

Overcome Common Problems When Starting a LLC Company:

How to overcome some of the most common problems business owners run into when starting a if you form a Limited Liability Company (LLC).

Business Problems Overview:

Did you know 90% of new businesses fail within the first five years? Most business owners do not have the vast knowledge needed to run a business alone. Many times crucial mistakes are made which can cause the business to fail.

So, what are the key things the other 10% of business owners are doing to succeed? The most important thing they are doing is creating relationships that help them in the areas where they are not an expert. Relationships are critical in order to build a solid foundation in areas such as accounting, bookkeeping, sales, marketing, IT services or legal and risk management services.

Your greatest risk is that you don't know what you don't know. This is why building a business team can be the difference in growing or closing your doors. And, doing it right the first time can save you two, three, or more times the original cost of hiring a professional.

Setting up your business properly when incorporating or forming an LLC takes experience and knowledge to ensure it is done right. Hiring a professional business attorney to walk you through the process can help save time, money and give you peace of mind.

Read the following pages to learn more important LLC concerns. If you then feel putting an attorney on your team is right for you, please give us a call to set up an appointment.

Overcome Common Problems When Starting a LLC Company:

Tips and Concerns when you are forming an LLC.

Top 6 questions to think about or ask your advisor before you form an LLC:

1. What is an LLC and what are it's pro & cons?

2. How do LLCs manage risk?

3. How are LLCs organized?

4. How do LLCs operate?

5. How are LLCs managed?

6. How does capitalization affect an LLC?

Overcome Common Problems When Starting a LLC Company:

What is an LLC?

1. A limited liability company [“LLC”] is a business structure that provides limited liability for participants and permits pass through treatment for tax purposes per M.G.L 156C. LLC’s can have one or more owners, can be manager or member managed and can, in many cases, elect to be taxed as a disregarded entity [single member only], partnership or a corporation both at the federal and state level.

2. LLC’s can elect to be taxed as a disregarded entity [single member only], partnership or a corporation depending on it’s structure. By comparison, S Corporations can have only 100 shareholders, no corporations or partnerships [but some trusts] as a shareholder, no nonresident aliens as a shareholder, no multiple class of stock, no REITS, etc.

3. LLC’s statutes have Mandatory Provisions and Default Provisions.

Default Provision apply if the Certificate of Organization or Operating Agreement do not address a given legal issue. So it is important to insert these LLC optional provisions.

4. LLC’s statutes are state specific so you need to refer to your state laws for detailed information on what applies to you. The references herein are general only for discussion with your attorney and specific to the laws of the Commonwealth of Massachusetts.

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Pros and Cons of an LLC?

LLC Advantages

- Limited Liability
- Management Structure
- Exist Indefinitely
- Multiple Tax Classifications
- Can have multiple members security

LLC Disadvantages

- Tax Limitations
- Statute of Frauds applies to oral OAs
- Some states have entity tax on LLC
- Some states limit certain activities
- Single Member LLCs may give false

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Risk

1. LIABILITY TYPES:

INSIDE-OUT:

Inside liability is a legal claim that arose inside the business. Liability is determined by the LLC statute and the Operating Agreement and veil-piercing case law. It is similar to corporate shareholder liability and limited to your investment.

OUTSIDE-IN:

Outside Liability is a legal claim outside the LLC between a non LLC creditor and an LLC member individually. It is enforced by a Charging Order.

OPERATIONAL [illegal]:

No entity protection for operational liability such as lack of authority, torts, improper distribution, crime, false documents, fraud, etc.

SECURITY:

An LLC share may be a security only if the facts and circumstances surrounding the transaction of the parties warrant it to be so [see 4 part investment contract test].

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2. REMEDIES:

DEFINITION:

A Charging Order is a creditor's remedy ONLY as an ASSIGNEE to reach the membership interest of the LLC member's economic interest [distribution] versus non-economic interest [management rights]. It can make the creditor liable for LLC pro-rata tax liability. It is based on "delectus personae" principles. An LLC can be a good asset protection tool.

INSIDE TRENDS:

INSIDE: Massachusetts courts tend to apply the 12 part corporate shareholder liability factors of My Bread Baking Company case for veil-piercing issues to reach the debtor LLC member interest and current case law as well.

OUTSIDE TRENDS: CHARGING ORDERS:

Courts and IRS in some instances disregarding single member LLC's as separate entities [no alter ego & free transferability of interest]. Consequently, both the economic and the management interest may be transferred to the creditor. [See Olmstead v. FTC.]

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Organization

PARTICIPANTS:

Any “person” can be an LLC member which includes individuals, corporations, partnerships, limited partnerships, trusts, estates, LLCs and other associations.

A “member” is a person with an ownership interest in an LLC, like a shareholder in a corporation - but unlike a Joint Venture where participants are personally liable.

Members hold no DIRECT ownership of LLC property. Their interest is intangible personal property. Members rights [e.g. transfer] and privileges are often spelled out in a written Operating Agreement.

OPERATING AGREEMENT KEY ISSUES:

Member Authority; Withdrawal of Members; Compensation; Contributions; Capital Accounts; Allocation of Profits and Losses; Distributions; Management; Meetings & Voting; Rights, Duties & Obligations of Members; Dissolution; Taxation; Dispute Resolution; Record Keeping; Transfers & Assignments

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Operation

- 1.** ELECTIONS: If there are 2 or more Members then it's an automatic partnership unless you would like to be taxed as a corporation.

- 2.** ALLOCATIONS OF INCOME OR LOSSES: They need not follow or match distributions. See IRS 704b: 3 Part Test "substantial economic effect" for restrictions.

- 3.** DISTRIBUTIONS: They can be of Cash or Property. If Member provides a disproportionate amount of funds to LLC he can get a return of the excess through [a] Preference, [b] Loan, or [c] Installment Payment.

- 4.** RISK: Creating a new LLC is a good merger and acquisition risk management strategy because it creates indirect ownership of the TARGET company once the LLC buys it making the LLC liable, not the Acquirer.

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Management

- 1.** LLC ACT: It allows flexibility regarding authority and management [§24]. Management is vested in all members unless stated otherwise in Operating Agreement [“OA”].

- 2.** VOTING: Majority Rule unless in OA. Meetings can be formal or informal depending on procedures.

- 3.** MANAGEMENT: By committee, board, or single manager. Generally there is no personal liability. Titles such as President, Chairman, Director, and General Manager can be used.

- 4.** DUTY OF CARE OF MANAGERS AND DEADLOCKS: Rule: No standard of care in LLC Act itself [unlike MBCA 8.30 and 8.42] Little case law yet [unlike Donahue v. Rodd in corporations]. Best practice is to insert a Duty of Care standard in OA. Some deadlock options in OA include [a] Withdrawal with no penalty, [b] dissolve, [c] Buy-Out, or [d] Mediation/Arbitration.

- 5.** INDEMNIFICATION: LLC Act is flexible provided that Member/ Manager acted in good faith and reasonably believes it is in best interest of the LLC. No mandatory provisions in LLC Act so insert same.

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Capitalization

1. TYPES OF CONTRIBUTION PROVISIONS:

- a) Initial
 - b) Additional
 - c) Interest on Contribution
 - d) Default on Contribution
 - e) Return of Contribution
 - f) Maintenance of Capital Account
 - g) Loans to LLC
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2. DEFAULT: [§28] A Member has to keep their “promise” to contribute regardless of death or disability, etc. or unless in OA otherwise.

3. MEMBERSHIP ACCOUNTS: [§27] LLC can accept cash, property, services, promissory note, or other obligation to contribute same.

4. ALLOCATION & DISTRIBUTION: [§29 & 30] Based on “Agreed Value” unless as stated in the record of the LLC of the contributions of each member to the extent they have been received by the LLC and have not been returned.