STATEMENT OF THE OHIO STATE BAR ASSOCIATION
IN SUPPORT OF HOUSE BILL 301
Before the Senate Judiciary Committee
Senator Nathan Manning, Chair

Chairman Manning, Vice Chair Reynolds, Ranking Member Hicks-Hudson, and members of the Senate Judiciary Committee: On behalf of the Ohio State Bar Association ("OSBA"), I am pleased to offer proponent testimony in support of House Bill 301.

My name is Russ Rosler. I am an attorney and partner with the Vorys, Sater Seymour and Pease LLP law firm, based in our Columbus office. I have been practicing business organizations law for 36 years and I am the head of our firm's Private Company Corporate Practice Group. I am active with the Ohio State Bar Association's Corporation Law Committee, and currently serve as the chair of the OSBA's Limited Liability Company Subcommittee.

I am here today to speak in favor of the portion of House Bill 301 that would amend the law governing tax pre-clearance for certain kinds of transactions affecting Ohio corporations—Section 1701.86 of the Revised Code.

Mandatory "tax pre-clearance" for Ohio corporate transactions is a problem; HB 301 is the solution.

Under the Ohio corporate laws, specific documents must be filed with the Ohio Secretary of State (the "SOS") to effect certain kinds of corporate transactions, including dissolutions, mergers, consolidations and conversions.

In 2013, long-standing Ohio law was changed to require that so-called "tax pre-clearance" by the Ohio Department of Taxation (the "Department") be obtained as a condition to a corporation filing with the SOS the documents needed to effect corporate dissolutions and certain corporate mergers, consolidations and conversions.

Tax pre-clearance is a process by which the Department reviews its records and if, in the Department's judgment, there are any outstanding tax filings or liabilities, the Department will not issue a tax pre-clearance until all such tax filings or liabilities are made and paid.

The Department requires that an application for tax pre-clearance be submitted at least 30 days prior to the date that the corporation intends to file the documents to effect the corporate transaction, but there is no assurance that the Department will issue the tax pre-clearance even within this 30-day period.

The primary timing-related concern is with mergers, consolidations and conversions. These types of transactions often are associated with large, complex, multi-step acquisition, internal

restructuring and financing transactions, as to which a particular sequencing of steps and precise timing is essential. They often involve multiple entities, some of which are Ohio entities and others of which may be organized under the laws of other jurisdictions. The uncertainties and delays of a tax pre-clearance requirement throw sand in the gears of those transactions.

These Ohio-peculiar requirements are not only burdensome but have a chilling effect on businesses organizing as Ohio entities.

By contrast, under Ohio corporate law in effect for decades *prior* to the 2013 change, tax pre-clearance was *not* required. It was sufficient to provide a written notice to the Department stating the scheduled effective date of the corporate transaction and acknowledging that ORC 1701.95 imposes personal liability on (i) directors of a corporation if they vote for a distribution to shareholders without the payment or provision for payment of all known obligations of the corporation and (ii) shareholders of a corporation who knowingly receive unlawful dividends. This was referred to as the "affidavit method". The 2013 amendment eliminated this "affidavit method."

Under the "affidavit method"--which HB 301 would reinstate--a certificate to effect the corporate transaction could be filed with the SOS immediately after providing such written notice to the Department, so there is no governmental delay in effecting the corporate transaction.

The tax pre-clearance burden is unnecessary to protect the economic interests that the Department seems concerned about, as I will describe, and is anti-business. Other states, such as Delaware, do not require tax pre-clearance for these kinds of transactions. As a consequence, businesses may be more likely to form corporations under the laws of Delaware and other states.

In addition to the timing concerns I described, the tax pre-clearance requirement also has the effect of conditioning the dissolution of a corporation on paying back taxes. As a result, an insolvent or bankrupt corporation that does not have the funds to pay outstanding tax liabilities may be effectively precluded from dissolving at all. This could result in an insolvent or bankrupt corporation essentially having a perpetual "zombie" life because it will *never* be able to be dissolved.

It is understood that the Department wants to collect taxes, just like any creditor wants to get paid. But shareholders of defunct corporations should not be required to come out-of-pocket to contribute additional monies to the defunct corporation to pay taxes to obtain the tax pre-clearance required for dissolution. This is contrary to fundamental notions of the corporate shield, is very anti-business, and may have a chilling effect on businesses organizing as Ohio entities.

The economic interests of the Department are fairly protected under other laws, which do not have the effect of jeopardizing corporate transactions the way tax pre-clearance does

The Department is fairly protected in mergers, consolidations and conversions, because the survivor, successor or resulting entity remains responsible for the tax filing and paying obligations of the predecessor entity, by operation of law.

As to dissolutions, the maximum exposure of shareholders to the taxing authorities for unpaid taxes should be the amount, if any, that is paid to the shareholders upon the dissolution. Under other applicable laws--such as the personal liability of shareholders and directors for wrongful distributions under ORC 1701.95, as described previously; the Ohio Uniform Fraudulent Transfer Act (ORC Chapter 1336); principles of bankruptcy laws; piercing the corporate veil common law in appropriate circumstances, the Department already has this protection, just like any other creditor.

Also, certain state and local tax laws impose direct personal liability on responsible officers, and perhaps others, for certain unpaid tax liabilities. This should give the Department additional comfort.

The good news is that the Department of Taxation *agrees* with HB 301. Before HB 301 was finally passed by the House, the Department was consulted and, based on input from the Department, revisions were made in the text to require that the advance notice given to the Department be in form as specified by the Department. With these changes, we understand that the Department is agreeable to the language of HB 301.

Conclusion

In conclusion, the right solution is HB 301, which would revert to the long-standing prior concept of the affidavit method, on the grounds that (i) the Department has fair economic protection under other applicable laws, (ii) the requirement of obtaining tax pre-clearance is unduly burdensome on time-sensitive transactions because it creates delays and unpredictability, (iii) the requirement of obtaining tax pre-clearance may be impossible for an insolvent or bankrupt corporation and (iv) the Department of Taxation is on board with the language.