

# ANNUAL CORPORATE CHECKLIST

2017

There are numerous requirements to operate a business in the State of California. This annual corporate checklist has been prepared to remind private corporations of some of the requirements that should be considered on an annual basis. The information is intended to present a broad guideline and is not exhaustive of the various details required to operate a business in California.

# CORPORATE MATTERS

COMPLETED N/A

## 1) ANNUAL MEETINGS

Have you held meetings for the shareholders and the board of directors? Annual meetings of the shareholders and the board of directors are required for corporations to elect directors and appoint officers. Holding such meetings is an important step in avoiding the piercing of the corporate veil, where a corporation's limited liability shield may be voided by a court, resulting in the shareholders being held personally liable for its debts and liabilities. Many corporations may use an action by written consent in place of an actual meeting.



## 2) STATEMENT OF INFORMATION

Have you filed a Statement of Information? Each California corporation (or foreign corporation authorized to conduct business in California) must file a Statement of Information with the Secretary of State prior to the end of the calendar month in which its original Articles of Incorporation (or original Statement of Designation by Foreign Corporation) were filed. A corporation is required to file this statement even though it may not be actively engaged in business at the time the statement is due. Failure to file a Statement of Information will result in the assessment of a penalty and may result in your company becoming suspended by the State of California. A suspended corporation may not sue or defend a lawsuit, do business in California and contracts made by such entity can be voided at the option of the other party.



## 3) PERMITS AND LICENSES

Does your business have all of the required permits and licenses? Are they current? Certain trades are directly regulated by federal, state and local governments. Many cities require a permit to conduct business. Failure to obtain and maintain such permits and licenses can have severe consequences, including fines, penalties and shutting down your business.



## 4) QUALIFICATION TO DO BUSINESS

If you are a California business and have conducted or are considering conducting business in states outside of the State of California, you should determine whether it is necessary to register to do business in such states. Foreign corporations must make the same determination regarding operations in California. A company not qualified to do business in a state in which it conducts business may be subject to serious restrictions, including a prohibition from suing or defending a lawsuit, fines, penalties, personal liability for officers or agents and contracts being voided at the option of the other party.



## 5) AUTHORIZED SHARES

Have you issued additional shares or options in the last year? The number of shares authorized to be issued by a corporation is set forth in its Articles of Incorporation. Likewise the number of options to be issued under equity plans are limited by such plans. If you have issued shares, options or other equity awards during the year you should confirm that you have not issued more shares than have been authorized. In each case appropriate securities filings or exemptions will be required. Even if you have not exceeded the limit, you may consider increasing such limits should your business plan call for future issuances. A current capitalization table showing all outstanding securities may be useful.



## 6) STOCK VALUATION

Have you obtained a recent independent appraisal of the value of your stock? Some shareholder buy/sell agreements require that the company obtain a yearly valuation of the company's stock in the event a buy/sell event occurs. Additionally, appraisals by an independent appraiser for purpose of complying with Section 409A of the Internal Revenue Code are only valid if made within 12 months of the date for which the stock value is being determined. Failure to obtain such a valuation could result in shareholder disputes or unintended tax consequences to employees receiving equity awards.

## CORPORATE MATTERS

COMPLETED N/A

### 7) NUMBER OF DIRECTORS

Have you appointed the proper number of directors? California law generally provides that the minimum number of directors of a corporation shall not be less than three, except when there are two or less shareholders, in which case the number may be less depending on the circumstances. Ensure you have the proper number of directors so that your corporate actions have been validly approved.



### 8) NUMBER OF SHAREHOLDERS

Do you know how many shareholders you have? The number of shareholders your company has may have an important impact on business. Companies that have \$10 million in assets and 2,000 shareholders of record (or 500 shareholders who are not accredited investors) are required to register with the Securities and Exchange Commission ("SEC") and are subject, among other things, to the SEC's reporting requirements. Additionally, companies with more than 100 shareholders are ineligible for S Corporation Status. See also "S Corporation Status" below.



### 9) CONTRACTS

A regular review of all contracts' terms is advised. For example, you will want to know if a contract is due to lapse or needs an execution of an option to extend. This is especially important in healthcare.



## TAX MATTERS

COMPLETED N/A

### I0) ANNUAL FEDERAL TAX RETURN

Have you timely filed your income tax return? Federal corporate returns for: (i) S Corporations are due annually on the fifteenth day of the third month after the company's tax year ends (March 15th for calendar year end corporations); and (ii) C Corporations are due annually on the fifteenth day of the fourth month after the company's tax year ends (April 15th for calendar year end corporations). A six-month extension of time to file is available for both S Corporations and C Corporations. The S Corporation's income and losses pass through directly to and are reported by the shareholders on their personal income tax returns. Failure to timely file tax returns may result in penalties and interest.



### II) ANNUAL STATE FRANCHISE TAX RETURNS

States require companies registered in or conducting business within the state to pay franchise taxes and file a state franchise tax return. In some states, franchise tax may apply to sales into the state, even via the internet. Failure to pay franchise taxes (including for all subsidiaries) may result in the state suspending your company from transacting business. If you are conducting business in states outside your state of formation, you should determine whether it is necessary to file franchise tax (or income tax) returns in such other states.



### I2) EMPLOYMENT TAX DEPOSITS AND RETURNS

Care must be taken to properly withhold federal and state employment taxes, and to timely remit the deposits and file associated returns. Failure by the company to withhold and remit employment taxes may result in personal liability for individual shareholders, officers, and directors.

# TAX MATTERS

COMPLETED N/A

### 13) STATE BOARD OF EQUALIZATION RETURNS

Sales and use tax applies to the retail sale of, or use or consumption of, tangible personal property in California. Most retailers, even occasional sellers of tangible goods (generally, those having more than 2 sales of tangible personal property in a calendar year), should register and obtain a seller's permit to collect sales or use tax. Failure to properly collect and remit sales and use taxes can result in significant penalties, interest and even personal liability. A "Qualified Purchaser," defined as a business or person that earns gross receipts of over \$100,000 per year, and not otherwise required to register with the State Board of Equalization to collect sales and use tax, must register and report and pay use tax on purchases from out of state retailers.



### 14) S CORPORATION STATUS

IRS Form 2553 (Election by a Small Business Corporation) is filed with the IRS to make the S election. If the election is not filed within the 15th day of the third month of your company's formation (approximately 75 days), the election will generally become effective on the first day of the company's tax year after the year the election was filed. This can result in unintended income tax consequences, and care should be taken to file the election by the deadline to avoid these consequences. In certain cases, relief exists for late filings and for defective filings. The most common reason an S election is defective is because one or more spouses having a community property interest in shares of the corporation fails to sign the consent portion of the election. Care must also be taken to properly maintain your S Corporation status. S corporation status automatically terminates if any event occurs that would have prohibited the company from making its initial S Corporation election, including: (i) transferring or issuing stock to ineligible shareholders, such as nonresident aliens, ineligible trusts, or other entities such as any corporation, partnership or limited liability company (unless the LLC is a single-member LLC that is a so-called "disregarded entity" for income tax purposes); (ii) having more than 100 shareholders; (iii) having more than one class of stock (however, voting and non-voting stock is permitted so long as the 2 classes are treated identically for all economic purposes); or (iv) excessive passive income in three consecutive tax years, if the company had previously been a C corporation and still has earnings and profits (i.e., a tax concept similar but not identical to retained earnings for accounting purposes). Inadvertent termination of S Corporation status that is not timely resolved will result in the company being taxed as a C corporation as of the date of such event, resulting in possible double taxation. If not caught quickly, the potential tax liability can be substantial.



### 15) RECEIPT OF RESTRICTED STOCK - §83(B) ELECTIONS

Has the company issued any restricted stock to service providers during the tax year? The stock recipient's recognition of ordinary compensation income attributable to such stock is delayed if on the date the stock is received (e.g., issuance by the corporation or upon exercise of a nonqualified stock option) the stock is both subject to a substantial risk of forfeiture and not transferable (i.e., unvested). When this tax treatment applies, the stock recipient should consider making an §83(b) election to accelerate the recognition of income to the date of stock receipt, in which case post-election appreciation in the stock should be taxed at capital gain rates. The election is generally beneficial where the value of the stock is low at the time of receipt and is expected to increase significantly in the future. To be effective, the election must be filed with the IRS within thirty (30) days of receipt of the stock, and a filing after the 30-day deadline generally cannot be remedied. An S corporation may issue stock options, but the options generally should meet certain requirements set forth in regulations.

# TAX MATTERS

COMPLETED N/A

**16) INFORMATION REPORTING**

In addition to tax return filings, there may also be information reporting requirements. For example, (i) IRS Forms 1099 must be filed in connection with payments of \$600 or more during the year to certain vendors, (ii) IRS Form 3921 must be filed, and information must be given to the shareholder, in connection with any stock issued pursuant to the exercise of an incentive stock option, and (iii) information returns may be required to be filed if the company owns foreign assets or foreign entities, or has one or more foreign shareholders (e.g., Forms 5471 and 5472). Withholding and information reporting may also be required with respect to payments to nonresident individuals or foreign entities.

**17) CHANGE IN OWNERSHIP OF ENTITY**

Has any one person or entity acquired control (more than 50% ownership) in your company through one or more transactions (a “Change of Control”)? Or have the original shareholders of your company cumulatively transferred more than 50% of the company in one or more transactions (a “Change in Ownership”)? If a Change of Control or Change of Ownership occurs and your company owns California real property, a Form BOE-100-B, Statement of Change in Control and Ownership of Legal Entities, must be filed with the State Board of Equalization within ninety (90) days from the date of the Change of Control or Change in Ownership. Depending on the California county in which the property is located, the corporation may also have to file a new deed and pay documentary transfer taxes on the net value of the property at the time of the Change in Control or Change in Ownership. Failure to timely file the required documentation results in an automatic penalty assessment. If the corporation has tax loss or tax credit carryforwards for income tax purposes that are a valuable asset of the corporation, great care should be taken to ensure that a Change in Ownership of the corporation over any rolling 3-year period does not occur, as such could greatly limit the corporation’s ability to use the carry forwards following the Change of Ownership.

# EMPLOYMENT MATTERS

COMPLETED N/A

**18) NUMBER OF EMPLOYEES**

If the company has experienced a change in the number of employees, attention should be given to whether certain provisions of law now need to be followed, or no longer followed. For example, employers with 5 or more employees are subject to the California Pregnancy Disability Leave provisions and disability accommodation and “interactive process” provisions of the Fair Employment and Housing Act; employers with 25 or more employees must provide leave for drug/alcohol rehabilitation and allow parents to take certain time off for child school conferences; the supervisors of companies with 50 or more employees must attend sexual harassment training every two years; and employers with 50 or more employees must adhere to the federal Family and Medical Leave Act and the California Family Rights Act. If the company’s complement of employees rises above the threshold (part-time employees are not always counted), new requirements may be mandated. If the number has dropped below the threshold, the company may prefer to no longer adhere to the specific requirement.

# EMPLOYMENT MATTERS

COMPLETED N/A

**19) EMPLOYEE HANDBOOK/PERSONNEL POLICIES AND PROCEDURES**

Have your handbook and policies been audited/reviewed recently for compliance with new legal requirements? Does the company follow policies that are no longer required? Do you adhere to the requirements of new statutes or regulations, such as those associated with personnel file inspections? Does the company follow the requirements for the panoply of leaves required by the California Labor Code, ranging from juror and election day leave, to civil air patrol leave, to organ and bone marrow donation leave, to lactation time, to literacy leave, to military leave? Have the company's hiring documents been updated as they relate to background checks to comply with federal and state law so as to avoid privacy claims? Have human resource personnel audited personnel files to make sure all personnel have signed hiring documents including "at-will" agreements and any arbitration agreements?

**20) WAGE AND HOUR ISSUES**

Has the company recently reviewed its employment policies as they pertain to wage and hour requirements? California employment law is complex and detailed and is the source of countless wage and hour class actions, which often result in significant wage liability, penalties, interest, and attorney fees. The company should periodically review its policies and procedures as to wage and hour requirements including timekeeping, time records, and meal/rest periods. Is the company complying with the new requirements for paid sick leave (PSL)? Does the company have employees working in one of the municipalities that has its own more expansive PSL ordinances? Is the overtime rate of hourly employees properly calculated and applied? Is the company's vacation/PTO policy unlawful under state law and is vacation/PTO paid out on the final paycheck? Are paystubs compliant with California requirements? Are employees properly classified as hourly (non-exempt) or salaried (exempt)? Are exempt employees paid the increased minimum monthly salary based on the higher minimum wage for hourly employees? Are your "independent contractors" properly so classified, or should they be employees? Have you filed with the state reports of new employees and of new independent contractors? Even if personnel were properly classified at one time, has the nature of the job changed to the point that the company is exposed to liability for misclassification? Does the company adhere to the requirement that commissioned employees have written commission agreements?

**21) CONFIDENTIALITY/NON-COMPETE/NON-SOLICITATION AGREEMENTS**

Have appropriate personnel signed confidentiality agreements to protect the company's trade secrets and private information as well as to prevent employees from using the confidential information of prior employers? Are the company's non-solicitation agreements drafted to maximize protection but avoid running afoul of the California law prohibiting unlawful non-compete agreements?

**22) WORKER'S COMPENSATION INSURANCE**

Has the company secured workers' compensation insurance? California law mandates such insurance no matter the number of employees. Violation is a criminal offense punishable by a fine of up to \$10,000 or imprisonment for up to one year, or both. The state may also impose penalties of up to \$100,000.

**23) TERMINATION OF EMPLOYMENT**

Has final pay (including vacation/PTO, and commissions and bonuses) been timely computed and tendered to the departing employee? Have departing employees completed all agreements and other documents for the assignment of IP developed in the employment? Have they been reminded of their confidentiality and trade secret obligations?

# INTELLECTUAL PROPERTY MATTERS

COMPLETED N/A

## 24) NEW TRADEMARKS

Has the company begun to use any new names, marks, logos, trade dress for which trademark registration has not been sought? If so, the company should consider filing for trademark protection. Failure to file for trademark registration in a timely manner could allow another party to file for the mark and expose the company to potential litigation, either to fight for its marks or to defend an infringement claim that may be brought by a registrant of the mark or a confusingly similar mark.



## 25) INTENT TO USE TRADEMARKS

Has the company begun to use any new names, marks, logos or trade dress for which an Intent to Use trademark application has been previously filed? If so, the company should file samples of the use with the USPTO to demonstrate usage in commerce.



## 26) NEW PATENTABLE TECHNOLOGY

Has the company developed any new technologies, ideas, materials, processes and other information which could be the subject of a patent application? If so, the company should consider applying for immediate patent protection. Public disclosure of intellectual property before filing a patent application can prevent the company from obtaining foreign patent protection later and limit the time you have to file in the U.S. If you have patentable technology, ensure it is protected before you show it to anyone.



## 27) REGISTRATION FEES

Have all patent or trademark registration fees or other maintenance obligations been complied with? Failure to pay such fees and/or comply with maintenance obligations can result in abandonment of the registration and loss of all related intellectual property rights. Reinstatement, when possible, can be difficult and expensive.



## 28) TECHNOLOGY ASSIGNMENTS

Have any employees, contractors or other third parties developed or made any contribution towards any new technologies, ideas, materials, processes and other information of the company? If so, have agreements assigning all intellectual property rights to the company been executed by such parties? Failure to obtain such assignments, especially upon termination of employment, can result in unclear title to the company's intellectual property assets, an issue that may expose the company to potential lawsuits and scare off potential investors and acquirers.



## 29) LICENSE COMPLIANCE

Is the company in compliance with all current license agreements or any other agreement having an impact on the company's technologies and intellectual property? Failure to comply with such agreements could cause the company to be in breach and jeopardize the company's ability to continue using the underlying licensed technology.



## 30) PRIVACY POLICIES

Do you have an up to date privacy policy? California law requires operators of commercial web sites or online services that collect personal information on California residents through a web site to conspicuously post a privacy policy on the site and to comply with its policy. The privacy policy must, among other things, identify the categories of personally identifiable information collected about site visitors and the categories of third parties with whom the operator may share the information.



## 31) NON-DISCLOSURE AGREEMENT

Do you have a form non-disclosure agreement? This agreement is useful whenever you discuss important information about your company. Failure to use agreement when disclosing confidential information can be harmful to the business.

# REAL ESTATE AND LEASING MATTERS

COMPLETED N/A

## 32) RENTAL ADJUSTMENTS

Are you subject to any applicable rental adjustments under your lease? Rental adjustments typically occur on the anniversary of the commencement date of the lease or every few years after the commencement date of the lease. Rental adjustments should be factored in when budgeting for the new year.



## 33) SIZE OF SPACE

Does the company have too much space or insufficient space? You may be able to negotiate adjustments in your lease to provide you with the necessary space.



## 34) PROPERTY INSURANCE CARRIED AS AN OWNER

If your lease requires you to carry property insurance, or you own your building, are you carrying adequate amounts of property insurance? If your building is damaged or destroyed, you may not have adequate insurance for the repair or reconstruction of the building, exposing your company to pay for the shortfall.



## 35) RENTAL DEADLINES

Are there any upcoming deadlines for extension options or rights of first refusal for extending the lease term, renting additional space or purchasing your premises? If these dates are missed, typically, the rights expire.



## 36) RENTAL COMPETITORS

Has your landlord rented space to a competitive business in violation of an exclusive use provision in your lease? If so, you may have remedies in your lease, such as a reduction in rent or a right to terminate the lease.



## 37) LIABILITY INSURANCE

If you are leasing space, are you carrying adequate liability insurance so that you are not in violation of the terms of the lease? If you own your premises, are you carrying adequate liability insurance so that you are not in violation of the CC&RS or any other recorded documents? Carrying insufficient liability insurance may expose you to the negligent actions of your employees.



## 38) OPERATING EXPENSE STATEMENT

If you are leasing space, have you reviewed the year end statement for annual operating expenses and considered requesting an audit if there are discrepancies? Some leases permit such an audit to be performed. Operating expenses can be cumbersome and confusing and you may be paying an amount in excess of what your lease requires.



## 39) LANDLORD PROPERTY INSURANCE

If your lease requires the landlord to maintain property insurance, do you know whether your landlord is maintaining adequate insurance? If your building is damaged or destroyed and your landlord is required to repair or reconstruct the building, your landlord may not have adequate insurance coverage to make such repairs, exposing your business to potential inconvenience or even shutdown.



## 40) MAINTENANCE AND REPAIRS

Most leases include certain provisions requiring the landlord to maintain and repair all or a portion of the premises and any common areas. Determine if there are any deficiencies or deferred maintenance and notify the landlord in writing within the time period required under the lease. The lease may also contain a warranty period for certain components of the premises (e.g., roof, HVAC) and, if so, confirm when the warranty period expires.



# TRUSTS, ESTATES AND SUCCESSION PLANNING

**COMPLETED**    **N/A**

## 41) BUSINESS SUCCESSION PLANNING

Have you or your shareholders properly planned for the succession of control and management of your business in the event of divorce, disability or death of a shareholder or principal of your business? Failure to properly plan for the succession of your business can cause considerable difficulty for the affected shareholder, the affected shareholder's family and the company itself if any of these events should occur. A shareholder's agreement outlining and planning for these events may be prudent.



## 42) GIFTS OF STOCK/SHARES

Have any of your shareholders made a gift of stock/shares during the calendar year? If so, the gifting shareholder may need to file a Federal gift tax return. Federal gift tax returns are due at the time individual income tax returns are required to be filed. Do you or your shareholders have an annual gifting plan? If the gifting plan incorporates use of the annual gift tax exclusion benefit, proper coordination with a tax professional and attorney should be made annually to assure compliance with the annual gifting plan, reporting of information, if necessary, and determine if any modifications should be made for subsequent years.



## 43) TITLE TO STOCK/SHARES OF INDIVIDUAL SHAREHOLDERS

For individual shareholders who are California residents, do they hold title to their stock/shares in the name of their trust? The failure to have shares titled in the name of a shareholder's trust and to conduct proper estate planning could result in a formal probate administration being required at the shareholder's death, depending on the value of the stock/shares. Formal probate administration presents additional costs and delay for the shareholder's family and often creates administrative difficulties for the company as well. If your company is an S Corporation, particular provisions must be included in the shareholder's trust holding title to S Corporation shares to be sure the trust is a qualified S Corporation shareholder (see "S Corporation Status" above).



## 44) KEY MAN INSURANCE/SUCCESSION INSURANCE

Do you have corporate-owned life insurance, either to provide a cash payout at the death of the primary shareholder or other "key man" or to fund a redemption of the shares of the surviving family of a deceased shareholder? If so, it is important to provide for timely premium payments or financing and maintain the policies properly in force, and correctly account for the policies as a corporate asset. This also applies to life insurance owned by shareholders but financed in part through the corporation on a split-dollar basis.



## 45) SHAREHOLDERS AGREEMENT

Do you have a shareholders agreement in the event of death or disability of shareholders? If so, is there an agreed upon annual valuation requirement that must be performed? Failure to do so can result in unintended consequences in the event of a death or disability or other occurrence that requires valuation.



## 46) LIQUIDITY EVENT PLANNING

Is there a chance that your business will sell or go public in the next 3 years? If so, you may want to consider making gifts of stock/shares or business interests to your children. You may also consider transferring stock/shares or business interest to irrevocable trusts, such as a Charitable Remainder Trust, to defer capital gains on sale, or provide for other planning opportunities that may be available at the time.

PROCOPIO, CORY, HARGREAVES & SAVITCH LLP ATTORNEYS WORK CLOSELY WITH A BROAD SPECTRUM OF BUSINESS CLIENTS TO HELP THEM ACHIEVE THEIR FINANCIAL OBJECTIVES. SHOULD YOU HAVE ANY QUESTIONS REGARDING THIS ANNUAL CORPORATE CHECKLIST OR THE APPLICATION OF THE RULES OR GUIDELINES DESCRIBED ABOVE, **PLEASE FEEL FREE TO CONTACT ANY OF THE PROCOPIO ATTORNEYS LISTED BELOW.**

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