

# Dissolving a Corporation in New Jersey

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**T**here are countless reasons why a corporation may choose to dissolve, from the unfortunate instance where the corporation's business is no longer profitable to the decidedly happy occasion of the profitable sale of its assets.<sup>1</sup> Regardless of the reason, it is important for a corporation to be dissolved properly in order to eliminate or minimize possible personal liability on its directors and shareholders. This article discussed the basic legal requirements and issues concerning dissolution.

## **Board of Directors' Plan of Dissolution and Liquidation**

There are two general methods of voluntarily dissolving a corporation that has been in business. The first method is by obtaining the consent of all voting shareholders by having them sign the certificate of dissolution to be filed with the Department of the Treasury.<sup>2</sup> Under this method, the board of directors is not required to take any action. A notice of dissolution must be given to all shareholders, even those not entitled to vote, at least 10 days, but not more than 60 days, prior to the filing of the certificate of dissolution.<sup>3</sup>

Although this is a simple way to dissolve a corporation, it may not be the best way to do so because it lacks a formal plan of dissolution and liquidation. The absence of such a plan may lead to the personal liability of the directors if, for example, the operations of the business are continued after the filing of the certificate of dissolution.

The balance of this article addresses the second method of dissolution, which is more complex but probably provides

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more protection to directors and shareholders; therefore, it is the preferred method of dissolution. It requires action by both the board of directors and the shareholders.<sup>4</sup>

Under this method, the board of directors prepares and adopts a plan of dissolution and liquidation. The plan sets out in detail the steps to be taken by the corporation in winding up its affairs, liquidating its assets, paying creditors and distributing dividends to shareholders. The board then recommends it to the shareholders by submitting the question of dissolution to a vote of the shareholders.<sup>5</sup>

## **Notice to Shareholders**

Written notice of the shareholders meeting must be given to all shareholders at least 10 days but not more than 60 days prior to the meeting, even to shareholders not entitled to vote (such as owners of preferred stock).<sup>6</sup> The voting shareholders must then vote to approve the plan of dissolution and liquidation.<sup>7</sup> The shareholders may also vote to approve the plan by signing a unanimous written consent of shareholders in lieu of a meeting.

## Vote by Shareholders

If the corporation was organized after January 1, 1969, then only a simple majority of the voting shareholders must approve the plan of dissolution, unless otherwise provided in the corporation's certificate of incorporation. However, if the corporation was organized before January 1, 1969, then a two-thirds majority of the shareholders must approve the plan.<sup>8</sup>

## Certificate of Dissolution and Tax Clearance Certificate

The specific contents of the certificate of dissolution are set forth in the statute. They include, for example, the names of the directors and officers of the corporation and the number of votes for and against dissolution.<sup>9</sup>

The certificate of dissolution must be accompanied by a tax clearance certificate evidencing that the corporation has paid its taxes or has provided for their payment. The tax clearance certificate must be dated within 45 days of the filing date of the certificate of dissolution.<sup>10</sup>

An application for a tax clearance certificate, accompanied by an estimated summary tax return, must be submitted to the Division of Taxation. The applicant must also submit the filing fee and a deposit equal to or greater than the corporation's estimated taxes through the estimated date of dissolution. It is common practice to deposit twice the estimated amount of taxes to expedite the issuance of the tax clearance certificate.<sup>11</sup>

A deposit is not necessary if one of the following scenarios apply: Another corporation agrees to pay all taxes due and certifies that its net worth is at least 10 times the amount of the taxes paid by the applicant during the last complete tax year.<sup>12</sup> Or, a parent corporation undertakes to pay the taxes or a corporation purchasing all or substantially all of the assets of the corporation in

exchange for shares of stock undertakes to pay the taxes.<sup>13</sup>

Under these last two scenarios, an application must be accompanied by an opinion letter from legal counsel stating that the requirements of the statute have been met.<sup>14</sup>

## Post-Dissolution Activities

After the certificate of dissolution is filed, a corporation cannot continue conducting its business, except for the sole purpose of winding up its affairs.<sup>15</sup> All of its activities must be directed towards winding up and liquidating. It may solicit orders and sell its remaining inventory; however, it may not otherwise continue its business activities or engage in new business.

The corporation should sell or otherwise dispose of its assets, except those assets to be distributed to its shareholders, and pay or provide for the payment (by creating reserves) of its debts and liabilities.<sup>16</sup> It should be noted that dissolution does not affect the corporation's assets or liabilities; that is, title to the assets remains in the corporation until the assets are sold or otherwise transferred.<sup>17</sup> Unlike other states, directors in New Jersey do not become trustees of the corporation's assets or obtain title to the assets.<sup>18</sup>

As will be noted later, violations of these legal requirements may result in personal liability to the directors. However, any problem in this area may be avoided by delaying the dissolution until the corporation is ready to terminate all of its business activities.

## Paying or Providing for Payment of Creditors

A dissolving corporation must pay, or provide for the payment of, its debts and liabilities before making distributions to its shareholders.<sup>19</sup> If this is not done, then the directors will be jointly and severally liable to the corporation for the benefit of its creditors.<sup>20</sup>

New Jersey law has a voluntary procedure for barring claims by creditors. Its purpose is to flush out creditors' claims and to bar such claims if they are not made within a specific period of time.<sup>21</sup>

Under this voluntary procedure, a corporation gives notice to its creditors requiring them to present their claims against the corporation within a specified period. The corporation must publish the notice in a newspaper of general circulation in the county where the corporation's registered agent is located. The notice must be published once per week for three consecutive weeks.<sup>22</sup> An affidavit of publication must then be filed with the Department of the Treasury.<sup>23</sup> The corporation must also mail notices to its creditors on or before the first date of publication requiring them to submit written proof of a claim.<sup>24</sup> Merely giving notice to a creditor does not, however, constitute the corporation's recognition of the creditor's claim.<sup>25</sup> Creditors must present their claims against the corporation on or before a certain date, which is not less than six months after the first publication of the notice.<sup>26</sup>

After the specified period, a creditor's claim will be barred, except that the creditor may convince a court to allow the claim because there was a good cause as to why it did not submit a claim within the specified period.<sup>27</sup> This procedure does not, however, bar claims already in litigation as of the date of first publication of the notice.<sup>28</sup>

A creditor includes "all persons to whom the corporation is indebted, and all other persons who have claims or rights against the corporation, whether liquidated or unliquidated, matured or unmatured, direct or indirect, absolute or contingent, secured or unsecured."<sup>29</sup> Therefore, the directors must cause the corporation to pay or provide for every *known* debt, liability and claim, including establishing reserves for any *known* contingent liabilities and unliquidated claims.

If the corporation rejects, in whole or

in part, any claim filed by a creditor, it must mail notice of such rejection to the creditor. If the creditor does not bring suit on the claim within 60 days from the mailing date, the creditor is forever barred from suing on such a claim. The corporation must file an affidavit of mailing with the Department of the Treasury.<sup>30</sup>

### **Possible Personal Liability of Directors**

As previously noted, New Jersey law provides that directors who cause or allow a dissolving corporation to engage in regular business activities, as opposed to winding up activities, are personally liable to shareholders and creditors for any losses that they may suffer.<sup>31</sup> Directors, however, are still entitled to the protection provided by the business judgment rule, which is addressed in detail below.<sup>32</sup>

Directors who do not pay or provide for known debts, obligations and liabilities of the corporation and the payment of all fees, taxes and other expenses incidental to dissolution will be jointly and severally personally liable for these items.<sup>33</sup> Their liability is to the corporation for the benefit of the corporation's creditors and shareholders.<sup>34</sup> Their liability, however, is limited to the value of the assets distributed to the shareholders and only to the extent that the debts and other items are not thereafter paid, discharged or barred (by, for example, the statute of limitations).<sup>35</sup> Moreover, they are entitled to be subrogated to the rights of the corporation against such shareholders.<sup>36</sup> In other words, when a director is found liable, he or she can sue the shareholders who received an improper distribution of assets.

### **Business Judgment Rule**

Notwithstanding the foregoing, directors are not liable if they discharge their duty in accordance with the statutory standard of care for directors. In addition, they are entitled to the protection

provided by the business judgment rule. In other words, they will not be liable if they discharged their duties in accordance with the business judgment rule.<sup>37</sup> Finally, any such action against a director must be started within six years.<sup>38</sup>

New Jersey law requires directors to "discharge their duties in good faith and with that degree of diligence, care and skill which ordinarily prudent people would exercise under similar circumstances in like positions."<sup>39</sup> The business judgment rule provides that in the absence of self-dealing, conflicts of interest, bad faith or fraud, directors are presumed to exercise their judgment in the best interests of the corporation and the court will not second guess the decision.<sup>40</sup>

As one can appreciate from the foregoing, directors must be careful to prepare and execute a detailed plan of dissolution in order to insulate themselves from possible liability.

### **Possible Personal Liability of Shareholders**

Shareholders may also be personally liable if they receive distributions when certain debts or claims have not been paid or provided for by the corporation. In other words, creditors may assert claims against a corporation in dissolution and, to a limited extent, against its shareholders who have received corporate assets in dissolution. Specifically, if the corporation's undistributed assets are insufficient to satisfy the claims, the claims may be asserted against the shareholders to the extent that they receive any assets from the corporation.<sup>41</sup> The courts have likewise noted that creditors may satisfy their claims by following the corporate assets distributed to the shareholders.<sup>42</sup>

In one case, the court held that the shareholders were liable to a creditor to the extent of any corporate assets received by them when the corporation was sued and dissolved before the litigation

was concluded. The court stated that under the circumstances the shareholders held the corporate assets in trust pending the outcome of the litigation.<sup>43</sup>

The foregoing discussion essentially addresses *known* claims. However, unknown claims, such as product liability and environmental claims, are also a concern to corporations in dissolution and their directors and shareholders. With respect to environmental claims in particular, one federal judge in New Jersey has held that the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) does not preempt a state corporate statute and that, therefore, a corporation may not be sued after its assets have been distributed and its affairs wound up under New Jersey statutory law governing corporate dissolution.<sup>44</sup> It did note, however, that this legal principle would not apply when the reason for dissolution is to avoid creditors or potential lawsuits. However, another federal judge in New Jersey held that state law was preempted by CERCLA.<sup>45</sup> It cannot be predicted how a New Jersey state court or another federal judge will interpret the corporate dissolution statute.

There is some repose to shareholders of a dissolved corporation. Thanks to a new law that took effect on August 27, 2001, a creditor is forever barred from suing shareholders of dissolved corporations after five years from the date of dissolution.<sup>46</sup>

Based upon the foregoing, it is clear that a corporation must be both cautious and realistic when preparing a plan of dissolution with respect to creditors' claims in order to avoid any possible personal liability to its directors and shareholders.

### **Distributions to Shareholders**

Distributions to shareholders may be made after the payment or the provision for payment of claims.<sup>47</sup> There is no time

limit on the winding up process.<sup>48</sup> Directors can hold off making distributions to shareholders until the winding up process is complete, or they may make one or more partial distributions during the winding up process.<sup>49</sup>

Partial liquidating dividends can be conditioned on the shareholders' surrender of their stock certificates for endorsement.<sup>50</sup> Final liquidating dividends can be conditioned on the shareholders' surrender of stock certificates for cancellation.<sup>51</sup>

### Other Issues

Although it is beyond the scope of this article, dissolution may raise additional issues, such as environmental and tax issues. For example, a dissolution, much like a sale of real property, a sale of a business, or a change in control of ownership of a corporation, may trigger environmental clean-up obligations under the Industrial Site Recovery Act (ISRA).<sup>52</sup> In addition, dissolution may have significant income tax consequences for the corporation and its shareholders.

### Conclusion

As one can appreciate from the foregoing, a corporation should be dissolved properly in order to eliminate or minimize liability to the corporation as well as possible personal liability to its directors and shareholders. ▽

### Endnotes

1. These examples are found in John R. MacKay II, *New Jersey Business Corporations* 2d, §11-2(b)(1) at 59 [hereinafter MacKay].
2. See N.J.S.A. 14A:12-1(1)(c); 14A:12-3.
3. N.J.S.A. 14A:12-3.
4. See N.J.S.A. 14A:2-1(1)(d); 14A:12-4(1).
5. N.J.S.A. 14A:12-4(2).
6. N.J.S.A. 14A:12-4(3); 14A:9-2(4).
7. N.J.S.A. 14A:12-4.

8. N.J.S.A. 14A:12-4(4).
9. See N.J.S.A. 14A:12-4(6).
10. N.J.S.A. 54:50-14; N.J.A.C. 18:7-14.17.
11. See MacKay, §11-3(d) at 72.
12. N.J.S.A. 54:50-15(c).
13. N.J.S.A. 54:50-13(b); N.J.A.C. 18:7-14.17.
14. N.J.S.A. 54:50-15(b).
15. N.J.S.A. 14A:12-9.
16. N.J.S.A. 14A:12-9(1).
17. N.J.S.A. 14A:12-9(2)(b).
18. N.J.S.A. 14A:12-9(2)(a).
19. N.J.S.A. 14A:12-9(1); 14A:12-19.
20. N.J.S.A. 14A:6-12(1)(c).
21. N.J.S.A. 14A:12-12 & -13.
22. N.J.S.A. 14A:12-12(1).
23. N.J.S.A. 14A:12-12(4).
24. N.J.S.A. 14A:12-12(2).
25. N.J.S.A. 14A:12-12(2).
26. N.J.S.A. 14A:12-12.
27. N.J.S.A. 14A:12-13(1)..
28. N.J.S.A. 14A:12-13(2).
29. N.J.S.A. 14A:12-12(3). See also *N.J. Title Guarantee & Trust Co. v. Berliner*, 136 N.J. Eq. 162, 167 (Ch. 1945) (the term debt includes contingent, even remote, claims).
30. N.J.S.A. 14A:12-14.
31. See *Matawan Bank v. Matawan Title Co.*, 2 N.J. 116 (1949); *Lancellotti v. Maryland Cas. Co.*, 260 N.J. Super. 579 (App. Div. 1992).
32. See N.J.S.A. 14A:6-14.
33. N.J.S.A. 14A:6-12(1)(c) & (d).
34. N.J.S.A. 14A:6-12(1).
35. *Id.*
36. N.J.S.A. 14A:6-12(3)(c).
37. N.J.S.A. 14A:6-12(4).
38. N.J.S.A. 14A:6-13(5).
39. N.J.S.A. 14A:6-14(1).
40. See, e.g., *Johnson v. Johnson*, 212 N.J. Super. 368 (Ch. Div. 1986); *Papalexiou v. Tower West Condominium*, 167 N.J. Super. 516 (Ch. Div. 1979).
41. N.J.S.A. 14A:12-13(1)(b).
42. See *N.J. Title Guarantee & Trust Co. v. Berliner*, 136 N.J. Eq. 162, 167 (Ch. 1945); *ERA v. River Bend*, 284 N.J. Super. 92, 98-99 (Law Div. 1994).

43. See *ERA v. River Bend*, 284 N.J. Super. 92, 98-99 (Law Div. 1994).
44. See *Global Landfill Agreement Group v. 280 Development Corp.*, 992 F. Supp. 692 (D.N.J. 1998).
45. See *Am Properties Corp. v. GTE Products Corp.*, 844 F. Supp. 1007, 1011-12 (D.N.J. 1994).
46. N.J.S.A. 14A:12-13.1.
47. N.J.S.A. 14A:12-16.
48. N.J.S.A. 14A:12-9.
49. N.J.S.A. 14A:12-9(4).
50. N.J.S.A. 14A:12-9(4)(a).
51. N.J.S.A. 14A:12-9(4)(b).
52. N.J.S.A. 13:1K-6 *et seq.*

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