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# End of the Calendar Year: A Good Time to Confirm Compliance Issues for Businesses

10 Dec 2019

**Erica L. Litovitz**, **John J. Matteo**

Corporations, limited liability companies (LLCs), and other business entities are certainly aware of the need to make certain end of year decisions for income tax purposes, but it also is a good time to perform a business audit for possible state, local, and personal property tax return deadlines.

It is also advisable for businesses to review other corporate compliance issues, such as training for board members to insure they are performing their legally required obligations. These types of reviews will not only secure a company's good standing, but will create an atmosphere of compliance that can protect against unexpected claims and personal liability of owners. This article highlights just a few of the areas business owners should be considering about their companies and why the information is so important to insure compliance with existing law.

## IS MY COMPANY IN EXISTENCE AND IN GOOD STANDING IN ALL JURISDICTIONS WHERE IT OPERATES?

A company cannot conduct business in any area unless it validly exists in that jurisdiction and remains in good standing. Corporations and LLCs exist upon the filing of articles of incorporation/organization with and acceptance by the appropriate government agency. Businesses that operate in more than one jurisdiction also must register or seek authorization to operate in every jurisdiction in addition to its original state of organization.

Business entities must also ensure that they remain in good standing. To remain in good standing after filing articles of incorporation/organization or registering to do business in a given jurisdiction, a company must satisfy six general requirements. First, it must maintain a registered agent for service of process in that jurisdiction. Second, the company must have paid all fees and penalties owed to the government of the jurisdiction in connection with any corporate filings. Third, it must be up-to-date on its annual or biannual reports (as described in greater detail below). Fourth, it must be up-to-date on all requisite tax returns. Fifth, the state's records must not reflect that the entity has been dissolved. Finally, no dissolution proceeding can be pending against the entity. An entity that satisfies all the foregoing requirements will generally be considered in good standing.

### Corporate Filing Requirements in Local Jurisdictions

All three local jurisdictions require corporations to file annual or biennial reports.

- The District of Columbia requires companies to file biennial reports, which must include certain information about the company. In the past, the District of Columbia sent notices and forms to every licensed business; however, that is no longer the case and companies are now responsible for filing online. The first biennial report must be filed by April 1 following the company's date of formation or registration in the District of Columbia. Thereafter, biennial reports must be filed by April 1 of alternating calendar years.
- Maryland requires each company to file a report annually no later than April 15 of each year.
- Virginia requires all companies to file annual a company must file its first annual report before the last day of the twelfth month after it was incorporated or authorized to do business in Virginia. Annual reports must be filed by the same date in each subsequent year.

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### Personal Property Tax Returns

All the local jurisdictions require business entities to file personal property tax returns.

- The District of Columbia requires every business that owns personal property in the District or holds it in trust to file a District of Columbia personal property tax return (Form FP-31) on or before July 31 of each year.
- Maryland requires all companies to file personal property tax returns on an annual basis and they must be submitted no later than April 15 each year. The state recently changed its rules and now allows for one common form to be filed for a company's annual report and personal property returns.
- In Virginia, personal property taxes are determined at the local county level.
  - Arlington County imposes a tax on most tangible personal property, including furniture, machinery, tools, and computer equipment. All corporations in Arlington County must file annual Business Tangible Personal Property Returns no later than May 1 of each year, covering all tangible personal property the corporation owned, leased, or had in its possession in Arlington County as of January 1 of the current year.
  - Fairfax County follows a similar rule. Business furniture and fixtures, machinery, tools, and computer equipment that are located in Fairfax County as of January 1 each year must be declared on county tax forms, which must be filed with the Fairfax County Department of Tax Administration by May 1 of each year.

### Consequences of Losing Good Standing Status

Companies that lose their good standing status face a range of serious consequences. For example, the company cannot file suit in that jurisdiction until its good standing is restored. Loss of good standing for failure to pay taxes may result in a tax lien. A company not in good standing may be subject to civil fines and penalties that must be paid before its good standing will be restored and can be costly if the company needs to be reinstated. The state may even revoke the company's charter and administratively dissolve the entity. Every company should confirm on an annual basis that it is in good standing so that it can lawfully continue to carry on its business and affairs.

If a company is in fact revoked and continues to operate, the penalties can be more than just the cost of paying late fees. In many jurisdictions, officers and directors who continue to conduct business on behalf of a revoked business entity subject themselves to personal liability. District of Columbia courts have held that when a director or officer is found to be personally liable for the acts of a revoked entity, even reinstatement of the entity will not relieve that director or officer of personal liability.

## CORPORATE FORMALITIES

### Basic Requirements: Boards, Meetings, Elections, and Recordkeeping

One advantage that LLCs have over corporations is that LLCs have fewer corporate formalities with which they must comply. In that sense, LLCs are more akin to partnerships than corporations.

Every corporation must have a board of directors, unless a shareholder agreement eliminates that requirement. However, all nonprofit corporations cannot eliminate this requirement. The board of directors has the authority to exercise the entity's corporate powers and to manage its affairs and activities. The corporation's articles of incorporation or bylaws should set forth the number of directors that will serve on the corporation's board.

Directors are elected by the shareholders at the annual shareholder meetings. The initial directors serve until their

successors are elected at the first shareholders' meeting. Otherwise, each director serves for the term specified in the bylaws. Unless otherwise provided by the articles of incorporation, the shareholders may remove any director with or without cause. However, they can only do so at a special meeting called for the purpose of removing such director.

Directors may hold both annual meetings and special meetings. At the absolute minimum, the board must hold an annual meeting at least once a year. It is imperative that the board prepare minutes of each board meeting, which operate as an official account of any actions taken by the board at the meeting. Unless the bylaws provide otherwise, the minutes of every meeting should be filed in the corporation's minute book. In addition to board meeting minutes, the corporate record book should include minutes of all shareholder meetings, records of all actions taken by the directors or shareholders without a meeting, and records of all actions taken by a committee of directors in lieu of the board. The corporation should also maintain appropriate accounting records. Finally, the corporation must maintain a record of its shareholders, including their names and addresses, that clearly sets forth the number of shares held by each.

The corporation's bylaws should expressly identify the types of officers the corporation will have. The board is responsible for electing the corporation's officers, unless the bylaws authorize one of the officers to appoint other officers.

Larger corporations are likely very familiar with these requirements, but often closely held and family owned corporations with a minimal number of owners are not as strict about holding meetings and documenting actions of the corporation, which can lead to other consequences.

## Action by Meeting or Resolution

Action by the board of directors is typically taken at a board meeting. The board cannot take action at any meeting unless a quorum of directors is present. Unless the corporation's governing documents provide otherwise, a quorum of directors means a majority of the directors on the board. So long as a quorum is present, the affirmative vote of a majority of directors present at the meeting will constitute an act of the board, unless a different vote is specified by the corporation's governing documents.

However, unless the corporation's governing documents require certain types of actions to be taken only at a meeting, the board may also act by resolution without holding a meeting. Action without a meeting requires the unanimous written consent of all directors. If the resolution does not have the unanimous consent of the directors, it is not an action of the board. A unanimous resolution of the board has the same effect as action taken at a meeting of the board of directors.

## Fiduciary Duties

The officers and directors of a corporation owe fiduciary duties to the corporation and its shareholders. In some jurisdictions, the managing members of an LLC may owe similar duties to the non-managing members. The two principal fiduciary duties are the duty of loyalty and the duty of care. The scope of the duties and responsibilities owed by corporate fiduciaries is defined by the courts rather than by statute. However, directors or officers who violate those duties expose themselves to potential personal liability.

## The Duty of Loyalty

The fundamental principal behind the duty of loyalty is avoiding conflicts of interest. Specifically, there should be no conflict between a director's self-interest and his loyalty to the corporation. Most litigation involving alleged violations of the duty of loyalty occurs in one of two contexts: interested director transactions and usurpation of corporate opportunities.

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The classic interested director transaction occurs when a corporation enters into a contract with a company that is owned by one of its officers or directors. For example, if one of the directors owns a landscaping company, and the corporation decides to retain that particular company for its landscaping needs, the director who owns that company is considered an interested director. However, a transaction is not automatically void simply because of a conflict of interest. If a director has a conflict of interest, he should immediately and fully disclose the conflict to the board and should be disqualified from voting on any issues relating to the transaction. It is imperative that the disclosure and the disqualification are appropriately documented in the corporate minutes.

Interested director transactions are permissible so long as certain criteria are satisfied. In the District of Columbia, an interested director transaction is effective if, after the requisite disclosures have been made by the interested director, the transaction was either: approved by the majority of disinterested directors who voted on the matter; approved by the majority of votes cast by qualified shareholders entitled to vote on the matter; or adjudged by a court of law to have been fair to the corporation.

Usurpation of a corporate opportunity occurs where a director or officer uses his or her position within the corporation for personal gain at the corporation's expense. If an officer or director is faced with a corporate opportunity, he or she must not take advantage of the opportunity unless he or she first brings it to the corporation's attention and offers the opportunity to the corporation. The director or officer should be disqualified from voting on any matters relating to the corporate opportunity. If the corporation rejects the offer, the director or officer may then proceed with the opportunity. The disclosure and offer of the opportunity the corporation, the director/officer's disqualification from voting, and the corporation's rejection of the offer should be carefully documented in the corporate minutes.

## The Duty of Care

The duty of care requires directors and officers to act in good faith and in a manner that they reasonably believe to be in the best interest of the corporation. This requires them to use the same level of care that a reasonably prudent person would be expected to exercise under similar circumstances.

To satisfy this requirement, directors and officers must adequately inform themselves of all facts necessary to reach a reasoned decision. Thus, directors must disclose to the other board members any information not already known by them that the director knows is material to the board's decision making or oversight. Directors who do not have knowledge may rely on information, opinions, reports, or statements of the board's attorneys, accountants, or other professionals retained by the corporation to the extent that the director believes such persons have the expertise needed to opine on the matter. A director may also rely on a committee appointed by the board if he or she believes the committee merits confidence. Finally, a director may rely on an officer or employee of the corporation if the director reasonably believes such person to be reliable and competent with respect to the information he or she is providing.

Examples of violations of the duty of care include failure to attend meetings, failure to keep oneself informed, failure to prevent harm to the corporation, make reasonable inquiries or adequately monitor, adequately supervise, and negligent appointment or retention of untrustworthy or incompetent officers.

## Ramifications of Breaches of Fiduciary Duties

Failure to maintain corporate formalities can result in officers and directors being held personally liable for the obligations of the corporation. This occurs in situations where there is such a unity of interest and ownership that the separate personalities of the corporation, on the one hand, and its individual officers and/or directors, on the other hand, cease to exist. Courts refer to this concept as piercing the corporate veil. The determination of whether to pierce the corporate veil is heavily fact-specific, and the factors that go into the analysis vary based on the circumstances. A few of

the more common factors that weigh in favor of piercing the corporate veil and imposing personal liability on an individual officer or director include:

- Undercapitalization or insolvency;
- Failure to observe corporate formalities or maintain adequate books and records;
- Using the corporation to deceive or defraud creditors;
- Commingling corporate funds or assets; and
- Diversion of corporate funds or assets.

Irrespective of alter-ego situations in which the corporate veil is pierced, any director who votes for or agrees to an excess distribution is personally liable to the corporation for the amount of the distribution in excess of what the corporation was authorized to distribute.

With respect to nonprofit corporations that maintain at least a certain amount of liability insurance coverage, an officer or director serving in such capacity as a volunteer is immune from civil liability unless the injury to the nonprofit resulted from: (i) the volunteer's willful misconduct; (ii) a crime, unless the volunteer had reasonable cause to believe it was lawful; (iii) a transaction that resulted in an improper personal benefit to the volunteer; or (iv) an act or omission not in good faith and beyond the scope of the nonprofit's authority.

While nonprofit employees who serve as officers or directors of the nonprofit do not enjoy the same immunity, their liability for injury to the corporation is limited to the amount of compensation they received from the nonprofit in the preceding twelve months, unless the injury to the nonprofit resulted from: (i) the employee's willful misconduct; (ii) a crime, unless the employee had reasonable cause to believe it was lawful; (iii) a transaction that resulted in an improper benefit to the employee; or (iv) an act or omission that was not in good faith and was beyond the scope of the nonprofit's authority. The foregoing limitations of liability do not exempt the nonprofit entity from liability; however, the nonprofit is only liable to the extent of the applicable limit of the insurance coverage it maintains.

### Personal Liability of Certain Officers and Directors for Payroll Taxes

Directors and officers who are responsible for the accounting of and paying for payroll taxes can be held personally liable for failure to do so. An officer or director is responsible for payroll taxes if he or she has the duty to account for, collect, and pay over the taxes to the government. Of note, personal liability will not attach simply because of a person's corporate title. Rather, an officer or director will only be personally liable for unpaid payroll taxes if he or she had a duty to account for, collect, and pay over the taxes to the government.

## OTHER COMPLIANCE ISSUES

These are just a few highlights of what would constitute a good corporate review; many are tied to specific dates. Other areas that should be reviewed are whether your business has engaged in properly training your employees, including training on avoiding sexual harassment in the workplace. Many states are beginning to require a variety of workplace training as a condition for operating a business.

## ADVICE FOR ALL COMPANIES

All companies would be wise to seek out their legal and accounting advisors to assist in answering what laws apply to their businesses and in which jurisdictions to assure they are in compliance. They would also be well served to make it a practice to conduct these types of business audits on an annual basis and to properly train their boards, officers, and staff on compliance issues regardless of their size or the nature of their business.

*Jackson & Campbell's Business Law Practice Group regularly advises for profit and nonprofit/charitable business of all sizes on formation, compliance, and regulatory issues across a wide spectrum of operating procedures. This advice also has included board training sessions on their fiduciary duties, and company-wide training on employment and related matters. Please contact John Matteo, Chair of the Business Law Practice Group at jmatteo@jackscamp.com or Erica Litovitz at elitovitz@jackscamp.com for further information or to schedule a training session for your company.*

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## Fiduciary Duties

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**TAGGED:** washington dc, maryland, nonprofits, Corporations, limited liability companies, business entities, District of Columbia, duty of loyalty, duty of care, LLC, Corporate Filing Requirements, Virginia, biennial reports, Annual Reports, property tax return (Form FP-31), l Business Tangible Personal Property Returns, Arlington County, Fairfax County, Fairfax County Department of Tax Administration, Corporate Formalities, Boards, Meetings, Elections, and Recordkeeping, Corporate Requirements, Corporate Bylaws, Fiduciary Duties, Breaches of Fiduciary Duties, Payroll Taxes