

CORPORATE COMPLIANCE: THE CONSEQUENCES OF LOSING GOOD STANDING STATUS



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FORMING A BUSINESS: RIGHTS & RESPONSIBILITIES

When business owners choose to form a corporation, LLC, or LP, they must file the proper formation papers with their home state and any other states in which they register to do business. The states then essentially grant the right to conduct business as a statutory business entity with all the advantages this brings. To maintain this right, the business becomes subject to a host of business laws and requirements. These include appointing a registered agent, making timely filings of required forms, and paying fees and/or franchise taxes.

As long as businesses comply with all these requirements, they are designated as being in “good standing” on the state’s records, and they keep all the rights and privileges of doing business as a statutory entity.

However, entities that don’t stay on top of their compliance obligations can lose their Certificate of Good Standing. The business will instead be considered “delinquent,” “void,” “suspended” or “dissolved.” The meaning and severity of these terms varies depending on the state, which compliance requirements were failed, and the duration of the failure.



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LOSS OF GOOD STANDING CAN DAMAGE YOUR ABILITY TO DO BUSINESS

All corporations should be aware of the serious consequences that losing good standing status can have, including these actions:

- Possible loss of access to the courts. This may be one of the most serious consequences and one that many are not aware of. In many states, a company that is not in good standing may not bring a lawsuit in that state until good standing is restored.
- Difficulties in securing capital and financing. Most lenders view a loss of good standing as an increased risk and may not approve new financing to a company that is not in good standing.
- Tax Liens. Adverse entity status due to non-payment of taxes can result in a tax lien. Lenders are extremely wary of tax liens since they take priority over other liens.

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- ▶ **Loss of name rights.** Once an entity loses its good standing status, it risks losing the right to use its name in the state. Other companies may be able to acquire the rights to its name while a company is sidelined due to loss of good standing.
- ▶ **Administrative dissolution or revocation.** In a worst-case situation in which a business repeatedly fails to respond to requests for required filings, the company can be administratively dissolved by the home state or revoked by the foreign states.
- ▶ **Fines and penalties.** States impose fines and penalties on companies that don't comply with the requirements that led to the loss of good standing. These can quickly add up, as cash-strapped governments have been steadily increasing their fines and penalties.
- ▶ **Personal liability.** In addition to fines and penalties levied on a company not in good standing, some states also hold individuals personally liable for conducting business on behalf of a company while it has a "revoked" status. These penalties can be severe and levied on each officer, director or employee who knowingly acted on behalf of the non-complying company.

WHAT CAUSES THE LOSS OF GOOD STANDING?

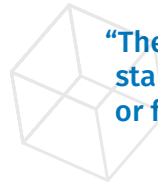
The primary reason a corporation loses its good standing status is that it lets annual report or franchise tax obligations lapse. However, there are many ways this can happen, and many reasons these issues can remain undetected until the worst possible time – for example, at the closing table for an expansion or financing deal.

Voluntary status changes. An entity's status can change several times during its business life-cycle. Status changes that are driven by the business itself frequently trigger new annual report or franchise tax requirements; these include mergers, acquisitions, expanding into new locations or converting entity types. It's also important to note that when closing a business, owners remain liable for all required filings, taxes and penalties until they file official dissolution or withdrawal forms with every relevant state.

States change requirements. States often change deadlines, raise fees, or issue new forms. For various reasons, businesses may not know about the changes – notifications

may not be sent or are directed to the wrong person, or the importance of the communication is overlooked.

Weak internal processes. Maintaining entity status is often not a core responsibility, and is sometimes spread across different departments such as legal, tax and finance. Even in businesses that have designated entity maintenance teams, employees may be relying on tools and processes that are inadequate for monitoring both entity information and state laws and requirements.



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STAY COMPLIANT AND PROTECT YOUR GOOD STANDING STATUS

Regardless of how the compliance failure happened, in the eyes of the state, a business has either met all its corporate compliance obligations and is in good standing, or it hasn't.

Take a proactive compliance stance to keep your business healthy and on track. Businesses have many options today, ranging from web-based tools that support a do-it-yourself approach, to partnering with an expert full-service registered agent to create customized best practices. Evaluate the complexity of your compliance situation. Businesses with simple entity structures may consider interactive, collaborative compliance calendars offered by companies that specialize in corporate compliance. Businesses with many entities doing business in multiple states have exponentially more complex compliance needs. Consulting with specialized service providers can head off status problems before they occur, and empower compliance professionals to proactively manage the risks.

LEARN MORE

[Managing annual report requirements](#) requires constant attention, especially if you have multiple entities across jurisdictions. Learn more about how to efficiently keep all your entities in good standing. Contact a CT representative at 844-682-1582 (toll-free U.S.)

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