Dissolving Your Business

After putting countless hours of work and worries into your business, large or small, a time may come when you need to cease operations and dissolve your business. (Dissolution may occur with or without a bankruptcy proceeding.) This is undoubtedly a stressful time, and the number of steps involved in dissolving a business doesn't make the job any easier. However, by engaging an experienced advisor and following the procedures outlined in this article, you will have taken the first steps to a successful dissolution and perhaps a springboard toward a new, more successful business.

There are six primary steps in dissolving a business, whether it is a corporation or a limited liability company (LLC): (1) corporate action; (2) filing articles of dissolution with the state; (3) filing all necessary federal, state, and local tax forms; (4) statutory notification to creditors; (5) settling creditor's claims and (6) distribution of remaining business assets.

(1) Corporate Action. The owners of the company must first propose and approve the dissolution of the business. For a small business, the owners of the company are often involved in the day to day operations of the business, and therefore know the circumstances leading to the dissolution. The procedures for corporate action differ slightly for a corporation and an LLC.

For a corporation, the shareholders must approve the action of dissolving the business. The bylaws of a corporation, which your attorney must prepare in order to start operating your business, will outline the requirements for shareholder and board of director approvals. To comply with the formalities of a corporation, the board of directors should approve the resolution to dissolve the company and recommend its passage to the shareholders. The shareholders should then carefully consider and approve or disapprove the recommendation to dissolve. Both actions should be documented and placed in the corporate record book.

For an LLC, the members must approve dissolution. The operating agreement of the LLC, which must be entered into when you commence operations may outline the process necessary for dissolution. If not, the statute under which the LLC was organized includes dissolution requirements. While an LLC is not subject to the same formalities as a corporation, documenting the decision to dissolve the LLC and the member's approval in writing is strongly recommended to demonstrate deliberations by the members on this important action.

(2) Filing the Articles of Dissolution with the State. After the shareholders or members have voted to dissolve the corporation or LLC, the appropriate paperwork must be filed with the state in which your business was formed. It is important for you to note that, if your business has been qualified to operate in other states, the appropriate paperwork must be filed in those states as well.

Because the requirements of filing differ from state to state, you should contact each state directly or seek the advice of a corporate attorney to determine the specifics of each state's dissolution filing requirements.

(3) File All Necessary Federal, State and Local Tax Forms. Just because your company is ceasing operations, does not mean that your tax obligations will immediately disappear. You must formalize the closing of your business with the IRS as well as your state and local taxing agencies. The IRS website (www.irs.gov) includes a checklist for closing a business and lists the types of forms that may be required to do so.

(4) Notification to Creditors. You must notify all of your creditors by mail concerning the dissolution of your business. The notice given should include the following information:

(a) That your corporation or LLC has been dissolved or has filed the statement of intent to dissolve;

(b) The mailing address to which creditors must send their claims;

(c) A list of information that should be included in the claim, such as:

1. The amount of the claim;
2. Legal name of the entity asserting the claim;
3. Identification or brief description of the agreement or other circumstances under which the claim arose; and
4. Any other information the creditor believes useful to verify the nature and the amount of the claim, including copies of any relevant documents.

(d) The deadline for submitting claims (this is often 120 days from the date of the notice);

The deadline for submission of claims by creditor is very important in the notice to creditors because a claim against your dissolved corporation will be barred if the creditor misses the deadline for submission of claims. The creditor's claim will be barred against your corporation as an entity and also against the entity's officers, directors, members, agents or employees.

(e) A statement that claims will be barred if not received by this deadline.

It is possible that a state in which your company is authorized to transact business allows for claims from creditors that are not known to you at the time of dissolution. In these states, notice in the local newspaper of your company's dissolution may be required. You should seek the advice of an attorney regarding what procedures each state mandates with respect to creditor notification.

(5) Settling Creditor's Claims. Claims submitted to the company by creditors can be accepted or rejected by your company. Accepted claims must either be paid or a satisfactory arrangement must be made with the creditor regarding the terms for repayment. For example,

it is possible that a creditor of your company may agree to settle the claim for a discounted percentage of the original claim amount, in order to be assured of some payment.

With respect to rejected claims, you must advise creditors in writing that your company rejects their claims. You should seek the assistance of an attorney in rejecting claims of creditors, as there are specific state statutes governing actions on rejected claims.

(6) Distribution of Remaining Assets. After the payment of all creditor claims, the remaining assets may be distributed to the owners of your company. Assets are distributed in proportion to the share of ownership in the company, subject to the liquidation preference of any preferred equity holder. For example, if you own 60% of the business and your brother owns 40% and there are no preferred holders, you would receive 60% of the remaining assets.

If your business is an LLC, your operating agreement should be reviewed to make sure that distribution is based on ownership percentages; sometimes, distribution may be based upon capital account balances as opposed to strict percentage ownership.

If your business is a corporation that has multiple classes of stock, such as common and preferred shares, your Articles of Incorporation should outline the preferred equity holders' priority rights in the distribution of assets. Further, it is important to remember that all distributions of the company's remaining assets must be reported to the IRS.

The process of dissolving a company can be a stressful one; however, if you follow the basic steps outlined in this article and consult with an experienced business attorney where appropriate; it is possible to dissolve and wind up your business in a cost-effective manner. If you have any questions regarding this article, please contact Serge Biberman at 312-410-7863.