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[Fundamentals of Limited Liability Company](#)

Thursday, May 24, 2012 by [Doron F. Eghbali](#)

Limited Liability Company offers the best of two worlds: LIMITED Liability aspect of corporations and PASS-THROUGH income-tax aspects of partnerships. Generally, a Limited Liability Company is formed with 1 or more members to carry on a business while none of the owners have personal liability for the obligations of the business.

FORMATION OF LIMITED LIABILITY COMPANY

Under Beverly Killea Limited Liability Act of 1994 (Corp C §§17000-17655), a Limited Liability Company is formed when:

- ARTICLES OF ORGANIZATION is filed with CA Secretary of State on the CA Secretary of State Form LLC-1 (ATTACHED TO THIS HANDOUT). AND,
- Members enter into an Operating Agreement. The Operating Agreement could be oral OR written. Operating Agreement could be entered into BEFORE filing the Articles of Organization or AFTER filing the Articles of Organization.
- The name of a Limited Liability Company MUST contain AT THE END the words "Limited Liability Company", or "LLC", or "L.L.C."

SOME ADVANTAGES OF LIMITED LIABILITY COMPANY VIS-A-VIS LIMITED PARTNERSHIP AND S CORPORATION

a) *SOME* ADVANTAGES OF LIMITED LIABILITY COMPANY vs. LIMITED PARTNERSHIP

- General Partner MUST be personally liable for the obligations of the business. On the other hand, each member, generally, has limited liability.



- Limited Partners MAY NOT take part in control of the business without losing their limited liability. On the other hand, each member regardless of their respective contributions may participate in the control of the Limited Liability Company without losing their limited liability.

b) SOME ADVANTAGES OF LIMITED LIABILITY COMPANY vs. S. CORPORATION

- S Corporation limits the ability of shareholders to structure their financial arrangements because of its limitation on only 1 class of stock and the distribution of income, gain, losses should be in accordance with the shareholder's prorate share of the corporation's stock.
- S Corporation shareholders MUST be US citizens or Resident Aliens.
- S Corporations HAVE NO special allocations, only 1 class of stock.

IN SUMMARY:

A Limited Liability Company MAY have different classes of ownership. Income, gain, loss and other items could be allocated disproportionately without affecting the Limited Liability Company's pass-through treatment. In addition, ANY individual or ANY partnership, trust, estate, association, corporation or other limited liability company whether domestic or foreign can be a member of an LLC. See Corp C §17001.

LIMITED LIABILITY COMPANY STATE TAXES AND FEES

A Limited Liability Company MUST pay a tax of \$800 per year for being a Limited Liability Company regardless of gross receipts or net income. This \$800 is equal to the amount corporations, including S Corporations, Limited Partnerships, and Limited Liability Partnerships have to pay.

Despite the fact new corporations are exempt from paying \$800 for the first year, new Limited Liability Companies are not accorded the same privilege.

MANAGEMENT AND FIDUCIARY DUTIES

Limited Liability Company is by far the most flexible type of business entity in CA in structuring control and management for its members.

Limited Liability Company could be managed by ALL the members ("Member-Managed LLC") or by 1 or more managers ("Manager-Managed LLC"). The manager could be a member or non-member. The default rule is LLC is considered to be member-managed. Nonetheless the default rule is superseded by the Articles of Organization Item 6 of Secretary of State Form in which it requires selection of whether the Limited Liability Company is member-managed or manager-managed, and Articles PREVAIL over any conflicting provision in the operating agreement (Corp C 17005(5)).



MEMBER-MANAGED LIMITED LIABILITY COMPANY

In a Member-Managed Limited Liability Company, each member is an agent of the company and any act of the member for the apparent purpose of carrying on in the usual way of doing business BINDS the company. Even if the members among themselves have stripped a member from having the authority to bind the company with third parties, third parties are NOT BOUND by such internal agreement, UNLESS the third parties know about it. Corp C §17157(b)(2).

MANAGER-MANAGED LIMITED LIABILITY COMPANY

In a Manager-Managed Limited Liability Company, members are NOT agents of the Limited Liability Company for just being a member. Corp C §17157(b)(1). On the other hand, the managers whether members of the Limited Liability Company or not BIND the company in actions or transactions for the apparent purpose of carrying on the usual affairs of the Limited Liability Company. Corp C §17157(b)(2). Again, a manager's lack of authority is not binding on third parties, UNLESS the third parties had actual knowledge of such lack of authority. Corp C §17157(b)(2).

OFFICERS OF LIMITED LIABILITY COMPANY

A Limited Liability Company may have officers: President, Chief Financial Officer and Secretary. Corp C §17154. Officers, similar to managers, could be members of the Limited Liability or not. Corp C §§ 17151(a), 17154(a).

FIDUCIARY DUTIES OF A MEMBER OR MANAGER OF LIMITED LIABILITY COMPANY

A member of a Limited Liability Company has similar fiduciary duties as a manager. Corp C §17150. In turn, the fiduciary duties owed by a manager to the Limited Liability Company and its members are similar to those of a partnership and its partners. Corp. C § 17153.

VOTING RIGHTS IN A LIMITED LIABILITY COMPANY

Voting rights are spelled out in Articles of Organization or Operating Agreement. Right to vote could be predicated upon: the amount of investment and corresponding share of profits or losses. Some members of the Limited Liability Company could have voting rights to the exclusion of other members.

The default rules for voting rights, if the Articles of Organization and Operating Agreement are silent, are:

- A member may vote in proportion to the member's interest in profits. Corp C §17103(a)(1).
- Unanimity of all members is required for a vote to amend the Articles of Organization or Operating Agreement. Corp C §17103(a)(2).



- Vote of a “majority in interest of the members” is sufficient for all other matters requiring a vote. Corp C §17103(a)(3).

SOME DISADVANTAGES OF LIMITED LIABILITY COMPANIES

a) Not Suitable for Existing Incorporated Businesses: Converting an existing corporation, even an S Corporation, into a Limited Liability Company would trigger a TAXABLE liquidation of the corporation. The tax cost of a merger or conversion of an existing corporation into a Limited Liability Company should be considered before such conversion.

b) Not Suitable for Professional Practices: There is no Professional Limited Liability Company. In fact, a Limited Liability Company in CA is NOT authorized to practice a profession.

DISCLAIMER:

This article NEITHER supplants NOR supplements the breadth and depth of such esoteric topic. In fact, this article ONLY provides a rather rudimentary synopsis of such esoteric subject matter.

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