CHAPTER 74

Limited Liability Companies

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Anyone who owns or operates a business should consider the advantages of doing business within a Limited Liability Company (LLC). The LLC is a very flexible form of business entity, incorporating elements of both corporations and partnerships. Because owners of an LLC, who are called "Members," are generally not liable for its debts, the LLC also offers superior asset protection advantages compared to partnerships and corporations. This freedom from personal liability, or "limited liability" is what the name implies.

Ownership interests in LLCs are usually characterized as Membership Interests, expressed either as shares or percentages of ownership. Since the LLC was first adopted by Wyoming in 1977, its popularity has spread, and LLCs, even single-Member LLCs, are now allowed in all 50 states and the District of Columbia. Although corporations are still popular for business owners who anticipate selling stock to attract investors, or who wish to distribute stock to employees, for most small businesses, the LLC is the preferred form of business entity.

FORMATION OF THE LLC

An LLC must have at least one Member who owns the business interest. The Member may be a natural person, another business entity such as a corporation or partnership, or a trust. Forming an LLC in most states is simple, requiring only the filing of form Articles of Organization in the LLC's home state, and appointing an Agent in the state for service of process on the entity. Annual filing fees to maintain an LLC in most states are also generally low.

OPERATION AND TAXATION

In addition to the freedom from personal liability for its Members, LLCs are also popular because of their flexibility in organization and administration. An LLC can be managed either by the Members or by one or more Managers who may, but need not be, Members. The choice is generally determined in the Articles of Organization or in a written agreement of its Members, called an "Operating Agreement." Most business owners want to actively participate in the business, so most LLCs are managed by the Members. Sometimes, however, Members

are merely passive investors in the business and do not want to participate in its management, and in these situations the Manager-managed LLC may be more appropriate. The choice does not affect the liability of the Members, whether they participate in the management or not, because they will all enjoy limited liability within the limits afforded by statute and applicable case law.

Although LLCs generally must, at least annually, file a basic informational document with the Secretary of State in its home state, most states do not require LLCs to hold meetings and prepare minutes. Accordingly, the record-keeping requirements for LLCs are generally less burdensome than for other business entities. Still, to ensure the separate legal existence of the company in the event it is audited or sued, it is a good practice to document and maintain records of important actions which affect the company, such as appointing and replacing Managers, adding and substituting Members, acquiring or disposing of significant company assets, etc.

An LLC can elect to be taxed as a corporation, either as a traditional C corporation or as an S corporation, or it can elect to be treated as partnership for income tax purposes. In the former case, the LLC will pay tax at the entity level and a separate income tax return will be filed. In the case of a partnership or S election, an informational return will be filed for the entity and all profits and losses will pass through to the Members on a K-1 and be reported on Schedule E of their individual income tax returns. In the case of a single-Member LLC (or an LLC owned by a husband and wife who live in a community property state), the Member(s) can elect for the entity to be disregarded as an entity separate from its owners for income tax purposes, in which case no income tax return is required to be filed for the LLC, and all profits and losses are reported by the Members on Schedule C of their individual income tax returns.

VOTING AND NON-VOTING INTERESTS

The Operating Agreement spells out the rights and duties of the Members and the Manager, including voting rights and restrictions on the transferability of Membership Interests. Like Limited Partnerships and Corporations, LLCs can have voting and non-voting interests. The Members can also decide whether to divide profits and losses among the Members equally, according to their capital interests, or unequally, according to other criteria. In the absence of an Operating Agreement these rights and duties are covered by state law.

LIMITS ON THE LIMITATION OF LIABILITY

While a Member of an LLC is generally not personally liable for the actions and obligations of the LLC, this protection is not absolute. A Member is at risk for the obligations of the LLC if the Member personal guaranteed them or offered the Member’s own assets as security for the company’s obligation. A Member is also at risk for his or her actions that cause injury to others, typically tort liability to injured third parties, such as if the Member operated a vehicle recklessly and caused injury

to another person, but the LLC will generally preclude the other Members from incurring liability for the actions of the Member who caused the damage or injury. A Member or a Manager can also be liable for breach of a duty of care owed to the company or to those with whom the company does business

Recently, some states, borrowing from the law of corporations, have allowed the "veil" of LLCs to be "pierced" and personal liability imposed on the Members when business formalities were not observed and Members failed to maintain the LLC's separate existence.

VARIATIONS ON THE THEME

Professional Limited Liability Company (or PLLC) is an LLC formed to provide professional services, such as legal services or accounting. Generally, the Members are not liable for the debts of the business or for the negligent or intentional acts of the other professional Members. However for public policy reasons, the professional remains liable for his own negligence. A variation on the PLLC is the Registered Limited Liability Partnership or RLLP.

Series LLCs allow a single LLC to separate assets of the LLC into separate "series" that may have separate Members and Managers, or different allocations of profits and losses between the separate series. The Series LLC generally protects the Members against liability generated within one series from carrying over to any other series. Series LLCs are popular, for example, for the client who owns multiple parcels of investment real estate and wants to segregate the assets for liability purposes without requiring a separate LLC for each parcel.

Family Limited Liability Companies, or FLLCs, are estate planning tools which, through the Operating Agreement, restrict the ability of Members with minority interests from participating in the management and control of the business, or restrict the free transferability of the Membership Interests. These restrictions require the value of a Member's interest to be discounted, which reduces taxes on eligible transfers during life or at death. FLLCs are similar to Family Limited Partnerships, but because there is no General Partner for a FLLC, all of the Members enjoy limited liability to the extent allowed by law.

Close LLCs — Many states have modified their statutes to permit "Close LLCs" which even further simplify the administration of the company. In a Close LLC, Members are generally prohibited from selling their membership interests without first offering them to the other Members, and certain record-keeping requirements are relaxed or eliminated.

Mr. Burau's practice focuses on wealth preservation planning for higher net worth clients. He has counseled hundreds of clients in regard to their estate and small business planning needs.