Parents, Subsidiaries And Section 2115

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California famously applies many of the provisions of its General Corporation Law to foreign corporations that meet the specific tests set forth in Corporations Code Section 2115. The first of these tests is a business test - the average of the corporation's property, payroll and sales factor must be more than 50% for the latest full income year. The second is a shareholder test - more than one-half of the outstanding voting securities must be held of record by persons having addresses in California on the corporate books. The statute itself is quite detailed and applying it can be challenging as illustrated by its application to foreign parent and subsidiary corporations.

As an initial matter, a foreign parent corporation that meets the business and shareholder tests will be subject to Section 2115 even though it does not itself transact intrastate business. Moreover, the two tests are applied separately to the parent and its subsidiaries and the three-factor business test must be applied to the parent on a consolidated basis, including in a unitary computation (after elimination of intercompany transactions) the property, payroll and sales of the parent and all of its subsidiaries in which it owns directly or indirectly more than 50% of the outstanding shares entitled to vote for the election of directors, but deducting a percentage of the property, payroll and sales of any subsidiary equal to the percentage, if any, in the subsidiary.

It is possible that a foreign subsidiary corporation will be subject to Section 2115 even though its parent is not. For example, more than one-half of the parent corporation's outstanding voting securities may be held by persons in other states. If the parent is located in California and holds more than one-half of the outstanding voting securities of the subsidiary, the subsidiary would be subject to Section 2115 if the subsidiary meets the business test. However, Section 2115 will not apply to the foreign subsidiary if all of the its voting shares (other than directors' qualifying shares) are owned directly or indirectly by a corporation or corporations not subject to Section 2115. In addition, other exceptions to Section 2115 may be available that I hope to address in a future post.

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