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Conversion of California Corporation to Another State

(October 3, 2023)

After years of political denial¹, the Federal Reserve Bank of Chicago finally confirms the California exodus of businesses leaving the “not so” Golden State of California due to California’s excessive tax rates, regulatory burdens, and higher cost of living.²

This Newsletter will discuss the conversion (also referred to as re-domicile or redomestication) of California corporations to other states (“Conversion”), such as Texas, Nevada, Florida, Tennessee, Washington, and other zero or low tax states.

There are three (3) potential ways of relocating a California corporation to another state.

Reincorporation. This ill-advised method involves forming a new-state corporation, transferring assets and liabilities of the existing corporation to the new-state corporation; and dissolving the existing corporation (known as "*Reincorporation*"). The dissolution of the existing corporation and transfer of the assets to a new corporation can, and often time does, result in an unnecessary and unacceptable taxable income and gain. *Reincorporation is highly discouraged due to the adverse tax ramifications.*

Conversion. If both states authorize a statutory corporate conversion or re-domicile procedure, a corporation can convert the existing corporation to a new state of incorporation ("*Conversion*" or "*Redomiciliation*"). Effective January 1, 2023, **California corporations are now allowed to convert to a foreign corporation or**

¹ California political leaders for years denied the departure of people and businesses leaving California, citing a now discredited University of California study which relied on old California Franchise Tax Board Data. Not only did the UC study rely on old California tax return filing data, but the author of the UC study failed to recognize that California taxpayers had to file California income tax returns for their year of departure, making the data three (3) years old.

² Using more reliable and contemporary data from moving company United Van Lines, the Federal Reserve Bank of Chicago, determined the 2018 and 2019 California outbound move rate was 56%, and the outbound move rate rose to nearly 60% in 2020-21.

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Conversion of California Corporation to Another State

Page 2

foreign other business entity provided the foreign jurisdiction also authorizes that type of conversion.³.

Merger. A new-state corporation is formed and merge the existing California corporation into the new state corporation via tax-free merger (via "**Merger**"). If the corporate laws of the other state do not expressly permit a Conversion, then the Merger method is the most tax efficient corporate relocation method authorized under the California Corporation Code in which the California corporation's assets are transferred to, and liabilities are assumed by, the new state corporation by operation of law.

The Conversion of the California corporation into another state corporation via Conversion requires corporate formalities, steps, and documentation listed below.

- Authorizing Minutes/Consent,
- Plan of Conversion,
- Certificate of Conversion, and
- Additional items discussed below.

The Merger of a California corporation into another state corporation requires the corporate formalities, steps, and documents listed below.

- Authorizing Minutes/Consent,
- Agreement of Merger, Certificate of Merger and Certificate of Ownership,
- Preparation of new-state corporate formation and governance documents, and
- Additional items discussed below.

Additional items to consider when preparing to move a California corporation to another state: Before starting a Conversion or Merger into another state, many tax and nontax issues need to be addressed and decided, such as:

- *Coordinating the Relocation.* When will you physically move to the new state? Can the California corporation be converted to the new state before your personal relocation? Will there be a new state physical location and employees established prior to your move to the new state?
- *Existence of Corporate Subsidiary.* Does the California corporation already own a corporation in the new state?
- *Capitalization and Shareholder Ownership.* How many shareholders does the California corporation have? What is the capital structure of the Corporation? Does the corporation have more than one class of stock? Are there any series of stock authorized and outstanding?

³ Prior to Senate Bill 49, (2021-2022), the California General Corporation Law did not authorize a procedure for converting California corporations into foreign corporations.

Silicon Valley Law Group

Conversion of California Corporation to Another State

Page 3

- Accountant. Discuss and plan the Conversion with your accountant and determine whether you need to establish a new accountant in the new-state. Does your accountant have sufficient state and local tax (SALT) expertise?
- Tax Elections. Is the California corporation an S corporation or does it have unique tax elections, credits, or characteristics? If so, consideration needs to be given to determine whether the new state allows S corporation status and to identify the relocation tax ramifications for the unique tax elections and characteristics.
- Corporate Name. Will the Corporation use the same corporate name or another corporate name? Do you want to use another corporate name? Is corporate name available in the new state?
- Corporate Status and Corporate Income Taxes. Is the California corporation in “Good Standing” with the California Secretary of State (i.e., current filing of Statement of Information and all taxes paid)? Has the California corporation filed all of its California Corporate Income Tax Returns and paid all of its California income taxes? California will not allow the filing of the required merger documents if your California corporation is not in good status or there are delinquencies in filing corporate tax returns or payment of taxes.
- Legal Title. Although legal ownership of assets of California corporation transfer to the new corporation by “operation of law,” legal title to some assets, such as patents and automobiles, may need to be formally changed or transferred, including, but not limited to, California Department of Motor Vehicles (and the comparable department in the new state) and the US Patent Office, respectively.
- Licensing. Does the Corporation possess or require unique business or professional licenses (e.g., contractor or professional license)?
 - Will the new state require a business or professional license? (i.e., (i) licenses for the practice of law, accounting, architecture, medical, and other professional licenses, (ii) contractor licenses, or (iii) business licenses?
 - If such licenses are required, is the reciprocity between California and the other state (i.e., Will the other state accept the California license)? If not, have you determined that you can timely secure the necessary licenses in the other state?
- Foreign Corporation Registration in other states. Is the California corporation registered as a “foreign corporation” in one or more other states (other than new state)? Is the California corporation currently registered as a “foreign corporation” in the new state?
- Foreign Sales Taxes, Employment Taxes, Corporate Income Taxes, and Annual Registration Fees. Has the California corporation filed all of its sales, employment, and income tax returns, and paid all outstanding tax payments? Has the California corporation filed all of its annual reports and registrations with taxing

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Conversion of California Corporation to Another State

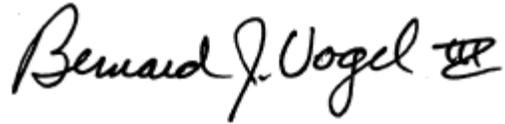
Page 4

authorities of other states in which it does business, and has the California corporation paid all of its annual fees?

- Registered Agent. The new-state generally may require a Registered Agent. The Registered Agent can either be a corporate registered agent (requiring payment of annual fees) or an individual residing in the other state.

If you have any questions or need assistance converting, re-domiciling, or re-domesticating your corporation to another state, please contact me.

Sincerely,

A handwritten signature in black ink that reads "Bernard J. Vogel III". The signature is written in a cursive style with a prominent "B" and "V".

Bernard J. Vogel, III