Doing Business as a Limited Liability Company

Introduction

Limited liability companies offer investors and business owners a new alternative for doing business. Although limited liability companies have existed in some states for more than ten years, they did not become popular until the Internal Revenue Service began to tax them as partnerships rather than as corporations. Limited liability companies provide the limited liability of corporations without many of the corporate formalities. Potential users of limited liability companies include:

•Start-up businesses •Estate planners •Venture capital organizations•Joint ventures • Real estate ventures • Subsidiary companies You should consider forming a limited liability company whenever you start a new venture or restructure an existing business. The benefits of limited liability companies include their favorable tax treatment, limited liability, flexible management, and relaxed formality. This pamphlet explains how to organize a limited liability company with the advice of your lawyer. The legal work is relatively inexpensive and will help you to avoid problems and pitfalls that await those who are not advised by legal counsel.

Forming the Company

In most states, a limited liability company is formed by filing a simple form of articles of organization with the secretary of state. The articles must include such information as the name of the company and its organizers, the address of the company's office, and the date on which the company is to be dissolved. The articles may also contain provisions appointing individuals to manage the company, creating obligations for owners to contribute capital to the company, limiting the authority of owners to bind the company, and other information desired by the owners.

The members of a limited liability company usually enter into an operating agreement to govern the company's internal affairs. The operating agreement of a limited liability company is similar to the bylaws and shareholders' agreement of a corporation or to a partnership agreement. The agreement remains confidential since it is not filed with the secretary of state. Operating agreements typically cover capital contributions, allocation of profits and losses, distribution of earnings, management, transfer of investment, and dissolution of the company.

In some states two or more persons must sign the articles of organization and the operating agreement. Most states require that limited liability companies be owned by at least two persons. The owners of the company can be individuals, partnerships, trusts or corporations. Your lawyer can help you plan how to satisfy these organizational and ownership requirements, prepare articles of organization and an operating agreement, and register the company in each state where it plans to conduct business.

Naming the Company

State laws require that the name of a limited liability company include the words "limited liability company," the abbreviation "LLC" or a similar notation of limited liability. The name of the company must differ from that of existing businesses to avoid conflicts with the names of other companies and partnerships. The process of naming the company ordinarily includes reserving a name with the secretary of state and then filing articles of organization using the name.

The process of naming the company can also include state and federal trademark registration if the name will be used on the company's products or associated with the company's services. A federal registration provides nationwide protection while state registration only protects against persons who infringe upon the name in the state of registration. Although registration is not legally required, it can provide a strategic advantage in the event of a dispute and it will also discourage others from using the name.

Your lawyer can help your company select, register and protect its business name. If your business name is important to you, your lawyer can take steps to protect it from use by others.

Financing the Company

The laws of most states allow the members of a limited liability company to make their investment in the form of cash, notes, property, or services. Rather than shares in a corporation, an investment in a limited liability company is often represented by certificates of membership interest. Profits and losses are allocated among the owners as provided in the company's articles of organization or operating agreement. These documents will be carefully prepared by your lawyer to provide the capital contributions and profit sharing that you want for your company.

The company may also borrow money from lenders and purchase from suppliers on credit terms. Generally, the owners and managers of the company are not personally liable for the company's debts. However, there are situations where owners and managers can become responsible for company obligations. For example, an owner who guarantees a loan may be forced to pay the lender if the company fails to repay the loan. Your lawyer can advise you how to avoid personal liability for company debts.

Doing Business in Other States. A company conducting business in a state other than the one in which it was organized must comply with that state's requirements for foreign limited liability companies. A company ordinarily must have a registered agent for service of process, file an annual report, and pay an annual fee. Companies usually do not need to register in other states if they engage in a single job or contract. Registration in a foreign state will be required if your company has an office or has numerous contacts over an extended period of time.

Failure to register can result in drastic consequences. Companies that fail to register may not start lawsuits or enforce their contracts. The company can also be held liable for significant taxes, fines and penalties.

Your lawyer can advise whether your company's activities require registration to do business in any states outside your state of organization. Your lawyer can also suggest the name of a person to use as your registered agent for service of process for each state in which your company is doing business.

Tax Aspects
Properly structured limited liability companies are not subject to state or federal income tax. Instead, the owners of the company pay tax on its income as if it were a partnership.

In addition to the requirements of state law, a limited liability company must meet certain tests established by the Internal Revenue Service to assure that it will be taxable like a partnership. The tax regulations require that the company avoid continued existence, free transferability of interests and centralized management.

A lawyer can help you to draft your company's organizational documents to satisfy the requirements of the Internal Revenue Service. For example, to avoid a claim of free transferability of interest the articles of organization or operating agreement may require that a majority of the owners consent to an owner's sale of an interest in the company. To avoid a claim of continued existence, the LLC may require a vote to continue the company after the death of an owner. To avoid a finding of centralized management, the articles of association can provide that at least 80 percent of the members must approve fundamental decisions affecting the company.

Another tax benefit of a limited liability company is the treatment of capital contributions to the company. As a general rule, investments in the company do not result in any tax on the company or its owners. In addition, the company may generally distribute cash or property to its owners without tax consequences.

Comparison to Subchapter Companies
The laws for limited liability companies are less burdensome than the state corporation statutes and stringent tax laws that govern Subchapter S corporations. As a result, Subchapter S corporations have administrative requirements and costs that do not apply to limited liability companies. For example, any person or company may own an interest in a limited liability company while Subchapter S corporations may not have shareholders that are corporations, nonresident aliens, or partnerships. Owners of limited liability companies also have greater ability to allocate income and losses in their taxes than shareholders of a Subchapter S corporation. Your lawyer can advise how to use the tax advantages of a limited liability company.

Conclusion
Limited liability companies are gaining widespread acceptance and many experts believe that they will become the preferred way of operating for both small and large businesses. Unlike a limited partnership, a limited liability company allows, owners to participate in the management of the business. Unlike a corporation, a limited liability company does not require formal rituals like director and shareholder meetings. Your lawyer can help you to use a limited liability company to start a new venture or to simplify the structure of an existing business.

Formation Checklist

Uses for limited liability company **Managing the company**

A. New Ventures
B. Conversion of existing corporation
C. Conversion of existing partnership
D. Estate planning
E. Joint ventures
F. Subsidiary companies

Taxes for company and owners
A. Treatment as partnership
B. Investment in company
C. Profits and losses
D. Distributions

Starting up the company
A. Articles of organization
B. Operating agreement
C. Organizers
D. Owners
E. Name
F. Registered agent
G. Registered office
H. Qualifying to do business

A. Owners' authority
B. Delegation to managers
C. Duties
D. Limitation of liability of owners and managers
E. Indemnification of owners and managers
F. Power of attorney

Decision making
A. Managers
B. Voting by owners

Recordkeeping
A. Organizational documents
B. Bookkeeping records
C. Tax records
D. Inspection by owners

Financing
A. Capital contributions
B. Loans
C. Guarantees
D. Sharing of profits and losses

Ownership
A. Sale of interests
B. Consents to transfers
C. Rights to receive distributions
D. Right to vote

This pamphlet provides general information. Laws develop over time and differ from state to state. This pamphlet does not provide legal advice about specific legal problems. Let us advise you about your particular situation.