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Dissolution of Corporations

What to Do When the Start-Up or Business Venture Does Not Work

When you form a corporation, the last thing you are thinking about is dissolution. Regrettably though, some legal entities fail and the founders are faced with tough choices. These choices become tougher when the founders had previously convinced friends and family to invest in their company. Rather than wait until the company has to declare bankruptcy, some opt to voluntarily dissolve a Corporation so that they can return some money to investors. While the exact rules are governed by the Act that governs corporations in each particular State, the following 6 steps outline the general process when one wishes to dissolve a company.

Step 1: Shareholder Vote: The easiest way to voluntarily dissolve a corporation is though a shareholder vote and to the extent that all shareholders eligible to vote are in agreement this will be an easy step. If the shareholders are not in agreement, then either the default rules in the State or the shareholder agreement will govern what is required. (eg. 2/3 majority). To make any vote official, the shareholders should hold a meeting providing proper notice to other shareholders and with all directors present. Someone should record minutes and the minutes should document that notice was provided to the shareholders, propose the voluntary dissolution of the company and record the results of the vote.

Step 2: Tax Clearance: Before a certificate of dissolution can be filed, most States require that you obtain tax clearance. More specifically, you must obtain written consent from the State Department of Taxation that your corporation does not owe any back taxes or returns. To get the necessary consent, you must file a corporate tax return, and if the tax authorities determine you have filed all necessary returns and paid all necessary taxes, it will issue written consent to dissolve your company.

Step 3: Certificate of Dissolution: Once you receive tax clearance a certificate of dissolution is prepared for filing with the State Department. This is a form that is similar to the articles of incorporation and it is a relatively straight forward form.

Step 4: Wind Up occurs. Following dissolution, your corporation continues to exist only for the purpose of taking care of certain final matters and this is often referred to as “winding up” the entity. Wind up activities include:

- fulfilling or discharging corporation contracts
- collecting the corporation's assets & debts

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- selling corporation assets for cash at public or private sale
- discharging or paying corporation liabilities; and
- preparing for the distributing remaining assets among the shareholders according to their respective rights.

Step 5: Notice To Creditors: One other key task is giving notice to creditors and other claimants of your corporation's dissolution. Giving notice is often optional but doing so will help limit your liability and also allow you to more safely make final distributions to shareholders. Under New York Law, at any time after dissolution, you can give notice to all creditors and claimants by publishing a notice once a week for at least two consecutive weeks in a newspaper of general circulation in the county where your corporation's office was located at the time of dissolution. Generally, claimants have around six months after the date of newspaper publication to bring a claim. During this stage, you can also interact with investors and explain the situation.

Step 6: Return of Funds to Investors: To the extent there is more money left in the company, the company can return the remaining proceeds to investors. Normally, preferred shareholders will be paid first and anything left over (usually not anything) will be given to common shareholders.

Keep in mind that Investors may be upset that the company is dissolving and that they are losing money. As such, you are best served to hire a lawyer to navigate you through this process.

For more practical or legal advice contact Scott Legal Services, P.C.. We offer services in a number of business areas including, Immigration, New Business set up, Contract review and development and entrepreneurial support. Call 212-223-2964 or email iscott@legalservicesincorporated.com for a consultation.

Ian E. Scott is a Harvard Law School Graduate, lawyer and author of Law School Lowdown: Secrets of Success from the Application Process to Landing Your First Job. Mr. Scott worked as a corporate litigator in the law firm Cleary Gottlieb and currently runs his own law firm Scott Legal Services, P.C. specializing in Immigration Law & New Business set-up.