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Domestication and Conversion of Business Entities

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Introduction

To take advantage of favorable corporate law in another state or a more suitable form of business, an entity may desire to change either its state of incorporation or business entity form through the use of a single-step process. While the majority of states have statutory provisions authorizing domestication and/or conversion, Mississippi has no statutes that explicitly permit these changes.

While the term “domestication” is sometimes used to describe the process of licensing a foreign corporation to do business in this state, for purposes of this article, the term refers to a corporation discontinuing its incorporation under the foreign state and reincorporating under the laws of this state or vice versa.¹ Whether a corporation is a foreign or domestic corporation generally depends upon its place of incorporation and organization, not upon its business activities or location of members and stockholders.²

Conversion of business entities permits the more efficient accomplishment of what would otherwise be a burdensome multi-step process. Without statutory authority to change its organizational form, an entity is not precluded from doing so.³ Instead, the entity must engage in procedures that are more elaborate, more cumbersome, and more expensive but achieve the same result.⁴ Because the end result of conversion can still be achieved through the use of alternative processes, a statutory provision authorizing domestication and/or conversion would merely create a more efficient system involving only one entity and one document.⁵

With the authorization of conversion, several problem areas could potentially arise. The rights of creditors, litigants, and owners must be protected.⁶ The conversion documents must clearly indicate the transfer of business property, and administrative procedures must enable the state to easily record and report on the current status of a business.⁷ In the case of conversions involving two jurisdictions, additional issues of coordination, reciprocity, and multiple sets of law arise.⁸

This article will examine general domestication and conversion statutes, discuss the advantages of each, and analyze how other states have dealt with the issue.

Domestication

Corporations often conduct a substantial amount of business outside their state of incorporation with the approval of other states.⁹ Most commonly, corporations obtain this approval through a certificate of authority, permitting the corporation to do business in the

state without altering its status as a foreign corporation.¹⁰ Domestication is a procedure whereby a foreign corporation discontinues its incorporation under the laws of the foreign state and becomes incorporated under the laws of the subject state or vice versa.¹¹ A domesticated corporation typically has all of the powers, privileges, and rights granted to corporations originally incorporated in the subject state, as well as all duties, liabilities, and limitations imposed upon them.¹²

Domestication under the Model Business Corporation Act

Section 9.20 of the Model Business Corporation Act provides for two types of domestication: a foreign business corporation becoming a domestic business corporation, and a domestic business corporation becoming a foreign business corporation.¹³ In each case, domestication must be permitted by the laws of the foreign jurisdiction, which also determine the conditions upon which a foreign corporation is authorized to domesticate in this state.¹⁴ A foreign corporation may become a domestic corporation only if the laws of its jurisdiction of incorporation so authorize.¹⁵ The domestication must be approved in the manner prescribed by domestication laws in the subject state.¹⁶

Domestication statutes typically include provisions for a plan of domestication, action on the plan, articles of domestication, surrender of charter upon domestication, effect of domestication, and abandonment of domestication.¹⁷ The filing of the articles of charter surrender terminates the status of corporation as a corporation incorporated under the laws of this state, but the procedure whereby a foreign corporation terminates its incorporation in the foreign state is governed by statute in that jurisdiction.¹⁸ When domestication becomes effective, the corporation is considered to be incorporated under and subject to the organic law of this state for all purposes.¹⁹ The domesticated corporation retains both its original date of incorporation in the former state and an uninterrupted status as the same corporation both before and after domestication.²⁰ Though each state has the option to adopt all or part of the Model Business Corporation Act's provisions, the act provides an accurate estimate of general domestication statutes.

Advantages of Domestication

Changing the state of incorporation may be favorable for several reasons, all depending on the laws of the subject state. Most notably, a corporation may want to domesticate in a certain state to benefit from advantageous tax laws in that state.²¹ For example, Nevada, Texas, and Wyoming impose no corporate income taxes, which may significantly reduce taxes overall, depending on the corporation's business operations.²² The laws of the jurisdiction in which a corporation is domesticated provide guidance on such issues as voting rights, protection of officers and directors, and liability.²³ Delaware has notoriously favorable corporate governance regulations,²⁴ while Nevada laws offer greater privacy and corporate officer liability protection.²⁵

Statutory Provisions for Domestication

Thirty jurisdictions in total provide for domestication of corporations.²⁶ Twenty jurisdictions have authorized domestication specifically by statute,²⁷ while ten additional jurisdictions have provided for domestication as a type of conversion authorized in conversion statutes.²⁸ Of the thirty jurisdictions authorizing domestication, five jurisdictions only authorize the domestication of foreign corporations domesticating into the state.²⁹

Entity Conversion

Entity Conversion under the Model Business Corporation Act

Section 9.50 of the Model Business Corporation Act provides for four types of entity conversions: (1) a domestic business corporation to a domestic other entity; (2) a domestic corporation to a foreign other entity; (3) a domestic other entity converting into a domestic business corporation; and (4) a foreign other entity converting to a domestic business corporation.³⁰ Chapter Nine of the Model Business Corporation Act concerns the conversion of entities, nonprofit corporations, and foreign nonprofit corporations.³¹ Though this article focuses solely on entity conversion, the provisions for nonprofit conversion and foreign nonprofit conversion are quite similar.³²

The concept of entity conversion as discussed in section 9.50 is scarcely found in statutes governing the incorporation and organization of business entities.³³ Thus, if the organic law of a domesticating unincorporated entity does not specifically provide for this type of conversion, section 9.50(c) is intended to authorize such a conversion: “A domestic unincorporated entity may become a domestic business corporation.”³⁴ A foreign unincorporated entity may only convert under section 9.50 if the laws of the foreign jurisdiction allow the conversion.³⁵ This provision avoids problematic issues arising if a foreign unincorporated entity were authorized to participate in transactions in this state which would not be permitted under the laws of the foreign jurisdiction.³⁶

Though many states have adopted parts, rather than the whole, of section 9.50, the Model Business Corporation Act’s conversion statute includes provisions for a plan of entity conversion, action on a plan of entity conversion, articles of entity conversion, surrender of charter upon conversion, effect of entity conversion, and abandonment of an entity conversion.³⁷ The plan of conversion must be adopted by the board of directors and include: (1) a statement of the type of entity the surviving entity will be; (2) the terms and conditions of the conversion; (3) the manner and basis of converting the corporation’s shares into interests or other securities, obligations, etc.; and (4) the text of the organic documents of the surviving entity.³⁸

The plan must be approved by the shareholders, voting individually as each class or series of shares of the corporation.³⁹ The meeting at which votes are cast must have a quorum of at least a majority of eligible voters in that voting group.⁴⁰ If the conversion would expose any shareholder to owner liability, each shareholder must consent in writing.⁴¹ After approval of the plan, the articles of conversion are executed and delivered to the secretary of state for filing.⁴² In the case of conversion from a domestic corporation to a foreign entity, articles of charter surrender are to be executed and filed.⁴³ The existence of the surviving entity is uninterrupted, and its date of incorporation or organization remains on its original date of incorporation or organization.⁴⁴ The surviving entity is subject to the rights and liabilities of the original entity, though a shareholder who becomes subject to owner liability is liable only for obligations arising post-conversion.⁴⁵

Several types of conversions are outside the scope of this provision: a domestic other entity to another form of unincorporated entity or to a foreign business corporation, and a foreign entity or foreign corporation to a domestic unincorporated entity.⁴⁶ However, many states have chosen to generalize the terms of their conversion provisions to allow these types of conversions not covered by section 9.50.⁴⁷

Advantages of Conversion

Without express statutory authority, an entity may still change its organizational form through the use of a multi-step process which is eliminated by the more efficient method prescribed by conversion statutes.⁴⁸ For example, without the use of a conversion statute, a partnership may change to a corporation through several methods.⁴⁹ In each situation, however, multiple steps are involved: the partnership is dissolved, its assets are transferred or sold to a newly formed corporation, and the former partners become shareholders in the new corporation.⁵⁰ Though accomplishing the desired result, this multi-step process involves expenses that would not otherwise exist with a statutory provision authorizing conversion.⁵¹ Distribution of assets is a taxable event, and the dissolution and sale of assets may trigger contractual terms already in existence, requiring accelerated debt payment.⁵² Additionally, documentation is necessary for transfers of assets, transfers of real estate, and the sale or assignment of personal property, all of which may impose additional expenses.⁵³

Conversion provisions offer a greatly simplified method of accomplishing a change in entity form with respect to property, transfer restrictions, and transaction costs.⁵⁴ Property of the converting entity becomes property of the surviving entity by operation of law, without the need for deeds, assignments, or other documents of conveyance.⁵⁵ Title insurance continues in favor of the surviving entity, and no sales or transfer taxes apply to a conversion.⁵⁶ Additionally, restrictions on transfer, such as non-assignment clauses in leases, are not triggered.⁵⁷

Statutory Provisions for Conversion

Of the forty-two jurisdictions that have a statutory provision for business entity conversions, twenty-eight have either adopted provisions identical to section 9.50 or authorized the types of conversions enumerated in section 9.50.⁵⁸ Furthermore, eighteen of those jurisdictions have chosen to adopt provisions authorizing other types of conversions beyond the four provided in section 9.50.⁵⁹

Ten jurisdictions have elected to not only expand the types of conversions authorized by statute but also to use such broad terms as to include domestication as a type of authorized conversion in lieu of providing a separate domestication statute.⁶⁰ The following states have included domestication in conversion statutes: Alabama, California, Colorado, Georgia, Hawaii, Michigan, North Carolina, Oregon, Rhode Island, and Texas.⁶¹ Wyoming has perhaps the most expansive conversion statute, broadly stating that “any entity, domestic or foreign, may convert to any other entity, domestic or foreign.”⁶²

In addition to flexibility regarding the provision’s coverage, states have options concerning the drafting and placement of conversion provisions. In the “junction box” model, cross-entity provisions are contained in a single statute, while the “self-contained” model repeats cross-entity provisions in individual statutory chapters governing the specific entity forms.⁶³ The “junction box” model assures consistency and requires fewer provisions; however, these provisions note that any conversion is subject to organic statutes governing each entity type that may prohibit or restrict any aspect involved in conversion.⁶⁴ Thus, three statutory provisions would need to be consulted to determine if conversion from one entity to a different entity form is authorized.⁶⁵ Though repetitive and lengthy, the “self-contained” model places a conversion provision in its entirety in chapters governing each entity form, reducing the number of provisions that must be consulted.⁶⁶

Conclusion

At a minimum, Mississippi would create a more efficient system by following the forty-one states that have enacted a statute authorizing conversion. Twenty-eight jurisdictions provide for both domestication and conversion.⁶⁷ Thirteen jurisdictions provide only for conversion,⁶⁸ while a mere two states provide only for domestication.⁶⁹ Thus, if a state authorizes conversion, it likely authorizes domestication as well. Furthermore, if Mississippi also elects to authorize domestication, the most efficient method would be to follow the ten states that authorize it as a type of conversion instead of creating a separate provision.

¹ See William Meade Fletcher, *Fletcher Cyclopaedia of the Law of Corporations* § 8302 (2012) (Westlaw, through February 2012).

² 36 Am. Jur. 2d *Determination as to domestic or foreign nature, generally* § 2 (2012).

³ See Robert C. Art, *Conversion and Merger of Disparate Business Entities*, 76 Wash. L. Rev. 349, 368-369 (2001), WL 76 WALR 349.

⁴ *Id.*

⁵ See *id.* at 352.

⁶ *Id.* at 353.

⁷ *Id.*

⁸ *Id.*

⁹ Fletcher, *supra* note 1, § 8302.

¹⁰ *Id.*

¹¹ *Id.*

¹² Model Bus. Corp. Act Ann. § 9.24 cmt. (2008) (revised 2009).

¹³ *Id.* § 9.20(a)-(b).

¹⁴ *Id.* § 9.20 cmt. 1.

¹⁵ Fletcher, *supra* note 1, § 8304.

¹⁶ *Id.*

¹⁷ See Model Bus. Corp. Act Ann., *supra* note 12, §§ 9.20-9.25.

¹⁸ *Id.* § 9.23 cmt.

¹⁹ *Id.* § 9.24(a)(6)(i).

²⁰ *Id.* § 9.24(a)(6)(ii)-(iii).

²¹ See generally Mark Robyn, *2012 State Business Tax Climate Index* (January 25, 2012), at taxfoundation.org/article/2012-state-business-tax-climate-index.

²² See *id.*

²³ See generally David Mace Roberts and Rob Pivnick, *Tale of the Corporate Tape: Delaware, Nevada and Texas* 52 Baylor L. Rev. 45 (2000), WL 52 BLRLR 45.

²⁴ See *id.* at 81.

²⁵ See *id.* at 51.

²⁶ See, e.g., D.C. Code § 29-205.01 (West, through May 10, 2012); Va. Code Ann. § 13.1-722.2 (West, through End of 2012 Reg. Sess. and End of 2012 Sp. Sess. I.); Wis. Stat. Ann. § 181.1533 (West, through 2011 Act 286, published April 26, 2012).

²⁷ See, e.g., Idaho Code § 30-18-501 (West, through End of 2012 2nd Regular Session of the 61st Legislature); La. Rev. Stat. Ann. § 12:164 (West, through 2011 First Extraordinary and Reg. Sess.).

²⁸ See, e.g., Col. Rev. Stat. Ann. § 7-90-201 (West, through laws effective July 1, 2012); Haw. Rev. Stat. Ann. § 414-271 (West, through Act 129 of 2012 Reg. Sess.); Or. Rev. Stat. Ann. § 60.472 (West, through 7/1/12).

²⁹ See, e.g., Fla. Stat. Ann. § 607.1801 (West, through Chapter 229 (End) of 2012 Second Reg. Sess. and 2012 Extraordinary Apportionment Sess. of Twenty-Second Leg.); Neb. Rev. St. § 21-20, 181.01 (West, through 102nd Legislature 1st Special Session (2011)).

³⁰ See Model Bus. Corp. Act Ann., *supra* note 12, § 9.50(a)-(d).

³¹ *Id.* §§ 9.30-9.56.

³² See Fletcher, *supra* note 1, § 3993.50.

³³ See Model Bus. Corp. Act Ann., *supra* note 12, § 9.50 cmt. 2.

³⁴ *Id.*

³⁵ *Id.*

³⁶ See *id.*

³⁷ See Model Bus. Corp. Act Ann., *supra* note 12, §§ 9.50-9.56.

- ³⁸ See *id.* § 9.51(a).
- ³⁹ *Id.* § 9.52(2)-(5).
- ⁴⁰ See *id.* § 9.52(5).
- ⁴¹ Fletcher, *supra* note 1, § 3993.50.
- ⁴² See Model Bus. Corp. Act Ann., *supra* note 12, § 9.53(d).
- ⁴³ *Id.* § 9.54.
- ⁴⁴ See *id.* § 9.55(a)(7).
- ⁴⁵ Fletcher, *supra* note 1, § 3993.50.
- ⁴⁶ See Model Bus. Corp. Act Ann., *supra* note 12, § 9.50 cmt. 1.
- ⁴⁷ See, e.g., Col. Rev. Stat. Ann. § 7-90-201 (West, through laws effective July 1, 2012).
- ⁴⁸ See Art, *supra* note 3, at 369.
- ⁴⁹ *Id.*
- ⁵⁰ See *id.*
- ⁵¹ See *id.*
- ⁵² *Id.* at 370.
- ⁵³ See *id.* at 371.
- ⁵⁴ See *id.* at 372-373.
- ⁵⁵ *Id.* at 373.
- ⁵⁶ *Id.*
- ⁵⁷ *Id.*
- ⁵⁸ See, e.g., Idaho Code § 30-18-401 (West, through End of 2012 2nd Regular Session of the 61st Legislature); Col. Rev. Stat. Ann. § 7-90-201 (West, through laws effective July 1, 2012).
- ⁵⁹ See, e.g., D.C. Code § 29-204.01 (West, through May 10, 2012); Wis. Stat. Ann. § 180.1161 (West, through 2011 Act 286, published April 26, 2012).
- ⁶⁰ See, e.g., Col. Rev. Stat. Ann. § 7-90-201 (West, through laws effective July 1, 2012); R.I. Gen. Laws § 7-1.2-1007 (West, through chapter 109 of 2012 Regular Session).
- ⁶¹ See, e.g., Haw. Rev. Stat. Ann. § 414-271 (West, through Act 129 of 2012 Reg. Sess.); Or. Rev. Stat. Ann. § 60.472 (West, through 7/1/12).
- ⁶² Wyo. Stat. Ann. § 17-26-101 (West, through the 2012 Budget Session).
- ⁶³ See Robert C. Art, *Conversion and Merger of Disparate Business Entities*, 76 Wash. L. Rev. 349, 381 (2001), WL 76 WALR 349.
- ⁶⁴ See *id.* at 381-382.
- ⁶⁵ See *id.* at 382.
- ⁶⁶ See *id.* at 383.
- ⁶⁷ See, e.g., Va. Code Ann. §§ 13.1-722.2, 13.1-722.9 (West, through End of 2012 Reg. Sess. and End of 2012 Sp. Sess. I.).
- ⁶⁸ See, e.g., Ark. Code Ann. § 4-26-1002 (West, Westlaw through end of 2012 Fiscal Sess.); Iowa Code Ann. § 490.1111 (West, through legislation from the 2012 Reg.Sess.).
- ⁶⁹ See Ariz. Rev. Stat. Ann. § 10-220 (Westlaw through legislation effective May 11, 2012 of the Second Regular Session of the Fiftieth Legislature (2012)); Neb. Rev. St. § 21-20, 181.01 (West, through the 102nd Legislature 1st Special Session (2011)).



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Domestication Fact Sheet

25 Jurisdictions with General Provisions Allowing for Domestication of a Foreign Corporation into This State and Vice Versa, Comparable to § 9.20(a) and (b):

ALABAMA	INDIANA	RHODE ISLAND
ARIZONA	KANSAS	SOUTH DAKOTA
COLORADO	LOUISIANA	TEXAS
CONNECTICUT	MAINE	UTAH
DELAWARE	MASSACHUSETTS	VIRGINIA
DISTRICT OF COLUMBIA	MICHIGAN	WISCONSIN
GEORGIA	NEVADA	WYOMING
HAWAII	NORTH CAROLINA	
IDAHO	OREGON	

5 States whose Statutes *Only* Apply to a *Foreign Corporation* Seeking to Transfer Domicile into the State:

CALIFORNIA	NEBRASKA	SOUTH CAROLINA
FLORIDA	PENNSYLVANIA	

10 States that Include Domestication as One of the Authorized *Conversions* in General Conversion Statutes:

ALABAMA	HAWAII	RHODE ISLAND
CALIFORNIA	MICHIGAN	TEXAS
COLORADO	NORTH CAROLINA	
GEORGIA	OREGON	



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Conversion Fact Sheet

42 Jurisdictions that Provide for the Conversion of Business Entities from or to the Various Forms of Business Available in that Jurisdiction:

ALABAMA	INDIANA	OHIO
ALASKA	KANSAS	OKLAHOMA
ARKANSAS	KENTUCKY	OREGON
CALIFORNIA	LOUISIANA	PENNSYLVANIA
COLORADO	MAINE	RHODE ISLAND
CONNECTICUT	MASSACHUSETTS	SOUTH CAROLINA
DELAWARE	MICHIGAN	SOUTH DAKOTA
DISTRICT OF COLUMBIA	MINNESOTA	TENNESSEE
FLORIDA	MONTANA	TEXAS
GEORGIA	NEVADA	UTAH
HAWAII	NEW HAMPSHIRE	VIRGINIA
IDAHO	NEW MEXICO	WEST VIRGINIA
INDIANA	NORTH CAROLINA	WISCONSIN
IOWA	NORTH DAKOTA	WYOMING

CONVERSIONS AUTHORIZED

7 Jurisdictions Adopted Provisions Virtually Identical to § 9.20(a)-(d):

FLORIDA	MAINE	SOUTH DAKOTA
IDAHO	MASSACHUSETTS	
INDIANA	MICHIGAN	

21 Jurisdictions Authorize the Four Types Listed in § 9.20(a)-(d):

ALABAMA	GEORGIA	OHIO
ARKANSAS	HAWAII	OKLAHOMA
CALIFORNIA	INDIANA	OREGON
COLORADO	IOWA	RHODE ISLAND
CONNECTICUT	KANSAS	TEXAS
DELAWARE	NEVADA	WISCONSIN
DISTRICT OF COLUMBIA	NORTH CAROLINA	WYOMING

9 Jurisdictions Permit Conversion into LLCs:

ALASKA	MONTANA	TENNESSEE
KENTUCKY	NEW HAMPSHIRE	VIRGINIA
MINNESOTA	NEW MEXICO	WEST VIRGINIA

Only Allows for Conversions of Domestic Entities into Other Domestic Forms:

LOUISIANA

Only Allows for a Business Corporation to Convert to a Non-Profit Corp.:

PENNSYLVANIA

Allows Conversion to or from a Corporation in All Situations *Except* Conversion of a Corporation to a General Partnership:

NORTH DAKOTA

South Carolina Labels Conversions “Mergers” and Explicitly Lists the Types of Entity a Business Corporation May Merge “With or Into”:

FOREIGN BUSINESS CORP.	LIMITED LIABILITY CO.	LIMITED PARTNERSHIP
NONPROFIT CORPORATION	PARTNERSHIP	

Utah Lists Types of Permissible Conversions:

CORPORATION TO A NONPROFIT CORP.	DOMESTIC LLC TO A CORPORATION
CORPORATION TO A DOMESTIC LLC	OTHER ENTITIES TO DOMESTIC COMPANY