



Excerpted from
FastTrac® TechVenture™



TAKE CHARGE OF YOUR BUSINESS®

A program of the Kauffman Foundation

Limited Liability Company (LLC)

The LLC is neither a corporation nor a partnership. This type of business entity, when properly structured, is designed to combine the benefits of corporate liability protection with the “pass through” tax treatment and management flexibility of a partnership.

Because it is the newest form of doing business, the laws concerning LLCs differ from state to state. You need to seek the guidance of an attorney before adopting this form of business.

To form an LLC, you must file articles of organization with the secretary of state. In addition, an operating agreement must detail how you will operate the business, share profits and losses, induct new members, and treat retiring and resigning ones.

The control of an LLC is in the hands of the owners, called members, and should be defined in your operating agreement. Members elect managers from among the membership or from outside. The operating agreement will determine not only how your management is selected but also the extent of the manager’s authority. It could be that only day-to-day operations are within the control of the manager and that the members as a whole will make all other decisions. The required number of members varies from state to state. Some states require at least two members to use this legal structure, while other states permit only one.

One principal advantage of an LLC occurs at tax time. The LLC may elect to be treated as a partnership. Like a partnership, then, the income and loss earned by the LLC are passed through to the members and reported on their respective tax returns. If no election is made, the LLC is taxed like a corporation.

The advantage of an LLC compared to a partnership is that the members’ liability for the debts of the LLC is limited to the extent of their investment in the business.

Transfer of ownership in an LLC requires the unanimous consent of all members unless the operating agreement provides otherwise. Thus, you have maximum flexibility regarding accepting new members and withdrawing or retiring existing members.

LLCs do not exist perpetually. Unless the operating agreement provides for its continued existence, an LLC ends upon the death of a member. Most states require a stated period of existence.

Since it is a collection of individuals, an LLC suffers from the same limitations on raising capital as partnerships. It does, however, have a method to raise modest amounts by requiring initial contributions or buy-ins by new members if the operating agreement provides this option.

Tip An LLC operating agreement, a critical document, should be written by an attorney. Its terms have a profound long-term effect and need to be carefully thought out.

Key Points about LLCs

- Owned by one or more entities in any combination (people, corporation, partnership, or other LLC).
- Controlled according to an operating agreement which details such specifics as operation and sharing of profits and losses.
- Income and loss passed through to individual members. Each partner's liability for the debts of the company is limited to the extent of their investment.
- Legal liability generally remains with the company.
- Can be sold as business or can be closed and its assets sold according to the operating agreement.
- An LLC operating agreement can provide for new partners, retirement, resignation, and continuation.
- Continues until dissolution according to terms of operating agreement. Some states set a 30-year lifetime.
- The operating agreement may provide for modest amounts of capital contributions from its members.

Limited Liability Corporation (LLC)

A group of highly skilled and successful scientists originally formed a partnership. They liked the flexibility of management. None liked to be told what they could or could not do by others, but they were concerned about losing individual property because of the actions of one of their partners. Their attorney initially suggested they form a corporation, however, they decided against a corporation alternative, objecting to the designation of one of their members as "President." Today they are happy as an LLC. They have hired a professional manager who runs the company administratively. Their personal assets are insulated from liability and income is taxed only once.

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