, in the event that directors make distributions to shareholders in dissolution of the corporation but either fail to formally dissolve the corporation or fail to provide for payment of the corporation's tax liabilities (including liabilities that will continue to accrue as a result of the failure to dissolve), the State of New Jersey could go after the directors personally for the taxes, interest and related penalties up to the amount of the distributions the directors approved to be paid to the shareholders. Late filing penalties, late payment penalties and collection costs can result in the accrual of significant liabilities.

Another advantage of dissolving is that it starts the statute of limitations for creditor claims running and gives the dissolving corporation the option to shorten the statute of limitations. Although the State may eventually revoke a corporation's charter for its failure to pay taxes (and therefore cause a dissolution), by actively dissolving, a corporation can start the clock running for creditor claims. A dissolved corporation has the option to send notice to its creditors requiring them to present their claims within a set period of time. If creditors do not respond within the prescribed time, their claims are time barred unless the Superior Court grants an exception for good cause. If no notice is sent, creditors are generally barred from bringing claims against shareholders five years after dissolution.

Section 14A:12-1 of the New Jersey Statutes sets forth several ways in which a corporation can dissolve. Dissolution commonly involves submission of an application to the Division of Revenue which includes (i) a certificate of dissolution; (ii) an estimated summary tax return with a separate payment for any taxes due, (iii) a request for a Tax Clearance Certificate; and (iv) payment of the dissolution fee and the Tax Clearance Certificate application fee. The dissolution becomes effective, and the taxpayer is notified, when all outstanding tax liabilities are resolved and the Division of Revenue receives the Tax Clearance Certificate from the Division of Taxation.

New Jersey Business Corporation Act Update: Governor Christie Signs Business Friendly Amendments to Corporate Statute

On March 1, 2011, New Jersey Governor Chris Christie signed into law two new bills designed to make it easier for New Jersey corporations to attract directors and officers.

Assembly Bill No. 3254: Maintains Right of Corporate Directors and Officers to Indemnification Under Certain Circumstances

This legislation provides that an amendment to a New Jersey corporation's certificate of incorporation or by-laws that eliminates or impairs a corporate officer's or director's right to indemnification or advancement of expenses, will not impact the rights of any officers or directors to indemnification or advancement of expenses with respect to a proceeding relating to acts or omissions that occurred prior to the amendment. The statute provides an

exception for New Jersey corporations whose certificates of incorporation or by-laws specifically authorize the retroactive elimination of such protections.

Talented individuals are sometimes reluctant to serve as officers or directors in corporations out of fear that their actions as officers or directors could result in personal liability. Corporations typically address such fears by including provisions in their certificates of incorporation or by-laws requiring indemnification of officers and directors and further providing for advancement of costs and expenses in certain cases. Many directors and officers agree to serve on the board or in office only after confirming that indemnification provisions and expense advancement provisions are included in the corporation's certificates of incorporation or by-laws. However, before the changes, retroactive by-law or certificate of incorporation amendments could have reduced or eliminated the expected protection.

Some corporations already protect their directors and officers from retroactive amendments by including 'savings clauses' in their certificates of incorporation or by-laws, which provide that an amendment to the indemnification provision or expense advancement provision will not adversely affect any right or protection of an officer or director relating to acts or omissions occurring prior to such amendment. However, many officers and directors are not aware of the need for a savings provision and fail to ask for its inclusion in the corporation's certificate of incorporation or by-laws. The new legislation removes this trap by making the default rule that an amendment to a New Jersey corporation's certificate of incorporation or by-laws will not impact the protections previously extended to officers and directors relating to actions occurring prior to the amendment.

Assembly Bill No. 3253: Provides New Jersey Corporations with the Right to Renounce the Corporate Opportunity Doctrine

This bill provides that a New Jersey corporation may renounce the corporate opportunity doctrine, which requires that directors and other corporate fiduciaries present business opportunities to their respective corporations before pursuing those opportunities on their own. The Corporate and Business Law Study Commission found that the "Corporate Opportunity Doctrine" operates as a disincentive and makes it difficult for New Jersey corporations to attract and retain business persons as board members.

Under the former law, the corporate opportunity doctrine could not be waived by a New Jersey corporation. The new law permits a corporation to renounce the corporate opportunity doctrine either generally, in its certificate of incorporation or in a board resolution, or on a case by case basis, by action of the board of directors.

SEC Issues Final Rule on Revised Net Worth Standard for Accredited Investors Under Dodd-Frank

The final rule adopted by the Securities and Exchange Commission ("SEC"), conforming the SEC rules with the modified net worth standards imposed by the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), became effective on February 27, 2012. The Dodd-Frank Act, signed into law by President Obama on July 21, 2010, includes a provision that changes the investor eligibility requirements for the private placements of securities. Specifically, Section 413 of the Dodd Frank Act changes the definition of "accredited investor" in Regulation D to exclude the value of a person's primary residence in calculating whether the person has a net worth of at least $1 million.

Issuers, including many hedge funds and middle market companies, often raise capital by relying on Regulation D, which provides a safe harbor exemption from registration under the Securities Act of 1933 for private placements. Rule 506 of Regulation D provides an exemption from registration for offerings that are made to an unlimited number of "accredited investors" and up to 35 other purchasers (who need not be accredited investors, but are required to have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment).

The definition of accredited investor includes, among other categories, any person:

- Who had an individual income in excess of $200,000 in each of the two most recent years or joint income with his or her spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; or
- Whose individual net worth, or joint net worth with his or her spouse, at the time of his or her purchase exceeds $1 million (such calculation excludes the value of an investor's primary residence).

The Dodd-Frank Act revises the accredited investor definition to exclude the value of a person's primary residence from the $1 million net worth test. This change effectively increases the net worth requirement for investors and therefore decreases the number of potential investors in upcoming offerings.

On December 21, 2011, the SEC amended Rule 501(a)(5) ("Rule 501") of Regulation D to conform Rule 501 to the Dodd Frank Act's modifications to the net worth test. In addition to excluding the value of a person's primary residence from the calculation of the person's assets, amended Rule 501 adds that any mortgage or other debt secured by a person's primary residence will not be counted as a liability in calculating the person's net worth, except to the extent that the debt exceeds the fair market value of the residence.

The SEC included a 60-day look back period in Rule 501 in an effort to prevent an investor from artificially inflating his or her net worth by borrowing funds secured by his or her primary residence immediately prior to making an investment. Under this provision, any debt incurred by a person within 60-days of the purchase of securities is

taken into account in counting net worth, even if that debt is secured by the person's primary residence and is not in excess of the estimated fair market value of the residence.

Amended Rule 501 contains a grandfather clause that permits use of the old net worth test for an investor who (a) is purchasing the securities in accordance with a right to purchase such securities (for example, a right arising by contract) which was held by the person on July 20, 2010, (b) qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and (c) held securities of the same issuer, other than such right, on July 20, 2010.

Companies engaging in the private placement of securities should reexamine their investor questionnaires, investor representations and warranties and other offering documents to ensure that they comply with the new net worth standards.

Doing Deals with New Jersey Taxpayers? Buyer Beware: New Jersey Tax Bulk Sales

Changes to the Bulk Sales Law several years ago significantly expanded the transactions that are subject to the Bulk Sales Law and the liability of purchasers, transferees and assignees (hereafter collectively referred to as "Purchasers") that fail to comply with its requirements. Clients and attorneys continue to be surprised by the breadth of the rule, so we thought it would be worth revisiting.

The current Bulk Sales Law, N.J.S.A. 54:50-38, applies to any sale, transfer or assignment (hereafter collectively referred to as a "Sale") in bulk of any part or all of a person's "business assets," other than in the ordinary course of business (i.e., the Bulk Sales Law would not apply to Sales of inventory in the ordinary course of business). [1] If a Sale is subject to the Bulk Sales Law, the Purchaser is required to notify the New Jersey Division of Taxation (the "Division") of the proposed Sale and, among other things, the price, terms and conditions thereof. The Division must be in receipt of such notice at least 10 days prior to Purchaser taking possession of or paying for the Sale assets. It is important to note that the Division has taken the position that 10 days for this purpose means "10 business days."

Within 10 business days of receiving a Purchaser's bulk sale notice, the Division will notify the Purchaser of any possible claim for New Jersey taxes (i.e., all taxes payable to or collectible by the Division and all interest, penalties and additions thereon) and the amount of such claim. If the Division receives a complete and timely bulk sale notice from the Purchaser and fails to provide timely notice to the Purchaser that a possible claim for New Jersey taxes exists, the Purchaser will be deemed to have complied with the Bulk Sales Law and will have no liability imposed pursuant to the Bulk Sales Law.

However, if the Division provides timely notice to the Purchaser that there is a possible claim for New Jersey taxes,

the Purchaser may not transfer to the seller a portion of the purchase price equal to the amount set forth in such notice. The Division typically requires the Purchaser to escrow such amount at the closing of the Sale. If Purchaser fails to withhold this amount from the Seller, it will be liable to the Division for all of Seller's taxes (not just the amount the Division requested be put in escrow). If the Division requests an escrow, the Purchaser must comply with the Division's instructions regarding release of funds from such escrow and may not otherwise release any funds from the escrow until the Division issues a "clearance letter" to the Purchaser authorizing release.

A Purchaser's failure to comply with the Bulk Sales Law, including failure to provide the required bulk sale notice or complying with the Division's escrow demands, results in the Purchaser being jointly and severally liable with the Seller for all of the Seller's New Jersey taxes (and interest, penalties and additions thereon). [2] It is important to note that such liability is not limited to the purchase price or other consideration paid for the assets that are the subject of the Sale.

Due to the severe sanctions imposed on Purchasers failing to comply with the Bulk Sales Law, it is critical to determine whether a transaction is subject to the Bulk Sales Law, and, if so, for the Purchaser to comply with the Bulk Sales Law.

The Division has aggressively administered the Bulk Sales Law. Some important observations concerning the Division's administration of the Bulk Sales Law and traps for the unwary are as follows:

1. The Division's interpretation of the term "business assets" used in the Bulk Sales Law is very broad. The Division interprets "business assets" to include any assets used in any endeavor from which revenue or consideration is realized for the purpose of generating a profit or loss. This would include both tangible and intangible assets.

2. Although the Bulk Sales Law applies to sales of business assets, the Division's broad interpretation of what constitutes a business asset by the Division could result in a sale of an equity interest being viewed as the sale of a business asset. Therefore, it would be prudent for a Purchaser to make a bulk sale filing in connection with such transactions.

3. The Sale of all of a Seller's business assets is not required for the Bulk Sales Law to apply. The Division indicates that partial sales are covered by the bulk sales law. The Division did not clarify at what point a sale of business assets would be too insignificant to be subject to the Bulk Sales Law.

4. The Division has indicated that a Purchaser must fully complete Form C-9600 and attach a binding executed contract of sale or other applicable transfer agreement showing the consideration for and all other terms and conditions of the transfer. It is the Division's position that if any required information is not accurate or if all required information and documentation is not received by the Division at least 10 business days prior to paying

for or taking possession of the Sale assets, the bulk sale notice submitted by the Purchaser will be incomplete and invalid, resulting in Purchaser being liable for Seller's New Jersey taxes as described above.

5. While the Division must receive the bulk sale notice at least 10 business days prior to a Purchaser paying for or taking possession of the Sale assets, the Division is required to merely notify the Purchaser within 10 business days that a possible claim exists for New Jersey taxes and the amount of such claim. There is no guidance on what constitutes notice or that the Purchaser must receive such notice from the Division. It is currently the Division's policy to mail such notices. However, the Division has indicated that it will fax the notice at the Purchaser's request.

Therefore, if a Purchaser has not received the Division's escrow notice, the Purchaser should not close after the passing of 10 business days from the Division's receipt of the bulk sale notice without first contacting the Division to determine if it has mailed such notice, and, if so, obtaining a copy of the same.

In summary, the scope of transfers subject to the New Jersey Bulk Sales Law is broad, requiring purchaser to be careful to determine if a transaction is subject to the Bulk Sales Law and, if so, to carefully comply with such law.

This is a summary of a more detailed January 2011 article on this topic that appears on our website and can be accessed at: http://www.riker.com/publications/doing-deals-with-new-jersey-taxpayers-buyer-beware-new-jersey-tax.

1.Prior to August, 2007, the Bulk Sales Law applied only to Sales by a seller, transferor or assignor required to collect New Jersey sales tax. Therefore, the transactions subject to the prior Bulk Sales Law were more limited than under current law. For instance, many Sales of real estate were not subject to the prior Bulk Sales Law, since, in many instances, sellers, transferors and assignors of real estate are not required to collect New Jersey sales tax.

2 Prior to August, 2007, a Purchaser's liability for failure to comply with the Bulk Sales Law was limited to a Seller's New Jersey sales and use tax. The changes to the Bulk Sales Law increased the potential liability of a Purchaser for failure to comply with the current Bulk Sales Law to all of a seller's New Jersey tax obligations (not just sales tax obligations).

Keeping Up With Delaware: New Amendments to the Delaware Limited Liability Company Act

On August 1, 2011, a number of amendments to Delaware's cutting-edge Limited Liability Company Act went into effect. Among the more notable changes was the inclusion of a default provision for the amendment of limited liability company agreements. Prior to the statutory revisions, it was unclear what consents were necessary to amend a limited liability company agreement if the agreement itself was silent. Uncertainty existed regarding whether manager or other non-member party approvals were needed. The new statutory provision located at Section 18-302(f) of the Limited Liability Company Act provides the answer. For Delaware limited liability companies formed by a certificate of formation filed on or after January 1, 2012, the default provision permits

amendment to a limited liability company agreement with the unanimous approval of the members. Note: this is just a default rule. Delaware permits non-unanimous amendments and other methods of amendment as long as they are set forth in the operating agreement or otherwise authorized pursuant to separate sections of the Limited Liability Company Act.

New Business Entity in New York: The Benefit Corporation

The introduction of the Benefit Corporation form in New York, effective February 10, 2012, provides business leaders with increased flexibility in shaping business models that consider the needs of constituencies other than investors. This corporate form allows leaders to use "sustainability and social innovation as a competitive advantage." Corporations electing Benefit Corporation status must have as one of their corporate purposes the "creation of general public benefit," or, in other words, corporate actions must be aimed at positively impacting society and/or the environment. Benefit Corporations may also list specific public benefits as a corporate purpose. The relevant legislation enumerates a number of examples of specific public benefits, including, among other things, the provision of beneficial products and services to communities, the promotion of economic opportunities beyond normal job creation, environmental preservation and advancement of the sciences. To become a Benefit Corporation, existing corporations must, with shareholder approval, amend their charters to include a benefit purpose. Benefit Corporations are also required under the law to deliver an annual benefit report to stockholders describing the corporation's performance in connection with such stated benefits. Despite the potential advantages, the decision to elect Benefit Corporation status should be considered carefully as it can increase shareholder reporting obligations and might lead to increased fiduciary liability for corporate officers and directors.

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