



California Corporate & Securities Law

Soon It Will Be Easier For California Corporations To Make Distributions To Shareholders

September 6, 2011 by [Keith Paul Bishop](#)

Chapter 5 of the Corporations Code establishes various limitations on distributions by California corporations. The term “distributions to its shareholders” is itself defined in Section 166. The question of appropriate limitations on dividends and other corporate distributions is not new. Even Samuel Clemens (aka Mark Twain) wrote about “cooked dividends” and got into a great deal of trouble for his efforts (A topic that I covered last year in “[‘Cooked Dividends’ Leads to Bloody Massacre](#)”).

When the legislature enacted Chapter 5, it abolished the antiquated concepts of “legal capital” and “surplus”. In general, the legislature’s approach was to use accounting concepts (albeit with some adjustments). Last week, the legislature took a big step in loosening some of the constraints on distributions imposed by Chapter 5 by enacting [AB 571](#) (Hagman). This bill was sponsored by the Corporations Committee of the [Business Law Section](#) of the California State Bar.

According to the Corporations Committee AB 571 will:

- Simplify and clarify the formula pursuant to which California corporations may make distributions to shareholders;
- Remove unnecessarily rigid restrictions on the ability of financial healthy California corporations to make distributions to shareholders;
- Eliminate material differences between the standards relating to dividends and distributions by California corporations and the standards relating to dividends and distributions by California limited liability companies and limited partnerships ;
- Enable shareholders of Subchapter S corporations to receive dividends and/or distributions to satisfy their tax obligations, just as partners or members of LLCs and LPs are able to do; and
- Align the approach used by California to restrict the issuance of dividends and distributions with the approach used by other states, and, in doing so, remove an existing competitive disadvantage experienced by California corporations.

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Pursuant to Art. IV, Sec. 8(c) of the California Constitution, AB 571 will take effect on January 1, 2012.

AB 571 will also affect foreign corporations subject to California's pseudo-foreign corporation statute, Corporations Code Section 2115.

Coincidentally, AB 571 was chaptered 101 years and 1 day after Teddy Roosevelt gave his famous "[The New Nationalism](#)" speech in Osawatomie, Kansas in which he famously asserted: "I am far from underestimating the importance of dividends; but I rank dividends below human character."

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