

Limited liability companies a summary of Texas law and Anatomy of a limited liability company

PREVIEW

1. The Texas Legislature created a new type of business entity called a limited liability company (LLC). LLC's are governed by the Texas Limited Liability Company Act.

a. The BOC codified the provisions of the prior law found in the Texas Business Corporation Act (TBCA), Texas Non-Profit Corporation Act (TNPCA), Texas Miscellaneous Corporation Laws Act (TMCLA), Texas Limited Liability Company Act (TLLCA), Texas Revised Limited Partnership Act (TRLPA), Texas Real Estate Investment Trust Act (TREITA), Texas Uniform Unincorporated Nonprofit Associations Act (TUUNAA), Texas Professional Corporations Act (TPCA), Texas Professional Associations Act (TRPA), the Texas Revised Partnership Act (TRPA), the Cooperative Associations Act (CAA), and other provisions of the Texas laws that govern domestic business entities.

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b. The BOC became effective January 1, 2006.

c. The BOC does not apply to entities that existed on January 1, 2006 unless the entity expressly elects after January 1, 2006 to adopt the BOC as its governing statute. The code applies thereafter on January 1, 2010. The BOC applies and governs all new entities that are formed after January 1, 2006.

2. A LLC is a new entity that has the characteristics and benefits of both a corporation and a limited partnership.

3. A LLC may engage in any lawful business unless the business is for a limited purpose which is limited in its Certificate of Formation or the business is governed by another corporate law which prohibits the entity from doing business as a LLC.

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4. A LLC may have the powers of a corporation under the Texas Business Corporations Act.

5. Its owners or investors are called members rather than shareholders.

6. A membership interest is a personal property interest and it may be evidenced by a membership certificate similar to a stock certificate.

7. The member, like a shareholder in a corporation, does not own any specific property in the LLC; all of the assets in a LLC are owned by and in the name of the LLC.

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8. A LLC also has the benefits of a Subchapter S corporation, in that a LLC can shield its members from personal liability arising from the operation of the business. The entity is treated as if it were a partnership for federal income tax purposes.

9. A LLC itself is not subject to federal income tax as regular corporations are.

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10. A LLC provides the tax benefits of a Subchapter S corporation, however, a LLC does not have to meet the restrictions that are applicable to S corporations, i.e. limited to Thirty-five shareholders.

PREVIEW

11. Many businesses which have previously elected to form a standard corporation, professional corporation, or limited partnership may choose to be formed as a LLC.

12. Attorneys and law firms may form LLC's or registered limited liability partnerships "RLLP".

13. The most significant feature of the act is the limited liability for members and managers. Members and managers are not liable for the LLC's debts, including but not limited to, a judgment, a decree, or an order of the court.

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14. A member of a LLC is not a proper party to a proceeding by or against the LLC, therefore, a LLC may provide more protection than a corporation.

15. A LLC will report for Federal Income Tax Purposes as a partnership.

16. A LLC will pay regular Texas Franchise tax. General Partnerships and sole practitioners in Texas do not pay franchise or business taxes.

17. The two terms used for the By Laws are Company Agreement or Regulations of the LLC.

Statutory authority

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1. Limited liability companies have the same power as a corporation under the Texas Business Organizations Code and a limited partnership under the Texas Revised Limited Partnership Act.

2. Except where the Company Agreement specifically provides otherwise, and to the extent the Company Agreement provides, a member or manager is not liable for the debts, obligations or liabilities of a limited liability company including under a judgment decree, or order of a court.

3. The Texas legislature, by enactment of this statute, intended that the legal existence of limited liability companies formed under this Act be recognized beyond the limits of Texas. In accordance with this intent and subject to any reasonable registration requirements, the legislature further provided that any such limited liability company transacting business outside of Texas should be granted the protection of full faith and credit under Section 1 of Article IV of the Constitution of the United States.

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4. The powers and business and affairs of a limited liability company are exercised and directed by the manager or managers, except to the extent the Company Agreement reserves such authority to the members of the company in whole or part.

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5. Any natural person who is at least 18 years old, or any other person (without regard to

place of residence, domicile, or organization) may act as an organizer of a limited liability company by signing the Certificate of Formation for the company and delivering the original and a copy to the Secretary of State together with a \$ 300 filing fee.

6. Each domestic or foreign limited liability company must have and continuously maintain a registered office in Texas which may be, but need not be, the same as its place of business. In addition, limited liability companies are required to have a registered agent whose business office is identical to the registered office.

Anatomy of a limited liability company

1. A LLC is organized and structured much like a standard Texas corporation. It is formed by the preparation and filing of Certificate of Formation by an organizer. This is similar to the filing Certificate of Formation (formerly known as Articles of Incorporation) by an incorporator for a Texas corporation.

2. LLC's are owned by members as compared to shareholders in a corporation.

3. A member may be any person, which includes:

- a. partnerships,
- b. limited partnerships,
- c. limited liability companies,
- d. foreign limited liability companies,
- e. trusts,
- f. estates,
- g. corporations,
- h. custodians,
- i. trustees,
- j. executors, etc.

4. Members may be divided into one or more classes or groups with differing rights, powers, and duties. They may also have differing voting rights.

5. A LLC is managed by its managers or manager in the same or similar fashion as a corporation is managed by its directors.

6. A LLC does not require its managers to be natural persons.

7. A LLC uses a Company Agreement to provide its rules. The Company Agreement should be in writing.

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8. A corporation is governed by its bylaws. LLC Company Agreements, although similar in form to corporate bylaws, are more akin to the traits of a partnership agreement.

PREVIEW

Limited liability company names

1. A limited liability company's name must contain the word "Limited Liability Company," or "Limited Company," or the abbreviations "L.C.C.," "LLC," "LC" or "L.C.". and any additional words that may be required by law.

2. It may not contain any word or phrase indicating or implying that it is organized for any purpose other than a purpose contained in the company's Certificate of Formation.

3. Furthermore, the company's name may not be the same as, or deceptively similar to, the name of an domestic limited liability company, corporation or limited partnership existing under the laws of Texas.

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4. Likewise the name may not be the same as the name of any foreign limited liability company, corporation or limited partnership authorized to transact business in Texas. The name may not be the same as one which has been reserved pursuant to the Texas Limited Liability Company Act or any other statute providing for the reservation of names by a corporation or limited partnership with the Secretary of State.

5. A limited liability company's name may be similar to a name reserved by another limited liability company, corporation, or limited partnership if written consent is obtained from the existing entity.

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6. Any domestic or foreign limited liability company having authority to transact business in Texas may do so under an assumed name by filing an assumed name certificate in the manner prescribed by law.

Management of a Limited Liability Company

1. A LLC may be managed by its members, managers, or officers. The author prefers to have the LLC managed by a manager and not the members.

2. The Certificate of Formation must specify how the LLC will be managed.

3. The Company Agreement, if adopted, shall state how the LLC will be managed. The Company Agreement may reserve the right to manage the LLC to the members, in whole or in part, or delegate the same to managers.

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4. If the LLC is being managed by managers, managers act in a similar manner as directors of a corporation.

5. Managers are elected initially by the members, they do not need to be residents of Texas or members of the LLC.

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6. Managers may be given the powers and duties that directors and officers would have in a corporation.

7. The act also provides that managers may designate one or more persons who are not managers to be officers of the LLC.

8. The officers may be given the powers as stated in the Company Agreement.

Voting by the Limited Liability Members

1. The Company Agreement may specify the manner and procedure for voting by the members.

2. There may be one or more classes of members and the same applies to voting rights.

3. A LLC may have voting and non-voting members.

4. When one considers the above along with the management operations unique to LLC's, a LLC has much more flexibility than a traditional corporation.

Distribution of Limited Liability Company property

1. The Company Agreement should state the manner in which cash or other assets will be distributed.

2. In the absence of a provision in the Company Agreement, the distribution shall be made on a pro rata basis in accordance with the agreed value of the contributions of each member.

Transferability of Limited Liability Company interests

1. A member may sale or assign his or her membership interest much like stock certificate.

2. The assignment does not give the assignee or purchaser the ability to exercise the rights or power of a member.

3. An assignment simply entitles the recipient to take the distributions that the assignor was entitled to.

4. One can only become a member of a LLC upon the consent of all the other members in the company. Of course the Company Agreement may provide for a majority vote.

Admission of new limited liability members

1. After a LLC has been organized, a person may become a new member pursuant to the terms of the Company Agreement.

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Registered agents & offices for limited liability companies

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1. LLC's are required to maintain registered offices and agents like corporations.
2. A member, manager or non-member/manager may be the registered agent.

Amendment and mergers with limited liability companies

1. The Certificate of Formation and Company Agreement may be amended (just as corporations).
2. Established and existing businesses and corporations may be merged into or converted to a LLC, however, this may constitute a dissolution of the corporation for tax purposes, therefore, the practitioner should have the decision reviewed by competent tax counsel prior to making the decision.

Dissolution of a limited liability company

1. A LLC may be dissolved as follows:
 - a. At the end of the thirty (30) year time period,
 - b. As stated in the Certificate of Formation or in the Company Agreement,
 - c. By written consent of all of the members
 - d. Upon the following events to one of its members:
 - i. death,
 - ii. retirement,
 - iii. resignation,
 - iv. expulsion, or
 - v. bankruptcy.
 - e. A LLC may continue its existence if all of the remaining members vote to continue the business.
 - f. Certificate for withdrawal or dissolution. The 77th legislative session, Senate Bill 1123 amended Articles 6.08.A and Articles 7.10A of the Texas Limited Liability Act to provide that application must be accompanied with a certificate that state all taxes, penalties and interest administered by the Texas Comptroller's Office under title 2 of the Texas Tax Code have been

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paid by the Company. Prior to the amendment, the application only had to state that franchise taxes were paid. Failure to pay the taxes and other fees administered by the Comptroller will prevent the issuance of a certificate of dissolution of a domestic limited liability company. A foreign limited liability company must also show that it has paid all of its taxes as well.

Special concerns for a LLC

1. Some special factors to consider before forming a LLC are as follows:
 - a. Doing business in other states. Other states may not recognize a LLC,
 - b. Lack of Recognition. Banks, Title Companies, or others may be uncomfortable dealing with a LLC and may impose different requirements than those imposed upon a corporation.

Tax protection

1. The Company Agreement may be subject to attack by the IRS, consequently a LLC's status may be challenged by the IRS.
2. A successful challenge by the IRS could do away with the intended tax benefits for forming a LLC.
3. Current tax law is well developed on corporate status, however, little law exists on LLC's. Consequently member's responsibilities are not as well defined as those in corporate law.
4. There is no limit on the number of members that a LLC may have, whereas, a Subchapter S Corporation is limited to 35 shareholders. Yet a LLC may have the same benefits as a Subchapter S Corporation assuming the IRS does not contest the LLC's status, which assumption cannot be lightly made.
5. It is not certain whether one person can form a LLC and receive the same tax protection when a LLC is formed with more than one person. Since a LLC is taxed as if it were a partnership, the IRS may disallow LLC's which are comprised of a sole member since it takes more than one person to form a partnership.
6. Consequently it may be possible for a one person LLC to be legally recognized under state law, but disallowed under IRS regulations or rulings.

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