

Business: Limited Liability Companies

LIMITED LIABILITY COMPANIES

Who should establish an LLC? If you are worried about personal exposure to lawsuits that arise from your company, you should think about forming an LLC (Limited Liability Company). For instance, you might be concerned that your commercial liability insurance will not completely protect your personal assets from possible slip-and-fall lawsuits or claims by your suppliers for unpaid invoices if you open a storefront business that works directly with the public. An LLC gives you personal protection from these and other possible claims against your business. However, not every business can function as an LLC. Businesses typically prohibited from establishing LLCs are those in the banking, trust and insurance industries.

Is an LLC or an S corporation better?

Even though the special tax status of the S corporation does away with double taxation, it doesn't have the elasticity of an LLC in distributing income to the owners. Various classes of membership interests are offered with an LLC, whereas you can only have one type of stock with an S corporation. In an LLC, a variety of individuals or entities may have interests, although the number of shareholders who can have ownership interest is restricted to no more than 100. C corporations, many trusts, LLCs, nonresident aliens, partnerships, or other S corporations may not have ownership of S corporations. It is also important to note that LLCs are permitted to have subsidiaries without limitations.

What does an LLC Operating Agreement signify?

It allows you to structure your financial and working relations with your co-owners in a way that best fits your company. Your co-owners and you determine each owner's percentage of ownership in the LLC, his/her rights and responsibilities, his/her share of gains or losses, and what will become of the business in case one owner leaves.

Is it necessary to have an Operating Agreement?

It is possible to have a written operating agreement in most states, but you are not advised to begin a business without one. The following are a few reasons why an operating agreement is necessary:

- By showing that you have been meticulous about organizing your LLC, it aids in guaranteeing that courts will be respectful of your personal liability protection.
- Rules that regulate how profits will be separated, the process for making major business decisions, and the measures for handling the departure and addition of members are established.
- It aids in avoiding misunderstandings between the owners and management over finances.
- It prevents your LLC from being regulated by the default rules in the LLC laws of your state, which may not be to your advantage.

Is it necessary to have LLC meetings?

Failure to have shareholder or director meetings can cause the corporation to be subject to alter ego liability, although this is not typical of LLCs in most states. For example, in California the failure of an LLC to have meetings with members or managers is normally not regarded as grounds for enforcing the alter ego doctrine if the LLC's Articles of Organization or Operating Agreement do not state the requirement of said meetings.

Are there exceptions to Limited Liability?

Even though LLC owners enjoy the benefits of limited personal liability for many transactions of their business, it is important to note that this protection is not absolute. The owner of the LLC may be held personally responsible if he/she purposefully does something illegal, fraudulent, or clearly wrong that causes injury to the company or someone else; is unsuccessful in depositing taxes withheld from employees' wages, or personally certifies a business debt or a bank loan that the LLC defaults on; personally and directly hurts someone; or acts as the LLC in the broadening of his or her personal affairs instead of an individual legal entity.

Continued on other side →

To access additional articles go to www.valleytax.net website and choose Financial Guides.

Business: Limited Liability Companies (cont.)

The most important is the final exception. There are times when a court may declare that an LLC isn't real and find that its owners are actually conducting business as individuals who are in fact responsible for their actions. To prevent this, be sure that your co-owners and you:

- Act legally and rationally. Do not hide or misrepresent material facts or the position of your finance to creditors, vendors or other third parties.
- Sufficiently fund your LLC. In order to meet foreseeable expenses and liabilities, make sure to invest adequate funds into the business.
- Maintain the LLC and personal business separate. Maintain your personal finances away from your LLC accounting books. Create a business-only checking account and obtain a federal employer identification number.
- Prepare an operating agreement. To create liability for your LLC's separate existence, a formal operating agreement in writing is helpful.

When your limited liability protection doesn't shield your personal assets, a good liability insurance policy will help. For example, if you are a massage therapist and you hurt a customer's back by accident, you will be covered by your liability insurance policy. This insurance also comes into play to protect your personal assets in the event that the court ignores your limited liability status.

This insurance can also protect your corporate assets from claims and lawsuits, as well as protect your personal assets in certain situations. However, it is important to realize that commercial insurance typically doesn't protect corporate or personal assets from unpaid debts of the business, whether they're personally insured or not.

To access additional articles go to www.valleytax.net website and choose Financial Guides.