

Date of Hearing: June 20, 2022

ASSEMBLY COMMITTEE ON BANKING AND FINANCE  
Timothy Grayson, Chair  
SB 49 (Umberg) – As Amended May 9, 2022

**SENATE VOTE:** Not relevant

**SUBJECT:** Corporate conversions

**SUMMARY:** Establishes a procedure similar to one available to other types of California businesses that allows a California corporation to convert in a single step to a business entity organized under the laws of a different state.

Specifically, **this bill:**

- 1) Establishes procedures for a domestic corporation to convert into a foreign corporation or a foreign business entity.
- 2) Provides that, where a person or entity seeks to enforce an obligation against a domestic corporation that has subsequently converted into a foreign corporation or foreign other business entity, and the entity's designated process recipient cannot be located through due diligence, a court may designate the Secretary of State (SOS) as agent for service of process in an action against that entity. When the notice is served on SOS following the procedures set forth in section 12197 of the Government Code for serving SOS with documents to be served on a business entity, the SOS must provide notice of the service of process to the entity via certified mail with return receipt requested.
- 3) Deletes a redundant provision of law authorizing the SOS to charge and collect a \$150 fee from a business entity converting itself into a different form.

**EXISTING LAW:**

- 1) Establishes procedures for the conversion of domestic corporations into domestic "other business entities." (Corporations Code Sections 1150 through 1157) and for the conversion of domestic other business entities into foreign other business entities or foreign corporations (Corporations Code Sections 15911.01 through 15911.19, 16901 through 16917 and 17710.01 through 17710.19).
- 2) Defines an "other business entity" as a domestic or foreign limited liability company, limited partnership, general partnership, business trust, real estate investment trust, unincorporated association, or domestic reciprocal insurers (Corporations Code Section 174.5).
- 3) Defines a "domestic corporation" as a corporation formed under the laws of California (Corporations Code Section 167) and a "foreign corporation" as any corporation other than a domestic corporation (Corporations Code Section 171).
- 4) Authorizes the Secretary of State to charge and collect a fee of \$150 from a business entity that converts its form (Government Code Section 12184).

**FISCAL EFFECT:** Unknown. This bill is keyed Fiscal by Legislative Counsel.

**COMMENTS:**

1) **Purpose.**

According to the author:

SB 49 will encourage new businesses to incorporate in California rather than another state by streamlining the corporate conversion process, thereby making California competitive with other states.

Business owners often desire to change the form of organization of their business, or the state where they incorporate, to respond to such things as changes in the economy, changes in the business they conduct, or changes in their shareholders' priorities.

These types of changes affect how a business is governed, but do not require the business to physically relocate. The Corporations Code provides California partnerships and limited liability companies (LLCs) with a simple process to change their form of organization, but it does not provide the same flexibility to California corporations. If a California corporation desires to move out of state, they must first convert to a different type of organization, and then take an additional step to move their organization out of state.

For many businesses physically based in California, it is significantly less costly to incorporate in California than in another state. However, new businesses often select the more expensive option of incorporating out of state partially because California fails to provide a statutory procedure for potential future conversions to a foreign (out of state) business entity, even if that flexibility is never ultimately needed. Thus, the use of existing multistep conversion processes results in an even greater expense to a business than incorporating in another state from the beginning.

SB 49 will eliminate this impediment and encourage California business owners to choose a California corporation by streamlining the process for the corporation to convert to a foreign corporation if needed.

2) **Types of businesses.**

When someone starts a business, they must consider the type of business entity to form and where to form it. This decision can depend on a number of business, financial, and economic factors, such as tax and liability issues, ownership concerns, administrative flexibility, and state and federal laws. Common business entities include:

- a) **Corporation:** A California corporation generally is a legal entity that exists separately from its owners. While normally limiting the owners from personal liability, taxes are levied on the corporation as well as on the shareholders. The sale of stocks or bonds can generate additional capital and the longevity of the corporation can continue past the death of the owners.

- b) **Limited Liability Company (LLC):** A California LLC generally offers liability protection similar to that of a corporation but is taxed differently. Domestic LLCs may be managed by one or more managers or one or more members.
- c) **Limited Partnership (LP):** A California LP may provide limited liability for some partners. There must be at least one general partner that acts as the controlling partner and one limited partner whose liability is normally limited to the amount of control or participation of the limited partner. General partners of an LP have unlimited personal liability for the LP's debts and obligations.
- d) **General Partnership (GP):** A California GP must have two or more persons engaged in a business for profit. Except as otherwise provided by law, all partners are liable jointly and severally for all obligations of the partnership unless agreed by the claimant. Profits are taxed as personal income for the partners.
- e) **Limited Liability Partnership (LLP):** An LLP is a partnership that engages in the practice of public accountancy, the practice of law, the practice of architecture, the practice of engineering or the practice of land surveying, or provides services or facilities to a California registered LLP that practices public accountancy or law, or to a foreign LLP. An LLP is required to maintain certain levels of insurance as required by law.

### 3) **Background on conversions.**

Current law allows for some California businesses to convert to another type of business entity, including an out-of-state entity, through a conversion process administered by the SOS. Without this process, a business seeking to change into a different type of entity would either need to close its operations and restart as a new type of business (which can have legal and tax implications) or merge operations with an existing business. The flow of allowable conversions under state law works as follows:

- a) A California corporation can convert to an "other business entity," such as an LLC or LP.
- b) A California "other business entity" can convert to a California corporation or a different California "other business entity."
- c) A California "other business entity" can *also* convert to an out-of-state business, depending on the laws in the other jurisdiction.
- d) An out-of-state business can also convert to a California corporation or a California "other business entity."

While the above menu of conversion options allows for much flexibility, a California *corporation* cannot convert to an out-of-state entity. To do so, the corporation must first convert to a different business entity, such as an LLC, after which they can then convert to an out-of-state entity.

### 4) **Promoting flexibility.**

This bill allows a California corporation to access a simpler process to convert to an out-of-state business entity. At first glance, this bill seems to reduce barriers for companies to move core operations elsewhere. However, the sponsors contend this simpler conversion process, which is already available to other types of California businesses and is standard in other states, will not encourage corporations to leave California. Instead, the sponsors argue this bill will encourage more business to incorporate in California because new companies value flexibility. Moreover, corporations that wish to convert to an out-of-state entity can already do so.

**5) Fee**

This bill repeals Corporations Code Section 1160 which authorizes SOS to charge a fee of up to \$150 for a business conversation. Proponents argue this fee is redundant because Section 12184 authorizes SOS to collect the same fee.

**6) Related legislation.**

SB 288 (Jones), of the 2021-2022 Legislative Session, is substantially similar to this bill and is pending in the Assembly Judiciary Committee.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California Lawyer's Association (sponsor)

**Opposition**

None on file.

**Analysis Prepared by:** Luke Reidenbach / B. & F. / (916) 319-3081