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Preface

The advent of limited liability companies and passage of California's Beverly-Killea Limited Liability Company Act on September 30, 1994, inspired CEB to design and publish a comprehensive practice book for California lawyers. The excellence of this practice book was recognized in 1996, when it won an "Award for Professional Excellence" in the "Best Publications" category, given by the International Association for Continuing Legal Education.

Forming & Operating California Limited Liability Companies provides the practitioner with the legal and practical guidance to organize, operate, and dissolve California limited liability companies (LLCs). It also assists them with the preliminary work, such as establishing the attorney-client relationship and choosing the correct form of entity for the client's business. This second edition builds on those efforts with helpful new forms, "plain language" improvements to existing forms, the latest information on new filing procedures at the Secretary of State's office, a newly revised chapter on the "series LLC" phenomenon, and updated statutory and case law developments.

The book contains features designed to make the contents more easily accessible, the forms more useful, and the practitioner's work more efficient:

- Chapter outlines: Listings of section headings provide a sequential preview of topics covered in each chapter. This outline not only helps the practitioner to turn directly to the sections that contain needed information, but also serves as a guide to the order of the steps necessary to pursue the procedures covered in the chapter.
- Scope: Each chapter begins with a brief description of the subject covered in the chapter and cross-references to other resources.
- Notes: Special practice notes highlight advice or information that may assist the practitioner to better advise the client or avoid a problem.
- Forms: Forms to implement the selected courses of action or procedures appear throughout the text of the book. Comments to the forms advise on their proper use and draw attention to legal principles that might affect how an attorney drafts a particular document or provision.

CEB gratefully acknowledges the California attorneys who wrote or updated chapters for the book and so generously gave of their knowledge and specialized skills. See "About the Authors" for biographical information. CEB also acknowledges the contributions of the practicing attorneys who reviewed each chapter manuscript and contributed many helpful suggestions to the text. Their names are listed under "Acknowledgments."

CEB Attorney David Peyerwold was the project manager for this book. Kindra Kemp copyedited the book and oversaw production. Legal research assistance was provided by Andy Rosner, Kristin Schwaighart, and Crin Valley. The book was designed by Grier Thornburg. The index was prepared by Kathryn Te Selle and Robert Burke. Composition was performed by CEB's Electronic Publishing staff.

May 2010 Update

CEB gratefully acknowledges the contribution of Ronald P. Wargo, of Friedemann Goldberg LLP in Santa Rosa, who prepared the detailed comparison of California and Delaware LLC law for this year's update. (See new Appendix D.)

CEB Attorney Editor David Peyerwold and Legal Editors Ken Marr and Kristin Schwaighart contributed to this update. Administrative support was provided by Kenya Denman and Nila Kanzaria. Christopher Forshay handled copyediting and production. CEB's Indexing staff updated the index. Composition was performed by CEB's Electronic Publishing staff.

Michael Fenger
Practice Group Manager
Business Law

Pamela J. Jester
Director

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About the Authors

CEB is grateful to the following members of the State Bar of California who served as authors of this book:

GARY L. BRADUS received his B.S. degree in 1984 from the University of California (Berkeley) and his J.D. degree in 1987 from the University of California (Los Angeles). Mr. Bradus practices in the areas of corporate, partnership, and banking law with the Weintraub Genshlea Chediak Law Corporation in Sacramento. He has represented debtors and lenders in numerous personal property secured transactions and has formed and advised professional corporations and partnerships.

RICHARD G. BURT received his B.A. degree in 1970 from the University of Pennsylvania and his J.D. degree in 1973 from George Washington University. Mr. Burt practices law in San Jose, specializing in commercial and real estate transactions and business organizations. He has served several times as a member of the Partnerships and Limited Liability Companies Committee of the State Bar's Business Law Section.

COLBY A. CAMPBELL received her A.B. degree in 1980 from the University of California (Berkeley), her J.D. degree in 1985 from the University of Santa Clara, and her LL.M. in taxation in 1992 from Golden Gate University. Ms. Campbell is a shareholder with the law firm of Trainor Fairbrook in Sacramento, specializing in tax, estate planning, limited liability companies, and partnerships.

LEONARD E. CASTRO received his B.A. degree in 1959 and his J.D. degree in 1962 from the University of California (Los Angeles), where he was Note and Comment Editor of the UCLA Law Review. Mr. Castro practices in Los Angeles, specializing in corporate and securities law. He has negotiated numerous joint ventures, mergers, and acquisitions and has counseled publicly traded corporations in wide-ranging business matters.

CHRISTOPHER CHEDIAK received his B.S. degree in 1980 from the University of California (Davis) and his J.D. degree in 1983 from the University of Southern California. Mr. Chediak is a shareholder and a member of the corporate department of the Weintraub Genshlea Chediak Law Corporation in Sacramento. He is a member of the State Bar Business Law Section's Corporations Committee and formerly a member of the Partnerships and Limited Liability Companies Committee that assisted the legislature in drafting California's LLC Act.

PAUL J. DERENTHAL received his B.A. degree in 1976 from the University of San Francisco and his J.D. degree in 1980 from Hastings College of the Law. Mr. Derenthal is a partner in the law firm of Derenthal & Dannhauser in San Francisco. His practice focuses on organizing, capitalizing, and counseling businesses and on securities law compliance matters. He also serves as an arbitrator for the National Association of Securities Dealers.

ALLAN B. DUBOFF received his B.A. degree in 1980 from the University of California (Los Angeles), his J.D. degree in 1984 from the University of Pennsylvania, and his M.B.A. from the Wharton Graduate School, University of Pennsylvania. Mr. Duboff, of Loeb & Loeb LLP, Los Angeles, specializes in general corporate, partnership, limited liability company, and real estate matters and in secured transactions. He was a member of the State Bar Business Law Section's Partnerships and Limited Liability Companies Committee that assisted the legislature in drafting California's LLC Act. He also has served as the Vice Chair of the Executive Committee of the Los Angeles County Bar Association, Business and Corporations Law Section.

STEVEN M. FLEISHER received his A.B. degree in 1966 from Yale University and his J.D. degree in 1969 from Harvard Law School. Mr. Fleisher is in the Law Department of Blue Shield of California in San Francisco. He has served as Secretary of the Executive Committee of the State Bar Business Law Section and as a member of its Partnerships and Limited Liability Companies Committee that assisted the legislature in drafting California's LLC Act.

DAVID M. GREENBERG received his A.B. degree in 1965 from Antioch College, his J.D. degree in 1968 from New York University, and his LL.M. in corporation law in 1971 from New York University. Mr. Greenberg is a securities lawyer in Larkspur. He was a member of the Partnerships and Limited Liability Companies Committee of the State Bar Business Law Section that assisted the legislature in drafting the statutory conversion provisions of California's LLC Act and partnership statutes.

KIRAN C. JAIN received her B.A. degree from Barnard College in 1998, a Master of International Affairs degree from Columbia University in 1999, and her J.D. degree from Georgetown University Law Center in 2004. She is an associate in the Land Use & Development Group at Bingham McCutchen in San Francisco. Before attending law school, Ms. Jain was an economics consultant in the International Transfer Pricing Group at Arthur Anderson LLP in New York and Washington, D.C. On graduating from Columbia University, she served as a consultant to the United Nations' Framework Convention on Climate Change in Bonn, Germany. She served as an intern at the White House in 1996.

PHILLIP L. JELSMA received his B.S. degree in 1979 from the University of Southern California and his J.D. degree in 1986 from Stanford Law School, where he was a member of the Stanford Law Review. Mr. Jelsma practices law in San Diego, specializing in tax law. He served as the Taxation Section's liaison to the LLC Drafting Committee and has served as a consulting editor of the California Tax Lawyer.

JACK S. JOHAL received his B.A. degree in 1978 from Occidental College, his J.D. degree in 1981 from Duquesne University, and his LL.M. in taxation from New York University. Mr. Johal is a partner with the firm of Hanson Bridgett Marcus Vlahos Rudy LLP in Sacramento. His practice focuses on tax, business organization, and estate planning law. He was a member of the State Bar Business Law Section's Partnerships and Limited Liability Companies Committee that assisted the legislature in drafting California's LLC Act.

PAUL L. ("CHIP") LION III received his B.A. degree in 1979 from the University of California (Davis), his J.D. degree in 1982 from Santa Clara University, and his LL.M. in taxation in 1983 from New York University. Mr. Lion is a partner in the firm of Morrison & Foerster, Palo Alto. He represents clients in all aspects of taxation, corporate finance, partnerships, health care law, and general business matters. As Chair of the Partnerships and LimitedLiability Companies Committee of the Business Law Section of the California State Bar 1991-1992, he formed and participated on the Limited Liability Company Act Drafting Committee and also participated in drafting the California Revised Uniform Partnership Act.

MARK D. LUBIN received his B.A. degree in 1973 from Columbia University and his J.D. degree in 1977 from the University of California School of Law (Berkeley). Mr. Lubin is a partner in the firm of Stein & Lubin LLP in San Francisco, specializing in business and real estate transactions, LLCs and partnerships, and real estate finance. He was CoChair of the Partnerships and Limited Liability Companies Committee of the California State Bar Business Law Section. His efforts were instrumental in the drafting and adoption of the California Revised Uniform Partnership Act and other legislation concerning partnerships and LLCs.

EDWARD S. ("DOC") MERRILL received his B.A. degree in 1968 from the University of California (Santa Barbara) and his J.D. degree in 1976 from Loyola Law School. Mr. Merrill is a partner with Bingham McCutchen in Walnut Creek. His practice emphasizes corporate and real estate matters. He specializes in noncorporate entities such as partnerships, limited liability companies, limited partnerships, limited liability partnerships, and business trusts. He has participated on state and national panels on structuring partnership agreements and is past chair of the California State Bar Business Law Section's Partnerships and Limited Liability Companies Committee and of the Revised Uniform Partnership Act Subcommittee.

MICHAEL S. POWLEN received his B.A. degree from Temple University in 1974 and his J.D. degree from Stanford Law School in 1984, where he was elected to Order of the Coif and was Senior Articles Editor for the Stanford Law Review. His practice experience encompasses a broad range of business, financial, and tax transactions, including entity formation, mergers and acquisitions, private equity and debt financing, real estate acquisition and financing, reorganizations, work outs, and public offerings. Mr. Powlen is also a well-regarded educator, having taught courses for the Practicing Law Institute, American Law Institute, American Bar Association, New York University Tax Institute, Continuing Education of the Bar, Tax Executive Institute, Stanford Law School, and other professional organizations.

MICHAEL G. SCHINNER received his B.A. degree from the College of Mount St. Joseph on the Ohio, his J.D. degree from the University of Cincinnati, and his LL.M (Taxation) from Golden Gate University. Mr. Schinner is the founder of The Schinner Law Group, a San Francisco and Silicon-Valley-based law firm specializing in corporate and tax law. He is also an adjunct professor at Golden Gate University, where he teaches courses on limited liability companies and S corporations.

ROBERT C. TRASK received his B.S. degree in 1981 from the University of South Dakota and his J.D. degree in 1984 from the University of Southern California. Mr. Trask presently is a principal with Metropolitan Pacific Capital, LLC in Santa Monica. He chaired the Partnerships and Limited Liability Companies Committee of the California State Bar Business Law Section, which assisted the legislature in drafting California's LLC Act.

WILLIAM F. WEBSTER received his B.A. degree in 1981 from the University of California (Santa Barbara) and his J.D. degree in 1989 from Hastings College of the Law. Mr. Webster is with the Lakeside Financial Group in Redding. He is a former member of the Executive Committee of the Business Section of the Sacramento County Bar Association.

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Jonathan Axelrad

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R. Douglas Bramhall

Phoenix

Richard H. Bruck

Richard H. Bruck, PC, Irvine

Richard G. Burt*

San Jose

Leonard E. Castro*

Los Angeles

Steven Charno

Douglaston, NY

James Dawe

Dawe & Christopherson LLP, San Francisco

James F. Donlan

Sidley Austin LLP, Los Angeles

James F. Fotenos

Greene Radovsky Maloney Share & Hennigh LLP, San Francisco

Lisa Hamilton Klein

Richardson & Patel LLP, Los Angeles

Kai Tamara Hare

Intuit Inc., Palo Alto

Sanford Holo

Musick Peeler & Garrett LLP, Los Angeles

Phillip L. Jelsma*

San Diego

Riaz Karamali

Thelen Reid Brown Raysman & Steiner LLP, Palo Alto

John E. Karayan

California State Polytechnic University, Pomona

Martina N. Knee

Heller, Ehrman, White & McAuliffe, Palo Alto

Marshall A. Lewis

Lewis Hoxie & Spear, San Diego

Mark D. Lubin*

Stein & Lubin LLP, San Francisco

Keith McBride

The Diepenbrock Law Firm, Sacramento

Edward S. Merrill*

Bingham McCutchen, Walnut Creek

David F. Morgan

Barton, Klugman & Oetting, Los Angeles

William K. Norman

Ord & Norman, Los Angeles

Richard W. Power

Carle, Mackie, Power & Ross LLP, Santa Rosa

Joseph S. Radovsky

Greene Radovsky Maloney Share & Hennigh, San Francisco

Michelle A. Reinglass

Laguna Hills

Sidney R. Rose

Los Angeles

Cynthia R. Rowland

Coblentz, Patch, Duffy and Bass LLP, San Francisco

Dale E. Short

Troy & Gould, Los Angeles

Lowell W. Tatkin

Playa Del Rey

Doron M. Tisser

Calabasas

Kevin S. Veenstra

Sonoma Law Group LLP, Santa Rosa

Thomas F. Wisialowski

Paul, Hastings, Los Angeles

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Selected Developments

May 2010 Update

Under IRC §1202(a), individual taxpayers may exclude 50 percent of any gain they realize from the sale or exchange of qualified small business stock held for more than 5 years. For small business stock acquired in 2009 and 2010, the 50-percent exclusion has been increased to 75 percent. IRC §1202(a)(3). See §3.20.

In Delaware, an LLC operating agreement may limit or eliminate the managers' fiduciary duties to a greater degree than is permissible in California. See *Fisk Ventures, LLC v Segal* (Del Ch 2008) 2008 Del Ch Lexis 158, aff'd (Del 2009) 984 A2d 124; §3.95.

Revenue and Taxation Code §§480.1 and 480.2 have been amended to require the filing of a change in ownership statement with the State Board of Equalization within 45 days of a change of ownership or control of an LLC owning real property in the state. A 10-percent penalty will be imposed for failure to file such a statement. See §4.30.

Revenue and Taxation Code §25135 has been amended to adopt the *Finnigan* rule in assigning sales from tangible personal property in California for taxable years beginning on or after January 1, 2011. Revenue and Taxation Code §25136 also has been amended to provide new rules for assigning sales from other than tangible personal property in California for taxable years beginning on or after January 1, 2011. See §5.4B.

For tax years beginning in 2009 or 2010, the 10-year "recognition period" has been shortened to 7 years, after which time no tax will be imposed on the net recognized built-in gain of an S corporation that liquidates or sells its assets after having converted from a C corporation. See §11.13.

A new chart has been added to the book, comparing California and Delaware law. See App D.

The Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07) became fully effective on January 1, 2010. All cites to the former California Revised Limited Partnership Act (former Corp C §§15611-15724) have been updated accordingly.

Note that the Secretary of State's San Diego regional office closed on April 2, 2010.

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Cutoff Dates and CEB Citation

Cutoff Dates

We completed legal editing and analysis of authorities cited in this publication as of March 1, 2010, and monitored developments through March 22, 2010.

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Overview of California Limited Liability Companies

Richard G. Burt

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I. INTRODUCTION

§1.1 A. Scope and Purposes of Book

This book is a basic practice guide to organizing, operating, merging, converting, and dissolving California limited liability companies (LLCs). The book also covers the operation of foreign LLCs in California (chap 14) and series LLCs (chap 15).

This book extensively discusses the tax issues involved in forming and operating an LLC (chaps 4-5), as well as in converting an existing entity to an LLC or vice versa (chap 11). Business and other nontax factors to consider in selecting the LLC form of business (chaps 3, 6), as well as filing requirements (chap 7), concerns relating to securities laws and issuance of membership interests (chap 12), and LLC operation (chap 13) and dissolution (chap 16) are also discussed.

This book also provides long- and short-form annotated operating agreements, with a discussion of when to use these forms (chaps 8-10). Prescribed Secretary of State forms are reproduced, as discussed, throughout the book.

This introductory chapter discusses LLCs generally, summarizes California's LLC law, and outlines the advantages and disadvantages of LLCs.

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B. Limited Liability Company Basics

§1.2 1. What Is a Limited Liability Company?

A limited liability company is a form of business organization that is treated as a partnership for income tax purposes and as a corporation for liability purposes. Generally, an LLC is a legal entity formed under a statutory scheme that allows one or more owners to carry on a business with none of the owners having personal liability for the obligations of the business.

Under the Beverly-Killea Limited Liability Company Act of 1994 (Corp C §§17000-17655) (the Act), an LLC is formed when articles of organization are filed with the California Secretary of State on the Secretary of State's Form LLC-1 and, generally, one or more LLC "members" enter into an operating agreement. The operating agreement may be entered into either before or after the articles of organization are filed. Corp C §17050. It may be oral or written and may consist simply of an agreement to form an LLC (Corp C §17001(ab)).

The salient nontax characteristics of an LLC are limited liability for its owners (as in a corporation) and freedom to structure management rights and financial interests in the entity in virtually any configuration the parties wish (as in a partnership).

Most often, an LLC will elect to be treated as a partnership for income tax purposes, in which case the income, gains, losses, deductions, and credits of the LLC generally will flow through to its members for reporting on their personal tax returns.

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§1.3 2. Advantages of LLC Form Over Limited Partnership and S Corporation Forms

Until the advent of the LLC, the limited partnership and the S corporation were the primary forms of business entity used to achieve the tax status and limited liability features now offered by the LLC. Each of those forms of business organization, however, has drawbacks. An LLC can provide the advantages of a limited partnership or an S corporation without the disadvantages.

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§1.4 a. Advantages Over Limited Partnership

Although a limited partnership allows pass-through tax treatment, flexibility in financial structuring, and limited liability for limited partners, at least one person, *i.e.*, a general partner, must be fully liable for the obligations of the business, and limited partners may not take part in the control of the business without jeopardizing their limited liability.

Unlike a limited partnership, no LLC owner ("member") need be personally liable for the company's obligations, and each member is permitted to manage the company and to take part in the control of its business without losing the member's limited liability (Corp C §§17101, 17150).

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§1.5 b. Advantages Over S Corporation

Although an S corporation allows pass-through tax treatment and limited liability for all owners, S-corporation status limits the parties' flexibility in structuring their financial arrangements because of the requirements that the corporation have no more than one class of stock (IRC §1361(b)(1)(D)) and that items of income, gain, loss, deduction, or credit be taken into account in accordance with the shareholders' prorata share of the corporation's stock (IRC §1366). Furthermore, only individuals, estates, certain types of trusts, and certain tax-exempt organizations are permitted to be S-corporation shareholders (IRC §1361(b)(1)(B)), and an S corporation will lose its pass-through tax treatment if an ineligible entity becomes a shareholder. Finally, the pass-through income tax treatment offered by an S corporation differs somewhat from that of a partnership, and this different treatment can sometimes have adverse tax consequences. See §§3.32-3.37.

An LLC can have different classes of ownership; income, gain, loss, and other items may be allocated disproportionately to ownership without affecting the LLC's pass-through tax treatment. Unlike an S corporation, any "person"—*i.e.*, any individual, partnership, limited partnership, trust, estate, association, corporation, other limited liability company, or other entity, whether domestic or foreign—can be a member of an LLC. See Corp C §17001(ae).

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II. OVERVIEW OF CALIFORNIA'S LLC ACT

§1.6 A. Definition of LLC

An LLC is defined in Corp C §17001(t) as an entity having one or more members that is organized under the Act. The definition in Corp C §17001(t) makes it clear that an LLC is an entity rather than an aggregation of the members.

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§1.7 B. Business Purpose

Corporations Code §17051(a)(2) requires that the articles of organization of a California LLC contain the following prescribed statement:

The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act.

Under Corp C §17002(a), an LLC may engage in any lawful business activity, whether or not for profit, except:

- The banking business;
- The business of issuing insurance policies and assuming insurance risks; or
- The trust company business.

Further, although it is clear that a profession may not be practiced in LLC form, there is some uncertainty over the degree to which a domestic or foreign LLC may render "professional services" that require a license, certification, or registration authorized by the Business and Professions Code. Corp C §§13401-13401.5, 17375; see §§1.28, 3.92, 7.13.

An LLC also may operate as a health care service plan if it is a subsidiary of a health care service plan licensed under Health and Safety Code Ch 2.2 and the LLC is established to serve an existing line of business of the parent health care service plan. Corp C §17002(b).

In California, the limited liability partnership (LLP) form is available to partnerships engaged in the practice of architecture, public accountancy, or law. Corp C §16101(6). For discussion of LLPs, see Advising California Partnerships, chap 6 (3d ed Cal CEB 1999).

Some other states permit the formation of professional limited liability companies (PLCCs) for the practice of law or other professions. California does not; nor will the Secretary of State allow PLCCs formed in other jurisdictions to register to do business in California.

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§1.8 C. Powers

In carrying out its business activities, an LLC has all the powers of a natural person. Corp C §17003. This includes the right to be a promoter, stockholder, partner, member, manager, associate, or agent of any person. Corp C §17003(k). It also includes the right to sue and be sued, to make contracts, to lend money, and to issue notes and bonds. Corp C §§17003(b), (d), (g)-(h).

An LLC can enforce any pre-organization contract made on its behalf, if the LLC adopts or ratifies the contract after formation. *02 Development, LLC v 607 South Park, LLC* (2008) 159 CA4th 609, 71 CR3d 608 (assignment of rights in hotel purchase agreement).

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§1.9 D. Default Rules

The Act sets forth in great detail rules governing the relationship of the members to each other and to the LLC, but expressly permits the members to vary most of the rules by provisions in the articles of organization or operating agreement. See Corp C §17005(a). The rules set forth in the Act apply in default of an agreement of the members to the contrary. With some limited exceptions, freedom of contract for internal affairs is the controlling principle of the Act. The rules that may not be changed or that may be varied only in a specified fashion are enumerated in Corp C §17005(b)-(c). On permitted modifications of the default rules, see §§8.4-8.5.

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§1.10 E. Articles of Organization

The articles of organization, amendments of the articles, and other filings with the Secretary of State are generally made on preprinted forms prescribed by the Secretary of State. See §7.15 for Form LLC-1 (Articles of Organization). The parties may add to the articles any provision not inconsistent with law (Corp C §17051(c)), *e.g.*, a restriction on the authority of the managers (Corp C §17051(c)(4)). The contents of the articles do not constitute constructive notice, however, and such a restriction or other limitation would not be binding on anyone without actual knowledge. Corp C §17051(d)(3). If provisions of the articles of organization conflict with the operating agreement, the articles control. Corp C §17005(f).

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§1.11 F. Operating Agreement

The operating agreement ordinarily sets forth the agreement of the LLC's members, much as a partnership agreement sets forth the agreement of the partners. An operating agreement typically covers, among other things, the members'

- Obligation to contribute capital;
- Allocations of profit and loss;
- Shares of distributions; and
- Management and voting rights.

On forms of operating agreements, see chaps 8-10.

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§1.12 G. Owners Not Personally Liable

The owners of an LLC are called members. See Corp C §17001(x). The Act states that a member is not personally liable for any contract, tort, or other obligation of the LLC by virtue of being a member. Corp C §17101. Further, the Act specifically permits members to manage the business and affairs of an LLC (Corp C §17150) and states that persons acting as managers of an LLC will not be liable for any contract, tort, or other obligation of the LLC by virtue of being a manager. Corp C §17158. Members of an LLC may waive their limited liability and agree to be obligated personally for any or all of the debts, obligations, and liabilities of the LLC, as long as the waiver is set forth in the articles of organization or in a written operating agreement that specifically refers to Corp C §17101(e).

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§1.13 H. Capital Contributions

A member may contribute to the capital of an LLC money or other property, services, or a promise to provide property or services. Corp C §17200(a). A member is not excused from performing a promise to contribute property or services by reason of death, disability, or otherwise, unless the articles of organization or operating agreement excuse it. Corp C §17201(a)(1).

A member who fails to contribute property or services may be required, at the LLC's option, to contribute cash in an amount equal to the fair market value of the property or services that have not been contributed; in addition, other rights (such as the right of specific performance) may be asserted against the noncontributing member. Corp C §17201(a)(2).

A provision in the operating agreement that specifies the consequences of a member's failure to make a promised contribution is enforceable unless the noncontributing member establishes that the provision was unreasonable under the circumstances when the agreement was made. Corp C §17201(a)(3).

Unless provided otherwise by the articles of organization or operating agreement, a member is not obligated to make any additional contribution to the LLC. Corp C §17200(b).

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§1.14 I. Profits and Losses

Unless the operating agreement provides otherwise, profits and losses will be allocated among the members in proportion to their capital contributions. Corp C §17202. One of the advantages of an LLC is the flexibility accorded members in the allocation of profits and losses. The tax effect of such allocations, often an important consideration, may depend on compliance with the IRS's "special allocation" regulations. See §§5.36-5.50 and Comments to the forms in §§9.23-9.31.

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§1.15 J. Distributions

Unless the operating agreement provides otherwise, distributions that are a return of capital will be made in proportion to the capital contributions made by each member and distributions that are not a return of capital will be made in proportion to the members' allocated shares of profit. Corp C §17250.

The Act sets forth certain restrictions on distributions, principally prohibitions on making distributions that render the LLC unable to pay its bills as they come due in the usual course of business and on making distributions that make the LLC's total assets less than the sum of its total liabilities. Corp C §17254. The recipient of a distribution made in violation of these statutory restrictions or in violation of the operating agreement may be required to return it to the LLC (Corp C §17254(e)), and the managers or members who voted in favor of such a distribution may be held personally liable for the amount of the distribution that exceeded permitted levels (Corp C §17255(a)). The statute of limitations for claims relating to distributions is generally four years. Corp C §17254(f).

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§1.16 K. State Taxes and Fees

An LLC must pay a tax of $800 per year for the privilege of being an LLC regardless of gross receipts or net income. Rev & T C §17941. This amount is equal to the minimum tax imposed on corporations, including S corporations (Rev & T C §23153(a)), on limited partnerships (Rev & T C §17935(a)), and on limited liability partnerships (Rev & T C §17948(a)). New corporations are not required to pay the minimum franchise tax for their first taxable year, but this exception to paying the $800 annual minimum tax does not apply to new LLCs. Rev & T C §23153(f)(1)-(2).

An LLC pays no net income tax, but unless it has total income of less than $250,000, the LLC must pay an annual fee based on the total income derived from or attributable to California for the taxable year. This annual fee is in addition to the $800 tax mentioned above. Rev & T C §17942(a). For taxable years beginning on or after January 1, 2009, the annual fee must be estimated and paid no later than the 15th day of the 6th month of the taxable year. See §§5.4-5.5.

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§1.17 L. Management and Fiduciary Duties

An LLC allows as much or more flexibility in structuring management and control than any other form of business organization under California law. An LLC can be managed either by all the members (a "member-managed LLC") or by one or more managers (a "manager-managed LLC"). The managers in a manager-managed LLC may be either members or nonmembers. The default rule is that an LLC is considered to be member managed (Corp C §17150), but the default rule is effectively superseded by the articles of organization because Item 6 of Secretary of State Form LLC-1 (Articles of Organization) requires a statement indicating whether the LLC is member managed or manager managed, and the articles prevail over any conflicting provision in the operating agreement (Corp C §17005(f)). See also Corp C §17151(b); §7.20.

In a member-managed LLC, each member is an agent of the LLC, and any act of a member for the apparent purpose of carrying on in the usual way the affairs of the LLC binds the LLC. Corp C §17157(a). Although the members may agree that a member has no authority to act, either generally or with respect to a particular matter, third parties are not bound by that agreement absent their actual knowledge that the member lacks authority to act. Corp C §17157(a). The rules in this regard are similar to the rules that apply to general partnerships.

In a manager-managed LLC, no member is an agent of the LLC by virtue of being a member. Corp C §17157(b)(1). Instead, every manager is an agent of the LLC, and any act of a manager for the apparent purpose of carrying on in the usual way the affairs of the LLC binds the LLC. Corp C §17157(b)(2). A manager's lack of authority to act is not binding on third parties without actual knowledge of the lack of authority. Corp C §17157(b)(2). The rules in this regard are similar to the rules that apply to limited partnerships (a manager corresponds to a general partner, and a member corresponds to a limited partner) except that the active participation by a member in the management and control of an LLC will not create liability for the member (see Corp C §§17101, 17150; compare Corp C §15903.03(a) with Corp C §§17101, 17150).

Whether the LLC is member managed or manager managed, the LLC may have officers, including a president, chief financial officer, and secretary. Corp C §17154. Officers, like managers, may, but need not, be members. Corp C §§17151(a), 17154(a).

Each member of a member-managed LLC has the fiduciary duties of a manager. Corp C §17150. The fiduciary duties that a manager owes to the LLC and its members are the same as those of a partner to a partnership and its partners. Corp C §17153. The fiduciary duties that a manager owes to the LLC and its members may be modified only in a written operating agreement "with the informed consent of the members." Corp C §17005(d).

No person who is a manager or an officer of an LLC has any personal liability for any contract, tort, or other obligation of the LLC by virtue of being a manager or officer. Corp C §17158.

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§1.18 M. Voting Rights

LLC members have voting rights as specified in the articles of organization or operating agreement. The right to vote may be based on number, capital interest, share of profits, or any other basis. The right to vote may be by class or group of members, and some members may have voting rights to the exclusion of other members. Corp C §17103(a). If the articles of organization and operating agreement are silent with respect to voting rights, the default rules are as follows:

- Each member may vote in proportion to the member's interest in current profits. Corp C §17103(a)(1).
- Unanimity is required for a vote to amend the articles of organization or operating agreement (Corp C §17103(a)(2)).
- The vote of a "majority in interest of the members" is sufficient on all other matters requiring a vote of the members. Corp C §17103(a)(3). This includes a vote to continue the business of the LLC after dissolution and a vote to approve an assignment of a membership interest and the admission of the assignee as a member.

The articles of organization or operating agreement can change the above default rules. For example, they may provide that the articles of organization or operating agreement may be amended by a majority in interest, rather than the unanimous vote of the members. However, in no case may the articles or operating agreement permit such amendment by *less than* a majority in interest. Corp C §17005(b)(3).

Corporations Code §17104 contains an extensive set of default rules for holding meetings, including rules on giving notice, determining quorums, proxies, and action by written consent in lieu of a meeting. See generally chap 13.

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§1.19 N. Membership Interests

The rights of a member in an LLC are collectively referred to as the member's membership interest. A membership interest includes not only a member's economic interest in the LLC but also all other rights of a member, such as the rights to manage, vote, and receive specified information. Corp C §17001(z). An economic interest in an LLC is a person's right to share in profits and losses of the LLC and the right to receive distributions from the LLC, but an economic interest does not include any other rights of a member, such as the right to manage or to vote, or, except as specified in Corp C §17106, the right to information. Corp C §17001(n). See §§6.17, 9.73, 13.17, and 16.20 about inspection rights.

Both a membership interest and an economic interest are personal property and neither comprises an interest in the property of the LLC. Corp C §17300. See *Gilliam v Speier (In re KRSM Props., LLC)* (BAP 9th Cir 2004) 318 BR 712 (member owners sold LLC's real property and used proceeds to pay their personal income tax obligations; when LLC filed for bankruptcy, trustee obtained order for IRS and Franchise Tax Board to return money used to pay taxes; court held that under Corp C §17300, LLC's member owners have no direct ownership interest in property of LLC, so use of sale proceeds to pay personal tax obligations was improper); *Paclink Communications, Int'l, Inc. v Superior Court* (2001) 90 CA4th 958, 109 CR2d 436 (court held that individual members of LLC had no standing to sue for fraudulent transfer of company assets and could bring derivative action in name of company only).

The distinction between a membership interest and an economic interest is most important when dealing with the transfer of an interest in the LLC. See §12.3. The default rule is that the transfer of a *membership* interest requires the consent of a majority in interest of the members not transferring their interests, but the transfer of an *economic* interest requires no consent. Corp C §17301(a)(1).

The transfer of an economic interest simply entitles the transferee to receive from the LLC any allocations of income and loss and any distributions that the transferor had the right to receive; the transfer of an economic interest does not dissolve the LLC or entitle the transferee to vote, participate in management, or exercise any other rights of a member. Corp C §17301(a)(2)-(3). The Act provides procedures for creditors of a member to obtain a charging order on the member's membership interest. Corp C §17302. See §12.8. There may be good reasons under the tax and securities laws, however, to restrict the transfer of an economic interest in the LLC even though the transferee has no voting, management, or other rights. See §4.18 on tax considerations; see chap 12 for securities law considerations.

The default rule is that the transferee of an economic interest may be admitted to the LLC as a member, in substitution for the transferor, only on a vote in favor of such admission by a majority in interest of the other members (Corp C §17303(a)), but whether or not such substitution occurs, the transferring member remains liable to contribute capital as agreed and to return any distributions made in violation of law or the operating agreement (Corp C §§17301(b), 17303(c)).

The operating agreement may provide for the termination of a member's membership or economic interest. On termination of a member's economic interest, the member is entitled to return of the member's capital contribution. Any provision of the operating agreement concerning the termination of membership and the return of a member's contribution will be enforceable unless the member establishes that the provision was unreasonable under the circumstances when the agreement was made. Corp C §17100(c). The right of a member to assert that such a provision is unreasonable may not be eliminated by the articles of organization or the operating agreement. Corp C §17005(b)(2).

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§1.20 O. Right of Access to Information

Members and holders of economic interests have the right to obtain certain information from the LLC, including the right to inspect and copy the LLC's books and records on reasonable request. Corp C §17106. California resident members of a foreign LLC who have at least 25 percent of the voting interests of the membership have the same information and inspection rights that would apply if the LLC were a California LLC. Corp C §17453. The right to information under Corp C §§17106 and 17453 may not be modified by the articles of organization or operating agreement. Corp C §17005(b)(4). On inspection rights, see §§6.17, 9.73, 13.16, and 16.20.

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§1.21 P. Securities Laws

An interest in an LLC is presumed to be a security under California law unless all the members are actively engaged in its management. Corp C §25019.

NOTE: Evidence that members vote or have the right to vote, or the right to information concerning the LLC's business and affairs, or the right to participate in management, does not establish, without more, that all members are actively engaged in the management of the LLC. Corp C §25019.

An LLC interest would probably be held to be a security under federal law as an "investment contract" for members who expect to receive a profit solely from the efforts of others. See §12.14.

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§1.22 Q. Withdrawal

The LLC's articles of organization or operating agreement may provide that a member may withdraw, resign, or retire from the LLC on the happening of specified events, or that a member does not have the right to withdraw. Corp C §17252(a). Notwithstanding any restriction in the articles or operating agreement, a member may withdraw at any time by giving written notice to the other members. The withdrawn member is not entitled to payment for the membership interest and has only the rights of the holder of an economic interest. If the withdrawal is in violation of the operating agreement, the LLC has the right to offset any damages for the breach of the operating agreement from any amounts otherwise distributable to the withdrawn member. Corp C §17252(a). The foregoing withdrawal provisions are default rules and may be modified by the articles of organization or operating agreement.

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§1.23 R. Dissolution

An LLC will dissolve at the time specified in the articles of organization, if any, or on the happening of the events, if any, specified in the articles of organization or operating agreement. Corp C §17350(a). In addition, a majority in interest of the members or greater percentage of the voting interests specified in the articles of organization or operating agreement may vote to dissolve. Corp C §17350(b). Neither the articles of organization nor the operating agreement may eliminate the right of a member to vote on the dissolution of an LLC. Corp C §§17005(b)(3), 17103(c). A dissolved LLC must wind up its affairs. Corp C §17352. See §16.35.

An LLC may also be dissolved on the entry of a decree of judicial dissolution under Corp C §17351. See §16.12.

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§1.24 S. Mergers and Reorganizations

The Act expressly authorizes the merger of one or more LLCs into another LLC (Corp C §17550(a)(1)), the merger of other business entities into an LLC (Corp C §17550(a)(3)), and the merger of an LLC into other types of business entities (Corp C §17550(a)(2)), including corporations, limited partnerships, general partnerships, business trusts, real estate investment trusts, or unincorporated associations (other than nonprofit associations). Corp C §17001(ac). The laws under which the other business entities are organized must authorize the other business entities to effect such a merger. Corp C §17550(b). On LLC mergers and reorganizations, see chap 11.

A limited partnership formed under the California Revised Limited Partnership Act (CRLPA) is authorized to effect a merger with a domestic or foreign LLC. Corp C §§15611(v), 15678.1. (This will continue to be true under the Limited Partnership Act of 2008 (Corp C §§15900-15912.07) also known as Re-RULPA, which becomes effective between January 1, 2007, and January 1, 2010. See Corp C §§15901.02(u), 15911.11.)

Similarly, a California corporation is authorized to merge with a domestic or foreign LLC. Corp C §§1113, 174.5. A general partnership is authorized to merge into an LLC, but the merger must be specifically permitted by the general partnership agreement. Corp C §16902.

A merger agreement must be approved by at least a majority in interest of the members. Corp C §17551(a). Neither the articles of organization nor the operating agreement may eliminate the right of a member to vote on a merger. Corp C §§17005(b)(3), 17103(c).

When an LLC is a party to a merger or certain other reorganizations and a member does not wish to participate in the merger or reorganization, the member may require that his or her interest be purchased for cash at its fair market value. Corp C §17601.

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§1.25 T. Statutory Conversions

California LLCs may convert into another form of business entity, including a foreign entity, provided that the law under which the other business entity is organized expressly permits the formation of such an entity by conversion and provided certain other conditions are met. Corp C §17540.2. If the conversion is into a domestic or foreign partnership (including a limited partnership) or into a foreign LLC, each member of the converting LLC must receive the same percentage interest in the profits and capital of the entity into which the LLC is converted as the member had in the converting LLC at the time of the conversion. If the conversion is into any other business entity, each member of the converting LLC must be treated the same as each other member of the same class with respect to any distribution of cash, rights, or other property (including securities) of the converted entity (unless all members of the class consent), and any nonredeemable membership interests of the converting LLC may be converted only into nonredeemable interests in the converted entity (unless all holders of the nonredeemable membership interests consent). Corp C §17540.2.

A California general partnership (other than a registered limited liability partnership) may be formed by conversion from an LLC. Corp C §16908. A limited partnership governed by the Uniform Limited Partnership Act of 2008 (Re-RULPA) (Corp C §§15900-15912.07) may be formed by conversion from an LLC. Corp C §15911.08. A California corporation may be formed by conversion from an LLC. Corp C §1157.

Other forms of business entities (including a foreign entity) may convert into a California LLC only if the converting entity is authorized to effect the conversion by the law under which the other business entity is organized and certain other conditions are met. Corp C §17540.8.

A California general partnership (other than a registered limited liability partnership) may convert into an LLC. Corp C §16902. A limited partnership governed by the California Revised Limited Partnership Act may convert into an LLC. Corp C §15677.2. (This will continue to be true under Re-RULPA; see Corp C §15911.02.) Each partner of the converting partnership must receive the same percentage interest in the profits and capital of the LLC as that partner had in the converting partnership at the time of the conversion.

A California corporation is permitted to convert into a domestic LLC under Corp C §1151, but such a conversion would probably be treated as a liquidation of the corporation for income tax purposes. Each share of the converting corporation must be treated the same as every other share of the same class or series of the converted entity with respect to any distribution of cash, rights, or other property (including securities) to be received by the shareholder (unless all shareholders of the class or series consent), but that does not preclude the shareholders from appointing one or more managers of the LLC under the plan of conversion. Corp C §1151(a). If any obligation is to be imposed on the holder of any share of the converting corporation, each share of the same class or series of the converted entity must be treated equally with respect to the obligation (unless all shareholders of the class or series consent). Corp C §1151(a). Any nonredeemable common shares in the converting corporation may be converted only into nonredeemable equity interests in the LLC (unless all such holders consent). Corp C §1151(a).

On conversion of an LLC into another entity or of another entity into an LLC, the rights and property of the converting entity are vested in the entity formed by conversion, and the debts and obligations of the converting entity are the debts and obligations of the entity formed by conversion. Corp C §17540.9(b). The Act expressly states that an entity that converts into another entity under the Act is "for all purposes the same entity that existed before the conversion." Corp C §17540.9(a). Notwithstanding the broadness of that statement, the conversion of an entity may have significant tax consequences. Statutory conversions generally are exempt from the permit requirements of the Corporate Securities Law of 1968 (Corp C §§25005.1, 25103(h)). See §§11.12-11.13. On statutory conversions, see §§11.24-11.40.

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§1.26 U. Foreign LLCs

The Act permits a foreign LLC to do business in California, provided the LLC registers with the California Secretary of State. Corp C §17451. The penalties for not registering are similar to those imposed on foreign corporations that do business in California without qualifying. See Corp C §§2203, 17456. Failure to register does not make a foreign LLC's members liable for the obligations of the LLC. Corp C §17456(c).

The laws of the state or country under which the foreign LLC is organized govern its internal affairs and the liability and authority of its managers and members. Corp C §17450(a). A foreign LLC may not be denied registration by reason of any difference between the foreign law and California law. Corp C §17450(b).

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III. ADVANTAGES AND DISADVANTAGES

§1.27 A. Advantageous Uses of LLCs

The favored tax treatment of the LLC, its limited liability features, and its flexibility for structuring financial and managerial operations make the LLC an especially desirable form of business organization for a new business to consider. An LLC can be particularly advantageous in the following situations:

Start-up businesses. Subject to the considerations discussed in §1.28, every start-up business should consider the LLC form of organization, whether it is a corner grocery store, real estate venture, or corporate high-tech joint venture.

Existing unincorporated businesses. Any existing business that is a partnership and any sole proprietor bringing in a partner should consider converting to LLC form. Generally, the conversion can be done without triggering income tax. On converting to an LLC, see chap 11.

Real estate investments. Because LLCs combine limited liability and flexible management with the ability to pass through losses and deductions, make special allocations, and avoid double taxation on the sale of appreciated assets, LLCs should be particularly attractive for real estate investments.

Joint ventures. An LLC can be an useful alternative to a general partnership or corporation as a means of organizing a joint venture or "strategic alliance." LLCs are preferable to general partnerships because of the limited liability they provide to members (thus eliminating the need for a venturer to form a special-purpose corporation) and are preferable to corporations because of pass-through tax treatment and the avoidance of double taxation.

Estate planning. The LLC, by virtue of its partnership tax treatment, limited liability, and flexibility of management and financial structures, may prove to be a valuable estate-planning tool for transferring ownership interests in businesses and real estate. See §§3.91, 4.36-4.39.

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§1.28 B. Problem Areas

Although the LLC form of organization has many desirable features, it is not suitable for every business. An LLC may not be appropriate in the following situations:

Existing incorporated businesses. Converting a corporation into an LLC will generally result in a taxable liquidation of the corporation, even if the corporation has elected to be an S corporation. See chap 11. A statutory merger or conversion of a corporation into an LLC, for example, will ordinarily be treated as a liquidation of the corporation and a contribution of the distributed assets by the shareholders to the LLC. The tax cost of liquidating the corporation should be calculated and considered before deciding to convert a business entity from a corporation to an LLC.

Businesses planning to go public. With some exceptions, a partnership whose ownership interests are publicly traded is taxed as a corporation. An LLC that becomes publicly traded would therefore lose one of the primary benefits of being an LLC, *i.e.,* partnership tax treatment, and, compounding that loss, the capital markets might discount the value of an ownership interest because of unfamiliarity with LLC interests as compared to stock. An LLC could incorporate before going public and avoid this result, and for certain businesses, an initial period of operation as an LLC may be suitable. Until it incorporates, however, an LLC could not offer tax-favored incentive stock options and employee stock purchase plans, which are common ways of compensating and motivating employees working for a business intending to go public, and, as mentioned above, an LLC might not attract certain investors. See §4.8.

Professional practices. A California LLC is not authorized to practice a profession that, if practiced in corporate form, would have to be organized as a professional corporation. See §3.92.

Certain regulated businesses. Businesses in certain regulated industries may need to be in corporate form to achieve limited liability because the governing statute may not recognize the LLC as a form of entity that can receive a license, certification, or registration. In addition, the limitation on practicing a profession, mentioned in the preceding paragraph (see Corp C §17375), may apply more broadly to any business that requires such licensure, certification, or registration.

On July 23, 2004, the California Attorney General rendered an opinion that a business that provides services that require a license, certification, or registration under the Business and Professions Code may conduct its activities as an LLC if the services rendered require only a nonprofessional, occupational license. The opinion stated that determining whether a particular service would be "professional" or "nonprofessional" would require an examination of the educational, training, and testing prerequisites, but it did not specify which services would be "professional" for the purpose of allowing an LLC to render them. 87 Ops Cal Atty Gen 109 (2004).

In light of the uncertainty, most practitioners are being cautious and advising clients they cannot use the LLC form of organization for any business that requires a license, certification, or registration under the Business and Professions Code. See §§3.92, 7.13. In addition, businesses in certain regulated industries may need to be in corporate form to comply with regulatory requirements.

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2

Establishing the Attorney-Client Relationship

Paul J. Derenthal

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§2.1 I. SCOPE OF CHAPTER

This chapter reviews certain practical and ethical concerns on which the attorney should focus in the process of establishing a relationship with a client organizing a limited liability company (LLC). The chapter also sets forth recommendations that in some cases may exceed the minimum standards for the profession. The attorney must first possess the necessary expertise to deal with all the issues that may arise in the course of representation. See §2.3. The attorney must then identify and address, at the outset and throughout representation, any conflicting interests that may exist among or between any participants in the venture, the entity to be organized, the attorney, and any other party with whom the attorney has a relationship. See §§2.4-2.8. The attorney and client then can come to a practical understanding of the general scope of the services the attorney will provide (see §§2.9-2.14) and execute the necessary formal agreements (see sample forms in §§2.15-2.16).

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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/ II. ETHICAL ISSUES IN REPRESENTING BUSINESS ORGANIZATIONS/§2.2 A. Gathering Information to Determine Whether Representation Is Appropriate

II. ETHICAL ISSUES IN REPRESENTING BUSINESS ORGANIZATIONS

§2.2 A. Gathering Information to Determine Whether Representation Is Appropriate

An attorney contemplating representation of a client in organizing and structuring a business entity must gather sufficient preliminary information to determine whether such representation falls within the attorney's areas of professional expertise. Sufficient experience and skill is required by Cal Rules of Prof Cond 3-110 (see §2.3).

The preliminary information gathered should enable the attorney to identify any potential conflicts of interest before discussing significant confidential information and rendering substantive legal advice.

At a minimum, the preliminary information should consist of:

- The identities and business affiliations of each of the principals (*e.g.,* members, managers (whether or not members), officers) of the business to be organized;
- The identities and business affiliations of any persons who are expected to enter into material relationships with the business to be organized; and
- A summary of the business operations in which the entity plans to engage and the business plan of the entity, in sufficient detail to permit the attorney to identify potential areas of legal advice and services that the client will need during the business's organizational and initial operating stages.

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§2.3 B. Assessing Attorney's Professional Competence to Represent Client

Before undertaking to advise a client on any matter, the attorney must have the requisite skill and expertise. Cal Rules of Prof Cond 3-110; ABA Model Rules of Prof Cond 1.1. Advising a client about organizing or operating a business entity requires competence in the areas of business organizations (*e.g.,* corporations, partnerships, sole proprietorships, associations, and LLCs), but can also involve many other areas of law, such as taxation, securities regulation, estate planning, family law, labor law, real property, and intellectual property. If an attorney does not have sufficient experience in a necessary area when consulted by a client, the attorney may nonetheless ethically perform those services if he or she acquires the necessary learning and skill before performance is required. Cal Rules of Prof Cond 3-110(C). This book may help in that regard.

An attorney has a duty to consult or associate a specialist if a reasonable attorney would do so under the circumstances. The performance of a nonspecialist who fails to consult or associate a specialist will be subject to review under the same standards as those applicable to a specialist in that area. *Horne v Peckham* (1979) 97 CA3d 404, 158 CR 714. See *Enriquez v Smyth* (1985) 173 CA3d 691, 219 CR 267. An attorney is also subject to discipline for failure to associate or consult with a specialist if he or she lacks necessary knowledge or experience. See *Lewis v State Bar* (1981) 28 C3d 683, 170 CR 634.

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C. Identifying Potential Conflicts of Interest

§2.4 1. Conflicts Among Parties

It is common for clients to ask a single attorney to organize or advise a business venture, and to represent both the entity and multiple participants with divergent interests.

Ethically, an attorney may not represent multiple parties with conflicting interests except with the informed written consent of each party. Cal Rules of Prof Cond 3-310(C). The attorney must analyze carefully whether it is possible or advisable to represent the parties as a group or whether the inherent conflicts are so great as to require separate representation. If the attorney determines that the various parties' interests are generally the same, the joint engagement may be accepted. Written consent must be obtained from each of the parties represented by the attorney, however, if their interests potentially conflict. Cal Rules of Prof Cond 3-310(C)(1). For a sample conflict letter and consent, see §2.15.

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§2.5 a. Inherent Conflict in Limited Liability Company: Managers and Nonmanagers

In LLCs a conflict of interest, or the potential for such conflict, exists between the interests of members who are to be active managers and those who are to be passive investors in the business. Members who actively manage the business may seek to receive compensation based on a share of profits and separate salaries or fees for specific services. Passive investors with no active role in management would generally depend solely on their share of the profits for a return on their investment. The attorney's role in representing an LLC resembles that of counsel for a corporation or partnership in which the shareholders, officers and directors, or partners are different individuals, and the corporation or partnership itself may have interests that are separate from or in conflict with the interests of one or more of the individual participants. Accordingly, the attorney must carefully define his or her role with respect to both the participants and the venture itself. See §§2.9-2.11.

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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/§2.6 b. When Multiple Representation Is Inappropriate

§2.6 b. When Multiple Representation Is Inappropriate

If multiple representation seems inappropriate for any reason, the attorney may wish to represent only the entity or only one of the parties to the formation of the entity. The attorney should then inform all parties (including the party to be represented) of the following matters:

- Whom counsel will and will not represent in the formation of the venture;
- The nature of existing, and to the extent appropriate, foreseeable conflicts of interest among the participants;
- That the attorney cannot undertake to advise the other parties or protect their interests and that if the other parties wish legal advice, they should consult separate counsel; and
- The proposed terms, if any, under which the attorney would represent the entity itself (rather than the individual participants in the entity) on completion of the entity's organization.

For the protection of the attorney, each party should acknowledge in writing receipt of this information and understanding of these matters before the attorney proceeds with the engagement.

The attorney should be alert for possible conflicts throughout the period of representation. If multiple representation initially appears appropriate, but interests diverge or a material conflict arises, the attorney should again advise the parties to obtain independent counsel, despite any prior consents the parties may have granted. If the conflicts are such that the clients' separate interests cannot be fairly represented, the attorney may be required to discontinue any representation of the business entity unless independent counsel is obtained. See Cal Rules of Prof Cond 3-310.

NOTE: Multiple representation is risky. The attorney should be sensitive to danger signs, *e.g.,* disagreements or expressions of dissatisfaction concerning operation of the entity, compensation levels, or interests in profits. See also ABA Model Rules of Prof Cond 1.13 concerning the duties of an attorney engaged as counsel for a corporation or other organization, and his or her responsibilities when corporate and individual interests differ. The attorney may represent the organization and its directors, officers, employers, shareholders, or other constituents subject to the requirements of Cal Rules of Prof Cond 3-310. Cal Rules of Prof Cond 3-600.

Explicit guidelines apply for an attorney representing an organization. The attorney must explain the client's identity to management, investors, employees, members, or other constituents when the organization's interests are or may become adverse to those of the individuals representing the organization. Cal Rules of Prof Cond 3-600.

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2. Conflicts Between Attorney and Client

§2.7 a. Disclosure Requirements

An attorney cannot accept or continue representation of a client without providing written disclosure to the client if the attorney:

- Has a legal, business, financial, professional, or personal relationship with a party in the same matter (Cal Rules of Prof Cond 3-310(B)(1)), or
- Knows or reasonably should know that the attorney previously had a legal, business, financial, professional, or personal relationship with a party or witness in the same matter that would substantially affect the representation (Cal Rules of Prof Cond 3-310(B)(2)).

Furthermore, an attorney cannot accept or continue representation of a client without providing written disclosure to the client if the attorney:

- Has or had a legal, business, financial, professional, or personal relationship with another person or entity that the attorney knows, or reasonably should know, would be affected substantially by resolution of the matter (Cal Rules of Prof Cond 3-310(B)(3)), or
- Has or had a legal, business, financial, or professional interest in the subject matter of the representation (Cal Rules of Prof Cond 3-310(B)(4)).

Conflicts arise if the attorney invests in a client's business, accepts an economic interest in the business in lieu of fees, or enters into transactions to provide goods or nonlegal services to a client. If an attorney enters into a business transaction with a client or knowingly acquires an ownership, possessory, security, or other pecuniary interest adverse to the client, the transaction or acquisition must be fair and reasonable to the client, and the attorney must fully disclose the transaction in writing, in a manner that should reasonably be understood by the client, advise the client that the client may seek independent legal advice, provide the client a reasonable opportunity to seek such advice, and obtain the client's informed written consent. Cal Rules of Prof Cond 3-300; see ABA Model Rules of Prof Cond 1.8, 1.13. The attorney may also need to disclose the transaction in writing to the members of the LLC and obtain their informed written consent.

Attorneys should be wary of providing legal advice to a client in whose business they have a financial stake. Such arrangements may be relatively common, but they are rife with conflicts of interest. Even the mere appearance of a conflict of interest or lack of independence on the attorney's part can cause problems.

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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/§2.8 b. Conflicts When Attorney Serves as Both Counselor to and Officer of Entity

§2.8 b. Conflicts When Attorney Serves as Both Counselor to and Officer of Entity

Attorneys are often asked to serve as directors or officers of corporations and may be asked to serve in similar quasi-managerial capacities in LLCs that take on management structures similar to corporations. There are many potential pitfalls in these arrangements. If the attorney is serving the entity in dual roles, the attorney's advice will not be truly independent and therefore is subject to a greater likelihood of material conflicts of interest. Because of the attorney's profession and training, he or she may be held to a higher standard of conduct in the managerial capacity than a nonattorney. Other members of management may have difficulty distinguishing when the attorney's statements constitute legal advice and when they are made as a manager in a business context at a committee or management board meeting. Economic benefits resulting from the attorney's managerial role are subject to Cal Rules of Prof Cond 3-300. Any actual or apparent impairment of the attorney's independence of judgment in such dual roles may be a source of misunderstanding and liability over the course of time. For these and other reasons, many experienced attorneys and law firms adopt a policy against serving in management roles.

NOTE: Information regarding a financial stake in a client's business or the attorney's role in a quasi-managerial capacity generally must be disclosed in errors and omissions insurance policy applications, and may result in increased premiums or denial of coverage to the attorney or exclusion of the particular relationship from coverage.

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III. ESTABLISHING SCOPE OF ATTORNEY'S ROLE

§2.9 A. Broad Range of Potential Responsibilities

After the attorney determines that the client's needs and objectives are compatible with forming an LLC, the character of the services the attorney will provide and the basis for charging for those services must be agreed on.

The scope of the attorney's responsibility for a business venture's affairs may vary substantially from one business client to another, and from time to time. In some cases the attorney is asked to represent and advise the entity in connection with ongoing routine business matters, while in other cases the representation is limited to organizational matters and major transactions and events.

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§2.10 1. Maintaining Lines of Communication

The attorney and client must identify the person or persons representing the client entity who will be responsible for communicating with the attorney and who will have the authority to make substantive decisions. Both the scope of the representation and the lines of communication may change over the course of time. Establishing a clear understanding in these areas at the earliest stages will aid in the development of a productive attorney-client relationship. To the extent appropriate, the attorney should also become informed about and establish contact with the client's other professional advisers.

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§2.11 2. Providing Business Advice as Well as Legal Counsel

Depending on the extent of the client's business experience, the attorney may be asked to give advice on business issues as well as legal issues, and it may often be difficult to separate the two. Although the attorney should limit advice to areas of his or her expertise, client interests may be best served when the attorney also helps clients focus on business issues at the crucial formative stages of a business enterprise.

The attorney must use great care and tact when counseling the client on the hard choices necessary for the client's long-term benefit. For example, forthright discussion of realistic financing needs and resources and potential business risks may prove uncomfortable to an entrepreneurial client who may view the business opportunities in only the most optimistic light. To best serve the client and establish a successful long-term relationship, however, the attorney should seek to provide constructive guidance through both the business and legal hurdles facing the entity to be formed.

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B. Compensation Issues

§2.12 1. Formal Requirements of Agreement

Fee agreements for legal services in the formation and counseling of business entities generally must be in writing. Bus & P C §6148. Contingent fee agreements are governed by Bus & P C §6147. Because of the nature of the services and circumstances, contingent fee arrangements are not typically entered into in the context of the formation and counseling of business entities.

An unwritten fee agreement is enforceable under Bus & P C §6148 under any of the following conditions:

(1) It is reasonably foreseeable that the total expense to the client, including fees and costs, will not exceed $1000. Bus & P C §6148(a).

(2) Foreseeable prejudice to the rights or interests of a client presents an emergency need for legal services, or a writing is otherwise impracticable. Bus & P C §6148(d)(1).

(3) An agreement regarding fees can be implied by the fact that the attorney has previously rendered services of the same general kind and the client has paid for them. Bus & P C §6148(d)(2).

(4) After full disclosure of Bus & P C §6148, the client knowingly states in writing that a written fee agreement is not required. Bus & P C §6148(d)(3).

(5) The client is a corporation. Bus & P C §6148(d)(4).

The "emergency need" exception to the in-writing requirement ((2) above) is unlikely to apply to formation of an LLC. The corporate client exception ((5) above) might apply if the client is a corporation that is a principal party in the formation of the LLC. There is no exception from the written agreement requirement for a client organized as a type of entity other than a corporation.

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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/ 2. Engagement Letter/§2.13 a. Purpose and Contents

2. Engagement Letter

§2.13 a. Purpose and Contents

The use of a written engagement letter for representation in business formations is generally good practice, regardless of the statutory requirement. The letter should clearly identify which party will be the attorney's client and the party responsible for payment of fees. The attorney and the parties must have a clear understanding about payment when multiple parties are involved, as is the case in many business formation situations. The written agreement should confirm the client's obligations of cooperation and timely payment, clearly establishing grounds for withdrawal from representation if the client fails to perform his or her obligations.

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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/§2.14 b. Statutory Requirements Governing Fee Agreements

§2.14 b. Statutory Requirements Governing Fee Agreements

Fee agreements must contain the following information:

- The hourly and other standard rates, including fees and charges applicable to the representation (Bus & P C §6148(a)(1));
- The general nature of the legal services to be provided to the client (Bus & P C §6148(a)(2)); and
- The respective responsibilities of the attorney and client in performing the agreement (Bus & P C §6148(a)(3)).

For a sample form of written fee agreement, see §2.16.

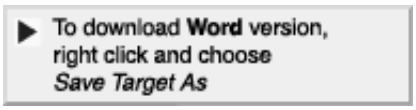
Unless it is exempt, a fee agreement that does not comply with the requirements of Bus & P C §6148 is voidable at the option of the client. If the agreement is voided by the client, the attorney remains entitled to collect a reasonable fee for the services rendered. Bus & P C §6148(c).

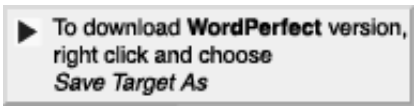
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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/ IV. ATTORNEY-CLIENT AGREEMENTS AND CONSENTS TO REPRESENTATION/§2.15 A. Form: Conflicts Letter and Written Consent

IV. ATTORNEY-CLIENT AGREEMENTS AND CONSENTS TO REPRESENTATION

§2.15 A. Form: Conflicts Letter and Written Consent





2.15-1 Conflicts letter and written consent

[*Law Firm Letterhead*]

_ _[*Date*]_ _

_ _[*Name and address of first party*]_ _

_ _[*Name and address of second party*]_ _

Re: _ _[*name of proposed company*]_ _, a proposed California limited liability company

Dear _ _[*Names of first and second parties*]_ _:

You have asked that we serve as counsel in connection with the organization of a new entity for your proposed business venture, a California limited liability company to be known as _ _[*name of proposed company*]_ _ ("Company").

As we have discussed, based on the information you have provided to us, we do not believe that our representation of both you and the Company in connection with its formation currently involves any conflicts of interest. However, the interests and objectives of each of you individually on certain issues may, at some time, become inconsistent with the interests and objectives of the Company and the other members of the Company.

The participants in the Company may have different goals with respect to their capital investments, different liquidity needs, and different control objectives. The allocations of profits and losses, and individual tax postures will also vary. In limited liability companies, an inherent conflict exists between the interests of members who are to be active managers and those who may be passive investors in the business. Members who actively manage the business may seek to receive compensation based on a share of profits and may also receive separate salaries or fees for specific services, while passive investors with no active role in management generally depend solely on their share of the profits for a return on their investment. Accordingly, diverging interests among the members and other participants in the venture may arise at any point in the formation and operation of the Company.

[*Add if appropriate*]

In particular, in connection with the organization of the Company, the participants in the venture have inherent conflicts of interests in that:

[*Indicate particular conflicts*]

[*Continue*]

With respect to information that our firm receives from you during the course of our representation of you in this matter, the attorney-client privilege, which normally protects your communications to us from disclosure, will not be applicable among the _ _[*number of participants*]_ _ participants with respect to this matter. Thus, we are permitted to tell one party anything that another party has told us about this matter. The attorney-client privilege will continue to protect your communications to us from disclosure to those whom we are not

representing in this matter (unless you otherwise waive the attorney-client privilege).

If there is a dispute among the Company, its members, or other participants, we may be precluded from representing the Company or any individual party without first obtaining the consent of all concerned. In that event, you would be required to hire new counsel. Also, at any time, any consenting party may withdraw its consent to our multiple representation, in which event we would be required to discontinue our representation.

For these reasons, our normal practice in these circumstances is to represent only one party. However, you have advised us that in this matter, _ _[*neither/none*]_ _ of you currently wishes to seek other counsel, and instead you desire that we represent your multiple interests in the formation of the Company.

In representing the Company, certain special rules apply. The client is the Company itself, acting through its manager, and not the individual members or managers. In dealing with the Company's members, employees, or other constituents, we must explain the identity of the client for whom we act whenever it becomes apparent that the Company's interests are or may become adverse to those with whom we are dealing.

Accordingly, to comply with these rules, we request that each of you sign and return to us a copy of this letter acknowledging that:

1. You have been advised of the conflicts associated with your respective interests and of your right to obtain independent legal counsel regarding these conflicts;

2. You have had an opportunity to obtain independent counsel regarding this consent; and

3. You nevertheless want us to represent you in connection with the matters discussed above.

On formation of the Company we will be representing the entity rather than each of you individually, and therefore we will look to the managers of the Company for our instructions regarding both the legal services to be performed for the Company and the resolution of any issues that may arise in the course of such services. For the convenience of all involved, we suggest that the _ _[*managers/members*]_ _ authorize one or more of you to represent and act for the Company in communicating instructions to us.

We want to stress that each of you remains completely free to seek independent counsel at any time even if you decide to sign the consent set forth below, and we strongly urge you to do so in the event you have any questions concerning your individual interests. Should you have any questions concerning this letter or the consent, please discuss them with us before signing and returning the enclosed copy of this letter.

Sincerely,

Date: _ _ _ _ _ _ _ _[*Name of firm*]_ _

By: __[*Signature*]__
_ _[*Typed name of attorney*]_ _

CONSENT

_ _[*Name of law firm*]_ _ **("Law Firm") has explained to each of the undersigned that there exist present and future conflicting interests in the formation of** _ _[*name of proposed company*]_ _ **("Company") and has informed each of us of the possible consequences of these conflicts.**

We acknowledge and understand that on the formation of the Company, the Law Firm shall represent the Company and shall not represent the individual interests of any of us.

We understand that we have the right, and acknowledge that we have had the opportunity, to seek independent counsel before signing this consent and at any time in the future should we wish to do so. Each of the undersigned nevertheless desires representation by the Law Firm to the extent described above, and consents to such representation.

Date: _ _ _ _ _ _ __[*Signature of first party*]__
_ _[*Typed name of first party*]_ _

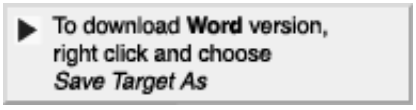
Date: _ _ _ _ _ _

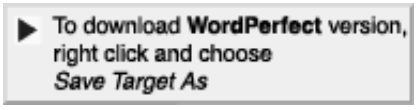
__[*Signature of second party*]__
_ _[*Typed name of second party*]_ _

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Source: Business Law/Forming and Operating California Limited Liability Companies/2 Establishing the Attorney-Client Relationship/§2.16 B. Form: Engagement Agreement for Hourly Rate

§2.16 B. Form: Engagement Agreement for Hourly Rate





2.16-1 Engagement agreement for hourly rate

[*LAW FIRM LETTERHEAD*]

_ _[*Date*]_ _

_ _[*Name and address of client*]_ _

Re: Fee Agreement for Legal Services

Dear _ _[*name of client*]_ _:

As we have discussed, this letter sets out the details of our relationship and our agreement for the legal services to be provided and the fees and costs relating to such services. If this letter accurately describes the services we are to perform for you and the terms for payment of the resulting legal fees and expenses that you will incur, please countersign one of the duplicate originals of this letter and return it to us.

You have asked us, _ _[*name of law firm*]_ _ ("Law Firm"), to form a California limited liability company ("Company") and provide legal services on its behalf. These services include analysis and consultation to confirm the appropriateness of the limited liability company form for your business and to determine the structure of the company. The services also include preparation of articles of organization, preparation of an operating agreement, and preparation and filing of any documents or notices necessary to comply with federal or state securities laws and regulations applicable to the issuance of membership interests. The services do not include advising on or obtaining business licenses, or permits; reviewing proposed leases, employment agreements, sales agreements, or other transactional documents; or drafting member buy-sell agreements.

You understand that once Company has been formed, it will become Law Firm's client. Law Firm will represent the interests of Company, the business entity itself, rather than those of any individual member(s). Company will timely make any payments required by this agreement. We understand that you have been authorized to represent and act for Company in communicating with Law Firm. Law Firm will keep you informed of progress and developments, and will respond promptly to your inquiries and communications. Company will cooperate with Law Firm to the extent necessary to complete the services described in this letter. Company will keep Law Firm reasonably informed of material business developments, its current address, telephone numbers of decision-makers, and any change in the person or persons authorized to represent and act for Company in communicating with Law Firm.

Company will pay Law Firm attorney fees for the legal services provided under this agreement at the respective hourly rates of the individuals providing the services. The rates fall within the following ranges: _ _[*dollar amount*]_ _ to _ _[*dollar amount*]_ _ per hour for partners; _ _[*dollar amount*]_ _ to _ _[*dollar amount*]_ _ per hour for associates; _ _[*dollar amount*]_ _ to _ _[*dollar amount*]_ _ per hour for law clerks; and _ _[*dollar amount*]_ _ to _ _[*dollar amount*]_ _ per hour for paralegals. Law Firm will charge in increments of one-tenth of an hour, rounded up for each particular activity to the nearest one-tenth of an hour. The minimum time charged for any particular activity will be two-tenths of an hour.

Law Firm will charge for all activities undertaken in providing legal services to Company under this agreement, including but not limited to the following: conferences (including preparation and participation), review and preparation of correspondence and legal documents, legal research, and telephone conversations. When two or more of Law Firm's personnel are engaged in working on the matter at the same time, such as in conferences between them or with Client, the time of each will be charged.

If, while this agreement is in effect, Law Firm increases the hourly rates being charged to clients generally for attorney fees, that increase may be applied to fees incurred under this agreement, but only for services provided 15 days or more after written notice of the increase is mailed to Company. If Company chooses not to consent to the increased rates, Company may terminate Law Firm's services under this agreement by written notice effective when received by Law Firm.

In addition to paying fees for legal services under this agreement, Company will reimburse Law Firm for all costs incurred by Law Firm on Company's behalf in rendering such services. These costs include, for example: postage, telephone charges, photocopying costs (at _ _[*dollar amount*]_ _ per page for in-house copying and invoice cost for outside vendor copying charges), word processing charges (at _ _[*dollar amount*]_ _ per hour), express delivery charges, travel expenses, and filing fees.

Law Firm estimates that the total amount of fees and costs for the services described in this letter will be approximately _ _[*dollar amount*]_ _ if the organization is structured generally in the manner discussed in our meeting of _ _[*date*]_ _. You understand that the amount of those fees may vary significantly from the estimate in the event of material changes to the transaction as it is currently proposed, or as a result of unforeseen circumstances or developments. Law Firm will endeavor to keep you apprised if it anticipates any significant changes to such estimated fees during the course of the engagement, but it is understood that Law Firm may not always be able to predict the timing or magnitude of such changes. Nevertheless, you acknowledge that Law Firm has not agreed to any maximum fee or any other promise about the total amount of legal fees and costs to be incurred under this agreement.

You will pay to Law Firm an initial deposit of _ _[*dollar amount*]_ _, to be received by Law Firm on or before _ _[*date*]_ _. This amount will be deposited by Law Firm in a trust account as an advance against fees and costs to be incurred. Company authorizes Law Firm to withdraw funds from the trust account to pay attorney fees and costs as they are incurred by Company. If, at the termination of services under this agreement, the total amount incurred by Company for attorney fees is less than the amount of the initial deposit, the difference will be refunded to Company. Whenever the full amount of any deposit has been applied to attorney fees or costs incurred by Company, Law Firm may, at its option, request Company to pay to Law Firm an additional deposit in an amount to be determined in Law Firm's reasonable discretion. Deposit of such additional amounts will be made in the same manner as the initial deposit.

Law Firm will send Company monthly statements indicating attorney fees and costs incurred and their basis, any amounts applied from Company trust account deposits, and any current balance owed. Company will pay any balance in full within 30 days after the statement is mailed. Any balance remaining unpaid after 30 days will incur a late payment charge of _ _[*number*]_ _ percent of the outstanding balance.

If a dispute arises between Law Firm and Company regarding attorney fees and Law Firm files suit in any court other than small claims court, Company will have the right to stay that suit by timely electing to arbitrate the dispute under Business and Professions Code sections 6200-6206, in which event Law Firm must submit the matter to nonbinding arbitration.

We look forward to working with you on your new business venture.

Date: _ _ _ _ _ _ _ _[*Name of firm*]_ _

By: __[*Signature*]__
_ _[*Typed name*]_ _
Attorney for _ _[*name of entity*]_ _

The undersigned has read the foregoing terms for the provision of legal services by Law Firm and agrees to these terms and conditions.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Name*]_ _
_ _[*Capacity, if appropriate*]_ _

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3

Choosing the Appropriate Business Entity

Robert C. Trask

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§3.1 I. SCOPE OF CHAPTER

This chapter outlines the factors that distinguish general partnerships, limited partnerships, corporations (including S corporations), limited liability companies (LLCs), and, to a limited extent, limited liability partnerships (LLPs). At the end of the chapter are two charts comparing the entities; one chart dealing with the business factors and the other dealing with the tax factors.

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§3.2 II. OVERVIEW: CHOOSING FROM ALTERNATIVE FORMS OF ENTITIES

Choosing which type of entity to use is among the most important decisions a business can make. Most clients wish to avoid personal liability for the obligations of the business (an attribute of corporations) and may also wish to personally deduct the losses of the business and avoid double taxation of the income of and distributions from the business (attributes of partnerships). For businesses with these objectives, the limited liability company offers the best of both worlds. An LLC is generally treated as a partnership for tax purposes. At the same time, the LLC's members, like corporate shareholders, are not personally liable for the debts of the business.

However, LLCs are not always the best form of entity, even for a closely held business. There may be circumstances in which a corporation or limited partnership is a more appropriate form.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.3 A. Sole Proprietorship

§3.3 A. Sole Proprietorship

A sole proprietorship is nothing more than a business in which an individual engages in business personally rather than by means of a separate entity such as a corporation. The sole proprietorship avoids many of the formalities and reporting requirements associated with other forms of business organization. However, the proprietor is personally liable for the obligations of the business. This makes a limited liability entity such as a corporation or LLC an attractive alternative.

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§3.4 B. Corporation (Including S Corporation)

A corporation is a limited liability entity in that none of the owners (shareholders) are liable for the obligations of the corporation. Corporations formed under California law are governed by California's General Corporation Law (Corp C §§100-2319).

The income of a corporation (other than an S corporation) is taxable, both by the federal government and California, at the corporate tax rate. Thus, a corporation and its shareholders are subject to "double taxation," because the corporation pays tax on its income and the shareholders pay tax on dividends received from the corporation, and the corporation is not allowed to deduct dividends as an expense.

Double taxation may be minimized in certain cases by the payment of salaries to shareholders and by the use of shareholder loans. In addition, a corporation that retains most of its income may find the corporate tax structure beneficial because the marginal rates applicable to corporations are often lower than the marginal rates applicable to individuals. See §3.28.

Qualifying corporations can ameliorate the effect of double taxation by making an S-corporation election. See §§3.25-3.37. If a corporation makes a valid S-corporation election, for federal tax purposes the corporation's net profits, losses, and tax credits are passed through (and taxed) to the corporation's shareholders, but are not taxed to the corporation. Thus, S corporations are treated similarly, but not identically, to partnerships. There are important restrictions on the ability to qualify as an S corporation. See §3.27. For a comprehensive discussion of corporations, see Organizing Corporations in California (3d ed Cal CEB 2001).

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§3.5 C. General Partnership

A general partnership is an association of two or more persons to carry on as co-owners of a business for profit that is not a limited partnership. Corp C §16101(9).

A general partnership has the following characteristics:

- Each partner is an agent of the partnership and can bind the partnership in its ordinary course of business (Corp C §16301(1)).
- Each partner is personally liable for the obligations of the partnership (Corp C §16306).

A joint venture is an entity formed for a limited or temporary business purpose. Joint ventures have generally been treated as general partnerships under California law. See §3.101.

A general partnership is generally not subject to federal or California income or franchise tax. See §§3.38, 3.61. For federal tax purposes, a partnership is any joint enterprise other than a trust or estate that carries on a business and is not organized as a corporation under state law. IRC §§761(a), 7701(a)(2); Treas Reg §301.7701-2.

For a detailed discussion of general partnerships, see Advising California Partnerships (3d ed Cal CEB 1999).

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§3.6 D. Limited Partnership

A limited partnership is a partnership with one or more "limited partners" (partners who do not participate in the control of the business and who are not personally liable for the obligations of the partnership), and one or more "general partners" (partners who actively engage in the management and control of the business and who have unlimited personal liability for the obligations of the partnership). Corp C §15901.02(q).

A limited partnership, like a general partnership, is generally not subject to federal or California income tax. Unlike a general partnership, a limited partnership is subject to an annual franchise tax of $800. Rev & T C §§17935, 23153.

For a detailed discussion of limited partnerships, see Advising California Partnerships (3d ed Cal CEB 1999).

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§3.7 E. Limited Liability Partnership

Many states have statutes authorizing the formation of limited liability partnerships (LLPs). An LLP is a form of general partnership in which the liability of each partner may be limited. Under most LLP statutes, a partner is relieved of liability for the negligence, wrongful acts, and misconduct of another partner and of employees and agents of the LLP. However, partners are not relieved of liability for their own negligent or wrongful acts or misconduct, or for the negligent or wrongful acts or misconduct of any person acting under their direct supervision and control. In most states, partners of an LLP remain liable for the contractual obligations of the partnership.

California law authorizes LLPs for lawyers, accountants, and architects and authorizes foreign LLPs to do business in California. Corp C §§16951-16962. See §3.11.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.8 F. Limited Liability Company

§3.8 F. Limited Liability Company

A limited liability company (LLC) is an unincorporated business organization whose members do not have personal liability for the debts of the LLC. LLCs formed in California are governed by the Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17656). A domestic LLC with one member is automatically disregarded for federal and California tax purposes unless the LLC files an election to be taxed as a corporation. Treas Reg §301.7701-3. A domestic LLC with two or more members is automatically classified as a partnership for federal tax purposes unless the LLC files an election to be taxed as a corporation. Treas Reg §301.7701-2.

An LLC doing business in California must pay an annual franchise tax plus a statutory fee for any year in which the LLC's total income derived from or attributable to California is $250,000 or more. Rev & T C §17942(a)-(b). See §§5.4-5.5.

Corporations Code §17003 sets forth the powers of the LLC:

Subject to any limitations contained in the articles of organization and to compliance with this title and any other applicable laws, a limited liability company organized under this title shall have all of the powers of a natural person in carrying out its business activities, including, without limitation, the power to:

(a) Transact its business, carry on its operations, qualify to do business, and have and exercise the powers granted by this title in any state, territory, district, possession, or dependency of the United States, and in any foreign country.

(b) Sue, be sued, complain and defend any action, arbitration, or proceeding, whether judicial, administrative, or otherwise, in its own name.

(c) Adopt, use, and at will alter a company seal; but failure to affix a seal does not affect the validity of any instrument.

(d) Make contracts and guarantees, incur liabilities, act as surety, and borrow money.

(e) Sell, lease, exchange, transfer, convey, mortgage, pledge, and otherwise dispose of all or any part of its property and assets.

(f) Purchase, take, receive, lease, or otherwise acquire, own, hold, improve, use, or otherwise deal in and with any interest in real or personal property, wherever located.

(g) Lend money to and otherwise assist its members and employees.

(h) Issue notes, bonds, and other obligations and secure any of them by mortgage or deed of trust or security interest of any or all of its assets.

(i) Purchase, take, receive, subscribe for, or otherwise acquire, own, hold, vote, use, employ, sell, mortgage, loan, pledge, or otherwise dispose of and otherwise use and deal in and with stock or other interests in and obligations of any person, or direct or indirect obligations of the United States or of any government, state, territory, governmental district, or municipality, or of any instrumentality of any of them.

(j) Invest its surplus funds, lend money from time to time in any manner which may be appropriate to enable it to carry on the operations or fulfill the purposes set forth in its articles of organization, and take and hold real property and personal property as security for the payment of funds so loaned or invested.

(k) Be a promoter, stockholder, partner, member, manager, associate, or agent of any person.

(l) Indemnify or hold harmless any person.

(m) Purchase and maintain insurance.

(n) Issue, purchase, redeem, receive, take, or otherwise acquire, own, hold, sell, lend, exchange, transfer, or otherwise dispose of, pledge, use, and otherwise deal in and with its own bonds, debentures, and other securities.

(o) Pay pensions and establish and carry out pension, profit-sharing, bonus, share purchase, option, savings, thrift, and other retirement, incentive, and benefit plans, trusts, and provisions for all or any of the current or former members, managers, officers,

or employees of the limited liability company or any of its subsidiary or affiliated entities, and to indemnify and purchase and maintain insurance on behalf of any fiduciary of such plans, trusts, or provisions.

(p) Make donations, regardless of specific benefit to the limited liability company, to the public welfare or for community, civic, religious, charitable, scientific, literary, educational, or similar purposes.

(q) Make payments or donations or do any other act, not inconsistent with this title or any other applicable law, that furthers the business and affairs of the limited liability company.

(r) Pay compensation, and pay additional compensation, to any or all managers, officers, members, and employees on account of services previously rendered to the limited liability company, whether or not an agreement to pay such compensation was made before such services were rendered.

(s) Insure for its benefit the life of any of its members, managers, officers, or employees, insure the life of any member for the purpose of acquiring at his or her death the interest owned by such member, and continue such insurance after the relationship terminates.

(t) Do every other act not inconsistent with law that is appropriate to promote and attain the purposes set forth in its articles of organization.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/ III. FACTORS IN SELECTING THE MOST APPROPRIATE FORM OF ENTITY/§3.9 A. Ease or Difficulty of Formation; Transaction Costs

III. FACTORS IN SELECTING THE MOST APPROPRIATE FORM OF ENTITY

§3.9 A. Ease or Difficulty of Formation; Transaction Costs

In general, the ease or complexity of forming a business enterprise and the associated costs depend more on the scope and complexity of the specific business venture than on the form of entity chosen. A general partnership formed to engage in a complex transaction, with detailed allocations of profits and losses and sophisticated management controls, may be much more complicated and costly to form than will a corporation with a handful of shareholders in a simple business enterprise.

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§3.10 1. Corporation

Although corporations are perhaps subject to the most formalities, corporations may in many cases be the simplest and least expensive entity to form, primarily because the parties need not negotiate a detailed agreement governing the structure and operation of the corporation, but can instead rely on the provisions of the General Corporation Law (Corp C §§100-2319). However, if the parties want to restrict the transferability or voting rights of corporate stock, or provide for different classes of stock, a detailed agreement or specially drafted articles of incorporation may be required.

A corporation is formed by filing articles of incorporation with the California Secretary of State and paying the appropriate filing fee. Corp C §200; Govt C §12186 ($100 for a domestic stock corporation or domestic close corporation). The articles must be signed and filed by the incorporator, who need not be a shareholder. Corp C §200(b).

An amount of at least $800 in estimated tax generally must be paid by the 15th day of the fourth month of a corporation's taxable year. Rev & T C §§23151, 19025. However, a corporation is not subject to the minimum tax for its first taxable year. Rev & T C §§23153(f), 23221. Thus, there is no prepayment of minimum franchise tax and a new corporation will pay only an estimated tax based on earnings in its first taxable year.

After formation, directors must be elected by the shareholders or appointed by the initial incorporator (Corp C §§164, 300-317), officers must be appointed by the directors (Corp C §312), bylaws should be prepared and adopted (Corp C §§211-212), and shares of stock issued to the shareholders (Corp C §§400-423). The election of directors and officers, the adoption of bylaws, the initial issuance of corporate shares, and other organizational matters should be reflected in organizational minutes.

Within 90 days after filing the articles of incorporation, the corporation must file with the Secretary of State a Statement by Domestic Stock Corporation, providing the name and address of the corporation's directors and executive officers, the general nature of the corporation's principal business activity, and the address of the corporation's principal business office. Corp C §1502.

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§3.11 2. General Partnership and Limited Liability Partnership

Considering only formalities, forming a general partnership is simpler than forming a limited partnership, corporation, or LLC, in that no filing of a certificate or articles is required. While it is advisable for the agreement to be in writing, there is no such statutory requirement. The cost and complexity of the agreement will depend on the structure of the partnership and the nature of the business to be conducted by the partnership. In some cases, depending in part on the number of parties and their respective roles in the venture, completing the agreement may involve extensive negotiating and drafting (and, therefore, significant attorney fees).

In California, a general partnership of lawyers, accountants, or architects may be formed as an LLP if one or more partners authorized to do so completes, executes, and files with the Secretary of State a registration in the prescribed form (Secretary of State Form LLP-1), accompanied by the appropriate filing fee (currently $70). Corp C §§16101(14), 16953; Govt C §12189(a). The partnership must be formed under a partnership agreement governed by Corp C §§16951-16962 (specific to LLPs) and generally must include as partners only persons licensed to practice architecture, law, or public accountancy in California or another jurisdiction.

An LLP may also be formed by a partnership that is related to the architecture, accounting, or law firm LLP, and that provides services related or complementary to those provided by the firm, or provides services or facilities to the firm. Corp C §16101(8). See Corp C §16101(8)(B) for the meaning of "related" in this context.

The inclusion of the practice of architecture as a professional LLP service extends until January 1, 2012. Corp C §16101(19).

A preexisting general partnership may convert to an LLP by the vote of the partners possessing a majority of the interests of its partners in the current profits of the partnership or by a different vote as may be required in its partnership agreement (and, on so converting, registering as an LLP as described above). Corp C §16955(a). A converted partnership is the same person that existed before the conversion and succeeds to all property and obligations of the converting partnership, and any action by or against the converting partnership may be continued as if the conversion had not occurred. Corp C §16955(b).

At the time of registration as an LLP, the LLP must provide security for claims against it based on acts, errors, or omissions arising out of the practice of architecture, public accountancy, or law, as the case may be. There are various ways to meet the security requirements. See Corp C §16956.

A foreign LLP must register with the State Bar, the State Board of Accountancy, or the State Board of Architectural Examiners, as appropriate, before transacting intrastate business, and also must submit to the Secretary of State an application for registration in the prescribed form (Secretary of State Form LLP-1) as a foreign LLP within 30 days after the LLP first transacts intrastate business in California, accompanied by a good standing certificate from its jurisdiction of organization, and the appropriate filing fee (currently $70). Corp C §16959; Govt C §12189(b).

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§3.12 3. Limited Partnership

A limited partnership is formed by filing with the Secretary of State, on the prescribed form (Secretary of State Form LP-1), a Certificate of Limited Partnership executed by all the general partners of the limited partnership and the payment of the statutory fee. Corp C §15902.01(a); Corp C §15902.04(a)(1); Govt C §12189.

Either before or after filing the certificate, all the partners must enter into a limited partnership agreement. Corp C §15902.01(a). Although the agreement may be oral (Corp C §15901.02(x)), it is advisable for it to be in writing, and it is essential that the agreement address all material issues among the partners. The cost and complexity of the agreement will depend on the structure and business of the partnership.

Limited partnerships are required to pay an annual franchise tax of $800 for the privilege of doing business in California. Rev & T C §§17935(a), 23153(d)(1). Any limited partnership that has filed a certificate of limited partnership or that has registered as a foreign limited partnership also must pay an annual tax of $800. Rev & T C §17935(b). However, the tax is not paid when filing the certificate of limited partnership, but is paid on the due date of the limited partnership's tax return. Rev & T C §17935(c).

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§3.13 4. Limited Liability Company

An LLC is formed by filing articles of organization with the Secretary of State on the prescribed form (Secretary of State Form LLC-1) and the payment of the $70 statutory fee. Corp C §17050(a); Govt C §12190. The articles must be signed and filed by the organizer of the LLC, who need not be a member or manager of the LLC. Corp C §17050(a). For detailed information on formation, see chap 7.

Either before or after filing the articles of organization, all the members must enter into an operating agreement. Corp C §17050(a). The operating agreement may be oral. Corp C §17001(ab). However, it is advisable that the agreement be in writing, and it is essential that it address all material issues among the members. The cost and complexity of the agreement will depend on the nature of the LLC and its business. As with partnership agreements, completing the LLC operating agreement may involve extensive negotiating and drafting. For forms of operating agreement, see chaps 9 and 10.

Within 90 days after filing the articles of organization, the LLC must file with the Secretary of State a Statement of Information (Form LLC-12), providing the name and address of the LLC's managers (if it is a manager-managed LLC) or its members (if it is a member-managed LLC), the general nature of the LLC's principal business activity, the name and address of the LLC's agent for service of process, and the address of the LLC's principal business office. Corp C §17060.

An LLC doing business in California is required to pay an annual franchise tax of $800 for the privilege. Rev & T C §§17941(a), 23153(d)(1); §§5.4-5.5. Like a limited partnership, an LLC is not required to pay the tax when filing the articles of organization, but must pay it on or before the 15th day of the 4th month of the LLC's taxable year. Rev & T C §17941(c).

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§3.14 B. Federal Income Tax Considerations

Sections 3.15-3.63 provide a brief overview of tax rules that apply to C corporations, S corporations, partnerships, and LLCs. On taxation of LLCs that are classified as partnerships, see chap 5. On taxation of partnerships, see Advising California Partnerships, chaps 7-9 (3d ed Cal CEB 1999). For in-depth analysis of the taxation of corporations, see Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders (7th ed 2000); for a brief review, see Organizing Corporations in California, chap 1 (3d ed Cal CEB 2001). For a review of S-corporation taxation, see Forming and Operating S Corporations (Cal CEB Action Guide Spring 2002); Eustice & Kuntz, Federal Income Taxation of S Corporations (4th ed 2001).

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§3.15 1. Classification of Entities for Tax Purposes

The fundamental distinction between a corporation and a general partnership, limited partnership, limited liability partnership, or LLC is that a corporation (other than an S corporation) is subject to entity level tax, while partnerships and LLCs classified as partnerships are as "pass-through" entities, in which items of income, loss, deduction, gain, and credit are not taxed at the entity level but are passed through to the partners or members.

Entities other than corporations and business trusts may elect to be classified as partnerships or corporations under the IRS check-the-box regulations. LLCs are generally classified as partnerships unless they elect to be taxed as corporations.

On IRS check-the-box regulations (Treas Reg §§301.7701-1—301.7701-3) and the parallel Franchise Tax Board classification regulations (18 Cal Code Regs §§23038(b)-1—23038(b)-3), see chap 4.

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§3.16 2. Tax Consequences of Formation

Neither a corporation, a partnership, nor an LLC is ordinarily taxed on the receipt of capital contributions (whether of cash, property, or services) by shareholders, partners, or members (as applicable). IRC §§721 (partnership and LLC), 1032 (corporation). However, a shareholder, partner, or LLC member may be taxed on the contribution, depending on the nature of the contribution.

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§3.17 a. Contributions of Cash

A contribution of cash in exchange for shares of corporate stock, a partnership interest, or a membership interest in an LLC will not result in a taxable event for the contributing party.

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§3.18 b. Contributions of Property

The contribution of property in exchange for shares of corporate stock (including shares in an S corporation) is a taxable event for the contributing party unless the transaction constitutes a tax-free exchange under IRC §351 (transfers to a controlled corporation). If a contribution of property to a corporation is taxable, it will be treated as a sale of the property in exchange for the shares of corporate stock and the shareholder will usually be taxed on the difference, if any, between the shareholder's basis in the property and the property's fair market value. IRC §1001.

The contribution of property in exchange for an interest in either a partnership or an LLC (assuming the LLC is treated as a partnership or disregarded for tax purposes) is generally not a taxable event, and will not subject the contributing partner or member to tax liability. IRC §721(a). However, if the contributed property is subject to a liability, the contributing partner or member may recognize gain to the extent that the liability exceeds the sum of (1) the partner's or member's basis in the contributed property plus (2) the partner's or member's basis in the partnership or LLC before the contribution. See §4.21. Furthermore, a contribution of property to a partnership (and, presumably, an LLC) may be recharacterized as a sale of the property by the partner to the partnership, under the "disguised sale" rules of IRC §707(a)(2)(B). See §§4.20, 5.64.

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§3.19 c. Contributions of Services

Contributions of services to a corporation (including an S corporation) in return for unrestricted shares of stock will generally be taxed to the contributing party as ordinary income to the extent of the fair market value of the stock received, although subjecting the stock to restrictions may enable the shareholder to defer taxable income. IRC §§61, 83.

If a partner of a partnership or a member of an LLC taxed as a partnership contributes services to the partnership or LLC, and receives in return an interest in the profits of the entity, but no interest in the underlying capital, in most situations the IRS will not take the position that the profits interest is taxable on receipt. Rev Proc 93-27, 1993-2 Cum Bull 343. If the partner or member receives a capital interest in the entity in exchange for services, however, the partner or member has taxable income. Treas Reg §1.721-1(b)(1). See §4.19.

NOTE: Revenue Procedure 93-27, 1993-2 Cum Bull 343, will be rendered obsolete when Prop Treas Reg §1.83-3(1) becomes final, but the statements above for which it is cited will remain essentially true. See IRS Notice 2005-43, 2005-1 Int Rev Bull 1221; see also §4.19.

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3. Taxation of the Entity and Its Owners

a. C Corporations

§3.20 (1) Entity Level Tax; Double Taxation

The net income of a "C corporation" (*i.e.*, a corporation that has not made an election to be an S corporation; see §3.27) is subject to taxation at the corporate level. IRC §11(a). Dividends distributed to shareholders are generally taxed to the shareholders at a rate of 15 percent (IRC §§1(h), 301, 316(a)), with no corresponding deduction to the corporation, resulting in the double taxation of corporate income distributed to shareholders. California does not have a preferential tax rate for dividends. See §3.54. Furthermore, if assets are distributed to shareholders, any gain inherent in the assets is recognized by the corporation on the distribution (IRC §311(b)), while losses inherent in distributed assets can be recognized only in a liquidating distribution, in which case limitations apply (IRC §336(d)).

Double taxation often can be avoided by distributing income to shareholder/employees as salaries or by using corporate earnings to pay interest on debt owed to shareholders or rents or royalties on property leased or licensed from shareholders. In each instance, while the shareholders have income, the corporation receives a corresponding tax deduction. These types of transactions are closely scrutinized by the IRS, so the company should take care to ensure that the amounts paid are reasonable. In considering the reasonableness of compensation "from the perspective of a hypothetical investor," courts in the Ninth Circuit apply a five-factor test that takes into account: (1) the employee's role in the company; (2) compensation paid to similarly situated employees in similar companies; (3) the character and condition of the company; (4) whether a conflict of interest exists that might permit the company to disguise dividend payments as deductible compensation; and (5) whether the compensation was paid under a structured, formal, and consistently applied program. *Elliotts, Inc. v Commissioner* (9th Cir 1983) 716 F2d 1241, 1245. In *O.S.C. & Assocs. v Commissioner* (9th Cir 1999) 187 F3d 1116, the court held that a closely held corporation could not deduct compensation payments made to two employees who were also its shareholders because, even if reasonable, they were payments of dividends in disguise. In *Label/Graphics, Inc. v Commissioner* (9th Cir 2000) 221 F3d 1091, the court held that a corporation could deduct less than half of compensation paid to the corporation's president, key employee, and sole shareholder. In *E.J. Harrison & Sons, Inc.,* TC Memo 2006-133, aff'd (9th Cir 2008) 270 Fed Appx 667, the Tax Court, applying the *Elliotts* test, allowed deductions of $1.4 million of the $2.1 million in total compensation paid over a three-year period to one of four officer-shareholders of a family business engaged in waste pickup and disposal services.

Double taxation cannot be avoided by transferring appreciated property to an LLC or limited partnership and then distributing membership or limited partnership interests to the shareholders. In *Pope & Talbot, Inc. v Commissioner* (9th Cir 1999) 162 F3d 1236, the court held that the gain on a corporation's transfer of appreciated property to a limited partnership was determined by the hypothetical fair market value of the property as if the corporation had sold it, not by the aggregate value of the interests received by the shareholders.

Businesses that reinvest most of their income, rather than distribute it, may find the corporate tax structure more beneficial, because income left in the corporation for reinvestment in the business may be taxed at a lower rate than it would be in the hands of an individual shareholder. However, it may be risky to accumulate too much income. See IRC §§531-537 (accumulated earnings tax), and IRC §§541-547 (personal holding company tax).

Gain realized on a shareholder's disposition of corporate stock is generally taxed at a 15-percent rate. IRC §1(h). There is a 50-percent exclusion from gross income for gain on disposition of qualified small business stock as defined in IRC §1202. Significantly, the 50-percent exclusion also applies for California income tax purposes. See §3.54.

NOTE: For small business stock acquired after February 17, 2009, and before January 1, 2011, the federal exclusion has been increased to 75 percent.

However, an amount of gain equal to the gain excluded is taxed at a 28-percent rate rather than a 15-percent rate. IRC §§1(h)(3), (6). Alternatively, gain realized on the sale of qualified small business stock may be rolled over to other qualified small business stock within 60 days. IRC §1045.

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§3.21 (2) Inability to Utilize Losses

Corporate losses stay in the corporation, and cannot be deducted by the shareholders, unlike the case of partnerships, S corporations, and LLCs, in which losses can be deducted by partners, shareholders, and members. Deductions must be postponed until the corporation has income, and may be permanently lost. For California tax purposes, depending on the tax year, between 50 and 100 percent of a net operating loss (NOL) incurred in any income year is eligible for carryover by an individual or corporate taxpayer. The portion eligible for carryover is 100 percent for taxable years beginning on or after January 1, 2004. Rev & T C §§17276, 24416.

For partnerships and LLCs, however, the NOL is not deductible at the entity level but may be deducted against other income by the individual partners or members, subject to a basis limitation. See §§3.44, 5.9, 5.54-5.57. For S corporations, the NOL may be deducted by the shareholders, subject to a basis limitation. See §3.29.

NOTE: See §5.54 on the suspension of NOL deductions for California tax purposes for the 2008 and 2009 tax years.

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§3.22 (3) Passive Loss Rules; At-Risk Rules

The at-risk rules of IRC §465 and the passive loss rules of IRC §469 will apply to a corporation if five or fewer shareholders own over half of the stock of the corporation. IRC §§465(a)(1)(B), 469(a)(2)(B), (j)(1), 542(a)(2). In the case of the passive loss rules, the only limitation is that passive losses cannot be deducted from portfolio income (*e.g.,* interest and dividends); corporate passive losses are fully deductible from the corporation's "net active income." IRC §469(e)(2).

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§3.23 (4) Method of Accounting

A C corporation may not, as a general rule, use the cash method of accounting. IRC §448(a)(1). Exceptions exist for C corporations with annual gross receipts of $5 million or less (IRC §448(b)(3)) and for qualified personal service corporations (IRC §448(b)(2)). Under the accrual method of accounting, certain payments cannot be deducted until economic performance has occurred with respect to the liability. IRC §461(h). See, *e.g.*, *Jimmy D. Weaver* (2003) 121 TC 273.

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§3.24 (5) Taxable Year

A C corporation (except a personal service corporation) may adopt a taxable year without regard to the taxable year of the shareholders. IRC §441(a)-(b). A personal service corporation must use a calendar year unless the corporation establishes a business purpose for having a different period for a taxable year. The deferral of income to shareholders will not be considered a "business purpose." IRC §441(i)(1). "Personal service corporations" are defined in IRC §269A(b)(1)-(b)(2); see also IRC §441(i)(2).

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§3.25 b. S Corporation

To become an S corporation, an "S election" is filed with the IRS under IRC §1362. The election has the effect of making the corporation a pass-through entity for federal tax purposes, but does not change the nature of the entity as a corporation for state law purposes.

NOTE: State law determines whether a taxpayer is a beneficial shareholder of an S corporation for federal income tax liability purposes. In *Pahl v Commissioner* (9th Cir 1998) 150 F3d 1124, the taxpayer entered into an agreement to purchase shares of stock to become a 25-percent shareholder of a law firm organized as an S corporation. The taxpayer never paid for any shares and failed to report his share of profits and losses. The court found the taxpayer to be a shareholder of the S corporation under California law and upheld the tax liabilities and penalties imposed by the IRS.

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§3.26 (1) Pass-Through Entity

The income and losses of an S corporation generally flow through to, and are taxed to or deducted by, the shareholders, retaining the character they had for the S corporation. Nonresidents are subject to California income tax on the amount of California source income they receive from S corporations doing business in California. *Valentino v Franchise Tax Bd.* (2001) 87 CA4th 1284, 105 CR2d 304. The basis in the shareholder's stock is increased by the shareholder's share of income and decreased by the shareholder's share of losses. IRC §1367. The shareholder's loss deduction is limited to the basis in the shareholder's stock and the basis of any debt owed by the corporation to the shareholder. IRC §1366. See, *e.g., Diane S. Blodgett,* TC Memo 2003-212. However, pass-through items from an S corporation are not included in net earnings from self-employment. Therefore, taxpayers may not deduct pass-through losses from an S corporation in calculating their self-employment taxes under IRC §1401. *Ding v Commissioner* (9th Cir 1999) 200 F3d 587. Likewise, shareholders may not deduct pass-through income from an S corporation contributed to the shareholder's Keogh account for income tax purposes. *Durando v U.S.* (9th Cir 1995) 70 F3d 548.

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§3.27 (2) Requirements to Qualify as an S Corporation

To qualify as an S corporation, a corporation cannot (IRC §1361):

- Have more than 100 shareholders;
- Have anyone other than an individual, an estate, or certain trusts and certain tax-exempt organizations, as shareholders (corporate and partnership shareholders are not permitted);
- Have a nonresident alien as a shareholder;
- Have more than one class of stock, except that differences in voting rights are permitted;
- Be an insurance company;
- Be a foreign corporation;
- Be a domestic international sales corporation;
- Be a financial institution that uses the reserve method of accounting for bad debts, as described in IRC §585; or
- Have an IRC §936 election in effect (involving Puerto Rico and possession tax credit).

An S corporation may own 100 percent of another S corporation or 80 percent or more of the stock of a C corporation, but an S corporation cannot elect to file a consolidated return with its affiliated C corporation under IRC §1504. Once an S election is made, failure to meet the requirements will terminate the S election; *i.e.*, S-corporation status can be inadvertently terminated. IRC §1362(d)(2). Once terminated, the election cannot normally be made again for 5 years. IRC §1362(g). However, inadvertent terminations may be waived under IRC §1362(f). Note that a qualified federal S corporation is treated as an S corporation for California tax purposes. See §3.55.

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§3.28 (3) Distributions to Shareholders

A shareholder is taxed on his or her share of S-corporation income, regardless of whether the shareholder receives that income. Distributions are not taxable to a shareholder except to the extent the money and fair market value of property distributed exceeds the shareholder's basis in his or her stock and the basis of debt owed by the corporation to the shareholder. IRC §1368. However, the S corporation will recognize any gain on the distribution of property under IRC §311(b), but, except in liquidation, no loss. Normally, as with other S-corporation income, the gain will flow through and be taxed to the shareholders. The amount of money and the fair market value of property distributed to a shareholder reduce the basis of his or her stock. IRC §1367. The shareholder takes a fair market value basis in distributed property under IRC §301(d).

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§3.29 (4) At-Risk Rules; Passive Loss Rules

The at-risk rules of IRC §465 and the passive loss rules of IRC §469 apply at the shareholder level.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.30 (5) Method of Accounting

§3.30 (5) Method of Accounting

Unlike C corporations, S corporations may generally use the cash method of accounting. IRC §446(a). However, the cash method may not be used by "tax shelters." IRC §448(a)(3). Application of the tax shelter definitions to S corporations requires that the accrual method, instead of the cash method, be used if over 35 percent of the losses are allocated to shareholders who do not actively participate in the management of the S corporation. IRC §§448(d)(3), 461(i)(3), 464(e)(2), 1256(e)(3).

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.31 (6) Taxable Year

§3.31 (6) Taxable Year

S corporations are generally required to use a calendar year, rather than a fiscal year, for tax purposes. IRC §441.

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§3.32 (7) Differing Tax Treatment Between Partnership and S Corporation

Although S corporations are pass-through tax entities, there are several important differences between the tax treatment of S corporations and partnerships.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.33 (a) No Special Allocations; Only One Class of Stock

§3.33 (a) No Special Allocations; Only One Class of Stock

Unlike partnerships and LLCs, an S corporation may not specially allocate profits and losses. Income and loss allocations are based exclusively on stock holdings. IRC §1366. Furthermore, an S corporation may have only one class of stock (although differences relating solely to voting rights will not violate the prohibition against having two classes of stock). IRC §1361(b)(1)(D), (c)(4).

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§3.34 (b) Debt Does Not Increase Basis in Stock

Corporate debt does not increase the shareholders' basis in their stock. To compare partnerships and LLCs, see §§3.38-3.50.

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§3.35 (c) No IRC §754 Election

There is no equivalent of a partnership §754 election for S corporations. See §3.42. Thus, if a shareholder dies, the shareholder's heirs will take a fair market value basis in the stock under IRC §1014, but there will be no corresponding step-up in the basis of appreciated corporate assets. If the corporate assets are sold at a gain, the income will flow through and be taxed to the inheriting shareholders, even though the appreciation occurred before the decedent's death. The same issue exists for a purchaser of stock in an S corporation with appreciated assets.

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§3.36 (d) Gain Recognized on Contribution of Appreciated Property

The contribution of appreciated property in exchange for shares of S corporation stock will, unless the transaction constitutes a tax-free exchange under IRC §351 (transfers to controlled corporations), be taxable to the contributing party as if that party had sold the property to the corporation, and the shareholder will be taxed on the difference between the property's fair market value and the shareholder's basis in the property. IRC §1001. The contribution of property in exchange for an interest in either a partnership or an LLC will not ordinarily subject the contributing partner or member to tax liability. IRC §721(a).

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§3.37 (e) Gain Recognized on Distributions of Appreciated Property

If an S corporation distributes appreciated property to its shareholders, the corporation recognizes gain that flows through to the shareholders. IRC §§311, 336. However, no loss is recognized on a distribution of depreciated property, except in liquidation. In a partnership and LLC, normally neither gain nor loss is recognized. See §§3.42, 3.52.

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c. Partnership

§3.38 (1) Pass-Through Entity

Partnerships are not subject to income taxation. IRC §701. Rather, the partnership's income and losses flow through to and are taxed to or deducted by the partners, normally retaining the character they had to the partnership. IRC §702. Thus, there is a single level of tax and losses are fully deductible by partners (but not in excess of their bases in their partnership interests (IRC §704(d)), and subject to the at-risk and passive loss rules (IRC §§465, 469).

Although a partnership's pass-through tax treatment avoids the potential of double taxation, and provides tax advantages to partners if the partnership loses money, it can be a disadvantage to a profitable business that reinvests a significant portion of its profits, since the partners in such circumstances would be taxed on their allocable share of the profits without receiving cash distributions with which to pay the taxes.

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§3.39 (2) Distributions

Distributions of cash or property by a partnership to its partners are generally not taxable events to the partners or partnership (no gain or loss is recognized). IRC §731. However, if the amount distributed to a partner (including a deemed distribution because of a reduction in a partner's share of partnership debt) exceeds his or her basis in the partnership interest immediately before the distribution, gain is recognized to the extent of the excess. IRC §731(a)(1). A partner's basis in his or her partnership interest is reduced by the amount of distributions made to the partner. IRC §705(a)(2). A partner generally takes a carryover basis in distributed property. IRC §732.

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§3.40 (3) Special Allocations

It is possible to make "special allocations" of profit, loss, deductions, and credits among the partners. IRC §704(a). Generally, to be effective, these allocations must have "substantial economic effect." IRC §704(b)(2); Treas Reg §1.752-3. The criteria for determining whether special allocations have substantial economic effect are set forth in Treas Reg §1.704-1(b).

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§3.41 (4) Debt Increases Basis

Under IRC §752(a), a partner's share of partnership debt is considered to be a contribution of money by the partner to the partnership, and the partner's basis in his or her partnership interest is increased accordingly under IRC §705. If a partner's share of partnership debt is decreased, it is treated as a distribution of money to the partner under IRC §752(b), and the partner's basis in his or her partnership interest is decreased under IRC §705.

The rules for recourse debt are different than those for nonrecourse debt. Recourse debt is shared by partners according to how partners share the "economic risk of loss" with regard to the debt. Treas Reg §1.752-2. While the evaluation of how economic risk of loss is shared can be complex, generally partners share the economic risk of loss based on their ultimate responsibility for payment of the recourse debt. Nonrecourse debt, on the other hand, is shared under a complex stacking rule; however, the general rule is that partnership nonrecourse liabilities are shared in the manner in which partners share profits. Treas Reg §1.752-3.

That entity-level debt increases the basis in ownership interests is a major advantage that partnerships (and, therefore, LLCs that are taxed as partnerships) possess over S corporations, because the higher a partner's basis in his or her partnership interest, the greater the loss deductions that are permitted to the partner.

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§3.42 (5) Section 754 Election

If a partner sells a partnership interest, or if a partner dies, it is possible to make a "section 754 election" under which the "inside" basis of the inheriting or purchasing partner's share of partnership assets is increased or decreased to equal the "outside" basis of that partner's partnership interest. IRC §§734, 743, 754-755. If the inside basis of a partner's share of partnership assets is "stepped up" as a result of the election, then when the relevant assets of the partnership are sold, the purchasing or inheriting partner will not recognize gain to the extent of the appreciation that occurred before the partnership interest was acquired.

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§3.43 (6) At-Risk Rules

Partners are permitted to deduct their allocable share of partnership losses only to the extent of their amount "at risk" with respect to the partnership. IRC §465. For this purpose, the amount at risk equals the partner's capital investment in the partnership plus the partner's allocable share of partnership debt for which the partner is personally liable. As a rule, nonrecourse debt is not included in the amount at risk, but an exception exists for "qualified nonrecourse financing," which is, generally, nonrecourse debt secured by real property. IRC §465(b)(6).

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§3.44 (7) Passive Loss Rules

Passive losses may be deducted only from passive income, and may not be deducted from active or portfolio income. IRC §469. If a partner does not "materially participate" in a partnership activity (as is the case typically with limited partners), the partnership's losses from that activity will be passive to that partner.

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§3.45 (8) Termination of Partnership for Tax Purposes

If 50 percent or more of the interests in a partnership's capital and profits are sold or exchanged within 12 months, the partnership is deemed to have terminated for tax purposes. IRC §708(b)(1)(B). If a partnership is terminated under IRC §708, the partnership assets are deemed distributed proportionately to the partners and then recontributed back to the partnership. If the amount deemed distributed to a partner exceeds his or her basis in the partnership interest, the partner will recognize gain to the extent of the excess. IRC §731(a)(1).

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§3.46 (9) Method of Accounting

Partnerships may generally use the cash method of accounting. IRC §§446(a)-(c). However, a partnership that has a C corporation as a partner and that has average annual gross receipts over the past 3 years in excess of $5 million must use the accrual method of accounting. IRC §§448(a)(2), (b)(3), (c). Likewise, partnerships that are tax shelters must use the accrual method of accounting. IRC §448(a)(3). A tax shelter includes a limited partnership in which over 35 percent of the partnership's losses are allocated to limited partners. IRC §§448(d)(3), 461(i)(3), 1256(e)(3).

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§3.47 (10) Taxable Year

A partnership must adopt a taxable year corresponding to that used by its majority or principal partners. IRC §706(b). If the majority or principal partners do not all have the same fiscal year, the partnership is generally required to adopt a calendar taxable year.

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d. Limited Liability Company

§3.48 (1) Pass-Through Entity

As a pass-through entity, the LLC's income and losses flow through and are taxed to or deducted by the members, normally retaining the character they had to the LLC. Thus, there is a single level of tax and losses are fully deductible by members (but not in excess of their bases in their membership interests). See IRC §§701-702, 704(d). If the LLC has a single member, the LLC is disregarded and all assets and liabilities of the LLC are treated as owned by the member. Treas Reg §301.7701-3(b)(1).

As with partnerships, pass-through tax treatment can be a disadvantage to a profitable business that reinvests a significant portion of its profits, since the members will be taxed on their allocable share of the profits without receiving cash distributions with which to pay the taxes.

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§3.49 (2) Distributions

Distributions of cash or property by an LLC taxed as a partnership to its members are generally not taxable events to the members or the LLC (*i.e.*, no gain or loss is recognized). See IRC §731. However, if money distributed to a member exceeds the member's basis in the membership interest, gain is recognized to the extent of the excess. IRC §731(a)(1). A member's basis in his or her membership interest is reduced by the distributions made to the member. IRC §705. A member generally takes a carryover basis in distributed property. IRC §732. For further information on distributions, see §§5.58-5.69; on a member's basis, see §5.67. A distribution to a member by a single-member LLC is a nonevent because the member is treated as having owned the assets of the LLC.

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§3.50 (3) Application of Partnership Tax Rules to LLCs

The partnership tax discussion in §§3.38-3.47 is generally applicable to LLCs taxed as partnerships. The application of partnership tax rules to LLCs is briefly reviewed below. See also chap 5.

Special allocations. An LLC may have special allocations of profit, loss, deductions, and credits to its members, provided the allocations have "substantial economic effect." See §§5.37-5.42.

Debt increases basis (IRC §752). Internal Revenue Code §752 should apply to LLCs. Therefore, a member's basis in his or her membership interest should be increased by his or her share of LLC debt. However, uncertainty arises because of the different treatment under §752 of recourse and nonrecourse debt and the application of the nonrecourse debt allocation rules to LLCs. See §§5.44-5.46.

Section 754 election. LLCs should be eligible for an IRC §754 election on the sale of a membership interest or the death of a member, with the effect that the "inside" basis of the inheriting or purchasing member's share of LLC assets is increased or decreased to equal the "outside" basis of that member's interest in the LLC. See §5.79.

At-risk rules. The at-risk rules of IRC §465 will apply to limit the losses deductible by LLC members. See §5.56.

Passive loss rules. The passive loss rules of IRC §469 will apply to limit the losses deductible by LLC members. There is an issue whether, under the passive loss regulations, members who manage the LLC business will be deemed to "materially participate" in the LLC's business, thereby causing the LLC's losses to be characterized as active, rather than passive, to such members. See §5.57.

Termination of LLC for tax purposes. If 50 percent or more of the interests in an LLC are sold or exchanged within 12 months, the LLC will be deemed to have terminated for tax purposes under IRC §708. See §§5.88-5.89.

Method of accounting. Whether LLCs are permitted to use the cash method of accounting is determined by the same criteria used to determine whether a partnership may use the cash method. As noted above, "tax shelters" may not use the cash method (§3.40). Because of the definition of tax shelter, whether a California LLC may use the cash method of accounting is open to question. See §§5.12-5.14.

Taxable year. LLCs are subject to the same limitations as partnerships in the adoption of a taxable year. See §§3.47, 5.11.

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4. Taxation on Disposition of Interests and Liquidation

§3.51 a. Corporation

A shareholder's disposition of shares of corporate stock generally constitutes a taxable event. Gain or loss is recognized based on the difference between the amount received for the stock and the shareholders' basis in the stock. IRC §1001. The gain or loss will generally be treated as resulting from the disposition of a capital asset. IRC §1221. With capital gains currently taxed, for federal purposes, at the rate of 15 percent, and with the top marginal rate on ordinary income currently at 35 percent, the treatment of gains as capital gains is potentially significant to upper-income taxpayers. The treatment of losses as capital losses is also significant because of the limitations on the deduction of capital losses. IRC §§1211-1212.

In a liquidating distribution, the shareholders recognize a gain or loss (generally treated as arising from the sale of a capital asset) based on the difference between the fair market value of the property received and the basis of their stock (IRC §§331, 1001), and any gain inherent in the assets distributed to the shareholders is recognized by the corporation (IRC §336). Thus, C corporations and their shareholders are subject to double taxation on the liquidation of the corporation.

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§3.52 b. Partnership

A partner's disposition of all or any portion of his or her interest in a partnership generally constitutes a taxable event. IRC §741. Gain or loss is recognized based on the difference between the amount received for the partnership interest and the partner's basis in the partnership interest. The gain or loss (except to the extent it is attributable to unrealized receivables or inventory items) will be treated as resulting from the disposition of a capital asset. IRC §§741, 751(a).

When a partnership is liquidated, the partnership does not ordinarily experience a taxable event. IRC §731(b). The partners are generally taxed only to the extent the money received exceeds their basis in their respective partnership interests (unless the distributions are disproportionate for unrealized receivables or inventory items that have substantially appreciated in value). IRC §§731(a), 751(b). Gain or loss on liquidation is generally treated as capital gain or loss for the partners. Thus, partnerships are not subject to double taxation on liquidation.

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§3.53 c. Limited Liability Company

A sale or exchange of a single-member LLC will be treated as a disposition of the LLC's assets by its member. Gain or loss will be determined by comparing the member's basis in the LLC interest with the amount received or realized on the disposition. LLCs that choose to be treated as partnerships will be so treated for disposition of membership interests and liquidation distributions. Thus, if a member of an LLC transfers all or any portion of his interest in the LLC, the resulting gain or loss will generally be taxed, based on the difference between the amount received for the membership interest and the member's basis in the interest, and will typically be treated as resulting from the disposition of a capital asset, subject to the same limitations that apply to transfers of partnership interests. For a more complete discussion of the taxation of dispositions of LLC interests, see §§5.76-5.78.

Likewise, when an LLC is liquidated, the LLC does not ordinarily experience a taxable event, and the members are generally taxed only to the extent the money received exceeds their basis in their respective membership interests, with the resulting gain or loss generally treated as a capital gain or loss (subject to the same limitations that apply to partnerships). Thus, LLCs, like partnerships, avoid double taxation on liquidation. For a more complete discussion of the taxation of LLC liquidations, see §§5.70-5.74. When a single-member LLC is liquidated, no gain or loss is recognized on the liquidation because the member is treated as having previously owned all the LLC assets.

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C. State Tax Considerations

§3.54 1. Corporation

The income of corporations incorporated in California is subject to the California franchise tax, which corresponds roughly to the federal corporate income tax. The maximum rate is 8.84 percent. Rev & T C §23151(d). The annual minimum franchise tax is $800, except that corporations are not subject to minimum tax during their first taxable year. Rev & T C §23153(d)(1), (f).

Gain realized on a shareholder's disposition of corporate stock is generally taxed at the same rate as ordinary income for California tax purposes. There is a 50-percent exclusion from gross income for gain realized on the sale or exchange of qualified small business stock held for more than 5 years. See Rev & T C §18152.5.

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§3.55 2. S Corporation

California recognizes S corporations. Rev & T C §23800. A corporation that is an S corporation for federal income tax purposes is also treated as an S corporation for purposes of California's income tax. Rev & T C §23801. California subjects S corporations (except financial corporations) to a tax of 1.5 percent of the corporation's net income. Rev & T C §23802(b)(1). S corporations are subject to the same $800 minimum annual franchise tax as C corporations. Rev & T C §§23802(c), 23153(d)(1). See §3.10.

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§3.56 3. Partnership

California's tax treatment of partnerships generally corresponds to the federal model. See Rev & T C §17851. Thus, California does not tax partnership income at the entity level, and the partnership's income and losses flow through to and are taxed to or deducted by the partners, normally retaining the character they had to the partnership. California subjects limited partnerships to an annual tax of $800 for the privilege of doing business in California. Rev & T C §§17935, 23153(d)(1). General partnerships are not subject to this tax.

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§3.57 4. Limited Liability Company

An LLC that is treated as a partnership for California tax purposes is subject to an annual fee based on total income. See §5.5.

California also subjects LLCs to an annual tax of $800 for the privilege of doing business in California. Rev & T C §§17941(a), 23153(d)(1). In *Amman & Schmid Finanz AG* (SBE 1996) CCH Cal Tax Rep ¶402-852, the State Board of Equalization (SBE) determined that the $800 minimum tax did not apply to an out-of-state corporation whose only California contact was as a limited partner in a limited partnership doing business in California. The corporation was subject to corporate income tax on its distributive share of ownership income as income derived from California sources. The Franchise Tax Board clarified that this holding also applied to foreign members of limited liability companies doing business in California. See California Franchise Tax Board News (January 1997).

NOTE: The annual franchise fee was declared unconstitutional by a San Francisco Superior Court decision. See §5.4.

On California's taxation of LLCs, see also §§5.3-5.6.

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D. Other Tax Considerations

§3.58 1. Self-Employment Income

A general partner's allocable share of partnership income will typically be self-employment income, which will be subject to self-employment taxes. IRC §§1401-1402. Conversely, a limited partner's share of partnership income will not normally be self-employment income, except to the extent the limited partner receives IRC §707(c) "guaranteed payments" for services rendered. IRC §1402(a)(13).

The IRS has proposed amendments to the self-employment income regulations that address how a member's allocable share of LLC income will be treated for self-employment tax purposes. Subject to certain conditions described in the regulations, a member of an LLC will be treated as a limited partner of a partnership (and, therefore, generally not subject to self-employment tax on the member's allocable share of LLC income) if the LLC has designated managers and the member is not a manager of the LLC and the member does not participate in the trade or business of the LLC for more than 500 hours per year. Prop Treas Reg §1.1402(a)-2(h). See §§4.34, 5.85.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/ 2. Fringe Benefits/§3.59 a. Corporation

2. Fringe Benefits

§3.59 a. Corporation

The cost of health insurance and certain other fringe benefits (such as group health, disability, and accident insurance) provided by a corporation to its shareholder-employees is deductible by the corporation (IRC §162) and excluded from the shareholder-employees' income (IRC §106).

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§3.60 b. S Corporation

If an S corporation provides medical insurance for employees (including shareholder-employees who own more than 2 percent of the stock of the S corporation), the S corporation may deduct the expenses under IRC §162. However, S-corporation shareholder-employees who own more than 2 percent of the stock must include the amount of medical insurance premiums paid by the corporation in their income. IRC §1372; Rev Rul 91-26, 1991-1 Cum Bull 184.

NOTE: For these purposes, the term "2-percent shareholder" means any person who owns (or is considered as owning within the meaning of IRC §318) on any day during the taxable year of the S corporation more than 2 percent of the outstanding stock of the corporation or stock possessing more than 2 percent of the total combined voting power of all stock of the corporation. IRC §1372(b).

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§3.61 c. Partnership

A partnership may follow one of two courses with respect to health insurance provided to partners. It may deduct the insurance premiums as a "guaranteed payment" under IRC §707(c), and the partners will have income to the extent of their respective shares of the guaranteed payment. Alternatively, the partnership may forgo the deduction (thus increasing the overall partnership income allocable to the partners) and treat the insurance premiums it pays as a deemed distribution of money to the partners, in which case the partners will not have income unless the deemed distribution exceeds their basis in their respective partnership interests. Rev Rul 91-26, 1991-1 Cum Bull 184.

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§3.62 d. Limited Liability Company

Because LLCs are generally treated like partnerships for tax purposes, health insurance provided by an LLC to its members will be treated similarly to health insurance provided by a partnership to its partners. See §3.61.

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§3.63 3. Employment Taxes

A corporation may have greater liability for employment taxes than a partnership or limited liability company taxed as a partnership. Under IRC §3121(d)(2), an "employee" includes any individual who has the status of an employee under applicable common-law rules. Under IRC §3121(d)(1), an officer of a corporation is a "statutory employee" if that officer performs substantial services for the corporation and receives remuneration for those services. See *Veterinary Surgical Consultants, P.C.* (2001) 117 TC 141, aff'd sub nom *Yeagle Drywall Co. v Commissioner* (3d Cir 2002) 2003-1 USTC ¶50,141, 90 AFTR2d 7744, cert denied (2003) 539 US 944, 156 L Ed 2d 630, 123 S Ct 2623. So-called statutory employees are considered employees regardless of their status under common law. See *Joseph M. Grey Pub. Accountant, P.C.* (2002) 119 TC 121, 126.

Thus, a corporation is liable for employment taxes not only for its "common-law" employees, but also for shareholders acting as corporate officers if those shareholders receive remuneration for services to the corporation.

The corporation is entitled to an income tax deduction for employment taxes paid. *Robert E. Kovacevich,* TC Memo 2003-161. These cases involved professional corporations, but LLCs taxed as a corporation also may be liable for employment taxes on amounts paid to members acting as managers. In this regard, see *McNamee v Department of the Treasury* (2d Cir 2007) 488 F3d 100 (single member LLC that did not elect to be taxed as corporation was disregarded for tax purposes; consequently, sole member was personally liable for employment taxes) and *Littriello v U.S.* (6th Cir 2007) 484 F3d 372 (same; state recognition of separate existence of taxpayer's single-member LLC was not binding for purposes of federal tax law; LLC's failure to elect status as "association" (corporation) meant that single member was individually liable as sole proprietor for employment taxes).

In *Charlotte's Office Boutique, Inc.* (2003) 121 TC 89, aff'd (9th Cir 2005) 425 F3d 1203, the court held that a corporation was liable for employment taxes on "royalties" paid to the sole shareholder that the court determined were in fact wages. Members acting as managers or otherwise participating in LLCs taxed as a partnership may be subject to self-employment tax. See §3.61.

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E. Management and Control

§3.64 1. Corporation

In a corporation, management is generally separated from ownership. Shareholders elect directors initially on formation (unless the initial directors are appointed by the incorporator; see Corp C §210) and thereafter elect a board of directors annually. Corp C §301. The directors in turn appoint officers. Corp C §312.

The business and affairs of the corporation are managed by or under the direction of the board of directors. Corp C §300(a). The directors generally determine corporate policy and authorize corporate actions outside the ordinary course of business, such as raising capital, borrowing money, and acquiring or disposing of substantial assets, and officers manage the day-to-day affairs of the corporation. Shareholders in their capacity as shareholders cannot bind the corporation to a contract and, except in the case of statutory close corporations (see below), have no right to participate in the day-to-day management of the business.

The relationship between management and ownership can be altered by control devices such as voting and nonvoting classes of stock, voting trusts, committees of the board, management agreements, shareholder agreements, and provisions in the articles requiring supermajority votes for specified corporate actions.

When there is a substantial number of passive investors, a corporation's management tends to become centralized. However, if there are only a few shareholders who are also directors and officers, the management structure may not differ significantly in substance from that of a partnership, although corporate formalities must be observed. A corporation may formally vest management in the shareholders, and avoid corporate formalities, by electing to be a statutory close corporation. Corp C §158. In a statutory close corporation the shareholders may manage the business much in the same way as a partnership by means of a shareholders' agreement. Corp C §§158, 186, 300(b).

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§3.65 2. General Partnership and Limited Liability Partnership

Unless the partnership agreement provides otherwise, all partners have equal rights to manage and conduct partnership business. Corp C §16401(f). Partners sometimes allocate control in the partnership agreement by establishing a formula for voting their respective interests on major business decisions, or by providing for a managing partner or management committee to be responsible for the day-to-day affairs of the partnership. Alternatively, the partners may restrict by agreement the authority of individual partners to take certain specified actions.

Under California law, each partner is an agent of the partnership for the purpose of its business, and the act of any partner that apparently carries on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership. Corp C §16301(1). The partnership agreement may restrict the authority of a particular partner to bind the partnership; however, a restriction on authority will not be effective against third parties who have no knowledge of the restriction. Thus, a partner acting within the scope of his or her apparent authority can enter into an agreement that binds the partnership and exposes the other partners to liability, even though the partner was not actually authorized to enter into the agreement.

An LLP formed under California law is subject to the same principles of management as a general partnership. The principal difference lies in the limitation of partners' liability, and the special provision that may be made in the partnership agreement to enable the partners by majority vote or a different vote to impose personal liability on all partners for specified obligations. Corp C §16306(c).

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§3.66 3. Limited Partnership

Limited partnerships are managed by the general partners. Limited partners may not participate in the control of the business, or they risk losing their limited liability. Corp C §15903.03.

A sole general partner of a limited partnership will have more independence and autonomy than will the partners of a general partnership, each of whom must work in conjunction with the other partners. Because the partnership agreement may eliminate the right of the limited partners to remove the general partner (Corp C §15901.10(b)), a general partner of a limited partnership may also have more independence and autonomy than will corporate directors (who are subject to annual election by the shareholders) or officers (who serve at the will of the directors). Thus, limited partnerships may have more centralized management and control than general partnerships or corporations.

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§3.67 4. Limited Liability Company

Unless the articles of organization state that the LLC is to be managed by managers, the business and affairs of the LLC are managed by its members. Corp C §17150; see §6.7. If an LLC is member managed, then the members have all the rights and are subject to all the duties of managers set forth in the Beverly-Killea Limited Liability Company Act. Corp C §17150.

If an LLC is managed by managers, then members do not, as members, participate in the management of the LLC's business, and are not agents of and cannot bind the LLC. Corp C §17157(b)(1). A written operating agreement may eliminate the right of members to remove managers. Corp C §§17152(b), 17005(b).

If authorized in a written operating agreement, an LLC may have officers, including a chairperson or president, or both, vice president, secretary, chief financial officer, and any other officers with whatever titles, powers, and duties are specified in the articles of organization or operating agreement, or determined by the managers or members. An officer may, but need not, be a member or manager of the LLC, and any number of offices may be held by the same person. Corp C §17154(a).

If the operating agreement does not address the issue, officers are appointed by the managers and serve at the pleasure of the managers, subject to whatever rights an officer may have under an employment contract. Corp C §17154(b).

In a member-managed LLC, every member is an agent of the LLC for the purpose of its business or affairs, and the act of any member for apparently carrying on in the usual way the business or affairs of the LLC binds the LLC. Corp C §17157(a); see §6.7. In a manager-managed LLC (1) every manager is an agent of the LLC for the purpose of its business affairs, and the act of any manager for apparently carrying on in the usual way the business or affairs of the LLC binds the LLC, and (2) members are not agents of, and cannot bind, the LLC. Corp C §17157(b); see §6.8. The articles of organization or the operating agreement may include limitations on the authority of members (in a member-managed LLC) or managers (in a manager-managed LLC) to bind the LLC. However, such provisions will not be effective against third parties without actual knowledge of the restrictions. Corp C §17157(a), (b)(2), (d).

An LLC provides great management flexibility. If the LLC is managed by its members, the management can be as decentralized, democratic, and informal as the management of a collegial general partnership. Alternatively, a corporate style management structure may be adopted, complete with officers and managers who act as a board of directors (with the caveat that managers, unlike directors, have agency power to bind the LLC). Or, the LLC may adopt a centralized structure analogous to a limited partnership, with a manager acting like a general partner and with the members having no right to remove the manager.

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F. Liability of Owners for Business Obligations

§3.68 1. Corporation

Corporate shareholders, directors, and officers are ordinarily not liable for the debts and other obligations of a corporation. As a separate legal entity, the corporation itself is liable for such obligations. Individuals, however, may be held liable

- To the extent they have personally guaranteed corporate debts;
- To the extent they have participated in tortious conduct (see *PMC, Inc. v Kadisha* (2000) 78 CA4th 1368, 93 CR2d 663);
- For the return of any distribution of money or property, made when the amount of the distribution exceeded the corporation's retained earnings (see Corp C §506(a));
- Whenever, in the process of winding up the corporation, any distribution of assets is made to any shareholder, otherwise than under an order of court, without prior payment or adequate provision for payment of any of the debts and liabilities of the corporation (see Corp C §2009(a));
- If a court "pierces the corporate veil" of a corporation to impose personal liability on the shareholders (see *Stodd v Goldberger* (1977) 73 CA3d 827, 141 CR 67); or
- If a director, officer, or controlling shareholder breaches a duty to the other shareholders or the corporation (Corp C §§309, 204(a)(10); see also *Jones v H. F. Ahmanson & Co.* (1969) 1 C3d 93, 81 CR 592).

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§3.69 2. General Partnership and Limited Liability Partnership

The partners of a general partnership are jointly and severally liable for all partnership obligations unless otherwise agreed by the claimant or provided by law. Corp C §16306(a). Each partner is an agent of the partnership, with authority to bind the partnership by his or her unilateral actions.

A partnership may insure against many potential liabilities, and the partnership may under some circumstances negotiate the terms of debt to limit the creditor's recourse against individual partners. A judgment against a partnership is not by itself a judgment against a partner. A judgment against a partnership may not be satisfied from a partner's assets unless there is also a judgment against the partner. Corp C §16307(c). See *In re Galetti* (Bankr CD Cal 2000) 2000-2 USTC ¶50,825, 86 AFTR2d 6433 (IRS must separately assess individual general partners of California partnership to make them individually liable for federal employment taxes owed by partnership). Nevertheless, each partner's personal assets ordinarily remain subject to the risks of the partnership business. In *Great W. Bank v Kong* (2001) 90 CA4th 28, 108 CR2d 266, the court held that co-obligor partners who settled a debt with a partnership creditor by becoming assignees of a deficiency judgment against the partnership could not enforce the judgment against the nonsettling partner, because assignment of a joint and several debt to any co-obligor extinguishes the debt. The nonsettling partner remained liable, however, for his proportionate share of the amount the other partners actually paid toward the partnership debt.

The defining characteristic of an LLP is its elimination of the vicarious liability of partners for partnership debts. Corp C §16306(c), (e). California's LLP law is unique in that a partner is liable for the partner's own torts but is not liable for the tort of another agent of the LLP merely by reason of the partner's supervision or control over the other agent. Corp C §16306(e).

The partners in an LLP may agree by majority vote, or a different vote required in the partnership agreement, to be liable as partners for specified obligations. Corp C §16306(d). In addition, a partner may guarantee or provide collateral for obligations of an LLP. Corp C §16306(h). In the case of an LLP engaged in the practice of law, the shield from liability afforded by an LLP does not apply to claims based on acts, errors, or omissions arising out of the rendering of legal services unless the LLP has a currently effective certificate of registration issued by the state bar. Corp C §16306(f).

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§3.70 3. Limited Partnership

The general partner of a limited partnership is liable for partnership obligations to the same extent as the partner of a general partnership. Corp C §15904.02(b). See, *e.g.*, *Wall v Siegel* (1998) 62 CA4th 875, 73 CR2d 102. However, limited partners, like shareholders in a corporation, are not normally liable for the debts of the partnership. Corp C §15903.03(a). The liability of a limited partner is usually limited to the amount of his or her agreed capital contribution and any distributions received by the limited partner from the partnership at a time when the partnership's assets were insufficient to satisfy its liabilities. Corp C §15905.09(b).

Limited partners may become liable as general partners if they participate in the control of the partnership business. Corp C §15903.03(a). However, a limited partner may be any of the following without adversely affecting his or her status as a limited partner (Corp C §15903.03(b)(1)):

- An independent contractor for the limited partnership or its general partner;
- An agent of the limited partnership or its general partner;
- An employee of the limited partnership or its general partner;
- An officer, director, or shareholder of a corporate general partner of the limited partnership;
- A member, manager, or officer of an LLC that is a general partner of the limited partnership;
- A limited partner of a partnership that is a general partner of the limited partnership;
- A trustee, administrator, executor, custodian, or other fiduciary or beneficiary of an estate or trust that is a general partner; or
- A trustee, officer, adviser, shareholder, or beneficiary of a business trust that is a general partner.

Limited partners also may become liable if they act as guarantors of partnership debt. When all limited partners execute guaranties of partnership debt, and there is no express agreement to the contrary, each limited partner's proportionate obligation for contribution is based on his or her ownership interest in the partnership. *Jens v Nelson* (2000) 83 CA4th 848, 100 CR2d 106.

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§3.71 4. Limited Liability Company

The members of an LLC are not personally liable for the debts, obligations, or liabilities of the LLC, whether the liability or obligation arises in contract, tort, or otherwise, solely by reason of being a member of the LLC. Corp C §17101(a). However, notwithstanding the general rule of limited liability, the following liabilities and obligations may apply:

- A member may be liable to the extent the member agrees in writing to be liable for such debts (other than in the operating agreement) or personally guarantees debts of the LLC (Corp C §17101(e)).
- A member may be subject to liability to third parties for the member's participation in tortious conduct (Corp C §17101(c)).
- A member may be obligated to return unlawful distributions (see Corp C §§17254(e), 17255, 17355(a)(1)(B)).
- A member may be liable if a court "pierces the company veil" of an LLC to impose personal liability on the member (see below).

A member of an LLC will be personally liable for any obligation of the LLC under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable for any obligation of the corporation. Corp C §17101(b). Thus, the criteria used to determine whether to "pierce the LLC veil" are the same criteria used to determine whether to "pierce the corporate veil," with one important exception. Among the factors considered by courts in piercing the corporate veil is the failure to observe corporate formalities, such as the failure to hold shareholder and director meetings. However, the failure to hold meetings of members or managers or the failure to observe formalities pertaining to the calling or conduct of meetings will not be considered a factor tending to establish that the members of an LLC have personal liability for any obligation of the LLC when the articles of organization or operating agreement do not expressly require the holding of meetings of members or managers. Corp C §17101(b). Thus, in organizing an LLC, it is generally advisable to not require the holding of meetings of members or managers.

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§3.72 G. Transferability of Interests; Liquidity

The ability to freely transfer ownership interests, although an important planning consideration, is usually not the determining factor in choosing the appropriate entity. Generally, the fewer the number of owners, the less weight given this factor. In fact, in a venture with only a few participants, the parties will generally want to restrict the transferability of ownership interests. Furthermore, in most closely held businesses, there is no ready market for the ownership interests in the business, regardless of the degree of transferability theoretically inherent in the business form selected. As a practical matter, "free transferability" (*i.e.,* the ability to readily liquidate an investment for its fair value) for other than the controlling interest in an enterprise is generally limited to registered stock of publicly held corporations.

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§3.73 1. Corporation

Shares of stock in a corporation are the most easily transferable of the ownership interests under discussion. There are generally no statutory limits on the right of a shareholder to transfer stock (other than those that may be imposed by applicable securities laws), and the shareholder does not need to obtain consent of other shareholders to the transfer. Further, a transfer of stock does not affect the status of the entity. However, in closely held corporations, the transfer or other disposition of shares is often restricted by a shareholders' agreement or by provision in the articles or bylaws. See Corp C §§204(a)(3), (b), 212(b)(1).

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§3.74 2. General Partnership and Limited Liability Partnership

Interests in general partnerships and LLPs are not easily transferred. Unless otherwise provided by specific agreement, partners in a general partnership cannot convey their rights as a partner to another person, because the admission of a new partner requires the consent of the other partners. Corp C §16401(i). Partners may assign their economic interest in the partnership to a third party, but this transfers only the right to share in distributions and profit and loss allocations, and does not transfer voting rights, the right to participate in the management of the partnership business, or the right to require accountings or inspect partnership records. Corp C §§16502-16503.

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§3.75 3. Limited Partnership

The economic interest of a limited partner in a limited partnership is transferable without the consent of the other partners, but, as with general partnerships, this transfers only the limited partner's right to share in distributions and profit and loss allocations, and does not transfer the limited partner's voting rights. Corp C §15907.02(a)(3), (b); see also Corp C §17001(n), (z).

Unless the partnership agreement provides otherwise, the assignee of an economic interest cannot be admitted as a substitute limited partner (thereby acquiring all rights of a limited partner, including voting rights) without the consent of all the general partners and a majority in interest of the limited partners. Corp C §15907.02(h). However, limited partnership agreements often provide that an assignee will be admitted as a substitute limited partner with the consent of only the general partner(s), eliminating the requirement of limited partner consent. Eliminating the requirement of limited partner consent makes the transfer of interests logistically less cumbersome, especially in limited partnerships with many limited partners.

It is possible to structure a limited partnership with freely transferable interests, and it has been done in the context of "master limited partnerships," in which the limited partnership interests are publicly traded. However, a "publicly traded partnership" (*i.e.,* a partnership the interests in which are traded on an established securities market or are readily tradable in a secondary market) will be taxed as a corporation, unless 90 percent or more of the partnership's gross income is from interest, dividends, rent, or other qualifying income. IRC §7704.

The transfer of the general partner's interest in a limited partnership is subject to the same rules as transfers of interests in general partnerships discussed above. The limited partners must approve the addition or substitution of a new general partner. Corp C §15904.01.

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§3.76 4. Limited Liability Company

The economic interest of a member in an LLC is transferable without the consent of the other members, but, as with partnerships, transfer of an economic interest transfers only the member's right to share in distributions and profit and loss allocations and does not transfer the member's voting and management rights. Corp C §17301(a). Unless the operating agreement provides otherwise, the assignee of an economic interest cannot be admitted as a substitute member (thereby acquiring all the rights of a member, including voting rights) without the consent of a majority in interest of the other members. Corp C §§17301(a)(1), 17303. See §12.3.

An operating agreement may eliminate or modify the requirement that all members consent to the admission of an assignee as a substitute member. Thus, the operating agreement may include a requirement of manager consent or eliminate the requirement of consent altogether. Corp C §17303(a)-(b).

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H. Ability to Raise Capital

§3.*77* 1. Corporation

A corporation is capitalized through equity capital contributions by its shareholders, loans from shareholders, and borrowing from third parties, both unsecured and secured (either by liens on corporate assets or by guaranties from individual shareholders). Because of limited liability and the relative free transferability of corporate shares (especially if there is a realistic possibility of the corporation "going public," with the corporate shares being traded on an established securities market), and because the consequences of investing in corporate stock may be more widely understood than the consequences of investing in partnerships or LLCs, corporations may be more attractive to risk capital.

Shares of corporate stock are typically securities subject to federal and state securities laws. See chap 12.

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§3.78 2. General Partnership and Limited Liability Partnership

A general partnership's capital usually comes from both the partners' capital contributions and loans, secured or unsecured, from partners or third parties. A partnership's ability to borrow usually depends on the creditworthiness of the individual partners and the value of partnership assets that can be offered as collateral for a secured loan. General partnerships usually are not attractive to passive investors, because of the risk of personal liability for partnership debts and the lack of free transferability of partnership interests.

In California, limited liability partnerships may perform only legal services, public accountancy services, and architectural services, and, except for related entities, may have only licensed persons as members. Consequently, they must be capitalized internally.

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§3.79 3. Limited Partnership

A limited partnership's sources of capital include those available to a general partnership, plus the capital contributions of limited partners. Because of limited liability and pass-through tax treatment, limited partnership interests are attractive to certain passive investors, especially in connection with real estate ventures and tax-advantaged investments. Thus, the sale of limited partnership interests can be a significant source of equity capital. However, because limited partners cannot participate in management without the risk (however remote) of incurring general partner liability, limited partnerships are generally less attractive to venture capital.

Limited partnership interests are typically deemed securities for federal and California securities laws. Thus, the offer and sale of limited partnership interests must comply with federal and state securities regulations. See §§12.12, 12.14.

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§3.80 4. Limited Liability Company

An LLC can be capitalized through capital contributions by its members, loans from members, and borrowing from third parties, both unsecured and secured (either by liens on LLC assets or by guaranties from individual members).

Because of the organizational and structural flexibility of LLCs, the ability to actively engage in management without fear of liability, and the ability to make special allocations and deduct losses, LLCs have become attractive to venture capital. LLC membership interests are also be attractive to certain passive investors, for the same reasons that limited partnership interests may be attractive.

Whether membership interests in a particular LLC constitute securities under the federal securities laws is determined on a case-by-case basis. See chap 12. An interest in an LLC will constitute a security under the California Corporate Securities Law of 1968 unless all the members actually actively engage in the management of the LLC. Corp C §25019; see §12.44.

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§3.81 I. Continuity of Business

The effect of the loss of one of the principals (by, for example, death, withdrawal, expulsion, disability, or bankruptcy) may be a significant planning consideration, depending on the nature of the business venture. If a particular individual is essential to the business, continuity of the business may be impossible when that person dies or is otherwise lost to the enterprise, notwithstanding that the entity itself continues in business. In other instances (*e.g.*, a passive investor owning a small percentage of the business), a participant's departure may not materially alter the enterprise, and the ability to continue the business entity may be highly desirable. In these cases, the practitioner should plan to minimize the risk of inadvertent dissolution.

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§3.82 1. Corporation

A corporation has an independent existence and is not terminated by withdrawal, death, or other events of termination affecting its shareholders, officers, or directors. Unless its articles of incorporation provide otherwise, a corporation continues in existence indefinitely until terminated by the affirmative act of its shareholders or by judicial decree. However, the fact that the entity continues in existence on the departure of a shareholder does not necessarily mean that the business of the corporation will continue uninterrupted. If the departed shareholder was a key individual, the business might well fail. Conversely, the corporate form itself is no guarantee that shareholders will be able to liquidate their interests in the corporation, particularly if the corporation is closely held. Shares of closely held corporations (especially shares representing a minority interest) are not marketable. In these circumstances, withdrawing shareholders, or the heirs of a deceased shareholder, may prefer that the corporation dissolve and liquidate.

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§3.83 2. General Partnership and Limited Liability Partnership

The death, withdrawal, or bankruptcy of a partner causes the partner's dissociation, but the entity is unaffected. Corp C §16601. The partnership is dissolved only by the express will of at least half of the partners to dissolve and wind up the partnership business, unless otherwise provided in the agreement or by law under certain conditions. Corp C §16801(1).

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§3.84 3. Limited Partnership

Neither the assignment of a limited partnership interest nor the death, bankruptcy, withdrawal, or incompetence of a limited partner causes the dissolution of a limited partnership. Corp C §15907.02(a)(2). However, under Corp C §§15906.03 and 15908.01(c), unless otherwise provided in the partnership agreement, the death, bankruptcy, withdrawal, removal, or incompetence of a general partner will cause the dissolution of a limited partnership unless:

(a) The remaining general partner or partners continue the business, or, if there is no remaining general partner,

(b) A majority in interest of the limited partners agree to continue the business of the partnership and admit one or more successor general partners.

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§3.85 4. Limited Liability Company

Unless otherwise provided in the articles of organization or a written operating agreement, neither the assignment of a limited partnership interest nor the death, bankruptcy, withdrawal, or incompetence of a member causes the dissolution of a limited liability company. In a manager-managed LLC, these dissolution events, if any, can be tied in the operating agreement to one or more member-managers. Corp C §17350(a).

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J. Other Factors Influencing the Choice of Entity

1. Fiduciary Duties

§3.86 a. Limited Liability Company

The fiduciary duties owed by a manager of an LLC are the same as those owed by a partner to the partnership and the other partners. Corp C §17153. The Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17655) is silent regarding the fiduciary duties of members; however, it provides that if management of the LLC is vested in the members, each member has the same rights and is subject to all the duties and obligations of managers as set forth in the Act. Corp C §17150. Thus, members of a member-managed LLC will owe to the LLC and the other members the fiduciary duty that a partner owes to the partnership and the other partners. The fiduciary duties of a manager (or of a member of a member-managed LLC) may be modified only in a written operating agreement with the informed consent of the members. Corp C §17005(d). See §§6.35-6.38.

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§3.87 b. Corporation

The duties of corporate directors are set forth in Corp C §309. The articles of incorporation may limit or eliminate the personal liability of directors for monetary damages for breach of these duties, subject to exceptions for intentional misconduct or violations of law. Corp C §§204(a)(10), 317. The General Corporation Law is silent regarding the fiduciary duties of shareholders; however, majority shareholders may owe certain fiduciary duties to minority shareholders. See *Jones v H. F. Ahmanson & Co.* (1969) 1 C3d 93, 81 CR 592. At least one court has held that a provision in a buy-sell agreement purporting to effect a waiver of fiduciary duties owed to minority shareholders by majority shareholders was against public policy and void. *Neubauer v Goldfarb* (2003) 108 CA4th 47, 133 CR2d 218.

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§3.88 c. Partnership

The fiduciary duties of partners are governed by Corp C §16404. Section 16404 establishes a duty of loyalty (Corp C §16404(b)) and a duty of care (Corp C §16404(c)), and specifies that partners discharge their duties and exercise their rights consistently with the obligation of good faith and fair dealing (Corp C §16404(d)).

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§3.89 2. Interstate Transactions

All states now authorize the formation of LLCs. However, LLC legislation varies significantly from state to state. An LLC doing business in other states may be required to qualify as a foreign LLC and file appropriate applications and pay the required fees. Similar requirements are imposed on limited partnerships and corporations, while general partnerships are generally exempt from these requirements.

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§3.90 3. Anonymity of Owners

The names of corporate shareholders need not be a matter of public record, but the names and addresses of officers and directors must be listed in the Annual Statement of Domestic Stock Corporation filed with the Secretary of State under Corp C §1502. The names of partners in a general partnership need not be of public record unless a Statement of Partnership is recorded. Corp C §16303(a)(1). However, if the partnership uses a fictitious business name, it is required to file and publish a statement of who is doing business under that name which must identify the general partners. Bus & P C §17913. The names of limited partners need not be of public record; only the names of the general partners must be shown on the Certificate of Limited Partnership filed under Corp C §15902.01(a)(1)-(4).

In a manager-managed LLC, the names of the members need not be a matter of public record, but the names and addresses of the managers must be listed in the Limited Liability Company Statement of Information (Secretary of State Form LLC-12) filed with the Secretary of State under Corp C §17060. However, if the LLC is managed by its members, then the names of the members will be of public record, because the names and addresses of the members must be listed in the Limited Liability Company Statement of Information. This requirement alone may compel clients concerned about confidentiality to choose a manager-managed LLC.

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§3.91 4. Estate Planning for Families

While an explanation of estate planning features is beyond the scope of this chapter, similar discounts may apply when valuing LLC or limited partnership interests, and an LLC avoids one argument against valuation discounts for a family limited partnership. See §§4.36-4.39.

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§3.92 5. LLC Use Prohibited for Professionals

Neither domestic nor foreign LLCs may render professional services in California. Corp C §17375.

The proscription of the Beverly-Killea Limited Liability Company Act on the right of professionals to use LLCs is broad, precluding many businesses, in addition to doctors, lawyers, and accountants, from using LLCs. Section 17375 refers to Corp C §13401(a), which defines professional services as

> any type of professional services which may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act.

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§3.93 IV. CHOOSING THE STATE OF ORGANIZATION OF THE LIMITED LIABILITY COMPANY

The Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17655) provides that the laws of the state or foreign country under which a foreign LLC is organized govern its organization and internal affairs and the liability and authority of its managers and members, and that a foreign LLC may not be denied registration by reason of any difference between those laws and the laws of California. Corp C §17450. Therefore, the Act permits members to "forum shop" for the LLC act most compatible with the members' business purposes.

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§3.94 A. Additional Costs of Foreign LLCs

Organizing an LLC in another jurisdiction may be more costly than doing so in California. There may be additional filing fees and annual maintenance fees, and the expense of maintaining an agent for service of process in the state of organization. Further, the practitioner must learn and keep abreast of the law of the foreign jurisdiction, and the client may need to engage local counsel. The California Act is flexible, giving members great latitude in drafting the operating agreement and structuring and operating the LLC. Thus, for most businesses headquartered and doing business primarily in California, there appears to be little advantage in choosing a jurisdiction other than California in which to organize an LLC. For further information on operating a foreign LLC in California, see chap 14.

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§3.95 B. Advantages of a Delaware LLC

Although California provides an attractive forum for most businesses, many practitioners recommend forming a Delaware LLC in lieu of a California LLC for transactions in which the additional costs are not a controlling factor. In Delaware, the operating agreement may limit or eliminate the managers' fiduciary duties to a greater degree than is permissible in California. See 6 Del Code §18-1101(b)-(c), (e). For example, in *Fisk Ventures, LLC v Segal* (Del Ch 2008) 2008 Del Ch Lexis 158, aff'd (Del 2009) 984 A2d 124, the LLC agreement stated that members had no duties other than those expressly articulated in the agreement; because the agreement did not expressly articulate *any* fiduciary obligations, the court found they had been entirely eliminated by the parties.

Further, Delaware permits the LLC to indemnify managers for breaches of fiduciary duty, something California may not permit. See 6 Del Code §18-108. For clients for whom the costs and inconvenience of litigating in a distant forum is not a dissuading factor, Delaware's judiciary is considered to be among the most knowledgeable and experienced in matters of business litigation. This factor may lead to Delaware's developing a comprehensive body of case law regarding LLCs more quickly than other jurisdictions. Finally, the Delaware Act makes explicit the principle of freedom of contract. 6 Del Code §18-1101(b). While this principle is undoubtedly implied in the California Act, it is not expressly stated. The express affirmation of freedom of contract in the Delaware Act may enhance practitioners' confidence that the operating agreement provisions they draft will be respected by a reviewing court. Delaware also permits the formation of series LLCs. See chap 15.

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§3.96 C. Advantages of Other States' LLCs

There may be unique circumstances that would cause counsel to recommend a jurisdiction other than California in which to form an LLC. For instance, California prohibits professional LLCs, while at least 45 other states authorize them. However, a foreign LLC may not render professional services in California.

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V. SUMMARY: WHEN TO USE AN LLC; WHEN NOT TO USE AN LLC

A. Comparative Advantages

§3.97 1. C Corporation versus LLC

While LLCs have many advantages, they are not the preferred choice of entity for every business venture. For example, C corporations, unlike LLCs, are subject to double taxation, and corporate losses remain in the corporation, unable to be utilized by the corporation's shareholders, while the losses of an LLC pass through to and may be deducted by the members. Yet, if the business is profitable, how losses are treated will not be an issue, and it is often possible to avoid double taxation through the use of salaries and shareholder loans. Corporations may also be preferred when most income is reinvested in the business. Furthermore, a corporation can deduct medical expenses for all shareholder-employees, and the receipt of this benefit will not be income to the persons insured, while LLC members are subject to taxation on the receipt of these benefits. Thus, when the ability to pass through losses is irrelevant, and when it is possible to minimize taxable income through the use of salaries and loans, or when medical insurance expenses are substantial, the corporate format may be preferable.

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.98 2. S Corporation versus LLC

§3.98 2. S Corporation versus LLC

Entities that wish limited liability and pass-through tax treatment but are ineligible to elect S-corporation status may find LLCs an attractive alternative.

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§3.99 3. Partnership versus LLC

It appears that an LLC would almost always be preferred to a general partnership in circumstances in which either is an appropriate vehicle. For lawyers, architects, and accountants, the limited liability partnership may be the preferred vehicle.

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§3.100 4. Limited Partnership versus LLC

The principal advantages of LLCs over limited partnerships are that all owners avoid liability for business debts, and all members can participate in the management of the business without fear of incurring liability. LLCs may have numerous active investors with more freely transferable interests, and may be structured so that the withdrawal of a passive investor will not cause the dissolution of the entity.

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§3.101 B. Real Estate Investments, Joint Ventures, Venture Capital

LLCs should be particularly attractive entities for real estate investments, because LLCs combine limited liability and flexible management with the ability to pass through losses and deductions, make special allocations, and avoid double taxation on the sale of appreciated assets.

LLCs should also be attractive for joint ventures. LLCs are preferable to general partnerships because of the limited liability they provide to members (thus eliminating the need for a venturer to form a special purpose corporation) and are preferable to corporations because of pass-through tax treatment and the avoidance of double taxation.

Finally, LLCs may be attractive to venture capital, because of the organizational and structural flexibility of LLCs, the members' ability to actively engage in management without fear of liability, and the tax advantages of making special allocations and deducting losses.

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VI. CHARTS: COMPARISON OF ENTITIES

§3.102 A. Business Factors

	General Partnerships	Limited Partnerships	Corporations	Limited Liability Companies
1. Ease or Difficulty of Formation; Transaction Costs (see §§3.9-3.13)	No filing required to form the entity. Partners should, but need not, enter into a partnership agreement. The cost and complexity of the agreement depends on the structure and business of the partnership. Drafting the agreement may be more time consuming and costly than drafting simple articles and bylaws for a corporation.	A limited partnership is formed by filing with the Secretary of State a Certificate of Limited Partnership (Form LP-1) executed by all the general partners (filing fee $70). Although oral agreements are permitted, the agreement should be in writing. The cost and complexity of the agreement will depend on the structure and business of the partnership. Drafting the agreement may be more time consuming and costly than drafting simple articles and bylaws for a corporation.	Articles of incorporation must be filed with the Secretary of State (filing fee $100). Statement of Domestic Stock Corporation must be filed with the Secretary of State within 90 days after filing the articles. The parties need not negotiate a detailed agreement governing the structure and operation of the corporation, but can instead rely on the General Corporation Law. However, if the parties desire to restrict transferability or voting rights of stock, or provide for different classes of stock, a detailed agreement or specially drafted articles of incorporation may be required. After formation, directors must be elected, officers appointed, bylaws prepared and adopted, and shares of stock issued, all of	An LLC is formed by filing articles of organization (Form LLC-1) with the Secretary of State (filing fee $70). Within 90 days after filing the articles, the LLC must file a Statement of Information with the Secretary of State. All members must enter into an operating agreement. Although oral agreements are permitted, the agreement should be in writing. The cost and complexity of the agreement will depend on the nature of the LLC and its business. Drafting the agreement may be more time consuming and costly than drafting simple articles and bylaws for a corporation.

			which (plus other organizational matters) should be reflected in organizational minutes.	
2. Management and Control (see §§3.64-3.67)	Unless the partnership agreement provides otherwise, all partners have equal rights in the management of the partnership. The partners may, by agreement, designate specific partners to manage the business, or restrict the authority of certain partners to take specified actions. Partnerships are flexible; a great variety of control and management structures are available by agreement.	Limited partnerships are managed by the general partners. If limited partners participate in the control of the business, they risk losing their limited liability. The partnership agreement may eliminate the right of the limited partners to remove the general partner. Limited partnerships may be structured with more centralized management and control than general partnerships or corporations.	A corporation is managed by or under the direction of the board of directors. Directors generally determine corporate policy and authorize corporate actions outside the ordinary course of business, and officers manage the day-to-day affairs of the corporation. Shareholders (except in the case of statutory close corporations) have no right to participate in the day-to-day management of the corporation. A corporation may formally vest management in the shareholders by electing to be a statutory close corporation. Corporate structure can be highly centralized, especially with a large number of shareholders. The management structure can be altered by devices such as voting and nonvoting classes of stock, voting trusts, committees of the board,	If the articles of organization state that the LLC is to be managed by managers, the LLC is managed by managers (who need not be members); otherwise, the LLC is managed by its members. If an LLC is managed by managers, then members do not, as members, participate in the management of the LLC. An LLC may have officers. A written operating agreement may eliminate the right of members to remove managers. An LLC provides great management flexibility. Management can be as decentralized and informal as the management of a general partnership. Or, a corporate style management structure may be adopted, with officers and managers that act as a board of directors (caveat: managers, unlike directors, have agency power to bind the LLC). Or, the LLC may adopt a centralized

			shareholder agreements, and supermajority voting requirements for specified actions.	structure analogous to a limited partnership, with a manager acting as general partner and with the members having no right to remove the manager.
3. Agency Authority of Owners and Management (see §§3.64-3.67)	Each partner is an agent of the partnership. The act of any partner for apparently carrying on in the usual way the business of the partnership binds the partnership. The partnership agreement may restrict the authority of a particular partner to bind the partnership; however, a restriction on authority will not be effective against third parties who have no knowledge of the restriction.	General partners are agents of the limited partnership. Limited partners do not have apparent agency authority to bind the partnership.	Officers are agents of the corporation. Neither shareholders nor directors have agency authority to bind the corporation.	In a member-managed LLC, every member is an agent of the LLC, and the act of any member for apparently carrying on in the usual way the business of the LLC binds the LLC. In a manager-managed LLC (1) every manager is an agent of the LLC, and the act of any manager for apparently carrying on in the usual way the business of the LLC binds the LLC, and (2) members are not agents of, and cannot bind, the LLC. The articles of organization or the operating agreement may limit the authority of members (in a member-managed LLC) or managers (in a manager-managed LLC) to bind the LLC. However, such limitations will not be effective against third parties without actual knowledge of the

				restrictions.
4. Liability of Owners for Business Obligations (see §§3.68-3.71)	Partners are jointly and severally liable for the wrongful acts or omissions of any partner acting in the ordinary course of partnership business or with authority of the partners, and are jointly liable for all other obligations of the partnership.	The general partner is liable for partnership obligations to the same extent as partners of a general partnership. Limited partners are not liable for partnership obligations and risk only the loss of their agreed capital contribution. Limited partners may become liable as general partners if they participate in the management of the partnership business.	Shareholders are not liable for the obligations of a corporation. However, shareholders may be liable (1) to the extent they personally guarantee corporate debts; (2) to the extent they receive improper distributions; (3) if a court "pierces the corporate veil" of a corporation to impose personal liability on the shareholders; or (4) if a controlling shareholder breaches a duty to the other shareholders or the corporation.	Members of an LLC are not liable for the obligations of the LLC. However, a member may be liable (1) to the extent he or she personally guaranteed debts of the LLC; (2) for the member's participation in tortious conduct; (3) for distributions from an LLC made in violation of the Beverly-Killea Limited Liability Company Act (LLC Act); and (4) if a court "pierces the company veil" of an LLC to impose personal liability on the member. The criteria used to determine whether to pierce the LLC veil are the same criteria used to determine whether to pierce the corporate veil, except that the failure to hold meetings of members or managers or to observe formalities pertaining to meetings will not be considered a factor if the LLC is not required to hold meetings of members or managers.
5. Transferability of Interests (see §§3.72-3.76)	Interests are not easily transferred. A partner may assign his economic interest in the partnership to a	A limited partner may transfer his economic interest without the consent of the other partners, but this transfers only	Shares of corporate stock are (if there is a market) more easily transferred than partnership or LLC interests. There are	A member may transfer his or her economic interest without the other members' consent, but this transfers only the

	third party, but this transfers only the right to share in distributions and profit and loss allocations, and does not transfer voting rights or the right to participate in management.	the right to share in distributions, profits, and losses, and does not transfer voting rights. Unless the partnership agreement provides otherwise, the assignee of an economic interest cannot be admitted as a substitute limited partner without the consent of the general partners and a majority in interest of the limited partners. The transfer of a general partner's interest is subject to the same rules as transfers of interests in general partnerships. Limited partners must approve the substitution of a general partner.	generally no statutory limits on the right of a shareholder to transfer his stock, and the consent of other shareholders to the transfer is not required. However, in closely held corporations, the transfer or other disposition of shares is often restricted by a shareholders' agreement or by provisions in the articles or bylaws.	right to share in distributions, profits, and losses and does not transfer voting and management rights. Unless the operating agreement provides otherwise, the assignee of an economic interest cannot be admitted as a substitute member without the consent of a majority in interest of other members.
6. Ability to Raise Capital (see §§3.77-3.80)	A general partnership's capital usually comes from the partners' capital contributions and from loans, secured or unsecured, from partners or third parties. General partnerships are generally not attractive to passive investors because of the risk of personal liability for partnership debts and the lack of free transferability of partnership interests.	A limited partnership's sources of capital include those available to a general partnership, plus the capital contributions of limited partners. Because of limited liability and pass-through tax treatment, limited partnership interests are attractive to certain passive investors, especially in connection with real estate	A corporation is capitalized through equity contributions by its shareholders, loans from shareholders, and loans from third parties, unsecured and secured. Because of limited liability and the relatively free transferability of corporate shares, and because the consequences of investing in corporate stock may be better understood than the consequences of investing in	An LLC is capitalized through capital contributions by its members, loans from members, and loans from third parties, unsecured and secured. Because of the organizational and structural flexibility of LLCs, the ability to actively engage in management without risk of liability, and the ability to make special allocations and deduct losses,

		ventures and tax-advantaged investments. However, because limited partners cannot participate in management without the risk of incurring general partner liability, limited partnerships are generally unattractive to venture capital.	partnerships or (especially) LLCs, corporations may be more attractive to risk capital.	LLCs may become attractive to venture capital. LLC membership interests should also be attractive to certain passive investors, for the same reasons that limited partnership interests are attractive.
7. Are Interests in the Entity Deemed Securities? (see §§3.77-3.80)	General partnership interests are not usually deemed securities.	Limited partnership interests are usually deemed securities.	Shares of corporate stock are almost always deemed securities.	LLC interests will be securities for purposes of California law, unless all members actually actively engage in the management of the LLC. LLC interests may or may not be securities for purposes of federal law, depending on the facts and circumstances.
8. Continuity of Business (see §§3.81-3.85)	Unless otherwise provided in the partnership agreement, a general partnership may be dissolved by the express will of at least half the partners to dissolve and wind up the partnership business.	Unless otherwise provided in the partnership agreement, the death, bankruptcy, withdrawal, removal, or incompetence of a general partner will dissolve a limited partnership unless (1) there is a remaining general partner or partners who elect to continue the business, or (2) if there is no remaining general partner, a majority in interest of the remaining limited partners agree to continue the business of	A corporation has an independent existence and is not terminated by the withdrawal, death, or other event affecting its shareholders, directors, or officers.	Unless otherwise provided in the articles of organization or a written operating agreement, an LLC will dissolve on the written agreement of all members to dissolve.

		the partnership and elect one or more successor general partners.		
9. Number of owners required	Two	Two	One	One
10. May licensed professionals use the entity in California?	Licensed professionals may not form partnerships with nonlicensed professionals.	No, but lawyers, accountants, and architects are permitted to use registered limited liability partnerships.	Yes (professional corporation)	No

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Source: Business Law/Forming and Operating California Limited Liability Companies/3 Choosing the Appropriate Business Entity/§3.103 B. Tax Factors

§3.103 B. Tax Factors

	C Corporations	S Corporations	Partnerships	Limited Liability Companies
1. Pass-through tax treatment (*i.e.,* do entity and its owners avoid "double taxation" on the earnings of the entity?) (see §§3.20-3.50)	No	Yes	Yes	Yes (single-member LLC disregarded)
2. S Corporation Restrictions: (see §3.27)				
a. May the entity have more than 100 owners?	Yes	No	Yes	Yes
b. May the entity have owners other than individuals, estates, and certain trusts (*e.g.,* corporate or partnership owners)?	Yes	No	Yes	Yes
c. May the entity have nonresident alien owners?	Yes	No	Yes	Yes
d. May the entity have more than one class of stock or other ownership interest?	Yes	No (however, differences in voting rights are permitted)	Yes	Yes (N/A to single-member LLCs)
e. May the entity be a member of an affiliated group (*e.g.,* may the entity own subsidiaries)?	Yes	No (wholly owned S corporation not treated as separate corporation; S corporation may not file consolidated return with C corporation subsidiaries)	Yes	Yes (N/A to single-member LLCs)
3. Are Contributions to Capital Taxed (see §§3.16-3.19):				
a. To the entity?	No	No	No	No
b. To the contributor?				
Property	Contribution of appreciated assets to a corporation is taxable unless tax-free under IRC §351.	Same as C corporation	Contribution of appreciated assets to a partnership may generally be made on a tax-free basis.	Same as partnership (property contributed to single-member LLC treated as owned by member)
Services	Contribution of services for corporate stock is taxable under IRC §83; tax may be deferred if stock is subject	Same as C corporation	Contribution of services in exchange for a profits interest in a partnership is generally not taxable;	Same as partnership (services contributed to single-member LLC treated as services for member)

	to restrictions.		contribution of services in exchange for an interest in the capital of a partnership may be taxed.	
4. Method of Accounting (see §§3.23, 3.30, 3.46, 3.50)	C corporations, except qualified personal service corporations, must generally use the accrual method, unless gross receipts are less than $5 million.	An S corporation may use the cash method, unless it is a tax shelter.	A partnership may use the cash method, unless (i) it has a C corporation as a partner and gross receipts greater than $5 million, or (ii) it is a tax shelter.	An LLC may use the cash method, unless it is a tax shelter (single-member LLC uses same accounting method as member).
5. Taxable Year (see §§3.24, 3.31, 3.47, 3.50)	Fiscal year of the corporation's choosing, regardless of the taxable year of the corporation's owners (unless a personal service corporation).	Generally the calendar year.	A partnership's taxable year must correspond to the taxable year of its majority or principal partners; if the majority or principal partners do not all have the same taxable year, the partnership must generally use the calendar year.	Same as partnership (single-member LLC uses same taxable year as member).
6. Double Tax on Liquidation? (see §§3.51-3.53)	Yes	Yes	No	No
7. Partnership Tax Features:				
a. May the entity make special allocations and pass-through tax losses? (see §§3.32-3.37, 3.40, 3.50)	No	No	Yes	Yes (N/A to single-member LLCs)
b. May the "inside" tax basis of the entity's assets be stepped up on the death of an owner or on the transfer of an ownership interest? (see §§3.32-3.37, 3.42, 3.50)	No	No	Yes	Yes (N/A to single-member LLCs)
c. Is an owner's basis in its interest in the entity increased by the owner's share of the entity's debt? (see §§3.32-3.37, 3.43, 3.50)	N/A	N/A	Yes	Yes (debt of single-member LLC treated as obligation of member)
8. California Tax Treatment (see §§3.54-3.57)	Subject to California franchise tax. Must pay	Pass-through entity. Subject to tax of 1.5 percent on net	Pass-through entity. Limited partnerships must pay	Pass-through entity. Must pay minimum tax of $800 per year.

	minimum tax of $800 per year (no minimum tax first taxable year). Maximum California tax rate is 8.84 percent.	income. Must pay minimum tax of $800 per year (no minimum tax first two taxable years).	minimum tax of $800 per year; general partnerships are not so required.	Must also pay an annual fee based on gross revenues.
9. Employment Tax Issues (see §§3.58-3.63)	Corporation liable for employment taxes on corporate officers; fringe benefits deductible.	Corporation liable for employment taxes on corporate officers; fringe benefits deductible but taxable as income to 2-percent owners.	General partners and limited partners participating more than 500 hours per year subject to self-employment tax on partnership income.	Managers treated as general partners; nonmanager members treated as limited partners.

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4

Tax Issues in Forming the Limited Liability Company

Phillip L. Jelsma

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.1 I. SCOPE OF CHAPTER

§4.1 I. SCOPE OF CHAPTER

This chapter discusses federal and California tax treatment of a limited liability company (LLC). It also covers the consequences of members' contributions to the LLC and the effect of operating a business in the form of an LLC on the individual owners.

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§4.2 II. CLASSIFICATION OF LLC FOR FEDERAL TAX PURPOSES

Under prior law, LLCs were classified for tax purposes as either partnerships or corporations based on a four-factor test. This test, provided that if the business entity had a preponderance of corporate characteristics (limited liability, centralized management, continuity of life, and free transferability of interests), it would be taxed as a corporation. Otherwise, it was taxed as a partnership.

Following the adoption of LLC acts by all 50 states and the District of Columbia, more and more businesses were being structured with the corporate advantage of limited liability but were managing to avoid the corporate characteristics of continuity of life and free transferability of interests. In response, the IRS promulgated the check-the-box regulations described in §4.3.

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§4.3 A. Federal Check-the-Box Regulations

The "check-the-box" regulations replaced the prior rules for classifying business organizations with a simpler elective system that generally allows unincorporated entities to choose to be taxed as either a partnership, a sole proprietorship, or a corporation. Treas Reg §§301.7701-1—301.7701-3. These regulations provide a significant benefit for all businesses, particularly closely held and family businesses in which tax classification and the attendant tax planning are extremely important. The regulations provide the maximum amount of flexibility in selecting the business entity and structuring the operative documents. In addition, the single-member LLC rule (see §4.7) is extremely beneficial because it avoids the need for a separate tax return for the entity if it is deemed to be a sole proprietorship, branch, or division.

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§4.4 B. Classification Process

Under the regulations, the first step in the classification process is to determine whether there is a separate entity for federal tax purposes. Treas Reg §301.7701-1(a)(1). Certain joint undertakings that are not entities under local law may nonetheless be considered entities for federal income tax purposes. For example, a tenancy in common may create a separate entity for federal income tax purposes if the individuals carry on a trade or business. However, not all entities formed under local law are recognized as separate entities for federal income tax purposes. Treas Reg §301.7701-1(a)(2)-(3).

If the organization is recognized as a separate business entity, it is classified as a business entity or trust. Next, the regulations provide that certain business entities are classified as corporations, including any entity formed as a corporation under state law, joint stock companies, insurance companies, banking institutions, and any organizations that are taxable as corporations under any other provisions of the Internal Revenue Code. Treas Reg §301.7701-2(b). An entity exempt from taxation under IRC §501(a) would be classified as an association taxable as a corporation.

Business entities other than corporations or trusts can elect their tax classification. Treas Reg §301.7701-3(a). If the entity has at least two members, it can be classified either as a partnership or an association taxable as a corporation. An election must be filed within the first 75 days of a tax year to be effective as of the beginning of that tax year. Treas Reg §301.7701-3(c)(1)(iii).

If a domestic entity with two or more members fails to file an election, its default classification is as a partnership. Treas Reg §301.7701-3(b)(1). If the entity has only a single member, it will be classified either as a sole proprietorship or an association taxable as a corporation if the one member is an individual, or as a branch (or division) or association taxable as a corporation if the one member is a corporation. Treas Reg §301.7701-2(a). If the single-member business entity fails to file an election, its default classification is either as a sole proprietorship, branch, or division. Treas Reg §301.7701-3(b)(1).

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§4.5 C. Making an Election

To be taxed as a corporation, a business entity files Form 8832, Entity Classification Election, with the IRS within the first 75 days of its taxable year if the election is to have retroactive effect. Treas Reg §301.7701-3(c)(1)(iii). After the first 75 days of its taxable year, any Form 8832 election will apply only to the entity's next taxable year.

If an entity makes an election to be taxed as a corporation, it cannot change its tax classification for 60 months, unless at least 50 percent of its interests change hands and the IRS consents to a new election. An election by a newly formed eligible entity that is effective on the date of formation is not considered a change for purposes of the regulation. Treas Reg §301.7701-3(c)(1)(iv). For example, if a business entity elected to be taxed as a partnership, it could at any time elect to be taxed as a corporation, but then could not change that election for a 60-month period.

The IRS will not challenge the classification of an existing entity if the entity has a reasonable basis within the meaning of IRC §6662 for its claimed classification and it claimed the same classification in all prior years. Treas Reg §301.7701-3(h).

Generally, the regulations require that a copy of Form 8832 be included with the first tax return for the electing entity. Treas Reg §301.7701-3(c)(1)(ii). The election must be signed by each member of the electing entity who, at the time of the election, is an owner, or by any officer, manager, or member who is authorized to make the election and makes the election under penalty of perjury.

The regulations specifically provide for the tax treatment of an elective change in classification of an entity from an association to a partnership or disregarded entity, or vice versa. Treas Reg §301.7701-3(g). For example, if an eligible entity classified as an association elects to be classified as a partnership, the following is deemed to occur: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership. Treas Reg §301.7701-3(g)(ii).

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.6 D. Foreign Business Entities

§4.6 D. Foreign Business Entities

There are special rules for foreign business entities. If the foreign entity has a single owner, the default classification is as a sole proprietorship if the sole owner is an individual, or as a branch or division if the sole owner is a corporation. Treas Reg §301.7701-3(b)(2)(i)(C).

If a foreign business entity has two or more members, and one of the members has personal liability under local law for all the debts of the organization, the default classification is as a partnership. Treas Reg §301.7701-3(b)(2)(i)(A). Unlike a domestic business entity, a foreign entity in which both members have limited liability would be deemed to have elected to be taxed as an association taxable as a corporation, unless it files a Form 8832 and elects otherwise. Treas Reg §301.7701-3(b)(2)(i)(B).

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§4.7 E. Single-Member Entities

If an entity has only one owner, that owner can elect to have the entity taxed as a corporation. If no election is filed, the entity will be ignored for federal income tax purposes. Treas Reg §301.7701-3(b)(1). Thus, the default rule is that if no election is filed and the owner is an individual, the entity is taxed as a sole proprietorship and all income or loss is reported on the owner's Form 1040 Schedule C. If an entity is owned by a corporation, it is treated as a branch or division and all of its income or loss is reported on the tax return of its corporate parent.

The classification of an entity as an association is not affected by any change in the number of members of the entity. Treas Reg §301.7701-3(f)(1). A single-member entity classified as a partnership becomes a disregarded entity when the entity's membership is reduced to one member. A disregarded entity is classified as a partnership when the entity has more than one member. Treas Reg §301.7701-3(f)(2).

Revenue Ruling 99-5, 1999-1 Cum Bull 434, describes the income tax consequences when a single-member domestic LLC that is disregarded as an entity separate from its owner becomes an entity with more than one owner classified as a partnership.

Revenue Ruling 99-6, 1999-1 Cum Bull 432, describes the income tax consequences when one person purchases all of the ownership interests in a domestic LLC classified as a partnership, causing the LLC's status as a partnership to terminate under IRC §708(b)(1)(A).

Revenue Procedure 2002-69, 2002-2 Cum Bull 831, clarifies the treatment of a single-member LLC membership interest issued to a husband and wife in a community property state like California. Before the issuance of Rev Proc 2002-69, there was a concern that an LLC with a single owner who was a resident of a community property state would automatically be treated as a two-member LLC, because community property law generally creates a joint ownership between husband and wife. Revenue Procedure 2002-69 states that the IRS will follow the parties' characterization of the LLC as having either one owner or two owners. Therefore, if a husband and wife treat an LLC as being owned entirely by the wife, it will be treated as a single-member LLC and be disregarded for federal income tax purposes, despite the fact that the LLC interest is community property under California law. Similarly, if a husband and wife treat the LLC as having two owners, the LLC will be treated as a partnership for federal income tax purposes. However, if the parties change the characterization, the IRS will treat the change as a restructuring of the LLC by either increasing the number of LLC members from one to two or decreasing the number of LLC members from two to one. Generally, the transfer of membership interests between husband and wife would not result in adverse income tax consequences, provided that the husband and wife are U.S. citizens or resident aliens.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.8 F. When Taxation as Corporation May Be Beneficial

§4.8 F. When Taxation as Corporation May Be Beneficial

Under the following circumstances, it may be beneficial for the LLC to be taxed as a corporation rather than a partnership:

- An LLC with foreign members may be required to withhold and pay taxes at the highest marginal rate on the income allocated to the foreign members under IRC §1446 (see §§5.19-5.21) (the members who are nonresidents also must file U.S. tax returns).
- Family members may prefer the certainty of corporate tax treatment for their closely held business.
- In a nonpersonal service business that distributes almost all of its profits as salaries or other compensation, the marginal tax rate for a corporation may be lower, *e.g.*, 15 percent on the first $50,000 of income and 25 percent of the next $25,000, when compared to the tax rate of the individual members, although the marginal tax rate for a corporation also may be higher (*e.g.*, 39 percent) on income over $100,000 but not over $335,000. (In a personal service business, the marginal tax rate for a corporation is the same as the maximum tax rate of the individual members, 35 percent.)

Moreover, an LLC taxed as a corporation may deduct certain employee benefits, such as accident and health insurance premiums, while avoiding state law corporate governance provisions.

In some instances, the practitioner will have no choice regarding tax classification, *e.g.,* an LLC will be classified as a corporation if it is a publicly traded partnership under IRC §7704 unless it comes within the narrow exceptions noted below. The IRS has provided two safe harbors from classification as a publicly traded partnership. Under IRS Notice 88-75, 1988-2 Cum Bull 386, an LLC will not be considered a publicly traded partnership if:

- Its interests are issued in a transaction not registered under the Securities Act of 1933 and either has fewer than 500 members or had an initial offering price of less than $20,000; or
- The sum of capital or profit interests sold or disposed of during the year is less than 5 percent of the total LLC capital or profits.

Income earned by an LLC taxed as a corporation is subject to a corporate-level tax unless the members opt to file an S corporation election (IRC §§1361-1379; IRS Form 2553) within the first two and a half months of the LLC's taxable year. If no S election is filed, the LLC is free to elect any tax year. If the LLC filed an S election, it normally has the same tax year as its principal shareholder. The tax basis of property contributed to the LLC carries over and built-in gains or losses are reported by the LLC, not the individual members.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.9 G. Form: Entity Classification Election (IRS Form 8832)

§4.9 G. Form: Entity Classification Election (IRS Form 8832)



Form **8832**
(Rev. March 2007)
Department of the Treasury
Internal Revenue Service

Entity Classification Election

OMB No. 1545-1516

Type or Print	Name of eligible entity making election	Employer identification number
	Number, street, and room or suite no. If a P.O. box, see instructions.	
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code.	

▶ Check if: ☐ Address change

1 Type of election (see instructions):

a ☐ Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.
b ☐ Change in current classification. Go to line 2a.

2a Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?

☐ **Yes.** Go to line 2b.
☐ **No.** Skip line 2b and go to line 3.

2b Was the eligible entity's prior election for initial classification by a newly formed entity effective on the date of formation?

☐ **Yes.** Go to line 3.
☐ **No.** Stop here. You generally are not currently eligible to make the election (see instructions).

3 Does the eligible entity have more than one owner?

☐ **Yes.** You can elect to be classified as a partnership or an association taxable as a corporation. Skip line 4 and go to line 5.
☐ **No.** You can elect to be classified as an association taxable as a corporation or disregarded as a separate entity. Go to line 4.

4 If the eligible entity has only one owner, provide the following information:

a Name of owner ▶ _____
b Identifying number of owner ▶ _____

5 If the eligible entity is owned by one or more affiliated corporations that file a consolidated return, provide the name and employer identification number of the parent corporation:

a Name of parent corporation ▶ _____
b Employer identification number ▶ _____

6 Type of entity (see instructions):

- **a** ☐ A domestic eligible entity electing to be classified as an association taxable as a corporation.
- **b** ☐ A domestic eligible entity electing to be classified as a partnership.
- **c** ☐ A domestic eligible entity with a single owner electing to be disregarded as a separate entity.
- **d** ☐ A foreign eligible entity electing to be classified as an association taxable as a corporation.
- **e** ☐ A foreign eligible entity electing to be classified as a partnership.
- **f** ☐ A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

7 If the eligible entity is created or organized in a foreign jurisdiction, provide the foreign country of organization ▶ .....

8 Election is to be effective beginning (month, day, year) (see instructions) . . . . . ▶ / /

9 Name and title of contact person whom the IRS may call for more information	**10** Contact person's telephone number ( )

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this consent statement, and to the best of my (our) knowledge and belief, it is true, correct, and complete. If I am an officer, manager, or member signing for all members of the entity, I further declare that I am authorized to execute this consent statement on their behalf.

Signature(s)	Date	Title

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

This revision of the Form 8832 instructions reflects an update to the filing locations. Our previous revision (December 2006) stated that all entity classification elections were sent to the service center in Ogden, UT. *This is no longer the case.* Now the form is filed either in Cincinnati or Ogden depending upon your principal business location. See *Where To File* on page 4 for your filing location.

- You are not required to sign the copy of Form 8832 filed with your tax return. See *Consent statement and signature(s)* on page 6.
- New questions on lines 2a and 2b highlight the general rule which limits an eligible entity's ability to change its classification by election again during the 60 months after the effective date of making an earlier entity classification election.
- All single-owner eligible entities electing either corporate or disregarded entity status must provide the name and identifying number of their owner on lines 4a and 4b. Previously this requirement applied only to single-owner eligible entities electing disregarded entity status.
- All eligible entities owned by one or more affiliated corporations that file a consolidated return must provide the name and employer identification number (EIN) of their parent corporation on lines 5a and 5b. Previously this requirement applied only to single-owner eligible entities electing disregarded entity status.
- All foreign eligible entities making an entity classification election, including those also organized under domestic law, must provide the name of the foreign country in which they are organized on line 7. Previously this requirement applied only to single-owner foreign eligible entities electing disregarded entity status.

Purpose of Form

An eligible entity uses Form 8832 to elect how it will be classified for federal tax purposes, as a corporation, a partnership, or an entity disregarded as separate from its owner. An eligible entity is classified for federal tax purposes under the default rules described below unless it files Form 8832 or Form 2553, Election by a Small Business Corporation, to elect a classification or change its current classification. See *Who Must File* on page 4.



A new eligible entity should not file Form 8832 if it will be using its default classification (see Default Rules *below).*

Eligible entity. An eligible entity is a business entity that is not included in items 1, or 3 through 9, under the definition of **corporation** provided under *Definitions.*

Eligible entities include limited liability companies (LLCs), partnerships, and any foreign entity that is not identified as a corporation under Regulations section 301.7701-2(b)(8) (see item 3 below).

Generally, corporations are not eligible entities. However, the following types of corporations are treated as eligible entities:

1. An eligible entity that previously elected to be an association taxable as a corporation by filing Form 8832. An entity that elects to be classified as a corporation by filing Form 8832 can make another election to change its classification (see the *60-month limitation rule* discussed below in the instructions for lines 2a and 2b).

2. A foreign eligible entity that became an association taxable as a corporation under the foreign default rule described below.

3. A foreign corporation that is not identified as a corporation under Regulations section 301.7701-2(b)(8). If a foreign corporation is not identified on the list included in these regulations, it qualifies as an eligible entity. See the list of *Foreign Entities Classified as Corporations for Federal Tax Purposes* under this regulation on page 6. Refer to the regulations for any changes to the list made after these instructions were printed.

The IRS will use the information entered on this form to establish the entity's filing and reporting requirements for federal tax purposes.

Default Rules

Existing entity default rule. Certain domestic and foreign entities that were in existence before January 1, 1997, and have an established federal tax classification generally do not need to make an election to continue that classification. If an existing entity decides to change its classification, it may do so subject to the 60-month limitation rule. See the instructions for lines 2a and 2b. See Regulations sections 301.7701-3(b)(3) and 301.7701-3(h)(2) for more details.

Domestic default rule. Unless an election is made on Form 8832, a domestic eligible entity is:

1. A partnership if it has two or more members.

2. Disregarded as an entity separate from its owner if it has a single owner.

A change in the number of members of an eligible entity classified as an **association** (defined below) does not affect the entity's classification. However, an eligible entity classified as a partnership will become a disregarded entity when the entity's membership is reduced to one member and a disregarded entity will be classified as a partnership when the entity has more than one member.

Foreign default rule. Unless an election is made on Form 8832, a foreign eligible entity is:

1. A partnership if it has two or more members and at least one member does not have limited liability.

2. An association taxable as a corporation if all members have limited liability.

3. Disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.

Definitions

Association. For purposes of this form, an association is an eligible entity taxable as a corporation by election or, for foreign eligible entities, under the default rules (see Regulations section 301.7701-3).

Business entity. A business entity is any entity recognized for federal tax purposes that is not properly classified as a trust under Regulations section 301.7701-4 or otherwise subject to special treatment under the Code regarding the entity's classification. See Regulations section 301.7701-2(a).

Corporation. For federal tax purposes, a corporation is any of the following:

1. A business entity organized under a federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic.

2. An association (as determined under Regulations section 301.7701-3).

3. A business entity organized under a state statute, if the statute describes or refers to the entity as a joint-stock company or joint-stock association.

4. An insurance company.

5. A state-chartered business entity conducting banking activities, if any of its deposits are insured under the Federal Deposit Insurance Act, as amended, 12 U.S.C. 1811 et seq., or a similar federal statute.

6. A business entity wholly owned by a state or any political subdivision thereof, or a business entity wholly owned by a foreign government or any other entity described in Regulations section 1.892-2T.

7. A business entity that is taxable as a corporation under a provision of the Code other than section 7701(a)(3).

8. A foreign business entity listed on page 6. See Regulations section 301.7701-2(b)(8) for any exceptions and inclusions to items on this list and for any revisions made to this list since these instructions were printed.

9. An entity created or organized under the laws of more than one jurisdiction (business entities with multiple charters) if the entity is treated as a corporation with respect to any one of the jurisdictions. See Regulations section 301.7701-2(b)(9) for examples.

Disregarded entity. A disregarded entity is an eligible entity that is treated as an entity not separate from its single owner. Its separate existence will be ignored for federal tax purposes unless it elects corporate tax treatment.

Limited liability. A member of a foreign eligible entity has limited liability if the member has no personal liability for any debts of or claims against the entity by reason of being a member. This determination is based solely on the statute or law under which the entity is organized (and, if relevant, the entity's organizational documents). A member has personal liability if the creditors of the entity may seek satisfaction of all or any part of the debts or claims against the entity from the member as such. A member has personal liability even if the member makes an agreement under which another person (whether or not a member of the entity) assumes that liability or agrees to indemnify that member for that liability.

Partnership. A partnership is a business entity that has at least two members and is not a corporation as defined on page 3 under *Corporation.*

Who Must File

File this form for an eligible entity that is one of the following:

- A domestic entity electing to be classified as an association taxable as a corporation.
- A domestic entity electing to change its current classification (even if it is currently classified under the default rule).
- A foreign entity that has more than one owner, all owners having limited liability, electing to be classified as a partnership.
- A foreign entity that has at least one owner that does not have limited liability, electing to be classified as an association taxable as a corporation.
- A foreign entity with a single owner having limited liability, electing to be an entity disregarded as an entity separate from its owner.
- A foreign entity electing to change its current classification (even if it is currently classified under the default rule).

Do not file this form for an eligible entity that is:

- Tax-exempt under section 501(a);
- A real estate investment trust (REIT), as defined in section 856; or
- Electing to be classified as an S corporation. An eligible entity that timely files Form 2553 to elect classification as an S corporation and meets all other requirements to qualify as an S corporation is deemed to have made an election under Regulations section 301.7701-3(c)(v) to be classified as an association taxable as a corporation.

All three of these entities are deemed to have made an election to be classified as an association.

Effect of Election

The federal tax treatment of elective changes in classification as described in Regulations section 301.7701-3(g)(1) is summarized as follows:

- If an eligible entity classified as a partnership elects to be classified as an association, it is deemed that the partnership contributes all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners.
- If an eligible entity classified as an association elects to be classified as a partnership, it is deemed that the association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.
- If an eligible entity classified as an association elects to be disregarded as an entity separate from its owner, it is deemed that the association distributes all of its assets and liabilities to its single owner in liquidation of the association.
- If an eligible entity that is disregarded as an entity separate from its owner elects to be classified as an association, the owner of the eligible entity is deemed to have contributed all of the assets and liabilities of the entity to the association in exchange for the stock of the association.

Note. For information on the federal tax consequences of elective changes in classification, see Regulations section 301.7701-3(g).

When To File

An election specifying an eligible entity's classification cannot take effect more than 75 days prior to the date the election is filed, nor can it take effect later than 12 months after the date the election is filed.

Late election relief. A newly formed entity may be eligible for late election relief under Rev. Proc. 2002-59, 2002-39 I.R.B. 615 if:

- The entity failed to obtain its desired classification solely because Form 8832 was not timely filed,
- The due date for the entity's desired classification tax return (excluding extensions) for the tax year beginning with the entity's formation date has not passed, and
- The entity has reasonable cause for its failure to make a timely election.

To obtain relief, a newly formed entity must file Form 8832 on or before the due date of the first federal tax return (excluding extensions) of the entity's desired classification. The entity must also write "FILED PURSUANT TO REV. PROC. 2002-59" at the top of the form. The entity must attach a statement to the form explaining why it failed to file a timely election. If Rev. Proc. 2002-59 does not apply, an entity may seek relief for a late entity election by requesting a private letter ruling and paying a user fee in accordance with Rev. Proc. 2006-1, 2006-1 I.R.B. 1 (or its successor).

Where To File

File Form 8832 with the Internal Revenue Service Center for your state listed below.

Attach a copy of Form 8832 to the entity's federal tax return for the tax year of the election. If the entity is not required to file a return for that year, a copy of its Form 8832 must be attached to the federal tax returns of all direct or indirect owners of the entity for the tax year of the owner that includes the date on which the election took effect. Failure to attach a copy of Form 8832 will not invalidate an otherwise valid election, but penalties may be assessed against persons who are required to, but do not, attach Form 8832.

Each member of the entity is required to file their return consistent with the entity election. Penalties apply to returns filed inconsistent with the entity's election.

If the entity's principal business, office, or agency is located in:	Use the following Internal Revenue Service Center address:
Connecticut, Delaware, District of Columbia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia, Wisconsin	Cincinnati, OH 45999

If the entity's principal business, office, or agency is located in:	Use the following Internal Revenue Service Center address:
Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Utah, Washington, Wyoming	Ogden, UT 84201
A foreign country or U.S. possession	Ogden, UT 84201-0023

Note. Also attach a copy to the entity's federal income tax return for the tax year of the election.

Acceptance or Nonacceptance of Election

The service center will notify the eligible entity at the address listed on Form 8832 if its election is accepted or not accepted. The entity should generally receive a determination on its election within 60 days after it has filed Form 8832.

Care should be exercised to ensure that the IRS receives the election. If the entity is not notified of acceptance or nonacceptance of its election within 60 days of the date of filing, take follow-up action by calling 1-800-829-0115, or by sending a letter to the service center to inquire about its status. Send any such letter by certified or registered mail via the U.S. Postal Service, or equivalent type of delivery by a designated private delivery service (see Notice 2004-83, 2004-52 I.R.B. 1030 (or its successor)).

If the IRS questions whether Form 8832 was filed, an acceptable proof of filing is:

- A certified or registered mail receipt (timely postmarked) from the U.S. Postal Service, or its equivalent from a designated private delivery service;
- Form 8832 with an accepted stamp;
- Form 8832 with a stamped IRS received date; or
- An IRS letter stating that Form 8832 has been accepted.

Specific Instructions

Name. Enter the name of the eligible entity electing to be classified.

Employer identification number (EIN). Show the EIN of the eligible entity electing to be classified.

Caution. Do not put "Applied For" on this line.

Note. Any entity that has an EIN will retain that EIN even if its federal tax classification changes under Regulations section 301.7701-3.

If a disregarded entity's classification changes so that it becomes recognized as a partnership or association for federal tax purposes, and that entity had an EIN, then the entity must continue to use that EIN. If the entity did not already have its own EIN, then the entity must apply for an EIN and not use the identifying number of the single owner.

A foreign person that makes an election under Regulations section 301.7701-3(c) and (d) must also use its own taxpayer identifying number. See sections 6721 through 6724 for penalties that may apply for failure to supply taxpayer identifying numbers.

If the entity electing to be classified using Form 8832 does not have an EIN, it must apply for one on Form SS-4, Application for Employer Identification Number. If the filing of Form 8832 is the only reason the entity is applying for an EIN, check the "Other" box on line 9 of Form SS-4 and enter "Form 8832" to the right of that box. The entity must have received an EIN by the time Form 8832 is filed in order for the form to be processed. An election will not be accepted if the eligible entity does not provide an EIN. **Caution.** Do not apply for a new EIN for an existing entity that is changing its classification if the entity already has an EIN.

Address. Enter the address of the entity electing a classification. All correspondence regarding the acceptance or nonacceptance of the election will be sent to this address. Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the entity has a P.O. box, show the box number instead of the street address. If the electing entity receives its mail in care of a third party (such as an accountant or an attorney), enter on the street address line "C/O" followed by the third party's name and street address or P.O. box.

Address change. If the eligible entity has changed its address since filing Form SS-4 or the entity's most recently-filed return (including a change to an "in care of" address), check the box for an address change.

Note. If a change of address occurs after the later of the filing of Form SS-4 or the most recently-filed return, use Form 8822, Change of Address, to notify the IRS of the new address. A new address shown on Form 8832 will not update the entity's address of record with the IRS.

Line 1. Check box 1a if the entity is choosing a classification for the first time (i.e., the entity does not want to be classified under the applicable default classification). Do not file this form if the entity wants to be classified under the default rules.

Check box 1b if the entity is changing its current classification.

Lines 2a and 2b. 60-month limitation rule. Once an eligible entity makes an election to *change* its classification, the entity generally cannot change its classification by election again during the 60 months after the effective date of the election. However, the IRS may (by private letter ruling) permit the entity to change its classification by election within the 60-month period if more than 50% of the ownership interests in the entity, as of the effective date of the election, are owned by persons that did not own any interests in the entity on the effective date or the filing date of the entity's prior election.

Note. The 60-month limitation does not apply if the previous election was made by a *newly formed* eligible entity and was effective on the date of formation.

Line 4. If an eligible entity has only one owner, provide the name of its owner on line 4a and the owner's identifying number (social security number, or individual taxpayer identification number, or EIN) on line 4b. Enter "DE" if the owner is a disregarded entity that does not have an identifying number. If the owner is a foreign person or entity and does not have a U.S. identifying number, enter "none" on line 4b.

Line 5. If the eligible entity is owned by one or more members of an affiliated group of corporations that file a consolidated return, provide the name and EIN of the parent corporation.

Line 6. Check the appropriate box if you are changing a current classification (no matter how achieved), or are electing out of a default classification. Do not file this form if you fall within a default classification that is the desired classification for the new entity.

Line 7. If the entity making the election is created or organized in a foreign jurisdiction, enter the name of the foreign country in which it is organized. This information must be provided even if the entity is also organized under domestic law.

Line 8. Generally, the election will take effect on the date you enter on line 8 of this form, or on the date filed if no date is entered on line 8. An election specifying an entity's classification for federal tax purposes can take effect no more than 75 days prior to the date the election is filed, nor can it take effect later than 12 months after the date on which the election is filed. If line 8 shows a date more than 75 days prior to the date on which the election is filed, the election will default to 75 days before the date it is filed. If line 8 shows an effective date more than 12 months from the filing date, the election will take effect 12 months after the date the election is filed.

Consent statement and signature(s). Form 8832 must be signed by:

1. Each member of the electing entity who is an owner at the time the election is filed; or

2. Any officer, manager, or member of the electing entity who is authorized (under local law or the organizational documents) to make the election. The elector represents to having such authorization under penalties of perjury.

If an election is to be effective for any period prior to the time it is filed, each person who was an owner between the date the election is to be effective and the date the election is filed, must sign.

If you need a continuation sheet or use a separate consent statement, attach it to Form 8832. The separate consent statement must contain the same information as shown on Form 8832.

Note. Do not sign the copy that is attached to your tax return.

Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping . . . . 1 hr., 49 min.

Learning about the law or the form . . . . 2 hr., 7 min.

Preparing and sending the form to the IRS . . . . . 23 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6406, Washington, DC 20224. Do not send the form to this address. Instead, see *Where To File* on page 4.

Foreign Entities Classified as Corporations for Federal Tax Purposes:

American Samoa—Corporation
Argentina—Sociedad Anonima
Australia—Public Limited Company
Austria—Aktiengesellschaft
Barbados—Limited Company
Belgium—Societe Anonyme
Belize—Public Limited Company
Bolivia—Sociedad Anonima
Brazil—Sociedade Anonima
Canada—Corporation and Company
Chile—Sociedad Anonima
People's Republic of China—Gufen Youxian Gongsi
Republic of China (Taiwan)—Ku-fen Yu-hsien Kung-szu
Colombia—Sociedad Anonima
Costa Rica—Sociedad Anonima
Cyprus—Public Limited Company
Czech Republic—Akciova Spolecnost
Denmark—Aktieselskab
Ecuador—Sociedad Anonima or Compania Anonima
Egypt—Sharikat Al-Mossahamah
El Salvador—Sociedad Anonima
Estonia—Aktsiaselts
European Economic Area/European Union—Societas Europaea
Finland—Julkinen Osakeyhtio/ Publikt Aktiebolag
France—Societe Anonyme
Germany—Aktiengesellschaft
Greece—Anonymos Etairia
Guam—Corporation
Guatemala—Sociedad Anonima
Guyana—Public Limited Company
Honduras—Sociedad Anonima
Hong Kong—Public Limited Company
Hungary—Reszvenytarsasag
Iceland—Hlutafelag
India—Public Limited Company
Indonesia—Perseroan Terbuka
Ireland—Public Limited Company
Israel—Public Limited Company
Italy—Societa per Azioni
Jamaica—Public Limited Company
Japan—Kabushiki Kaisha
Kazakstan—Ashyk Aktsionerlik Kogham
Republic of Korea—Chusik Hoesa
Latvia—Akciju Sabiedriba
Liberia—Corporation
Liechtenstein—Aktiengesellschaft
Lithuania—Akcine Bendroves
Luxembourg—Societe Anonyme
Malaysia—Berhad
Malta—Public Limited Company
Mexico—Sociedad Anonima
Morocco—Societe Anonyme
Netherlands—Naamloze Vennootschap
New Zealand—Limited Company
Nicaragua—Compania Anonima
Nigeria—Public Limited Company
Northern Mariana Islands—Corporation
Norway—Allment Aksjeselskap
Pakistan—Public Limited Company
Panama—Sociedad Anonima
Paraguay—Sociedad Anonima
Peru—Sociedad Anonima
Philippines—Stock Corporation
Poland—Spolka Akcyjna
Portugal—Sociedade Anonima
Puerto Rico—Corporation
Romania—Societe pe Actiuni
Russia—Otkrytoye Aktsionernoy Obshchestvo
Saudi Arabia—Sharikat Al-Mossahamah
Singapore—Public Limited Company
Slovak Republic—Akciova Spolocnost
Slovenia—Delniska Druzba
South Africa—Public Limited Company
Spain—Sociedad Anonima
Surinam—Naamloze Vennootschap
Sweden—Publika Aktiebolag
Switzerland—Aktiengesellschaft
Thailand—Borisat Chamkad (Mahachon)
Trinidad and Tobago—Limited Company
Tunisia—Societe Anonyme
Turkey—Anonim Sirket
Ukraine—Aktsionerne Tovaristvo Vidkritogo Tipu
United Kingdom—Public Limited Company
United States Virgin Islands—Corporation
Uruguay—Sociedad Anonima
Venezuela—Sociedad Anonima or Compania Anonima



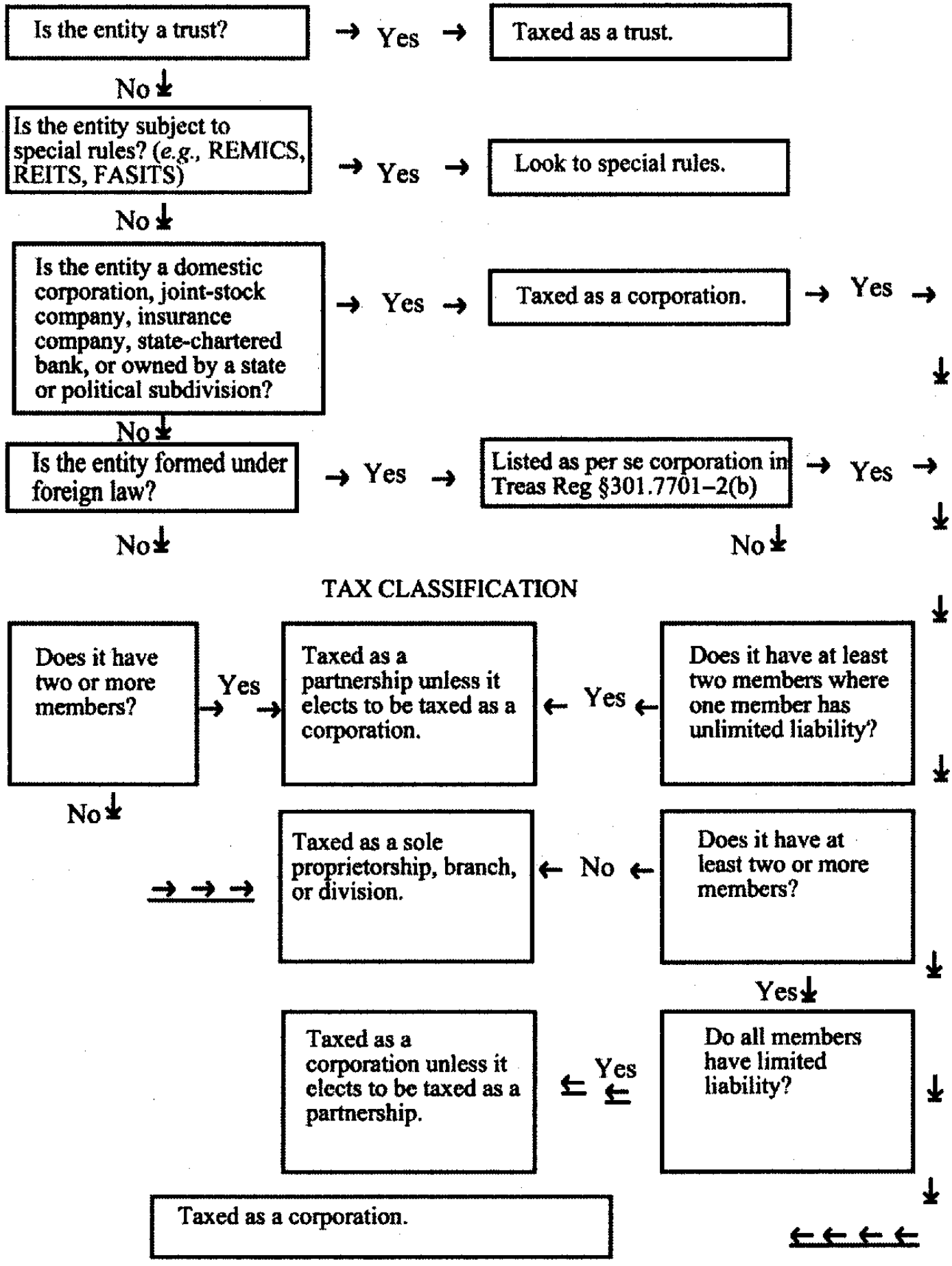
See Regulations section 301.7701-2(b)(8) for any exceptions and inclusions to items on this list and for any revisions made to this list since these instructions were printed.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.10 H. Diagram: Tax Classification

§4.10 H. Diagram: Tax Classification





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§4.11 III. CLASSIFICATION OF LLC FOR CALIFORNIA TAX PURPOSES

Under prior California law, LLCs were classified for tax purposes as either partnerships or corporations based on a four-factor test. This test looked at four relevant corporate characteristics (limited liability, centralized management, continuity of life, and free transferability of interests) and provided that if the business entity had a preponderance of corporate characteristics, it was taxed as a corporation. Otherwise, it was taxed as a partnership. California has now adopted regulations conforming to the federal check-the-box regulations discussed in §§4.3-4.10. On these regulations, see §§4.12-4.16.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.12 A. California Check-the-Box Regulations

§4.12 A. California Check-the-Box Regulations

The Franchise Tax Board (FTB) has adopted regulations consistent with the federal check-the-box regulations. See 18 Cal Code Regs §23038(b)-1(b). The California rules generally follow federal law in classifying entities, and the federal classification is binding for California income and franchise tax purposes. 18 Cal Code Regs §23038(b)-3(c).

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§4.13 B. Treatment of Existing Entities

An eligible business entity that was properly classified as an association taxable as a corporation for any income year beginning in the 60-month period before the effective date of the regulations (January 9, 1998), will continue to be so taxed until it irrevocably elects to be classified or disregarded for California tax purposes in the same manner it is classified or disregarded for federal tax purposes. 18 Cal Code Regs §23038(b)-3(b)(4)(A).

This particular provision deals with certain business trusts that were classified as associations taxable as corporations under prior California law but that may have been treated as partnerships for federal tax purposes. These entities, if they wish either California partnership classification or disregarded entity classification, must make a separate election and pay any tax consequences associated with the deemed liquidation of a corporation.

Generally, an election to be classified in accordance with federal law or as a disregarded entity is effective on the date specified in the written election or on the date it is filed if no date is specified in the written election. The effective date specified in the written election can be no more than 90 days before the date on which the election is filed and no more than 12 months after the date on which the election is filed. 18 Cal Code Regs §23038(b)-3(b)(4)(B).

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§4.14 C. Changing Classification

Any eligible entity required to file a California taxpayer information return for a taxable year for which an election is made under the federal check-the-box regulations must attach a copy of its federal Form 8832 to its California taxpayer information return for that year. If the entity is not required to file a California return for that year, a federal Form 8832 must be attached to the California income tax, franchise tax, or information return of any direct or indirect owner of the entity for the taxable year of that owner, that includes the date on which the election was filed. 18 Cal Code Regs §23038(b)-3(c)(3).

An indirect owner of the entity does not have to attach a copy of its federal Form 8832 to its return of the entity in which it held an interest if the entity has filed a copy of the federal Form 8832 with its return. 18 Cal Code Regs §23038(b)-3(c)(3). If an entity or one of its direct or indirect owners fails to attach a copy of its return, its election will not be invalidated. However, the nonfiling party may be subject to penalties, including those that apply if the California franchise or income tax or the information return are inconsistent with the entity's federal election.

Generally, for an entity not covered by the check-the-box regulations in existence on January 1, 1997, the claimed classification will be respected for all periods before January 1, 1997, if the entity had a reasonable basis for its claimed classification, the entity and all members of the entity recognized the California tax consequences of any change in the entity's classification within the first 60 months before January 1, 1997, and neither the entity nor any member was notified in writing before May 8, 1996, that the entity's classification was under examination. 18 Cal Code Regs §23038(b)-3(f)(1)-(2).

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§4.15 D. Foreign Eligible Entities

If a foreign-eligible entity's classification is relevant before the regulation's effective date but no California tax or information return has been filed, or the tax or information return does not indicate the entity's classification, its classification for the period before the effective date of the check-the-box regulations is determined under the regulations then in effect. 18 Cal Code Regs §23038(b)-3(b)(3).

A foreign-eligible entity's classification is relevant when it affects any person's liability for any tax or information purposes. For example, a foreign business classification would be relevant if the California source income was paid to the entity and the determination by the withholding agent of the amount to be withheld under the Revenue and Taxation Code would vary depending on whether the entity was classified as a partnership or an association. Thus, the classification might affect the documentation the withholding agent must receive from the entity or the type of tax information return to file or how the return must be prepared. The classification of a foreign entity is relevant, for example, on the date an interest in the entity is acquired that would require a California person to file an information return. 18 Cal Code Regs §23038(b)-3(d)(1).

If a foreign-eligible entity's classification was relevant but ceases to be relevant for California tax purposes for 60 consecutive months, its classification will initially be determined under the default classification when the entity's classification again becomes relevant. 18 Cal Code Regs §23038(b)-3(d)(2). The date the foreign entity's classification ceases to be relevant is the date an event occurs that causes the classification to no longer be relevant. If no event occurs in a taxable year that causes the classification to be relevant, the date is the first day of that taxable year.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.16 E. Single-Member Entities

§4.16 E. Single-Member Entities

The regulations recognize that single-owner organizations can elect to be recognized as associations taxable as corporations or disregarded as entities separate from their owners. 18 Cal Code Regs §23038(b)-1(a)(4). For California income tax purposes, a single-member entity is disregarded as a separate entity unless an election is filed to be taxed as a corporation. 18 Cal Code Regs §23038(b)-3(b).

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§4.17 IV. TAX EFFECT OF MEMBERS' CONTRIBUTIONS TO LLC

Members' contributions may take the form of cash, property, services, and guaranties of the LLC's debts. Corp C §17200. After electing the LLC's tax treatment under federal and state law, the practitioner must deal with the tax effects of members' contributions to the LLC: the gain or loss for income tax purposes to the member and to the LLC, and whether the transfer triggers property taxes.

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A. Tax Treatment of Member

§4.18 1. General Rule: No Gain or Loss on Contribution

When an LLC is taxed as a partnership, a member generally does not recognize gain or loss on the contribution of cash or property to the LLC in exchange for an interest in the LLC. IRC §721(a). However, there are six exceptions to this nonrecognition rule:

(1) The nonrecognition rules apply only to property contributed to the LLC. IRC §721. A member's receipt of an LLC capital interest in return for services may be taxable (see §4.19).

(2) The contribution may not be part of a "disguised sale" under IRC §707(a). If it is, the member transferring property recognizes gain on the sale. On disguised sale, see §§4.20, 5.64.

(3) Under IRS Notice 89-37, 1989-1 Cum Bull 679, the acquisition by a partnership, and, by analogy, an LLC, of stock of a corporate partner in exchange for property may not qualify for nonrecognition by the LLC.

(4) The member may realize gain on the contribution if the property contributed is subject to liabilities and the LLC assumes the liabilities or takes the property subject to them. See §4.21.

(5) Recognition of gain or loss on contribution will occur if the LLC is in effect an investment company. IRC §721(b).

(6) Any "boot," *i.e.*, property other than a membership interest, received by a contributing member will be treated as a distribution from the LLC under IRC §731 or as consideration received for partial sale for contributed property under IRC §707(a)(2)(B). See §§5.59, 5.64.

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§4.19 a. Contribution of Services in Exchange for LLC Interest

A member contributing services in exchange for a capital interest in the LLC will immediately recognize ordinary income equal to the value of the capital interest. IRC §61; Treas Reg §1.721-1(b)(1). If receipt of the interest is contingent or subject to a substantial risk of forfeiture, recognition is delayed unless the member elects to be taxed in the year of receipt. IRC §83.

However, if the member contributing services receives a profits interest, rather than a capital interest, he or she generally will not recognize income. A profits interest is dependent on the LLC's future profits, whereas a capital interest includes the right to receive money or property on the LLC's dissolution.

The IRS will generally not tax the receipt of a profits interest to either the member or the LLC. Excepted from that rule, however, are the following three situations:

(1) The profits interest relates to a substantially certain and predictable stream of income from LLC assets;

(2) Within 2 years of receipt the member disposes of the profits interests; or

(3) The profits interest is in a "publicly traded partnership" within the meaning of IRC §7704(b).

The determination of whether an interest is a capital interest or a profits interest is made at the time of its receipt, even if, at that time, the interest is substantially nonvested under Treas Reg §1.83-3(b). If the interest is a profits interest, the IRS will not tax the member or the LLC on either the receipt of the interest or the event that causes the interest to become substantially vested.

NOTE: In May 2005, the IRS and the Treasury Department issued proposed regulations (Prop Treas Reg §§1.83-3, 1.83-6) concerning the transfer of partnership interests in connection with the performance of services for the partnership. See Notice 2005-43, 2005-1 Int Rev Bull 1221. The same principles would apply to an LLC treated as a partnership for tax purposes. Under the proposed regulations, an LLC interest (whether a capital interest or a profits interest) would be treated as property within the meaning of IRC §83, and the transfer would be subject to §83. See §§3.19, 4.23 for more detailed discussion. Accordingly, the excess of the fair market value of the LLC interest received by the service provider over the amount, if any, paid by the service provider would generally be includible in income during the taxable year of the service provider in which the interest is substantially vested (within the meaning of IRC §83(a) and Treas Reg §1.83-3(b)).

Consistent with Rev Proc 93-27, 1993-2 Cum Bull 343 and Rev Proc 2001-43, 2001-2 Cum Bull 191, a safe harbor election would be available to permit LLCs to value compensatory interests using the liquidation value approach. As a result, the receipt of a profits interest would not result in income to the recipient if the safe harbor election under IRC §83(b) is made within 30 days.

Consistent with IRC §83 principles, if a restricted (*i.e.,* unvested) interest is transferred in connection with the performance of services, and if an election under IRC §83(b) is not made, the holder of the LLC interest would not be treated as a member until the interest becomes substantially vested. Conversely, a service provider who receives a restricted compensatory interest and who makes a §83(b) election would be treated as a member from the date of receipt of the interest.

Under the proposed regulations, an LLC would recognize neither gain nor loss on the issuance or vesting of an interest (whether a profits interest or a capital interest) issued in connection with the performance of services for the issuing LLC.

As of October 19, 2006, the proposed regulations had not yet become final. They apply only to transactions occurring after they become final. Notice 2005-43, 2005-24 Int Rev Bull 1221.

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§4.20 b. Gain Recognized if Contribution Is Disguised Sale

Internal Revenue Code §707(a)(2)(B) creates a general exception to nonrecognition treatment for so-called disguised sales of property to a partnership, applicable to LLCs taxed as partnerships. The purpose of §707 is to prevent taxpayers from disposing of appreciated property without recognizing gain by contributing the property to a partnership or an LLC and receiving cash back. The disguised sale rules apply when a member transfers property or money to the LLC and there is a related direct or indirect transfer of money or property by the LLC to that member. The transaction will either be treated as an exchange between the member and the LLC or between two members. In either event, the member disposing of the property will recognize gain or loss on the disposition. The regulations list the facts and circumstances for determining whether a transaction is a disguised sale. See Treas Reg §1.707-3(b)(1). Transfers between the LLC and a member made more than 2 years apart are presumed not to be a sale or exchange.

A disguised sale is likely to be found if a member contributes property to the LLC and within the 2-year period receives other property that is not "like kind" from the LLC. The like-kind definition is consistent with the rules of IRC §1031. On disguised sales, see also §5.64.

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§4.21 c. Potential Gain if LLC Assumes Member's Liabilities

If the LLC assumes a member's liability in connection with the member's contribution of property, or takes property subject to a liability, the member is treated as receiving a distribution of money equal to the liability. As discussed in §§5.30-5.34, the distribution reduces the member's basis, and if the member's resulting basis is less than the amount of the deemed distribution of money, the member has gain. IRC §§752, 722, 731(a)(1); Treas Reg §1.752-1(f).

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§4.22 d. Member's Basis

Following the contribution of property to the LLC, the member will take a basis in his or her membership interest equal to the basis the member has in the contributed property. IRC §722. Any precontribution gain or loss on the property will be allocated to the contributing member under IRC §704(c). On basis and related tax issues, see §§5.23-5.34.

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§4.23 2. LLC Taxed as Corporation

If the LLC is, intentionally or unintentionally, treated as an association taxable as a corporation, the contribution of cash or property is a nonrecognition event, when it is part of an overall transaction in which the contributing members end up owning 80 percent or more of the interests in the LLC. IRC §§351(a), 368(c).

If a member exchanges services for membership interests, the member immediately recognizes income equal to the fair market value of the shares when the shares are freely transferable and no longer subject to a substantial risk of forfeiture. IRC §§61(a)(1), 83, 351(d)(1).

If IRC §351(a) applies, the LLC's assumption of liabilities in connection with a transfer to the LLC results in taxable income to the member relieved of those liabilities if the liabilities exceed the tax basis of the contributed assets. IRC §357(c).

PRACTICE TIP: When making a contribution of encumbered property to an LLC taxed as a corporation, a taxpayer can avoid gain under IRC §357(c) by additionally contributing a promissory note. *Peracchi v Commissioner* (9th Cir 1998) 143 F3d 487. The court in *Peracchi* noted that the shareholder's personal exposure had been increased by the amount of the promissory note because the note was valid and unconditional. If the corporation went into bankruptcy, the corporation would have a legal and valid claim against the note and the shareholder would be required to pay it off. The court also noted that, if the corporation forgave the note at a later date, the shareholder would then be taxed on the full amount as cancellation of indebtedness income. IRC §61(a)(12). The court concluded that the taxpayer had a basis in the note equal to its face value and, accordingly, did not have to realize gain under IRC §357(c). The liabilities transferred did not exceed the basis of assets transferred to the corporation. The court noted that contributions of nonrecourse notes to pass-through entities such as partnerships, S corporations, and LLCs taxed as partnerships could create artificial increases in basis and allow deduction of losses that otherwise would not be deductible. The court expressly declined to extend its ruling to pass-through entities.

The member's basis in the LLC interest is equal to the tax basis in the contributed property under IRC §358.

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B. Tax Treatment of the Entity

§4.24 1. General Rule: No Gain or Loss on Receipt of Contribution

The general rule is that an LLC that is classified as a partnership will not recognize gain or loss on the receipt of property, cash, or services in exchange for an interest in the LLC. IRC §721(a). On the contribution of property, the LLC takes a tax basis equal to the member's basis in the contributed property. IRC §723.

However, if the disguised sale rules apply to the contribution of property (see §4.20), the LLC's basis in the contributed property is a cost basis under IRC §1012.

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§4.25 2. LLC Taxed as Corporation

An LLC that is taxed as a corporation generally does not recognize any income on receipt of contributed property. IRC §1032. The LLC's basis in the contributed property is equal to the member's tax basis under IRC §362 if the transaction is governed by IRC §351; if not, the corporation receives a stepped-up basis. Treas Reg §1.1032-1(d).

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/ C. Taxes Incurred on Transfer of Real and Personal Property/§4.26 1. Sales Tax

C. Taxes Incurred on Transfer of Real and Personal Property

§4.26 1. Sales Tax

California imposes a sales tax on retailers for the privilege of selling tangible personal property at retail in California. Rev & T C §6051. Retailer is defined broadly as every individual, firm, copartnership, joint venture, trust, business trust, syndicate, association, or corporation that makes more than two retail sales of tangible personal property during any 12-month period. Rev & T C §§6015, 6019. Any individual or entity's sale for consideration is potentially subject to the sales tax. The practitioner must determine whether a member's transfer of property to the LLC, or a merger of a business or other entity into an LLC, will incur sales tax, or whether an exemption applies.

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§4.27 a. Transfer of Property for First Issue of Membership Interests

On formation of the LLC, the member's transfer of property to the LLC in exchange for a membership interest should not be subject to sales tax. The State Board of Equalization has exempted a similar transfer of property, to a corporation rather than an LLC, in exchange for the first issue of stock because it is not a sale, or, if a sale occurs, the measure of taxable gross receipts is zero. 18 Cal Code Regs §1595(b)(4); see STC Rulings 395.1860 (July 31, 1950), 395.2280 (Jan. 3, 1963), 2 CCH Cal Tax Rep ¶60-590.

Tax does apply, however, if the transferor receives consideration, *e.g.*, cash, notes, assumption of indebtedness, in exchange for the transfer. 18 Cal Code Regs §1595(b)(4); *Industrial Asphalt, Inc. v State Bd. of Equalization* (1992) 5 CA4th 1237, 7 CR2d 444; *Cal-Metal Corp. v State Bd. of Equalization* (1984) 161 CA3d 759, 207 CR 783. This tax may be avoided if the occasional sale exemption under Rev & T C §6367 applies.

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§4.28 b. Other Transfers of Property by Member

A member's transfer of personal property to an LLC for consideration other than a membership interest may be a sale subject to California sales tax, unless an exemption applies. Likewise, a member's transfer of personal property to an existing LLC, as opposed to a newly formed LLC, is a taxable sale, unless it qualifies for an exemption. Rev & T C §6006(a). The most likely applicable exemption will be the occasional sales exemption found in Rev & T C §6367, and defined in Rev & T C §6006.5(a). It applies to sales by vendors not engaged in business activities, and to isolated or occasional sales by vendors engaged in business activities that do not regularly involve making retail sales subject to sales tax. See Rev & T C §6007.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.29 c. Transfers of 80 Percent of Business

§4.29 c. Transfers of 80 Percent of Business

One exemption that may apply on creation of an LLC or the merger or conversion of a business into an LLC is the exemption for transfers of 80 percent or more of all tangible personal property used in a business when 80 percent or more of the real or ultimate ownership of the property remains the same after the transfer. Rev & T C §6006.5(b); 18 Cal Code Regs §1595(b)(2).

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.30 2. Property Taxes

§4.30 2. Property Taxes

A transfer of real property to an LLC, in connection with formation or a merger, will constitute a change in ownership of the property triggering a reassessment for California property tax purposes, unless an exception is available. Rev & T C §§60-62. Under Rev & T C §62(a)(2) and 18 Cal Code Regs §462.180, an exception applies on formation for the following kinds of transfers:

(1) The transfer of real property is between separate legal entities or by one or more individuals to a legal entity (or vice versa);

(2) The transfer results solely in a change in the method of holding title; and

(3) The proportional interest in the property remains the same after the transfer.

Likewise, if co-owners transfer real property to an LLC and take back proportionate ownership interests in the LLC, there is no change in ownership. Rev & T C §62. At a later point in time, there may be. A change of ownership of the property originally transferred occurs when more than 50 percent of the total interests in the LLC are transferred by any of the original co-owners in one or more transactions. Rev & T C §64(d).

A member's transfer of his or her interest in the LLC is not a change in ownership of the LLC's real property, unless control of the LLC changes. Rev & T C §64(a). Likewise, addition or deletion of a member should not cause a change in ownership of the LLC's real property without a change of control. See 18 Cal Code Regs §462.180(e)(2). Control changes, and there will be a change in ownership of all the LLC's real property, whenever a person or entity obtains direct or indirect ownership of more than 50 percent of the total interests in the LLC. Rev & T C §64(c).

A change of ownership of real property is usually reported to the local assessor on a preliminary change of ownership form. Changes in entity control must be reported to the State Board of Equalization (SBE) within 45 days from the date of the change in control. Rev & T C §480.1(a). To do this, the person or entity acquiring control must file a change in ownership statement with the SBE's office in Sacramento. The statement may be signed by an officer, manager, or an employee or agent who has been designated in writing to do so. Rev & T C §§480.1(c), 480.2(c).

Such a statement also must be filed within 45 days from the date that shares or other ownership interests representing cumulatively more than 50 percent of the total control or ownership interests in the entity are transferred by any of the original co-owners in one or more transactions. Rev & T C §480.2(b).

A change in ownership statement also must be completed and filed whenever a written request is made for it by the SBE, regardless of whether a change in ownership of the legal entity has occurred. Rev & T C §480.2(b). (The SBE's request is usually prompted by state income tax returns forwarded to it by the Franchise Tax Board, business property statements filed with local assessors, or information it obtains from monitoring business publications.)

Failure to file a change in ownership statement within 45 days from the earlier of the date of the change of ownership/control or the date of the SBE's written request will result in a penalty of 10 percent of the taxes applicable to the new base year value reflecting the change in ownership of the real property owned by the LLC, or 10 percent of the current year's taxes on that real property if no change in ownership occurred. This penalty will be added to the assessment roll and collected like any other delinquent property tax, and be subject to the same penalties for nonpayment. Rev & T C §480.1(b).

For further information on property tax in general, see California Real Property Sales Transactions, Appendix A: Transfers Triggering Reappraisal (4th ed Cal CEB 2007).

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.31 3. Documentary Transfer Tax

§4.31 3. Documentary Transfer Tax

Cities and counties may impose a tax on each deed or other instrument transferring real property. Rev & T C §§11901-11934. Depending on the property's location, a transfer of property to an LLC may be subject to both county and city transfer taxes, unless exempt. Exemptions are found in Rev & T C §§11921-11930. They are not the same as exclusions from property tax reassessments. In some counties the contribution of property to an LLC may trigger a documentary transfer tax though the property will not be reassessed for property tax purposes.

The documentary transfer tax will not be imposed on a transfer of real property when the transfer is between one or more individuals and a legal entity (or between legal entities), provided the transfer results solely in a change in the method of holding title to the real property and provided the proportional ownership interest in the real property and the proportional ownership interest in the entity are the same immediately after the transfer. Rev & T C §11925(d).

In other words, a contribution of real property to an LLC by its members (and a distribution of real property by an LLC to its members) is exempt from the documentary transfer tax if the proportional ownership interest in the real property by the LLC members and the proportional ownership interest in the LLC by the LLC members are the same immediately after the transfer. This exemption may not apply to a sale or other conveyance for value.

The county rate of tax is $1.10 per $1000 (.11 percent), excluding the amount of any note secured by a deed of trust. The rate that cities charge varies. Title companies usually have current information.

For further information on the documentary transfer tax, see California Real Property Sales Transactions §§10.11-10.12 (4th ed Cal CEB 2007).

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§4.32 V. TAX IMPACT ON INDIVIDUAL MEMBERS

In advising a client who is considering forming an LLC, the practitioner must consider not only the tax consequences of the formation of an LLC on the business, but the consequences to the individual members of the LLC as well. Income taxes on the member, together with Social Security and Medicare taxes on LLC income, can approach 50 percent. On the major considerations, see §§4.33-4.39.

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§4.33 A. Marginal Income Tax Rates

When structuring the LLC, a practitioner must consider the effect of marginal income tax rates on the income earned by the business. The marginal rate is 35 percent on taxable income in excess of $250,000 (indexed for inflation, equal to $349,700 in 2007) for single individuals or married individuals filing a joint return. IRC §1(a)-(c). Corporations are taxed at graduated rates ranging from 15 percent (on income not over $50,000) to 39 percent (on income over $100,000 but not over $335,000) but equal to 34 or 35 percent on most corporate income. IRC §11. Thus an LLC's income can be subject to a higher or lower tax rate than the rate applicable to the corporation's. To the extent that incremental income of the business may be taxed at a rate in excess of the applicable corporate rate, it may be preferable not to use an LLC taxable as a partnership, and to consider either an LLC taxable as a corporation, or a corporation. However, if taxable as a corporation, the LLC is subject to tax on its taxable income, and the members must include in income the amount received as distributions paid out of earnings and profits. IRC §§11, 61(a)(7).

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§4.34 B. Compensation of Members: Employment or Self-Employment and Medicare Taxes

The practitioner must consider not only the rate of tax on income of the business, but also how that income will be characterized when paid to members. If the business is taxable as a corporation, amounts paid to members that participate may be deductible as salary, subject to the limitation that excessively high compensation may be recharacterized as a dividend. Treas Reg §1.162-8. The business also may be liable for employment taxes on the amounts paid as compensation to members that participate. See §3.63. Other amounts distributed to members out of earnings and profits will be taxed as dividends.

When an LLC is taxable as a partnership, a member's eligible share of income may be treated one of three ways: (1) as net earnings from self-employment, (2) as salary or wages, or (3) as distributable shares of partnership income under Subchapter K. Self-employment income incurs an additional tax of 15.3 percent. IRC §1401.

Under Treas Reg §1.1402(a)-2(d), a member's distributive share of LLC income from a trade or business is self-employment income. However, if the member is treated as a limited partner for purposes of the self-employment tax, the partner's share of income is not treated as net earnings from self-employment. IRC §1402(a)(13). On self-employment tax, see §5.85.

Under Prop Treas Reg §1.1402(a)-2(h)(2), an individual will be treated as a limited partner unless the individual (1) had personal liability for the debts of or claims against the partnership by reason of being a partner; (2) had authority to contract on behalf of the partnership under the statutory law under which the partnership is organized; or (3) participated in the partnership's trade or business for more than 500 hours during the taxable year.

There are several important exceptions to this rule. First, if substantially all activities of the partnership or LLC involved performing services in the fields of health, law, engineering, architecture, accounting, actuarial science, or consulting, any individual who provided services in that business would not be treated as a limited partner. Prop Treas Reg §§1.1402(a)-2(h)(5), 1.1402(a)-2(h)(6)(iii).

Second, an individual who holds more than one class of interests in the partnership or LLC could be treated as a limited partner if immediately after the individual acquires an interest in the partnership or LLC: (1) Limited partners own a substantial, continuing interest in a specific class of partnership interest, and (2) the individual's rights and obligations with respect to this specific class are identical to the rights and obligations of the other limited partners holding that specific class. Limited partners are generally treated as owning a substantial continuing interest if they own at least 20 percent of the partnership. Prop Treas Reg §§1.1402(a)-2(h)(3); 1.1402(a)-2(h)(6)(iv).

Third, an individual owning only one class of partnership interests who is disqualified as a limited partner by application of the 500-hour participation test is treated as a limited partner if, immediately after acquiring the partnership interest: (1) Limited partners own a substantial, continuing interest in that specific partnership class, and (2) the individual's rights and obligations with respect to the specific class are identical to the rights and obligations of all other limited partners holding that specific class. Prop Treas Reg §1.1402(a)-2(h)(4).

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.35 C. Members' Ability to Use Business Losses

§4.35 C. Members' Ability to Use Business Losses

When structuring the LLC, counsel must consider the limitations that the form of entity places on the ability of a taxpayer to use losses generated by the business. In an LLC taxed as a partnership, a member's right to use losses is limited by his or her basis in his or her membership interest (see §5.55), and also by the at-risk and passive loss rules. See §§5.56-5.57.

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§4.36 D. Estate Planning With LLCs

Although a comprehensive analysis of the advantages and disadvantages of LLCs in estate planning is beyond the scope of this book, there are several tax and nontax benefits of using an LLC to hold family and personal assets or a closely held business.

Among the potential estate planning benefits of using limited partnerships and LLCs are the following:

- Income may be shifted among family members from a higher-bracket taxpayer to a lower-bracket taxpayer.
- The giving of an interest in a large asset, while allowing the donor to retain substantial control of the asset is facilitated.
- The annual gift tax exclusion (IRC §2503(b)) and the equivalent unified estate and gift tax credit (IRC §2010(a)) can be leveraged for transfer tax purposes through valuation discounts (*e.g.*, minority interest, lack of marketability; see §4.37). In *Hackl v Commissioner* (7th Cir 2003) 335 F3d 664, however, the court held that gifts of LLC membership interests were gifts of future interests that did not qualify for the annual gift tax exclusion. Units could not be transferred without the manager's consent and the donors could not prove that there would be a current steady flow of income to the donees. See generally California Estate Planning, chap 18 (Cal CEB 2002); Kinyon & Smith, *The Use of Family Investment Companies in Estate Planning*, Estate Planning 2003, chap 4 (Cal CEB 2003). On issues involved in using LLCs rather than limited partnerships, see §§4.37-4.39.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.37 1. Value of LLC Interest May Be Based on Discounted Liquidation Value

§4.37 1. Value of LLC Interest May Be Based on Discounted Liquidation Value

Like an interest in a family limited partnership, an interest in a family-controlled LLC is entitled to a valuation discount for lack of marketability or lack of control.

The discount is based on the inability of a limited partner or LLC member to transfer more than an assignee interest without the consent of the general partners and a majority in interest of the limited partners or a majority in interest of the members. The assignee of an interest in a limited partnership or LLC generally has few rights other than a right to share in distributions. Corp C §§15907.02, 17301. See §§3.75-3.76.

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Source: Business Law/Forming and Operating California Limited Liability Companies/4 Tax Issues in Forming the Limited Liability Company/§4.38 2. LLC as General Partner of Family Limited Partnership

§4.38 2. LLC as General Partner of Family Limited Partnership

Although LLCs have not traditionally been used for estate planning, they do merit consideration since, unlike family limited partnerships, no one is liable for the debts of the entity. If the practitioner is convinced that a family limited partnership is a better estate planning device, consideration should be given to forming an LLC as a general partner of a family limited partnership. The older generation would contribute assets to the family limited partnership in return for limited partnership interests, which are then given to family members. This two-tier structure limits the liability of the older generation through the LLC but allows discounts to be calculated on the gift of the limited partnership interests.

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§4.39 3. LLC as Alternative to Family Limited Partnership

In some cases, counsel should consider using an LLC rather than a family limited partnership for estate planning purposes, because the transfer of assets to an LLC does not involve the same disproportionate transfer of control as the transfer of assets to a family limited partnership in exchange for limited partnership interests. The IRS has contended that a gift occurs when parents, for example, transfer assets to a limited partnership in exchange for a 99-percent limited partnership interest and children make a token contribution in exchange for a 1-percent general partnership interest. The fair market value of the gift is the value of the assets transferred to the limited partnership, reduced by the value of the partnership interests received in return. This argument rests on the contention that the limited partnership interests received by the parents are not proportional because of the relinquishment of control that results. See IRS Letter Ruling 9842003; Field Service Advice 199950014. Using an LLC with only one class of interests instead of a limited partnership avoids an initial disproportionate transfer of control, assuming that all the members make a prorata contribution of assets to the LLC. However, the "gift on formation" argument was rejected in *Estate of W.W. Jones II* (2001) 116 TC 121, *Church v U.S.* (WD Tex 2000) 2000-1 USTC ¶60,369, 85 AFTR2d 804, aff'd (5th Cir 2001) 2001-2 USTC ¶60,415, and *Estate of Albert Strangi* (2000) 115 TC 478, aff'd in part and rev'd in part sub nom *Gulig v Commissioner* (5th Cir 2002) 293 F3d 279. In Field Service Advice 200143004, the IRS recommended against the gift-on-formation argument in valuing gifts of shares of an S corporation owning marketable securities. Instead, the IRS argued that the entity should be disregarded for valuation purposes because the corporation lacked economic substance. The IRS then argued that the donor made indirect gifts of the underlying assets. The IRS further argued that the transfer of securities to the corporation imposed restrictions on the right to sell or use the property that were to be disregarded under IRC §2703. The IRS criticized the Tax Court decisions in *Estate of Albert Strangi, supra,* and *Ina F. Knight* (2000) 115 TC 506, which rejected the "lack of economic substance" argument in valuing limited partnership interests.

These and other IRS arguments against valuation discounts for partnership interests that have been accepted by the courts would apply equally to LLCs. In *Shepherd v Commissioner* (11th Cir 2002) 283 F3d 1258, the court held that transfers to a partnership resulted in gifts of the transferred property rather than gifts of partnership interests. The parties had agreed that as gifts of partnership interests the transfers would have been entitled to a 33.5-percent valuation discount for lack of marketability and the fact that the transfers involved minority interests. See also IRS Letter Ruling 200212006 (transfer of publicly traded municipal bonds to limited partnership results in a gift of bonds to other partners). In *Estate of Morton B. Harper*, TC Memo 2002-121, the court held that assets transferred to a limited partnership were included in the transferor's estate under IRC §2036 because evidence established an implied agreement that the transferor would continue to enjoy the assets. The court held that there was not an adequate and full consideration for the transfers because there was a mere "recycling" of value through the partnership. See also *Estate of Albert Strangi,* TC Memo 2003-145 (on remand from *Gulig v Commissioner, supra*); *Estate of Theodore R. Thompson,* TC Memo 2002-246. But see *Estate of Eugene E. Stone,* TC Memo 2003-309 (assets transferred to limited partnerships shortly before death not included in transferor's estate; on facts of particular case, involving settlement of long-standing family disputes, there was no mere "recycling" of value). However, the Tax Court allowed substantial discounts for gifts of interests in a family limited partnership funded with cash, money market funds, and publicly traded securities in *Peter S. Peracchio,* TC Memo 2003-280. In this case, the IRS made a variety of attacks on the partnership, but later abandoned them, leaving only the issue of the size of the discounts.

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Income Taxation of LLC Operations

Colby A. Campbell
Jack S. Johal

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§5.1 I. SCOPE OF CHAPTER

This chapter provides an overview of the basic rules governing the income taxation of a limited liability company, assuming the LLC is treated as a partnership for tax purposes. An LLC that is not classified as a partnership will be taxed as a corporation. See §4.8. For a comprehensive discussion of partnership income taxation, counsel should refer to partnership treatises, such as Friedland & Petersen, California Partnerships and Proprietorships: Practice and Compliance Guide (1992); McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners (4th ed 2007); and Willis, Pennell & Postlewaite, Partnership Taxation (6th ed 1997). Practitioners will also find discussions of the taxation of LLCs in Bishop & Kleinberger, Limited Liability Companies: Tax and Business Law (1994) and Wood, Limited Liability Companies: Formation, Operation, and Conversion (2d ed 2001).

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§5.2 II. APPLICATION OF PARTNERSHIP TAX RULES TO LLCs

One of the primary benefits of an LLC is that it can be treated by the Internal Revenue Service as a partnership. See chap 4.

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III. CALIFORNIA TAXATION

§5.3 A. Follows Federal Law in Taxing LLC Classified as Partnership

Generally, California law conforms to federal law with respect to the income taxation of partnerships, except for the minimum franchise tax on limited partnerships, LLCs, and limited liability partnerships. Rev & T C §§17851, 17851.5.

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§5.4 B. California Taxes and Fees

Unlike federal law, California law imposes taxes and fees on LLCs at the entity level. LLCs organized in California, foreign LLCs qualified to do business in California, and foreign LLCs whether or not qualified but that conduct intrastate business in California are subject to:

- An annual franchise tax of $800 for the privilege of doing business in California (Rev & T C §§17941(a)-(b), 23153(d)(1)) (deductible for California income tax purposes); and

- An income tax for any year in which the LLC's total income derived from or attributable to California is $250,000 or more. Rev & T C §17942(a)-(b) (not deductible for California income tax purposes). See §5.4B.

Note that in *Tin Tin Corp. v Pacific Rim Park, LLC* (2009) 170 CA4th 1220, 88 CR3d 816, the court characterized both of the above taxes as "costs of operating a business in a form that limits the personal liability of its principal[s]." 170 CA4th at 1231. Therefore, the LLC owner and operator of a shopping center could not pass them on to its tenants as common area operating expenses.

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§5.4A 1. Former Income Tax Unconstitutional

In *Northwest Energetic Servs., LLC v California Franchise Tax Bd.* (2008) 159 CA4th 841, 71 CR3d 642, the court of appeal held that the California annual fee paid by LLCs (based on worldwide gross income) was unconstitutional under the commerce clause (Art I, §8) of the United States Constitution.

Plaintiff Northwest was an LLC organized under the laws of the State of Washington, with business locations in Washington and Oregon. It engaged in the business of distributing explosives and explosives-related services to customers in Washington, Montana, Oregon, and Idaho. Northwest had no operations, property, inventory, employees, agents, independent contractors, or place of business in California. Nor did it solicit customers in California or make any deliveries to customers in California. Northwest nonetheless registered as an LLC with the California Secretary of State under Corp C §17451. In years following, it filed tax returns with the FTB and paid the annual $800 franchise fee (Rev & T C §17941). It did not, however, pay any fee based on its "total income from all sources."

The Franchise Tax Board subsequently notified Northwest that it owed $27,458 for amounts due under Rev & T C §17942 (the "total income" fee), along with late payment penalties and interest, for tax years 1997 (when Northwest had first registered in California), 1999, 2000, and 2001. Northwest paid the $27,458 and cancelled its registration with the Secretary of State effective June 13, 2002. It then filed a claim for a refund, which the FTB denied. Northwest then exhausted its administrative remedies by appealing the FTB's decision to the State Board of Equalization, without success.

Northwest next filed an action in superior court, seeking a refund of the amounts it paid. Among other things, it alleged that the fee required by Rev & T C §17942 was unconstitutional on its face and as applied, because it was in fact a tax on activities that had nothing to do with California. There was no apportionment mechanism in the statute, so that only economic activity in California was being taxed; all of an LLC's income, wherever it was earned, was counted for purposes of the fee. This was overreaching on California's part. As a matter of constitutional law, it discriminated against interstate commerce and violated due process and equal protection rights.

The court of appeal did not reach the due process and equal protection claims because it decided the case solely on the basis of the commerce clause.

In order not to run afoul of the commerce clause, a tax must, among other things, be "fairly apportioned." Fair apportionment requires both "internal consistency" and "external consistency." Internal consistency is preserved when the imposition of a tax identical to the one in question by every other state would add no burden to interstate commerce that intrastate commerce would not also bear. External consistency looks to the economic justification for the state's claim on the value taxed, to discover whether a state's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state.

The levy at issue here satisfied neither standard.

First, the court found, if the levy were replicated in every state, an LLC engaging in business in multiple states with the same total income as Northwest would pay the maximum levy in every state in which it did business or registered to do business. An LLC operating only in one state would pay the maximum levy only once. Thus, the levy placed a greater burden on interstate commerce than intrastate commerce.

Second, the Franchise Tax Board's economic justification for the levy was either to replace the revenue lost from corporate taxes after adoption of the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656) or to raise the funds necessary to provide certain benefits to LLCs in California. Because the levy was measured by each LLC's total income, wherever earned, and not just what was earned in California, the levy reached beyond that portion of value that was fairly attributable to economic activity within the state.

In *Ventas Fin. I, LLC v Franchise Tax Bd.* (2008) 165 CA4th 1207, 81 CR3d 823, the court came to a similar conclusion regarding the unconstitutionality of the annual fee. However, it held that the trial court had erred in ordering the FTB to refund the entire amount the LLC had paid. Neither federal due process nor California law required that. The refund was limited to the amount the LLC paid for the relevant years that exceeded the amount it would have been assessed, without violating the commerce clause, using a method of fair apportionment. See §5.4B.

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§5.4B 2. Legislative Response

In response to the ruling in *Northwest Energetic Services*, the California legislature amended Rev & T C §17942 (Stats 2007, ch 381, §3), to fix the apportionment problem identified by the court. The amendment redefined "total income from all sources" to mean "total income from all sources *derived from or attributable to this state*." Thus, for tax years beginning January 1, 2007, the tax reaches only economic activity in California. Further details about calculating "total income" are in Rev & T C §17492(b)(1)(A):

(b) (1) (A) For purposes of this section, "total income from all sources derived from or attributable to this state" means gross income, as defined in [Rev & T C §24271, which refers in turn to IRC §61, with special provisions for income derived from a partnership, estate, or trust], plus the cost of goods sold that are paid or incurred in connection with the trade or business of the taxpayer. However, "total income from all sources derived from or attributable to this state" shall not include allocation or attribution of income or gain or distributions made to a limited liability company in its capacity as a member of, or holder of an economic interest in, another limited liability company if the allocation or attribution of income or gain or distributions are directly or indirectly attributable to income that is subject to the payment of the fee described in this section.

"Total income … derived from or attributable to" California is determined using the rules for assigning sales under Rev & T C §§25135 and 25136 and the regulations thereunder, as modified by regulations under Rev & T C §25137, other than those provisions that exclude receipts from the sales factor. Rev & T C §17942(b)(1)(B).

NOTE: Revenue and Taxation Code §25135 has been amended to adopt the *Finnigan* rule (see FTB Notice 1990-3 (June 8, 1990)) in assigning sales from tangible personal property in California for taxable years beginning on or after January 1, 2011. Rev & T C §25135(b). Revenue and Taxation Code §25136 also has been amended to provide new rules for assigning sales from other than tangible personal property in California for taxable years beginning on or after January 1, 2011.

In addition, total income includes (Rev & T C §17942(b)(2)):

- Income that the LLC derives from outside California, as well as within California, subject to a water's edge election under Rev & T C §25110; and
- The income of members of the LLC's "commonly controlled group" as defined in Rev & T C §25105(b).

For LLCs that have paid the fee required by Rev & T C §17942, the legislature enacted Rev & T C §19394, which provides:

If the fee provided under [Rev & T C §17942] is finally adjudged to be discriminatory or unfairly apportioned under the California Constitution, or the laws or the Constitution of the United States, the fee of a disfavored taxpayer that files, or has filed, a timely claim for refund within the period allowed by this part asserting discrimination or unfair apportionment shall be recomputed by the Franchise Tax Board for the taxable year in question, as of the time of allowance of the recomputation, only to the extent necessary to remedy the discrimination or unfair apportionment that is not otherwise relieved by [Rev & T C §19393] and the amount of the fee, as originally computed, shall be subject to the provisions hereof relating to original computations.

The above section applies to suits for refunds filed on or after October 10, 2007, and suits for refunds filed before that date that were not final as of that date. Refunds of fees payable as a result of the *Northwest Energetic Services* case will be limited to the amount by which the fee paid, plus interest assessed, exceeds the amount that would have been assessed if the fee had been based on the correct apportionment between economic activity in California and elsewhere. Stats 2007, ch 381, §4.

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§5.4C 3. FTB Refund Claim Procedure

The Franchise Tax Board has established a procedure for making a protective claim for refund. The information below and further details can be obtained on the FTB's website. See this book's Directory for the URL.

To file a protective claim, the LLC should fax a letter to the Franchise Tax Board with the following information:

- The LLC's name and identification number issued by the Secretary of State. Unregistered LLCs should use the identification number issued by the Franchise Tax Board;
- A statement indicating that a protective claim is being filed;
- The tax years involved;
- The amount of the claim, which should match the amount of the tax that the LLC paid;
- A description of the basis for the claim (according to the FTB, stating that the LLC fee is unconstitutional is enough; however, Rev & T C §19394 refers to refund claims "asserting discrimination or unfair apportionment," so the more prudent practice may be to mention both grounds); and
- The name of the person to contact, and his or her phone number and fax number.

The letter must be signed by the representative with power of attorney or by the LLC's managing member. The FTB will send a fax confirmation receipt. It cannot email information since the letter will contain confidential information.

Although a fax is preferred, taxpayers may also mail their protective claims. The fax number and mailing address are also noted in the Directory.

The LLC should file separate protective claims for each calendar year for which the income tax was paid.

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§5.5 4. Calculating and Paying Statutory Fee

The statutory fee is provided by Rev & T C §17942(a). The amount of the statutory fee is:

- $900 for an LLC with annual total income derived from or attributable to California of $250,000 to $499,999;
- $2500 for an LLC with annual total income derived from or attributable to California of $500,000 to $999,999;
- $6000 for an LLC with annual total income derived from or attributable to California of $1,000,000 to $4,999,999; and
- $11,790 for an LLC with annual total income derived from or attributable to California of $5,000,000 or more.

For taxable years beginning on or after January 1, 2009, the fee must be estimated and paid by the 15th day of the 6th month of the current taxable year. A penalty of 10 percent of the amount of any underpayment will be added to the fee. The penalty will not be imposed if the estimated fee that is paid is equal to or greater than the fee paid by the LLC for the preceding taxable year. Rev & T C §17942(d)(1)-(2).

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§5.6 5. Nonresident Member's Tax

An LLC with a nonresident member who fails to consent to California tax jurisdiction (see §5.21) must pay the tax attributable to the nonconsenting member's distributive share of LLC income. Rev & T C §18633.5(e).

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IV. TAX ACCOUNTING

§5.7 A. Pass-Through Treatment

For federal income tax purposes, the LLC is not a separate taxpaying entity and is not subject to tax at the entity level. IRC §701. Instead, the LLC's members report their respective distributive shares of LLC income, gain, loss, and deduction and credit on their individual federal income tax returns. IRC §702(a). On the determination of the members' distributive shares, see §§5.35-5.57.

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B. Computing Taxable Income

§5.8 1. Income Computed at Entity Level

Although the LLC is not a separate taxpaying entity, its taxable income is computed at the entity level. IRC §703. An LLC must report its taxable income on an annual information return, which also reflects the members' distributive shares. IRC §6031(a). On the filing requirements for an LLC, see §§5.17-5.18.

In general, the taxable income of an LLC is computed in the same manner as that of an individual. IRC §703(a). In computing that income, however, IRC §703(a)(2) disallows certain deductions available to individuals. In addition, IRC §703(a)(1) requires certain items of LLC income, gain, loss, and deduction and credit to be "separately stated."

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§5.9 2. Disallowed Deductions

In computing LLC taxable income, IRC §703(a)(2) disallows deductions for, among other deductions:

- Personal exemptions under IRC §151;
- Net operating losses under IRC §172; and
- Items that must be "separately stated" under IRC §702(c) (see §5.10).

Because members can take the above items into account in determining their individual taxable income, the disallowances under IRC §703(a)(2) are necessary to avoid the double deductions that would result if those items were factored into LLC taxable income.

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§5.10 3. Separately Stated Items

Additionally, IRC §702(a) requires specific items of LLC income, gain, loss, and deduction and credit to be segregated from LLC taxable income and included as separate items on the members' individual returns. This process of "separately stating" certain LLC items preserves the tax character of such items in the hands of its members.

The tax character of most "separately stated" items is determined at the entity level, by reference to the activity of the LLC. IRC §702(b). Treas Reg §1.702-1. Those items include (IRC §702(a)):

- Short-term capital gains and losses;
- Long-term capital gains and losses;
- IRC §1231 gains and losses;
- Charitable contributions as defined in IRC §170(c);
- Dividends eligible for deduction under IRC §§241-249;
- IRC §901 taxes paid or accrued to foreign countries and possessions of the United States;
- IRC §212 nonbusiness expenses;
- IRC §213 medical and dental expenses;
- IRC §215 alimony payments;
- IRC §216 taxes and interest paid to cooperative housing corporations;
- IRC §175 soil and water conservation expenditures and endangered species recovery expenditures; and
- IRC §263(c) intangible drilling and development costs.

The tax character of certain "separately stated" items must be determined at the member level, by reference to the activity of the member. A partial list of such items includes:

- Cancellation of indebtedness income (IRC §108);
- Nonbusiness bad debts (IRC §166); and
- Income or loss from the LLC's IRC §465 "at-risk" activities.

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§5.11 C. Selecting Tax Year

The taxable year of the LLC is determined as though the LLC were a separate taxpayer. IRC §706(b)(1). However, an LLC is severely limited in its ability to use a taxable year that differs from that of its members. In general, an LLC must adopt the same taxable year as those of its members who own, in the aggregate, more than 50 percent of LLC profits *and* capital. IRC §706(b)(1)(B)(i), (b)(4)(A)(i). If those members do not have the same taxable year, the LLC must adopt the same taxable year as all of its principal members. IRC §706(b)(1)(B)(ii). A principal member for these purposes is one who owns 5 percent or more of LLC profits *or* capital. IRC §706(b)(3). If the principal members do not have the same taxable year or if there are no principal members, the LLC must adopt the calendar year. IRC §706(b)(1)(B)(iii).

An LLC can elect an alternative taxable year only if it can establish, to the satisfaction of the IRS, a sufficient business purpose for the other taxable year. IRC §706(b)(1)(C). For information regarding what constitutes a sufficient business purpose, see Rev Proc 96-1, 1996-1 Cum Bull 385, Rev Proc 2002-38, 2002-1 Cum Bull 1037, and Rev Rul 87-57, 1987-2 Cum Bull 117. In addition, under IRC §444, an LLC can elect a taxable year permitting not more than 3 months' deferral of recognition of income for its members, provided the LLC makes payments under IRC §7519 so that there will be no deferral in the payment of tax. Practically speaking, the 3 months' deferral means that an LLC may have a taxable year that ends on September 30, when the members are individuals on the calendar year.

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§5.12 D. Selecting Method of Accounting

An LLC is entitled to select its method of accounting, which may be different from its members' method of accounting. IRC §§446(c), 703(b). Small closely held businesses may benefit from the use of the cash method of accounting, which permits the deferral of recognition of income and flexibility in claiming deductions, and avoids the IRC §461(h) provisions limiting the accrual of certain deductions until economic performance. As discussed in §§5.13-5.14, an LLC's ability to use the cash method of accounting is limited in two primary respects. The inability of a business to use the cash method under such circumstances may be a determinative factor in choosing the form of entity in which to conduct business. See chap 3.

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§5.13 1. If C Corporation a Member

An LLC cannot use the cash method of accounting if it has a C corporation as a member. IRC §448(a)(2). However, this limitation does not apply under any of the following conditions:

- The C corporation is a "qualified personal service corporation" within the meaning of IRC §448(d)(2) (IRC §448(b)(2)).
- The LLC is engaged in a farming business within the meaning of IRC §263A(e)(4) (IRC §§448(b)(1), (d)(1)).
- For every prior taxable year the LLC had no more than $5,000,000 in average annual gross receipts for the three-year period ending with each such prior taxable year. IRC §§448(b)(3), (c)(1).

The general standards limiting selection of a method of accounting are set forth in IRC §446. See IRC §§447 and 464 for special rules regarding accounting methods for LLCs engaged in the trade or business of farming.

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§5.14 2. If LLC a Tax Shelter

An LLC cannot use the cash method of accounting if it constitutes a tax shelter as defined by IRC §461(i)(3). IRC §§448(a)(3), (d)(3). Any one of the following arrangements constitutes a "tax shelter":

(a) An enterprise (other than a C corporation) in which at any time interests are offered for sale in an "offer required to be registered" with a federal or state agency regulating securities. (The IRS has adopted the securities law definition of "sale" and "offering." IRS Letter Ruling 8837068.)

(b) A syndicate. A syndicate for tax-shelter purposes is defined, by reference to IRC §1256(e)(3)(B), as any enterprise (other than a C corporation) in which more than 35 percent of the losses are allocable to limited partners or limited entrepreneurs under IRC §1256(e)(3)(B).

(c) A tax shelter as defined in IRC §6662(d)(2)(C)(iii); *i.e.,* any entity, plan or arrangement, the principal purpose of which is to avoid or evade federal income taxes.

Under the definition set forth in (a) above, an LLC that sells shares in a registered offering will clearly constitute a tax shelter. The authorities disagree about whether an LLC offering securities using the Corp C §25102(f) exemption will constitute a tax shelter. (Corp C §25102(f) is described in §§12.55-12.66.) An offering is "required to be registered" if, under applicable federal or state law, failure to file a notice of exemption will result in a violation of applicable federal or state law. Temp Reg §1.448-1T(b)(2). Failure to file the notice of transaction under Corp C §25102(f) does not cause the loss of the exemption. Corp C §25102(f)(4). Nevertheless, failure to file the notice *may* violate state law, notwithstanding that the Department of Corporations' remedy is to ask for the notice accompanied by the highest filing fee payable had the transaction been qualified without an exemption.

An LLC will not constitute a syndicate tax shelter if it has only profits. IRS Letter Rulings 9415005, 8911011. An LLC can fail the syndicate test by allocating more than 65 percent of its losses to members who actively participate in the management of the LLC. IRC §1256(e)(3)(C).

The IRS has issued several letter rulings defining active participation for the purpose of avoiding treatment as a syndicate: IRS Letter Ruling 9432018 (all members were represented to be fully engaged in the business); IRS Letter Ruling 9321047 (although the members elected five managers as the management committee with authority to conduct business for the firm, all members engaged in the practice of law and participated in various described management activities). See also IRS Letter Rulings 9421025 and 9328005.

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E. Elections Affecting Computation of Taxable Income

§5.15 1. Elections Made by the LLC

As a general rule, elections affecting the tax treatment of LLC items are made by the LLC, rather than its members. IRC §703(b). These elections include:

- The method used to compute depreciation of LLC property;
- The amortization of costs of pollution control facilities under IRC §169;
- The choice of inventory method under IRC §§471-474;
- The reinvestment of involuntary conversion proceeds under IRC §1033;
- The expensing of certain depreciable assets under IRC §179;
- The amortization of organizational and syndication expenses under IRC §709;
- The election not to use the installment method of reporting gain under IRC §453 if the LLC is a cash method taxpayer; and
- The election under IRC §754 to adjust basis of LLC assets on (1) the transfer of an LLC interest or (2) certain distributions from the LLC; see §5.79.

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§5.16 2. Elections Made by LLC Members

A number of specific elections relating to the tax treatment of LLC items must be made by the individual members, rather than the LLC. Those elections include (IRC §703(b); Treas Reg §1.703-1(b)(2)(iii)):

- The IRC §901 credit (rather than deduction) for taxes paid to foreign countries and United States possessions;
- The deduction of certain mining exploration expenditures under IRC §617;
- The discharge of indebtedness income under IRC §108(b)(5), (c)(3); and
- That of nonresident alien individuals and foreign corporations to treat gross income derived from real property that is not trade or business income as if it were trade or business income, and to claim their distributable shares of deductions effectively connected with their distributable shares of gross income (IRC §§871(d), 882(d)(1)).

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F. Federal and State Income Tax Reporting Requirements

§5.17 1. IRS Form 1065; Schedule K-1 (1065)

In general, an LLC must file a partnership information return (IRS Form 1065) with the IRS for each year it receives income or incurs expenditures allowable as deductions. Treas Reg §1.6031(a)-1(a)(1). If a member takes into account any LLC items in determining his or her tax liability, the LLC must file a return, unless excepted by regulations. Tax Equity and Fiscal Responsibility Act of 1982, §404 (Pub L 97-248, §404, 96 Stat 324, 669). At least one member must sign IRS Form 1065. If a tax matters member is designated, this person should sign. See §5.22.

The LLC must file IRS Form 1065 on or before the 15th day of the 4th month following the end of each taxable year. Treas Reg §1.6031(a)-1(e)(2). The LLC may obtain an automatic 5-month extension on application using IRS Form 7004. Treas Reg §1.6081-2(a), (b)(1). The extension does not operate to extend the time for filing the members' income tax returns. Treas Reg §1.6081-2(e).

In addition, an LLC must provide each member with (Temp Reg §1.6031(b)-1T(a)(1), (a)(3)):

- A copy of the information shown on the LLC's IRS Form 1065; and
- A statement reflecting the member's distributive share of LLC income, gain, loss, deduction, credit, and other tax items (Schedule K-1 (1065)).

Schedule K-1 must be furnished on or before the due date for the LLC's tax return, determined with regard to extensions. Temp Reg §1.6031(b)-1T(b).

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§5.18 2. FTB Forms 568, 3522, 3832; Schedule K-1 (568)

Every LLC doing business in California, organized in California, or organized in another state but registered with the California Office of the Secretary of State, must file an annual "limited liability company return of income" (FTB Form 568) with the FTB. Rev & T C §18633.5. Unless an extension is granted, the LLC must file FTB Form 568 on or before the 15th day of the 4th month following the close of each taxable year. An automatic 6-month extension can be obtained on application using FTB Form 3537. Rev & T C §18567.

Not only is Form 568 used in a manner paralleling IRS Form 1065, but it also is used to report and pay the LLC statutory fee under Rev & T C §17942. Furthermore, the LLC must use tax voucher FTB Form 3522 to pay its annual franchise fee of $800. The LLC must submit Form 3522 together with the corresponding tax payment on or before the 15th day of the 4th month of the LLC's taxable year. Rev & T C §17941(c).

If the LLC has one or more members who are nonresidents of California, it must file a list of members and consents (FTB Form 3832) with its FTB Form 568. The purpose of FTB Form 3832 is to list the names and tax identification numbers of all members and to provide evidence of each nonresident member's consent to the jurisdiction of California to tax the member's prorata share of LLC income attributable to California sources. Rev & T C §§18535(d), 18633.5(e). See §§5.20-5.21 regarding an LLC's withholding requirement for foreign and nonresident members.

In addition, Rev & T C §18633.5 requires an LLC to provide each member with:

- A copy of the information shown on the LLC's FTB Form 568; and
- On or before the due date for the LLC's tax return, a statement reflecting the member's distributive share of LLC income, gain, loss, deduction, credit, and other tax items (FTB Schedule K-1 (568)).

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G. Withholding Taxes of Foreign and Nonresident Members

§5.19 1. Withholding of Federal Taxes on Foreign Member's Distributive Share

Nonresident alien individuals and foreign corporations are subject to tax under IRC §1, §11, §55, §59A, §402(d)(1), or §1201(a) on income that is effectively connected with a U.S. trade or business. IRC §§871(b), 882. Income not effectively connected but that is fixed or determinable, annual or periodical gains, profits, and income, such as rents, dividends, and interest, is taxed at 30 percent. A nonresident alien or foreign corporation that is a partner is considered to be engaged in the business of the partnership (IRC §875(1)). The same rules apply to LLCs taxed as partnerships.

An LLC must withhold taxes on a foreign member's distributive share of the LLC's effectively connected taxable income and of the LLC's rents, dividends, and interest. IRC §§1446(a), 1441. The LLC must withhold at the highest IRC §1 tax rate for noncorporate foreign members, or the highest IRC §11(b)(1) tax rate for corporate foreign members on income that is effectively connected. IRC §1446(b). On the rents, dividends, and interest that is not effectively connected, the rate is generally 30 percent. IRC §1441(a).

If the LLC owns U.S. real property interests, IRC §1445(e)(1) imposes a 35-percent withholding tax on the amount of gain realized from the disposition of U.S. real property interests to the extent that gain is allocable to a foreign person. To the extent that the rules governing withholding on disposition of U.S. real property interests overlap the general rules under IRC §1446, IRC §1446 displaces IRC §1445. Treas Reg §1.1445-3(c)(2).

Additionally, sale of a membership interest by a foreign member of an LLC owning U.S. real property interests may trigger a withholding obligation. That withholding obligation is on the purchaser and is equal to 10 percent of the amount of the sale (IRC §1445(e)(5)). That withholding obligation is triggered if the gross assets of the LLC consist of 50 percent of U.S. real property interests, and 90 percent or more of the value of the gross assets consist of U.S. real property interests and cash or cash equivalents. Temp Reg §1.1445-11T(d).

An LLC must file an annual return for withholding tax (IRS Form 8804) and foreign member information statements (IRS Form 8805) to report and pay tax that it is required to withhold under IRC §1446(a). Treas Reg §1.1445-3(d)(1).

For further information on the elaborate rules governing withholding obligations of LLCs that have foreign members, see 1 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners ¶9.03[4] (4th ed 2007).

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2. Withholding of California Taxes on Foreign and Domestic Nonresident's Distributive Share

§5.20 a. Foreign Nonresidents

California conforms to the federal provisions and requires that an LLC withhold tax on income allocable to foreign members, to the extent that the amounts withheld under IRC §1446 represent income from California sources. Rev & T C §18666.

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§5.21 b. Domestic Nonresidents

An LLC must also withhold on distributions of California source income to domestic nonresident members (*e.g.,* members that reside in New York) unless the LLC files agreements by each nonresident member to file a return and make timely payment of all California taxes. Rev & T C §18633.5(e). An LLC with domestic nonresident members that does not file such agreements must pay on behalf of each nonresident member an amount equal to the highest marginal tax rate in effect under Rev & T C §17041 (or under Rev & T C §23151 in the case of members that are corporations). If the LLC pays, it is entitled to reimbursement under Rev & T C §18633.5.

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§5.22 H. Tax Matters Member

If the LLC has more than ten members, or a member who is a nonresident alien or entity other than a natural person, it is subject to comprehensive unified audit proceedings. IRC §6231. Internal Revenue Code §6231 requires a "tax matters partner" for such proceedings to act as the primary representative and facilitate dealings with the IRS. IRC §6231(a)(7). The LLC may elect for any taxable year not to be subject to these proceedings. IRC §6231(a)(1)(B)(ii).

Under Treas Reg §301.6231(a)(7)-2, only a member-manager of an LLC, as defined, is treated as a general partner for purposes of selecting or designating a tax matters member. If there are no elected or designated member-managers, each member of the LLC is treated as a member-manager. LLCs subject to the unified audit proceedings should designate one or more managers or members as the tax matters member. This designation should be made in the operating agreement. See §§9.53-9.54.

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V. MEMBER'S BASIS IN AN LLC INTEREST

§5.23 A. Purposes of Calculation

A member's basis in an LLC interest must be calculated to:

(1) Determine the amount of gain or loss that the member must realize on the sale, liquidation, or other disposition of his or her LLC interest. See §§5.70-5.73, 5.76-5.78.

(2) Ascertain the consequences of LLC distributions to the member under IRC §§731 and 732. See §§5.58-5.66.

(3) Determine the basis of property distributed to a member. A member often takes, for example, a basis in distributed property equal to the lesser of the LLC's basis in the property or the adjusted basis of the member's interest in the LLC. See IRC §732(a); see §5.68.

(4) Ascertain the member's ability to deduct LLC losses. Losses are deductible, for example, only to the extent of a member's basis in the LLC interest. IRC §704(d). See §5.55.

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B. Determining Member's Initial Basis

§5.24 1. Acquisition by Capital Contribution

The initial basis of a member who acquired an LLC interest in exchange for contributions to the LLC's capital is equal to the sum of (1) the cash contributed, (2) the adjusted basis of property contributed, and (3) the amount of any gain recognized under IRC §721(b) on the contribution of that property to the LLC. IRC §722. But see IRC §721(b) regarding gain that a member must recognize on a transfer of property to an LLC that would constitute an investment company within the purview of IRC §351 if the LLC were incorporated.

The initial basis of a member who acquires an LLC interest in exchange for a promissory note is zero because a promissory note generally has a basis of zero. IRC §722. The member is treated as contributing capital to the LLC, and receives corresponding increases to his or her basis, in such amounts and at such times as payments on the promissory note are actually made. Rev Rul 80-235, 1980-2 Cum Bull 229; *Levy v Commissioner* (9th Cir 1984) 732 F2d 1435, 1437; *Irvin J. Bussing* (1987) 88 TC 449, 463

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§5.25 2. Acquisition by Purchase of an LLC Interest

The initial basis of a member who acquires an LLC interest by purchase is the consideration paid for the LLC interest. IRC §§742, 1012.

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§5.26 3. Acquisition by Gift

The initial basis of a member who acquires an LLC interest by gift generally equals the sum of (1) the donor's adjusted basis for the LLC interest and (2) any gift taxes paid in connection with the gift. IRC §§*74*2, 1015.

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§5.27 4. Acquisition by Inheritance

The initial basis of a member who acquires an LLC interest by inheritance is the fair market value of the LLC interest for estate tax purposes. IRC §§742, 1014(a). Fair market value for estate tax purposes is determined as of the date of the decedent's death. However, if an alternate valuation is elected under IRC §2032, fair market value is determined as of the date 6 months after the decedent's death. IRC §§2031-2032.

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C. Adjustments to Member's Basis

§5.28 1. Increases in Basis

The following six factors increase the initial basis in a member's LLC interest:

- The member's distributive share of LLC taxable income (IRC §705(a)(1)(A); see §5.35);
- The member's distributive share of LLC tax-exempt income (IRC §705(a)(1)(B); see §5.9);
- The member's distributive share of the excess of the deductions for depletion over the basis of LLC property subject to depletion (IRC §705(a)(1)(C));
- Additional cash that the member contributes to the LLC's capital (IRC §722; Treas Reg §1.705-1(a)(2));
- The member's adjusted basis for additional property contributed to the LLC capital (IRC §722; Treas Reg §1.705-1(a)(2)); and
- Any increase in the member's share of LLC liabilities (IRC §752(a); see §§5.30-5.34).

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§5.29 2. Decreases in Basis

The following six factors decrease, but never below zero, the initial basis of a member's LLC interest:

- The member's distributive share of LLC losses (IRC §705(a)(2)(A); see §§5.24, 5.35, 5.54-5.57);
- The member's distributive share of nondeductible LLC expenses not properly chargeable to capital accounts (IRC §705(a)(2)(B));
- The member's distributive share of depletion deductions for LLC oil and gas property (but only to the extent that the share does not exceed the proportionate share of the adjusted basis of property allocated to the member under IRC §613A(c)(7)(D)) (IRC §705(a)(3));
- The amount of cash that the LLC distributes to the member (IRC §733(1), Treas Reg §1.705-1(a)(3));
- The adjusted basis of property that the LLC distributes to the member (IRC §733(2), Treas Reg §1.705-1(a)(3)); and
- Any decrease in the member's share of LLC liabilities (IRC §752(b); see §5.31).

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§5.30 D. Effect of LLC Liabilities on Member's Basis

Liabilities play a significant role in determining a member's basis and in other aspects of LLC operations. Unlike a corporation, the LLC's incurrence or payment of a debt has a direct effect on a member's basis. A member's basis is increased by the member's proportionate share of LLC liabilities and decreased for any of the member's separate liabilities assumed by the LLC.

NOTE: Counsel must be careful in structuring LLC transactions that alter a member's share of LLC liabilities; those transactions could trigger deemed distributions and phantom gain, especially in situations in which the member's basis has supported prior loss deductions.

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§5.31 1. Increase and Decrease in Member's Share of LLC Liabilities Reflected in Basis

Any increase in a member's share of LLC liabilities is treated as a contribution of money by that member to the capital of the LLC and therefore increases the basis of the member's LLC interest. IRC §752(a); Treas Reg §1.752-1(b). Conversely, any decrease in a member's share of LLC liabilities is treated as a distribution of money by the LLC to that member and therefore reduces the basis of the member's LLC interest. IRC §752(b); Treas Reg §1.752-1(c).

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§5.32 2. Determining a Member's Share of LLC Liabilities

Determining a member's share of LLC liabilities is a two-step process. First, the debt must be classified at the entity level as recourse or nonrecourse. Second, the allocation rules of IRC §752 must be applied to determine each member's share of the liability for basis purposes. Treas Reg §§1.752—1.752-5.

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§5.33 a. Recourse Liabilities

An LLC liability is generally treated as recourse only to the extent that one or more members (or related persons) bear the economic risk of loss for that liability. Treas Reg §1.752-1(a)(1). Related persons for these purposes are defined by reference to IRC §§267(b) and 707(b)(1), with certain modifications. Treas Reg §§1.752-1(a)(3), 1.752-4(b).

A member's share of any LLC recourse liability is that portion of the liability for which the member bears the economic risk of loss. Treas Reg §1.752-2. A member bears the economic risk of loss for an LLC recourse liability to the extent that the member (or related person) would be legally obligated to make net payments of non-LLC assets to a creditor or to contribute capital to the LLC on account of the liability if the LLC had no assets and all of its liabilities were due. Treas Reg §1.752-2(b)(1). In determining whether a member (or related person) has such a legal obligation, all statutory and contractual obligations relating to the recourse liability are taken into account, including the LLC's operating agreement, applicable state law, and collateral agreements such as guaranties. Treas Reg §1.752-2(b)(3).

In general, if a member makes a nonrecourse loan to the LLC the loan will be treated as recourse for tax purposes. Treas Reg §1.752-2(c)(1).

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§5.34 b. Nonrecourse Liabilities

An LLC liability is nonrecourse to the extent that no member or related party bears the economic risk of loss for that liability. The LLC's creditor, rather than its members, bears the risk of loss with respect to that liability since the creditor can look only to the assets of the LLC for repayment of the liability. Treas Reg §1.752-1(a)(2).

A member's share of LLC nonrecourse liabilities equals the sum of the following:

(1) **The member's share of LLC "minimum gain."** Treas Reg §1.752-3(a)(1). LLC minimum gain is essentially the excess of nonrecourse liability secured by property, or treated as secured by LLC property, over that property's adjusted tax basis. Treas Reg §1.704-2(d)(1). See §§5.44, 5.46. The regulations do not contain any special rules for allocating nonrecourse deductions associated with liabilities that are not secured by specific assets of the entity, and the determination is uncertain.

(2) **The amount of gain that the member would recognize under IRC §704(c) if the LLC disposes of property in a taxable transaction in full satisfaction of liabilities and for no other consideration.** Treas Reg §1.752-3(a)(2). For purposes of determining the amount of gain, if the LLC holds multiple properties subject to a single nonrecourse liability, the LLC may allocate the liability among the multiple properties under any reasonable method. Treas Reg §1.752-3(b).

(3) **The member's share of LLC "excess nonrecourse liabilities."** Treas Reg §1.752-3(a)(3). "Excess nonrecourse liabilities" equal (a) the aggregate amount of all LLC nonrecourse liabilities, less (b) the aggregate amount of such nonrecourse liabilities that are allocated with respect to LLC minimum gain and IRC §704(c) gain. Treas Reg §1.752-3(a)(3).

For examples illustrating the application of these rules, see Treas Reg §1.752-3(c). On the special rules for allocation of nonrecourse deductions, see §§5.44-5.46.

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VI. MEMBER'S DISTRIBUTIVE SHARE

§5.35 A. Significance of Distributive Shares

A member's distributive share represents the member's share of overall LLC income, gain, loss, deduction, and credit. IRC §702(a). Because of the pass-through nature of LLC taxation, each member is taxed on his or her distributive share of income, regardless of whether the member receives a corresponding distribution of cash or property from the LLC. Members report their distributive shares on their personal income tax returns for the year in which the LLC's taxable year ends. IRC §706(a).

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§5.36 B. Determining a Member's Distributive Share

The members can decide, by placing specific provisions in the LLC operating agreement, what each member's distributive share of LLC income, gain, loss, deduction, or credit will be. IRC §704(a). This freedom of members to allocate LLC tax items among themselves in a manner that takes into account their individual economic objectives and tax situations is one of the primary benefits of the LLC. However, the paramount importance given to the agreement of the members by IRC §704(a) is not unfettered; other provisions of the Internal Revenue Code restrict their freedom to allocate. For example:

(1) If the members' agreement about distributive shares lacks substantial economic effect, allocations are subject to reallocation unless they are in accordance with the member's interest in the LLC. IRC §704(b). Treas Reg §1.704-1(b)(1)(i).

(2) All tax items with respect to property contributed by a member to an LLC must take into account variations between the basis of the property to the LLC and its value when contributed. IRC §704(c); §§5.47-5.50.

(3) If a membership interest is created by gift, special rules apply to allocate LLC income between the donor and donee. IRC §704(e)(2).

The restrictions described in items (2) and (3) apply to specific items and situations and must be complied with in addition to the substantial economic effect provisions of IRC §704(b). The restriction in item (1) above (IRC §704(b)) limits special allocations that the members may wish to include in their operating agreement and aims to ensure that the tax consequences of allocations conform to the economic consequences. In drafting the operating agreement, the practitioner must understand and test provisions for distributive shares to ensure that they will be respected by the IRS under IRC §704(b). Under the regulations to IRC §704(b), an allocation of income, gain, loss, deduction, or credit to a member will be respected if it

- Has substantial economic effect (Treas Reg §1.704-1(b)(2)); or
- Is in accordance with the member's interest in the LLC (Treas Reg §1.704-1(b)(3)).

Allocations with "substantial economic effect" are deemed to be in accordance with a member's interest in the LLC.

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§5.37 1. Allocations With Substantial Economic Effect

Subject to special rules for nonrecourse deductions (see §§5.44-5.46), allocations of LLC income, gain, loss, deduction, or credit will be deemed to accord with the members' interests within the meaning of IRC §704(b) under the following conditions:

(1) The allocations are reflected in specially maintained capital accounts as defined in the regulations;

(2) On liquidation, liquidating distributions are to be made in accordance with positive capital account balances;

(3) When a member has a deficit balance in his or her capital account, the member is unconditionally obligated to restore the deficit on liquidation or, in the alternative, is subject to a qualified income offset; and

(4) The economic effect of the allocations is "substantial" (Treas Reg §1.704-1(b)(2)(i)).

The regulations under IRC §704(b) that set forth the capital account analysis and safe harbor test are intended to ensure that members receiving allocations of LLC income, gain, loss, deduction, or credit actually bear the economic benefits and detriments associated with those items. Treas Reg §1.704-1(b)(2)(ii)(*b*). Despite the subjectivity involved in determining the "substantiality" of the economic effect of a particular allocation, overall that standard is a safe harbor from the considerably less detailed and more subjective "members' interests in the LLC" standard. See §5.43.

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§5.38 a. Capital Account Maintenance

The LLC's operating agreement must provide that capital accounts will be established and maintained in accordance with the provisions set forth in Treas Reg §1.704-1(b)(2)(iv). Treas Reg §1.704-1(b)(2)(ii)(*b*)(*1*). It is important to understand that a member's capital account balance is generally not identical to the basis of that member's LLC interest. As a result, a member's capital account cannot be relied on to determine a member's adjusted basis.

Although the formulas for calculating the two are similar, major differences can arise for two primary reasons: First, a member's share of liabilities under IRC §752 is not taken into account in determining his or her capital account balance. Treas Reg §1.704-1(b)(2)(iv)(*c*). Second, a capital account is adjusted by the net fair market value, rather than the adjusted basis, of assets contributed to or distributed by the LLC. Treas Reg §1.704-1(b)(2)(iv)(*b*).

In addition, the balance of a member's capital account can fluctuate for reasons that have no effect on the member's adjusted basis (*e.g.,* revaluations under Treas Reg §1.704-1(b)(2)(iv)(*f*)). Likewise, a member's basis can vary without affecting the member's capital account; *e.g.,* death results in a step-up of basis but does not affect the capital account.

For more detailed discussion concerning the determination of a member's capital account balance, see Friedland & Petersen, California Partnerships and Proprietorships: Practice and Compliance Guide §34.23[2] (1992); 1 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners ¶10.02[2] (4th ed 2007); 1 Willis, Pennell & Postlewaite, Partnership Taxation ¶10.04[3] (6th ed 1997).

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§5.39 b. Liquidating Distributions

The LLC's operating agreement must provide that liquidation payments (after payments to creditors) will be distributed to the members in accordance with their positive capital account balances either by the end of the LLC taxable year in which the LLC is liquidated, or, if later, within 90 days after the date of liquidation. Treas Reg §1.704-1(b)(2)(ii)(*b*)(*2*).

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§5.40 c. Capital Account Deficit Restoration Requirement

The LLC's operating agreement must include a "deficit restoration requirement" (or, alternatively, a "qualified income offset provision"; see §5.41). A deficit restoration provision requires any member who has a negative capital account balance on liquidation to contribute cash to the LLC in an amount sufficient to restore that member's capital account balance to zero either by the end of the LLC taxable year during which liquidation occurs, or, if later, within 90 days after liquidation. Treas Reg §1.704-1(b)(2)(ii)(*b*)(*3*).

A capital account "deficit restoration requirement" effectively subjects a member to an unlimited capital contribution obligation. Given the limited liability nature of an LLC, a "qualified income offset" provision is likely to be more appropriate than a "deficit restoration requirement" in an LLC operating agreement, and the economic effect requirement will still be satisfied. See §5.41.

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§5.41 d. Qualified Income Offset

If the LLC's operating agreement provides for capital account maintenance and liquidating distributions as described above, allocations under the agreement may still be deemed to have economic effect even without a deficit makeup if the LLC's operating agreement includes a "qualified income offset" provision.

Under such a provision, if a member unexpectedly incurs a negative capital account balance, that member will be allocated items of income and gain to return his or her capital account balance to zero as quickly as possible. Treas Reg §1.704-1(b)(2)(ii)(*d*). An allocation under this alternative test is valid only if it will not create or increase a deficit in a member's capital account after the capital account is reduced to reflect certain adjustments and distributions that are reasonably expected to occur in the future. Treas Reg §1.704-1(b)(2)(ii)(*d*). As stated above, because of the limited liability enjoyed by members of an LLC, a "qualified income offset" provision is likely to be more appropriate than a "deficit restoration requirement" in an LLC operating agreement. For the operating agreement provision meeting the substantial economic test and providing for a qualified income offset, see §§9.24-9.25.

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§5.42 e. Substantiality of Economic Effects

The economic effect of an allocation will be "substantial" if a reasonable possibility exists that it will substantially affect the dollar amounts that members receive from the LLC, independent of tax consequences. Treas Reg §1.704-1(b)(2)(iii)(*a*). The economic effect of an allocation is generally not substantial in any of the following situations:

- The allocation enhances one member's after-tax economic position, but is not likely to substantially diminish another member's after-tax economic position (Treas Reg §1.704-1(b)(2)(iii)(*a*));
- The allocation is likely to shift tax consequences among the members without substantially altering economic consequences (Treas Reg §1.704-1(b)(2)(iii)(*b*)); or
- The allocation is transitory due to the likelihood of a subsequent offsetting allocation (Treas Reg §1.704-1(b)(2)(iii)(*c*)).

The determination of whether the economic effect of an allocation is substantial is complex. For a detailed discussion regarding presumptions and safe harbors available to reduce or eliminate the subjectivity of the substantiality test, see Friedland & Petersen, California Partnerships and Proprietorships: Practice and Compliance Guide §34.22 (1992); 1 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners ¶10.02[2] (4th ed 2007); 1 Willis, Pennell & Postlewaite, Partnership Taxation ¶10.04[4] (6th ed 1997).

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§5.43 2. Allocation in Accordance With Member's Interest in the LLC

If the operating agreement provides for allocations that do not have substantial economic effect, the member's distributive share is determined in accordance with the member's interest in the LLC. Treas Reg §1.704-1(b)(1)(i). The member's "interest in the LLC" is based on the manner in which the members have agreed to share the economic benefits and burdens among all members, taking into account all facts and circumstances relating to their economic arrangement. Treas Reg §1.704-1(b)(1)(i). These include, without limitation, the members' respective interests in (Treas Reg §1.704-1(b)(3)(ii)):

- Capital contributions;
- Economic profits and losses (if different from their interests in taxable income and losses);
- Cash flow;
- Nonliquidating distributions; and
- Liquidating distributions of capital.

Although the regulations recite relevant factors to consider, no objective, quantifying test exists and the analysis remains ambiguous and subjective.

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§5.44 3. Special Rules for Allocations of Nonrecourse Deductions

Allocations of LLC losses, deductions, or IRC §705(a)(2)(B) expenditures attributable to nonrecourse debt ("nonrecourse deductions") lack economic effect because the lender, rather than any member, bears the economic risk of loss with respect to those items. Treas Reg §1.704-2(b)(1). Generally, nonrecourse deductions equal the net increase in "minimum gain" of an LLC reduced by the aggregate of any distributions of proceeds from its nonrecourse liabilities. See Treas Reg §1.704-2(c). Essentially, minimum gain is the excess of nonrecourse liability allocated to LLC properties over the adjusted basis of the properties. Increase in LLC minimum gain resulting from conversions, refinancings or other changes to debt instruments are not treated as generating nonrecourse deductions. Most commonly, nonrecourse deductions result from allowance of depreciation or amortization of LLC property. For example, if nonrecourse liabilities of an LLC are held constant, the depreciation or amortization deductions will lower the basis of the properties held by the LLC and result in an increase in excess of liabilities over adjusted basis, *i.e.*, minimum gain. Thus, in the example, the depreciation or amortization deductions will, to the extent of the increase in minimum gain, be treated as nonrecourse deductions.

Under the regulations, nonrecourse deductions must be allocated in accordance with the members' interests in the LLC. Allocations of nonrecourse deductions will be deemed in accordance with such interests if the LLC's operating agreement complies with the "safe harbor" test for nonrecourse deductions contained in Treas Reg §1.704-2(e).

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§5.45 a. Safe Harbor Test

The "safe harbor" test for nonrecourse deductions described above consists of four requirements:

(1) Throughout the entire term of the LLC, the LLC's operating agreement must satisfy IRC §704(b)'s basic requirements for economic effect. Treas Reg §1.704-2(e)(1). See §5.37.

(2) Beginning in the year that nonrecourse deductions first arise, allocations of LLC nonrecourse deductions must be reasonably consistent with valid allocations of other significant LLC items (with substantial economic effect) attributable to the property securing nonrecourse debts. Treas Reg §1.704-2(e)(2).

(3) The LLC's operating agreement must contain the "minimum gain chargeback" provision set forth in Treas Reg §1.704-2(f). Treas Reg §1.704-2(e)(3). See §§5.46, 9.25.

(4) All other material allocations and capital account adjustments must be valid under the final Treasury Regulations under IRC §704(b). Treas Reg §1.704-2(e)(4).

For illustration of an operating agreement provision allocating nonrecourse deductions, see §9.26.

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§5.46 b. Minimum Gain Chargeback

For allocations of nonrecourse deductions to comply with the safe harbor test, the operating agreement must contain a minimum gain chargeback provision. The minimum gain chargeback provision will require that each member be allocated items of income and gain for the taxable year equal to that member's share of the net decrease in the LLC's minimum gain. Minimum gain is the amount by which the LLC's nonrecourse liabilities exceed the adjusted tax basis of the properties securing the liabilities. It is the amount of gain that the LLC would realize if it disposed of property subject to a nonrecourse liability for no consideration other than the full satisfaction of the liability. Treas Reg §1.704-2(d). Minimum gain increases as additional liability is incurred with respect to encumbered property, and as the adjusted basis of the property decreases, *e.g.*, through depreciation. Minimum gain decreases when there is a decrease in the amount by which the nonrecourse liability exceeds the adjusted tax basis of the encumbered property.

Special rules apply when one or more members bear the economic risk of a particular nonrecourse liability of the LLC. See §5.34. These rules are set forth in Treas Reg §1.704-2(b)(4) (definition of partner nonrecourse debt or liability) and Treas Reg §1.704-2(i) (allocation of partner nonrecourse debts or liabilities; nonrecourse debt minimum gain). To cover those situations, the operating agreement may contain a special "member nonrecourse debt minimum gain chargeback." See §9.25.

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§5.47 4. Allocations of Precontribution Gain, Loss, and Deduction

An LLC is often formed by the contribution of property other than money by one or more of the members. That property may have appreciated in value. LLC allocations with respect to contributed property are subject to additional limitations set forth in IRC §704(c).

Internal Revenue Code §704(c) is designed to prevent the shifting of tax consequences among members regarding contributed property that, at the time of contribution, had an adjusted basis different from its fair market value ("IRC §704(c) property"). In particular, income, gain, loss, and deduction with respect to IRC §704(c) property must be shared among the members in a manner that takes into account any variation between the contributing member's basis for the property and its fair market value at the time of contribution. IRC §704(c)(1)(A). Fair market value for these purposes is generally determined by agreement among the members, provided there is no indication of manipulation or abuse. H Rep No. 432, pt 2, 98th Cong, 2d Sess 1209 (1984), reprinted in 1984 US Code Cong & Ad News 697, 876.

For the operating agreement provisions providing for allocations with respect to IRC §704(c) property, see §9.30.

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§5.48 a. Allocations of Built-In Gain or Loss

Under the traditional method of making IRC §704(c) allocations, any built-in gain or loss attributable to IRC §704(c) property is allocated to the contributing member on the LLC's disposition of that property. Treas Reg §1.704-3(b)(1). Built-in gain or loss for these purposes is the difference between the IRC §704(c) property's book value (*e.g.*, fair market value) and its adjusted tax basis at the time of contribution. Treas Reg §1.704-3(a)(3)(ii). The built-in gain or loss is reduced as the difference between the book value and basis of the IRC §704(c) property decreases (*e.g.*, book value reduced by book depreciation and basis reduced by tax depreciation). Treas Reg §1.704-3(a)(3)(ii). For examples that illustrate the traditional method of making IRC §704(c) allocations of built-in gain and loss, see Treas Reg §1.704-3(b)(2), Example (1). See Treas Reg §§1.704-3(c) and 1.704-3(d) for the curative and remedial allocation methods of making IRC §704(c) allocations, which address the ceiling problem (see §5.50).

In general, each IRC §704(c) property is dealt with separately; the built-in gain or loss of different IRC §704(c) properties cannot be aggregated. Treas Reg §1.704-3(a)(2). However, certain types of IRC §704(c) property contributed by a member during a single taxable year may be aggregated and treated as one item of IRC §704(c) property. Those types include: (1) depreciable property other than real property included in the same general asset account under IRC §168, (2) all property other than real property with a basis of zero, and (3) inventory other than securities and similar investments for partnerships that do not use a specific identification method of accounting. Treas Reg §1.704-3(e)(2).

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§5.49 b. Allocations of Cost Recovery Deductions

Internal Revenue Code §704(c) is also applicable to cost recovery deductions. Members must share depreciation and depletion, like gain and loss, in a manner that recognizes the variation between the basis and value of contributed property. Under the traditional method of making IRC §704(c) allocations, depreciation deductions attributable to IRC §704(c) property are allocated, to the extent possible, to the noncontributing members based on their respective book depreciation allocations. Treas Reg §1.704-3(b)(1). This denies the contributing member deductions equivalent to the deferred gain. For an example illustrating the traditional method of making IRC §704(c) depreciation allocations, see Treas Reg §1.704-3(b)(2), Example (1)(ii).

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§5.50 c. Ceiling Limitation and "Small Disparity" Rule

The application of IRC §704(c) is limited in two significant respects. First, under the ceiling rule, the total gain or loss allocated to all members under IRC §704(c) cannot exceed the gain or loss that the LLC realizes for tax purposes as a result of the disposition. Treas Reg §1.704-3(b)(1). Second, the application of IRC §704(c) may be ignored or deferred with respect to any IRC §704(c) property that has only a small disparity between the book value of the property and the contributing member's adjusted basis for the property. A disparity is "small" if (Treas Reg §1.704-3(e)(1)):

- The disparity between the book value and adjusted basis of all properties that a member contributes to the LLC during a single taxable year is not more than 15 percent of the adjusted bases for such properties; and
- The total gross disparity does not exceed $20,000.

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§5.51 C. Allocations Relating to Family LLCs

The IRS specifically recognizes family partnerships under IRC §704(e) and, by analogy, family LLCs. However, IRC §704(e) can restrict the ability of family members to shift income among family members through gifts of LLC interests. On family LLCs, see §§4.36-4.39.

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§5.52 1. Donating an LLC Interest to a Family Member

Internal Revenue Code §704(e) and Treas Reg §1.704-1(e) set forth requirements that must be satisfied when a donor gives an interest in an LLC to a family member. The sale of an LLC interest to a family member is treated as a gift for purposes of IRC §704(e). Treas Reg §1.704-1(e)(3)(i)(*a*). A family member for these purposes is a spouse, ancestor, lineal descendant, or trust established for the primary benefit of such a person. Treas Reg §1.704-1(e)(3).

If the requirements of IRC §704(e) are not satisfied, the donee will not be recognized as a member for tax purposes. In that case, the members' distributive shares, as set forth in the LLC's operating agreement, will be invalid for tax purposes and subject to reallocation. Treas Reg §1.704-1(e)(3)(i)(*b*).

If the donee is recognized as a member and the allocations are otherwise valid, IRC §704(e) can also result in a reallocation of income to a partner providing services to the partnership.

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§5.53 2. When Donee Recognized as Member of the LLC

A donee of an LLC interest will be recognized as a member for tax purposes under IRC §704(e), if the following five conditions are satisfied:

(1) Capital must be a material income-producing factor for the LLC. Treas Reg §1.704-1(e)(1)(ii). The determination of whether capital is a material income-producing factor is based on all the facts and circumstances. In general, capital will be a material income-producing factor if a substantial portion of the LLC's gross income is attributable to the LLC's capital. Capital is typically not a material income-producing factor if the LLC's income consists principally of fees, commissions or other compensation for personal services performed by members or employees of the LLC. Even if the LLC's business is primarily service oriented, capital may be deemed a material income-producing factor if the operation of the LLC's business requires substantial inventories or a substantial investment in plants, machinery, or other equipment. Treas Reg §1.704-1(e)(1)(iv).

(2) The donee must own a capital interest in the LLC. Treas Reg §1.704-1(e)(1)(ii). A capital interest for these purposes is an interest in the LLC's assets that is distributable to the donee on the donee's withdrawal from the LLC or the LLC's liquidation. The mere right to participate in LLC earnings and profits is insufficient. Treas Reg §1.704-1(e)(1)(v).

(3) The LLC must reasonably compensate the donor member for services rendered to the LLC. Treas Reg §1.704-1(e)(1)(ii).

(4) The donor's and donee's share of income should remain in parity. The donee's distributive share of LLC income relative to his or her capital interest cannot be greater than the donor member's distributive share of LLC income relative to his or her capital interest. Treas Reg §1.704-1(e)(1)(ii).

(5) The donor member's transfer of the LLC interest to the donee must not be a sham merely for tax avoidance purposes; the donee must exercise sufficient dominion and control over the gifted LLC interest. Treas Reg §1.704-1(e)(1)(iii). If the donor member retains too much control over the gifted LLC interest, the donee will not be deemed the owner of that LLC interest for tax purposes. No mechanical or formal test exists for determining whether a donor member has retained too much control for these purposes; all of the facts and circumstances are taken into account, with no one isolated factor being determinative. Treas Reg §1.704-1(e)(2)(i). Factors indicating that the donor member has retained too much control include:

- The donor member's retention of the unilateral right to withhold LLC distributions, unless it is necessary to retain such amounts for reasonable needs of the LLC's business (Treas Reg §1.704-1(e)(2)(ii)(*a*));
- Limitations on the donee's right to sell or liquidate his or her LLC interest without financial detriment (Treas Reg §1.704-1(e)(2)(ii)(*b*));
- The donor member's retention of control over assets essential to the LLC's business, *e.g.*, donor member's lease of those assets to the LLC (Treas Reg §1.704-1(e)(2)(ii)(*c*));
- The donor member's retention of management powers inconsistent with normal relationships among members (Treas Reg §1.704-1(e)(2)(ii)(*d*)); and
- The donee's status as a minor (Treas Reg §1.704-1(e)(2)(viii)).

Factors indicating that the donee exercises sufficient dominion and control include:

- The donee's substantial participation in the management of the LLC's business (Treas Reg §1.704-1(e)(2)(iv));
- The LLC's distribution to the donee of all or a major portion of his or her distributive share of LLC income for the sole use and benefit of the donee (Treas Reg §1.704-1(e)(2)(v)); and
- The treatment of the donee as a member of the LLC in the conduct of the LLC's business or in relations with customers and creditors; factors considered in this regard include (Treas Reg §1.704-1(e)(2)(vi)):
- Formal compliance with state and local law,
- Control of LLC bank accounts,

- Recognition of the donee's interest in LLC contracts and litigation affecting the LLC,
- The existence of written agreements establishing the nature of the LLC's operating agreement and the members' rights and liabilities, and
- The filing of LLC tax returns.

For information regarding factors taken into account in determining whether a donee is recognized as a member for tax purposes, see 1 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners, chap 14 (4th ed 2007).

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§5.54 D. Limitations on Deductibility of a Member's Share of LLC Losses

A member's deduction of LLC losses is subject to three limitations: basis, at risk, and passive loss, applied in that order. Since disallowed losses are suspended and can be carried over, the limitations actually relate to when the losses can be taken by a member.

LEGISLATIVE NOTE: To raise additional revenues for the state, the California Legislature in its 2008 session enacted measures disallowing net operating loss (NOL) deductions and carryovers during tax years beginning on or after January 1, 2008, and before January 1, 2010 (*i.e.,* the 2008 and 2009 tax years). The carryover periods for those NOLs are extended, allowing taxpayers to have the same number of years to utilize the deduction as they would have had if the change in law had not been enacted.

These measures affect taxpayers with business income of $500,000 or more for the tax year.

For NOLs incurred in taxable years beginning on or after January 1, 2008, the carryover period is extended to 20 years (from 10 years under current law), which conforms to federal law. Additionally, NOLs attributable to taxable years beginning on or after January 1, 2011, may be carrybacks to each of the preceding 2 taxable years. This also conforms to federal law.

No NOL carrybacks will be allowed for any NOLs attributable to taxable years beginning before January 1, 2011. After that date, the NOL may be carried back for each of the 2 tax years preceding the tax year of the loss. No NOL carrybacks may be carried back to any taxable year beginning before January 1, 2009.

The following limitations on the amount of carrybacks apply:

On or after January 1, 2011, and before January 1, 2012: 50 percent of the NOL;

On or after January 1, 2012, and before January 1, 2013: 75 percent of the NOL; and

On or after January 1, 2013: 100 percent of the NOL.

This is the third time the NOL deduction has been suspended; the first time was in 1991-1992, and the second time was in 2002-2003. The measure suspends the NOL carryforward for tax years 2008 and 2009. In addition, for any NOL attributable to taxable years beginning on or after January 1, 2010, the carryover will be allowed for 20 years following the year of the loss. The way this provision works is that for any NOL for which a deduction is denied, the carryover period is extended by 1 year for losses incurred in taxable years between January 1, 2008, and January 1, 2009, and by 2 years for losses incurred before January 1, 2008.

See Stats 2008, ch 763, §§3, 4, 5, 11, 12, and 13, amending Rev & T C §17276 and adding Rev & T C §§17276.9, 17276.10, 24416, 24416.9, and 24416.10.

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§5.55 1. Basis Limitation

A member's distributive share of LLC losses is deductible only to the extent of the adjusted basis of the member's LLC interest at the end of the LLC taxable year in which the loss occurs. IRC §704(d). That portion of a member's distributive share of LLC losses that is disallowed in any year can be carried over and deducted in subsequent years to the extent of the member's adjusted basis. IRC §704(d). On the determination of a member's basis, see §§5.23-5.34.

If a member's distributive share of LLC losses consists of capital, ordinary income, and other loss items, but is only partially deductible in a given year, the deductible portion is allocated among the different loss components in proportion to their respective amounts. Treas Reg §1.704-1(d)(2).

Even if the adjusted basis of a member's LLC interest is sufficient to absorb his or her distributive share of LLC losses, all or a portion of such losses may still be disallowed under the "at risk" limitations, the passive loss limitations, or other loss limitations. See §§5.56-5.57.

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§5.56 2. At-Risk Limitation

The at-risk rules have potential application in any venture, especially one involving seller financing. They are almost always a concern in real estate and equipment leasing transactions.

A member who is an individual or a closely held C corporation can deduct his or her distributive share of LLC losses only to the extent that he or she is at risk for an amount at least equal to the loss. IRC §465(a)(1).

In general, a member is at risk to the following extent:

- The amount of money that he or she has contributed to the LLC (unless borrowed from a lender who has a noncreditor interest in the LLC);
- The aggregate adjusted bases of all property that he or she has contributed to the LLC; and
- Under IRC §465(b)(3)(A), with the exception noted below for real estate, his or her share of all amounts borrowed by the LLC except those borrowed from a lender who has a membership interest in the LLC.

A member is not at risk for amounts protected against loss through nonrecourse financings, guaranties, or similar agreements.

There is an exception to the at-risk rules for real estate. If the LLC finances real estate, and the financing is "qualified nonrecourse financing," the members are considered at risk for their proportionate share of the financing. Qualified nonrecourse financing is nonconvertible financing for which no person is personally liable for repayment, secured by real property, and borrowed from a qualified person or government agency. IRC §465(b)(6).

That portion of any loss that a member cannot deduct on account of the at-risk limitations is suspended. A member can deduct suspended losses in subsequent years to the extent that member's at-risk amount is sufficient to absorb the loss. IRC §465(a)(2).

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§5.57 3. Passive Loss Limitation

A taxpayer may be limited by the passive loss rules from using a deduction from a business activity.

Under the passive loss rules, a loss or credit from a passive activity may be used only to the extent the member has income from a passive activity. IRC §469. Passive activities generally include all trades or businesses, and rental activities in which the taxpayer does not materially participate, with certain exceptions. (For rental activities, see IRC §469(e)(7)). The Treasury Regulations define limited partner in a manner that would include LLC members and set forth the limited circumstances in which a limited partner is deemed to materially participate. Temp Reg §1.469-5T(e)(2), (e)(3)(ii).

Under Temp Reg §1.469-5T(e)(2), a limited partner is treated as materially participating in partnership activities only to the extent the individual participates for more than 500 hours or has materially participated for 5 out of the preceding 10 years (for service activity, the individual must have participated in any 3 preceding years). The IRS has generally applied the same rules to LLCs. There is a question of whether members who manage the LLC business will be deemed to "materially participate" in the LLC's business, thereby causing the LLC's losses to be characterized as active, rather than passive, to those members. The IRS has acknowledged the need to revise the passive loss regulations for LLCs, but nothing has been proposed.

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VII. CURRENT DISTRIBUTIONS TO A MEMBER

§5.58 A. Member's Recognition of Gain and Loss

A member's distributive share of LLC income is an allocation for tax purposes only; the member must pay tax on his or her distributive share of LLC income, regardless of whether he or she receives that income. However, a current distribution represents money or property that the LLC actually distributes to the member. Whether the member will be taxed on a distribution depends on the nature and timing of the distribution.

The basic rules are summarized in §5.59. For in-depth analysis, see 2 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners, chaps 19-21 (4th ed 2007); 2 Willis, Pennell & Postlewaite, Partnership Taxation, chaps 13-14 (6th ed 1997).

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§5.59 1. Distributions of Cash

The general rule is that a member recognizes gain on the LLC's distribution of money to the member only to the extent that the amount of money exceeds the adjusted basis of his or her LLC interest. IRC §731(a)(1). Money includes marketable securities. (See IRC §731(c) for the definition and valuation of marketable securities, and exceptions to the treatment of the distribution of marketable securities as a cash distribution.)

Different rules apply under the following conditions:

- The distribution changes the member's interests in IRC §751 property, *i.e.,* unrealized receivables and substantially appreciated inventory items. See §5.61.
- The distribution retires the member's interest in the LLC. See §§5.70-5.73.
- The distribution is not composed of capital or earnings, but is paid to the member in his or her nonmember capacity, *e.g.,* LLC's payment for services by the member to the LLC under IRC §707(a) or (c), or is to repay a loan under IRC §707. See §§5.82-5.84.
- The distribution is part of a disguised sale of property by the member to the LLC. Treas Reg §1.707-3(a)(2). See §5.64.

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§5.60 2. Distributions of Other Assets

In general, neither an LLC nor its members recognize gain or loss on the LLC's current distribution of property to a member. IRC §731(a)(1), (b). One or more of the exceptions to this provision may cause either the LLC or its members to recognize gain when it distributes property to a member.

If the LLC intends to distribute both cash and property during the same year, generally the cash distribution should be made first, unless the distributee member wishes to recognize gain. This order is advisable because making the property distribution first would reduce the basis of the distributee's LLC interest by the LLC's interest in the distributed property (see §5.29), thereby reducing the amount of basis that the member can set off against the subsequent cash distribution.

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§5.61 a. Distributions That Alter a Member's Interest in IRC §751 Property

An LLC's distribution to a member will be treated as a taxable sale and therefore subject to gain to the extent that the member receives in the distribution (1) more than his or her share of LLC unrealized receivables or substantially appreciated inventory in exchange for his or her interest in other LLC property, or (2) more than his or her share of other LLC property in exchange for his or her interest in LLC unrealized receivables or inventory items that have substantially appreciated in value. IRC §751(b).

For these purposes, inventory items that have a fair market value in excess of 120 percent of the LLC's adjusted basis for those items will be considered to have substantially appreciated in value. IRC §751(b)(3). Unrealized receivables for these purposes typically include both rights to payment for goods and services and potential depreciation recapture income. IRC §751(c); Treas Reg §1.751-1(c)(4).

For a detailed list of those items that constitute unrealized receivables, see Treas Reg §1.751-1(c).

Internal Revenue Code §751(b) can apply, for example, if:

- The property distributed is subject to depreciation recapture; or
- The distribution changes the member's interest in the LLC's total unrealized receivables.

Any gain or loss attributable to IRC §751 property is ordinary gain or loss. Treas Reg §1.751-1(a)(2).

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§5.62 b. Distributions That Alter Members' Shares of LLC Liabilities

A member recognizes gain on receipt of an LLC's distribution of money to the extent that the amount of money exceeds the adjusted basis of the member's LLC interest. IRC §731(a)(1). A decrease in a member's share of LLC debt is treated as a distribution of money. IRC §752(b); Treas Reg §1.752-1(c). For these purposes, a member's share of LLC debt is determined under IRC §752 and Treas Reg §1.752-2. See §§5.32-5.34. Therefore, a distribution that operates to reduce a member's share of LLC debt can result in taxable gain. Generally, this issue arises only to the extent that a member's tax basis that is attributable to his or her share of liabilities has supported prior allocations of loss or prior distributions of cash attributable to or sourced from such financing.

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§5.63 c. Distributions Relating to Built-In Gain Property

The term "built-in gain property" refers to property that a member contributes to an LLC that has a fair market value that differs from its tax basis on the date of contribution. If the LLC sells the built-in gain property, or distributes it to another member within 5 years after the date of contribution, the contributing member must recognize the built-in gain attributable to the property. IRC §704(c)(1)(B). Built-in gain for these purposes generally equals the fair market value of the property at the time of contribution *minus* the adjusted tax basis for that property. Treas Reg §1.704-3(a)(3)(ii).

The member contributing property with built-in gain also must recognize gain on *any* distribution of property (other than cash or the property contributed to the LLC by the member receiving that distribution) within 5 years of the contribution, to the extent of the lesser of (1) the excess of the fair market value of the property distributed over the member's basis for his or her LLC interest, reduced by any money distributed *or* (2) the net precontribution gain of the member. IRC §737(a). Net precontribution gain is the net gain attributable to any property held by the LLC on the date of the distribution that was contributed to the partnership within the preceding 5-year period. IRC §737(b); Treas Reg §1.704-3(a)(3)(ii).

The character of any gain, ordinary or capital, that a member must recognize under IRC §704 or §737 is determined by reference to the character of the property in the hands of the member immediately before its contribution to the LLC. IRC §704(c)(1)(B)(ii). In addition, the contributing basis of the member's LLC interest and the LLC's basis for the built-in gain property both are adjusted to reflect the gain. IRC §§704(c)(1)(B)(iii), 737(c)(1).

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§5.64 d. Distributions Treated as Disguised Sales

A member's transfer of property to an LLC in exchange for an LLC interest is usually a nontaxable transaction. IRC §721; see §4.18. If the transfer is followed by the LLC's transfer of money or other consideration to the contributing member, however, the transaction may be subject to recharacterization as a disguised sale under IRC §707(a)(2) and constitute a taxable transaction to both the LLC and the member. See Treas Reg §1.707-3(a)(2); on disguised sales, see §4.20.

A distribution risks recharacterization as a disguised sale when it results in the withdrawal of all or part of the contributing member's equity in the property transferred to the LLC. Treas Reg §1.707-3(a)(1), (b)(1). If a member's transfer of property to the LLC and the LLC's corresponding transfer of money or other consideration to that member occur within 2 years of one another, the transfers are presumed to be a sale under IRC §707(a)(2). Treas Reg §1.707-3(c). Conversely, if those transfers occur more than 2 years apart, they are presumed not to be a sale within the purview of IRC §707(a)(2). Treas Reg §1.707-3(d).

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e. Distributions of Property Subject to Depreciation and Investment Credit Recapture

§5.65 (1) Depreciation Carries Over

Gain on the disposition of certain depreciable property is treated as ordinary income to the extent of depreciation or amortization deductions previously claimed for that property. See IRC §§1245, 1250. This recharacterization of gain is often referred to as depreciation recapture.

An LLC's distribution of depreciable property to a member generally does not trigger depreciation recapture. Instead, the depreciation recapture inherent in the distributed property carries over to the member receiving that property. See IRC §§1245(b)(6), 1250(d)(6). However, some recapture items, including depreciation recapture, are treated as unrealized receivables and subject to the IRC §751 rules; see §5.61.

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§5.66 (2) Investment Credit Recapture

In general, an LLC's distribution of investment credit property to a member before the close of the estimated useful life that was taken into account in computing that investment credit will trigger a recapture of that credit for both the nondistributee members and the distributee member. Treas Reg §1.47-6(a)(2).

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B. Member's Basis in LLC Interest and Distributed Property

§5.67 1. Basis for LLC Membership Interest

A nonliquidating distribution reduces the basis of a member's membership interest, but not below zero, by the amount of money distributed plus the basis of the distributed property in the hands of the distributee partner. IRC §733.

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§5.68 2. Basis for Distributed Property

On receipt of property from an LLC in a current distribution, a member receives a basis for the property equal to the LLC's adjusted basis for the property immediately before the distribution. IRC §732(a)(1). However, if the LLC's basis in the distributed property exceeds the predistribution basis of the member's LLC interest, the member's basis in the distributed property is limited to his or her predistribution basis less the amount of any cash that the member receives in the same distribution. IRC §732(a)(2).

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§5.69 C. Holding Period for Distributed Property

A distributee member's holding period for distributed property includes the LLC's holding period for the property, but only if the distributed property does not constitute unrealized receivables or IRC §751(d)(2) inventory items. IRC §735(b).

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§5.70 VIII. LIQUIDATING PAYMENTS TO A MEMBER

When a member dies or withdraws from the LLC, voluntarily or involuntarily, a number of tax and operational consequences may result. Under the terms of the operating agreement, the LLC may dissolve. A distribution may or may not result in a tax termination. See §§5.86-5.90. The interest of the terminating member may be transferred by sale to a member or nonmember or transferred to the heir who becomes a member. These exchanges are covered in §§5.75-5.81. The third alternative is that the LLC may liquidate the interest of the withdrawing or deceased member by making liquidating payments from the LLC under IRC §736. The LLC may structure the termination to achieve the desired result.

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§5.71 A. When Payments Are Liquidating Payments

A member receives liquidating payments, as opposed to current distributions, when the member completely withdraws from the LLC because of death or retirement. Treas Reg §1.736-1(a)(1)(i). A member is deemed retired for these purposes when he or she ceases to be a member under California law, regardless of whether the retirement results from a voluntary withdrawal or an involuntary expulsion from the LLC. Treas Reg §1.736-1(a)(1)(ii); *Francis E. Holman* (1976) 66 TC 809, aff'd (9th Cir 1977) 564 F2d 283. A member's interest is deemed liquidated when it is terminated by a distribution or series of distributions. IRC §761(d).

Liquidating payments are different from payments of distributive shares or guaranteed payments. Liquidating payments are payments to the member of his or her interest in the LLC property, and, except for IRC §736(a) payments, are generally nondeductible distributions by the LLC and taxed as a capital transaction to the withdrawing member.

Internal Revenue Code §736 governs the tax treatment of a liquidating payment. IRC §736 applies only to payments made by an LLC. Payments made by other members or third parties in exchange for a withdrawn member's LLC interest do not come within the scope of IRC §736. Treas Reg §1.736-1(a)(1)(i). See §5.74. In addition, IRC §736 does not apply to payments in connection with a partial liquidation. If, however, a series of payments are intended to result in the ultimate liquidation of a member's interest, all those payments will be treated as liquidating payments. Furthermore, IRC §736 applies only to liquidating payments made by a continuing LLC; it does not apply to payments related to the complete liquidation of an LLC.

Liquidating payments are treated as either (1) payments made for the member's interest in LLC property (IRC §736(b)), or (2) all other payments (IRC §736(a)). In addition, the payment may trigger a member's deficit restoration obligation. See §5.40.

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§5.72 B. Payments for LLC Property

Internal Revenue Code §736(b) payments consist of that portion of any liquidating payments attributable to the withdrawn member's share of (1) LLC property, (2) LLC unrealized receivables to the extent of the LLC's basis for such unrealized receivables, and (3) LLC goodwill to the extent of the LLC's basis in such goodwill. IRC §§736(b)(1)-(b)(2); Treas Reg §§1.736-1(b)(2)-(3).

The IRS will generally respect the value that members place on a withdrawn member's interest in LLC property and goodwill. Treas Reg §1.736-1(b)(1), (3). If, however, the value attributed to LLC property reflects only the member's net interest in the property (*i.e.*, total assets less liabilities), the value must be adjusted to take into account the member's share of LLC liabilities under IRC §752. Treas Reg §1.736-1(b)(1). See §5.62.

Liquidating payments that constitute IRC §736(b) payments are treated as current distributions. Treas Reg §1.736-1(b)(4). Accordingly, the tax treatment of IRC §736(b) payments will be determined under IRC §§731 and 751, and generally result in capital gain or loss to the withdrawn member. Treas Reg §§1.736-1(b)(1), (b)(4). See §§5.58-5.66.

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§5.73 C. All Other Payments

Payments that are not for the withdrawn member's interest in LLC property, and all other payments, are considered distributive shares of LLC income under IRC §702 or guaranteed payments under §707(c). IRC §736(a). Generally, the payments constitute ordinary income to the withdrawn member and reductions in the income taxable to the remaining members. Treas Reg §1.736-1(a)(4); see §§5.35-5.36. To the extent the IRC §736(a) payments are fixed and not determined by reference to LLC income, they are treated as guaranteed payments under IRC §707(c). IRC §736(a)(2). Guaranteed payments are deductible by the LLC under IRC §162(a) and taxable as ordinary income to the recipient under IRC §61(a). Treas Reg §1.736-1(a)(4). See §5.84.

For further information on liquidating payments, see 2 Willis, Pennell & Postlewaite, Partnership Taxation, chap 15 (6th ed 1997); 2 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners, chaps 22-23 (4th ed 2007).

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§5.74 D. Close of Taxable Year With Respect to Withdrawing Member

On the complete liquidation of a member's LLC interest, the LLC's taxable year closes for that member. IRC §706(c)(2)(A)(ii). In this regard, a withdrawn member receiving payments under IRC §736 is treated as a member for tax purposes until the entire LLC interest of that member is completely liquidated. Accordingly, if the IRC §736 payments are to be made over a period of time, the LLC's taxable year will not close with respect to the withdrawn member until the last of those payments is made. Treas Reg §1.736-1(a)(6).

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IX. SALES AND EXCHANGES OF LLC INTERESTS

§5.75 A. Liquidating Payments Distinguished From Sales Proceeds

The tax consequences of a member's transfer of an LLC interest by sale or exchange may differ significantly from a liquidation, even when the economic consequences are the same. See §§5.70-5.74 for a discussion of the tax consequences of a liquidation. In a liquidation, a member receives payments from the LLC in exchange for an LLC interest; in a sale or exchange a member receives consideration from another member or a third party in exchange for an LLC interest.

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B. Tax Consequences to Selling Member

§5.76 1. Amount of Gain or Loss

A member's sale or exchange of an LLC interest is taxable in the same manner as the sale or exchange of other kinds of property. Accordingly, the selling member recognizes gain or loss equal to the difference between the amount realized and the adjusted basis of his or her LLC interest at the time of the sale. IRC §§741, 1001(a). A selling member may not, however, recognize or deduct a loss resulting from the sale if the sale is to a related party. See IRC §267(a)(1).

The amount a member realizes on the sale or exchange of an LLC interest includes not only the sum of any money and the fair market value of any property received for the LLC interest, but also the selling member's share of LLC liabilities under IRC §752. IRC §1001(b); Treas Reg §1.752-1(h). See §§5.32-5.34. When the aggregate amount of LLC liabilities included in the basis of the selling member's LLC interest exceeds his or her adjusted basis for that LLC interest, the member will recognize phantom gain equal to the amount of the excess. IRC §752. A member is likely to recognize phantom gain when the adjusted basis of his or her LLC interest has supported loss deductions or cash distributions before the time of sale or exchange (see §5.30).

The selling member determines the adjusted basis of his or her LLC interest under IRC §705, adjusted to take into account the selling member's distributive share of LLC tax items for that portion of the LLC's taxable year ending on the date of disposition. See IRC §705(a); Treas Reg §1.705-1(a)(1). If the sale or exchange involves less than the entire LLC interest, the member allocates the adjusted basis between the transferred portion and the retained portion, generally in proportion to their respective fair market values. Special rules apply, however, if a member includes in the adjusted basis LLC liabilities under IRC §752. See Rev Rul 84-53, 1984-1 Cum Bull 159, for a detailed discussion of allocation methods in those circumstances.

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§5.77 2. Character of Gain or Loss

Gain or loss recognized on the sale or exchange of all or any part of an LLC interest is treated as gain or loss from the sale of a capital asset, except to the extent that IRC §751(a) applies. IRC §741. Under IRC §751(a), gain or loss attributable to IRC §751 property is treated as gain or loss from the sale of a noncapital asset and as ordinary income. Section 751 property consists of unrealized receivables and substantially appreciated inventory. See §5.61. If Congress lowers the tax rate on capital gains, the characterization of amounts recognized as capital gain or ordinary income will become even more significant.

If an LLC has IRC §751 property, a portion of the sales price and the selling member's adjusted basis must be allocated to that property to determine the amount of gain or loss subject to IRC §751(a) treatment. In general, the IRS will acquiesce to the manner in which a seller and a buyer allocate their sales price to IRC §751 property in an arm's-length agreement. Treas Reg §1.751-1(a)(2). Absent such an agreement, the IRS generally will determine the sales price allocated to the IRC §751 property by applying to the total sales price the ratio of fair market value of the IRC §751 property to the fair market value of all LLC assets. Treas Reg §1.751-1(g). For illustrative examples, see 2 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners ¶16.02 [3] (4th ed 2007); 2 Willis, Pennell & Postlewaite, Partnership Taxation ¶12.01[12] (6th ed 1997). That portion of the selling member's adjusted basis allocated to IRC §751 property generally equals the adjusted basis the IRC §751 property would have had under IRC §732 if the selling member had received that property in a current distribution immediately before the sale. Treas Reg §1.751-1(a)(2).

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§5.78 3. Suspended Losses

The selling member may deduct any suspended losses up to the amount of the adjusted basis of his or her LLC interest at the end of the short taxable year closed by the sale or exchange. IRC §704(d); Treas Reg §1.704-1(d)(2). All suspended passive losses may be deducted on disposition of the LLC interest, provided the interest represents the member's entire interest in the passive activity and unless the disposition is to a related party. IRC §469(g)(1).

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§5.79 C. Tax Consequences to Purchaser

A purchaser determines his or her initial basis in the LLC interest by reference to the general tax rules applicable to property acquisitions. IRC §742. Accordingly, the initial basis of a purchased LLC interest is its cost. Cost includes that portion of the LLC's liabilities allocable to the LLC interest under IRC §752. IRC §§752, 1012. The holding period for a purchased LLC interest commences on the date of acquisition. IRC §1223. The basis of LLC assets is adjusted, however, if the LLC has an IRC §754 election in effect when the sale occurs. The IRC §754 election requires that the LLC adjust the basis of its assets to reflect any difference between the basis of the purchaser's LLC interest and his or her share of the basis of the LLC's assets. IRC §743(b). The adjustment affects only the purchaser and prevents the distortion in the timing of the purchaser's recognition of LLC income. The adjustment matches revenue with expenses as if the purchaser purchased a prorata share of the LLC's underlying assets. Without the election, the prorata share of underlying assets is not adjusted, and the purchaser may recognize income in one period and capital loss in another.

In addition, on the sale or exchange of an LLC interest, the capital account of the selling member attributable to the transferred LLC interest carries over to the purchaser. Treas Reg §1.704-1(b)(2)(iv)(*l*). Basis adjustment under IRC §743 has no effect on the capital account of the transferee partner. §1.704-1(b)(2)(iv)(*m*)(2).

The American Jobs Creation Act of 2004 (AJCA) (Pub L 108-357, 118 Stat 1589) amended IRC §743(b) to provide another ground for adjusting the basis of an LLC interest; namely, when there is a "substantial built-in loss" immediately following the transfer of the interest. An LLC has a substantial built-in loss with respect to a transfer of an interest if the adjusted basis in the property exceeds the fair market value of the property by more than $250,000.

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§5.80 D. Allocation of LLC Tax Items

If a member sells or exchanges his or her entire LLC interest, the LLC's taxable year closes with respect to that member on the date of the sale. IRC §706(c)(2)(A)(i). The selling member must report his or her distributive share of LLC income, gain, loss, deduction, and credit and other tax items on his or her tax return for the year in which the sale occurs. IRC §706(a). If a member sells or exchanges only part of his or her LLC interest, the LLC's taxable year does not close with respect to that member. IRC §706(c)(2)(B). Instead, the LLC's taxable year continues to its normal close, and the seller and purchaser determine their distributive shares of LLC income, gain, loss, deduction, and credit and other tax items for the taxable year by taking into account their varying interests in the LLC during the taxable year. IRC §706(d)(1).

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§5.81 E. Tax Consequences to LLC and Remaining Members

The sale or exchange of an LLC interest ordinarily does not affect the LLC or its remaining members from an income tax standpoint. However, if the transaction results in the transfer of 50 percent or more of the total interests in LLC profits and capital in any 12-month period, the LLC will terminate for tax purposes under IRC §708(b)(1)(B). See also Rev & T C §64(c); 18 Cal Code Regs §462.180; on the potential change of ownership in LLC real property resulting from a sale or exchange of an LLC interest, see §4.30.

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Source: Business Law/Forming and Operating California Limited Liability Companies/5 Income Taxation of LLC Operations/ X. LLC TRANSACTIONS WITH MEMBERS/§5.82 A. Distributions Treated Differently From Other LLC Payments to Members

X. LLC TRANSACTIONS WITH MEMBERS

§5.82 A. Distributions Treated Differently From Other LLC Payments to Members

Not every transfer of money or property by an LLC to a member is a distributive share of LLC income (see §§5.35-5.57). An LLC may also transfer money or property to a member because a member has sold property to the LLC, has rendered services to the LLC, or has lent money to the LLC. To determine the tax consequences, the first question is whether a member is acting as a member or nonmember of the LLC in the transaction.

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§5.83 1. Payments to Member Acting in Nonmember Capacity

A transaction between an LLC and a member acting in a nonmember capacity is taxed as though the transaction had occurred between unrelated parties. IRC §707(a)(1). For example:

- Payments that an LLC makes on a member loan are interest;
- Payments that an LLC makes for the use of a member's property are rent;
- Payments that an LLC makes to a member in exchange for such member's property are sales proceeds; and
- Payments that an LLC makes to a member for services rendered in a nonmember capacity are compensation.

In determining whether a member is acting in a nonmember capacity, the substance, rather than the form, of the transaction controls. Treas Reg §1.707-1(a). For example, for tax purposes a transfer by the LLC of money or property to a member will be treated as a loan payment rather than a distribution only if the member made a bona fide loan to the LLC. Treas Reg §1.731-1(c)(2). Factors indicating a bona fide loan by the member to the LLC include:

- The LLC reasonably expected repayment at the time the advance was made;
- The likelihood existed at the time of the advance that the member would repay the advance;
- The member has an unconditional and enforceable obligation to repay the advance; and
- A specific manner of repayment is required.

Rev Rul 73-301, 1973-2 Cum Bull 215; *John W. Mangham,* TC Memo 1980-280. Similarly, a mortgage payment on property that reduces the personal debt of a member will be treated as a payment of rent rather than a distribution only if the LLC made the payment as rent and the payment represents fair rental value for the property. *Curtis R. Bitker,* TC Memo 2003-209.

In addition, a member's transfer of property to an LLC in exchange for an interest in the LLC is a nontaxable transaction. IRC §721. See §4.18. If, however, the transfer is followed by the LLC's distribution of money or other consideration to the contributing member, the transactions could be collectively recast as a sale under IRC §707(a)(2). Treas Reg §1.707-3(a)(2). See §§4.20, 5.64.

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§5.84 2. Payments to Member Acting in Member Capacity

If a member is acting as a member in the transaction, IRC §*707*(c) controls *if* the payment to the member is determined without regard to LLC income, as in a guaranteed payment. Any other payment, including a payment to a member for services or capital supplied in his or her capacity as a member is simply a distributive share of LLC income, taxable under IRC §§702-*704*. See §§5.35-5.57.

A guaranteed payment is a payment that an LLC makes to a member for services rendered in his or her capacity as a member or for the use of such member's capital contributions, provided the amount of the payment is fixed and determined without regard to LLC income. IRC §*707*(c); Treas Reg §1.*707*-1(c). However, if the payment is calculated by reference to LLC income, the member's right to receive the payment is included in his or her distributive share of LLC income and the actual payment is treated as a distribution.

The tax treatment of a guaranteed payment differs significantly from that of a distribution. A guaranteed payment always results in ordinary income to the member. IRC §§61(a), *707*(c); Treas Reg §1.*707*-1(c). In addition, a guaranteed payment constitutes an LLC expense unless it is made in connection with a capital expenditure under IRC §263. If an expense, the LLC can deduct it under IRC §162(a). IRC §§162(a), *707*(c).

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§5.85 B. Self-Employment Tax

Internal Revenue Code §1401 imposes a 15.3-percent tax on self-employment income less than or equal to the Social Security tax base and a 2.9-percent tax on all additional self-employment income.

A member who is allocated LLC income *may* be required to include the income as self-employment earnings, but the issue is not clear. Under IRC §1402(a)(13), the distributive share of income of a limited partner is excluded from self-employment earnings, except for guaranteed payments under IRC §707(c). If the LLC member can be treated as a limited partner, because the member is not an LLC manager, and the LLC could have been formed as a limited partnership under state law, that member's share of LLC income will not be treated as net earnings from self-employment. See Prop Reg §1.1402(a)-2(h).

If the LLC is a service LLC, the IRS may treat all income allocable to the members as self-employment income, even during a year when the member did not render services for the entire year. In IRS Letter Ruling 9432018, concerning an LLC in which all of the members were actively engaged in the LLC's services, the IRS held that all income would be treated as members' earnings from self-employment.

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XI. TAX TERMINATIONS

§5.86 A. Distinguished From Dissolution

It is important to distinguish between a tax termination and a dissolution. Dissolution is strictly a state law concept and has no counterpart in the income tax treatment of LLCs. On events causing dissolution of the LLC, see chap 16. An LLC is not terminated for tax purposes merely because it is dissolved under state law. A conversion of a limited partnership to a limited liability company does not cause a termination under IRC §708(b). IRS Letter Ruling 9119029.

One of two events may terminate an LLC for tax purposes (IRC §708(b)):

(1) The LLC's business ceases; or

(2) 50 percent or more of the total interest in the LLC's capital and profits is sold or exchanged within 12 consecutive months. See §§5.87-5.88.

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B. Methods of Tax Termination

§5.87 1. Cessation of Business

An LLC ceases for tax purposes when it ceases to carry on any business, financial operation, or venture. IRC §708(b)(1)(A). Even a nominal amount of business will prevent a termination for tax purposes, notwithstanding that the primary business is abandoned. If the members agree to discontinue the LLC's business, the LLC will terminate on the date on which it winds up its affairs and distributes all of its assets to its members. Treas Reg §1.708-1(b)(1)(i).

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§5.88 2. Sale or Exchange of 50-Percent Interest in LLC Capital and Profits

An LLC terminates for tax purposes if 50 percent or more of the total interests in LLC capital and profits is sold or exchanged during any period of 12 consecutive months. IRC §708(b)(1)(B). Such a termination can be caused by one transaction or by a series of transactions that result in aggregate sales or exchange of 50 percent or more of the interests in LLC capital and profits. Multiple sales of the same LLC interest during the same 12-month period, however, are not aggregated. Treas Reg §1.708-1(b)(1)(ii).

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§5.89 C. Effect of Tax Termination on Members

On the termination of an LLC under IRC §708(b)(1)(B) (Treas Reg §1.708-1(b)(1)(iv)):

- The LLC's assets are deemed distributed to the LLC's members in proportion to their respective interests in the LLC; and
- The LLC's members are deemed to contribute their respective interests in those assets to a new LLC.

A reconstitution of the LLC can trigger several negative tax consequences. For example, the LLC's taxable year closes with respect to all members, which could result in bunching of LLC income on the members' respective tax returns. Treas Reg §1.708-1(b)(1)(iii). In addition, a member may recognize gain if the amount of money that the LLC hypothetically distributes to the member exceeds the adjusted basis of the member's LLC interest. Furthermore, the termination may trigger the application of IRC §704(c) or a member's deficit restoration requirement. See §§5.40, 5.47. For a thorough discussion of the tax consequences of a tax termination under IRC §708(b)(1)(B), see 2 Friedland & Petersen, California Partnerships and Proprietorships: Practice and Compliance Guide §44.05 (1992); 1 McKee, Nelson & Whitmire, Federal Taxation of Partnerships and Partners, chap 12 (4th ed 2007).

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§5.90 D. Planning to Avoid Inadvertent Tax Termination

With careful planning, the disposition of a member's LLC interest can be structured to avoid a tax termination under IRC §708(b)(1)(B). For example, a sale of an LLC interest that would otherwise terminate the LLC can be divided into two sales that are more than 12 months apart.

In the alternative, the selling member's interest in capital or profits could be reduced before the contemplated sale. For example, the LLC's operating agreement could be amended to reduce the selling member's profits interest. Unless the reduction is bona fide, however, the IRS may disregard it. Alternatively, the LLC could reduce the selling member's capital interest through a distribution.

Furthermore, IRC §708(b)(1)(B) does not apply to a transfer of an LLC interest by liquidation. Treas Reg §1.736-1(a)(6). As a result, a tax termination of the LLC can be avoided if the interest of the retiring member is liquidated by the LLC rather than purchased by the other members. See §§5.70-5.74.

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6

Nontax Factors in Structuring the Limited Liability Company

Allan B. Duboff

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§6.1 I. SCOPE OF CHAPTER

This chapter contains a basic summary of the factors to consider in structuring a limited liability company that has at least two members, including:

- Company management;
- Members' rights;
- Liability of members and managers to third parties, to other members, and to the LLC itself;
- The LLC's capital structure;
- Financing mechanisms;
- Distribution strategies and methods;
- Members' withdrawal rights; and
- Members' rights to transfer membership interests.

For a form of operating agreement reflecting a simple structure appropriate for a single-member limited liability company, see chap 10. The discussion in this chapter assumes that the limited liability company will have at least two members.

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II. DOES LLC FORMATION SERVE THE CLIENT'S INTERESTS?

§6.2 A. Taking Client's Existing Business Arrangements Into Account

If a client is converting an existing business entity into an LLC by statutory conversion, merger, or otherwise, counsel should carefully review all agreements relating to the existing entity. The review should focus on the method for converting the entity and on pinpointing issues that must be resolved before the conversion, such as the statutory requirements for conversion, the need to obtain consents from third parties, and the potential tax liability resulting from the conversion. See chap 11.

Counsel should also review organizational documents of the existing entity to determine the current arrangement among its owners regarding issues such as restrictions on transfers of ownership interests, management rights, allocation of liability, allocations of profits and losses, capital structure, and distribution rights. In each instance, counsel should discuss these issues with the client to determine whether the operating agreement should continue to reflect the existing structure.

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B. Weighing Compatibility of Client's Goals With California LLC Act

§6.3 1. Limitations on Purpose or Business

Under the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17655) (the Act), an LLC may engage in any lawful business activity except banking, insurance, or trust company business. Corp C §17002. Limited liability companies also may not render professional services that may be lawfully rendered only under a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act. Corp C §17375.

In addition to statutory restrictions, the purpose or business of an LLC may be restricted in its articles of organization. Corp C §§17002, 17051(c)(1). Such restrictions may be desired if members are concerned that their existing or anticipated business activities conflict with the anticipated activities of the LLC. By placing limitations on the business or purpose of the LLC in its articles or operating agreement, members or managers who continue to engage in activities that might be viewed as competitive with those of the LLC or who do not offer the LLC the chance to participate in new business opportunities may avoid breaching their fiduciary duties to the company or the members. See §§6.35-6.40 for a more detailed discussion of fiduciary duties.

Members also may wish to include restrictions in the articles on the LLC's business activities, or restrictions on the powers of managers, officers, and members, for the purpose of placing third parties on notice as to those restrictions. For example, Corp C §§17151(b) and 17157 allow the power of members as agents to be limited by a statement in the articles that the LLC is managed by managers.

Although the Act does not treat parties that deal with an LLC as having constructive notice of the contents of its articles, the LLC is not bound by an agreement if the other party had *actual* knowledge of the lack of authority of a member, manager, or officer to enter into the agreement on the LLC's behalf. Corp C §§17151(b), 17154(c), 17157. By including restrictions in the articles, a member who is concerned that managers may exceed their authority need only deliver a copy of the articles containing the restrictions to the third party.

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§6.4 2. Incorporating Act's Provisions Into Operating Agreement

The Beverly-Killea Limited Liability Company Act contains comprehensive rules governing the internal management of an LLC, the allocation of its profits and losses, and the distribution of its assets. Except for certain provisions, however, the Act applies only if these matters are not addressed in the articles of organization or the operating agreement. See Corp C §17005.

To ensure that the client does not incorporate unwanted provisions of the Act into its operating agreement (and thereby change its business arrangement or create an arrangement that was not anticipated), counsel should review the Act thoroughly in connection with the preparation of an operating agreement.

The client may choose to make use of the Act's default provisions (see §6.5) by using a short-form operating agreement (see chap 10), which incorporates statutory provisions simply by not including any provision contrary to those in the Act. For example, if the operating agreement does not address members' meetings, the provisions in the statute regarding members' meetings will apply. Although this drafting approach may effect some savings, it is usually preferable to recite the statutory rule in the body of the operating agreement, so members of the LLC will be able to determine their rights and obligations by examining only that document and not have to refer to the text of the Corporations Code.

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§6.5 3. Freedom of Contract Afforded by Act's Default Provisions

Unlike the General Corporation Law, the Beverly-Killea Limited Liability Company Act is written in a "default" style—that is, its provisions generally apply only when the LLC's operating documents do not provide otherwise. This limited application gives members broad discretion to define their business arrangement in their articles of organization and operating agreement. See §§7.14-7.39 on articles of organization; chaps 8-10 on the operating agreement. In this respect, the Act is like the Uniform Limited Partnership Act of 2008 (Corp C §§15900-15912.06) and the Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962); members may determine by contract most of the LLC's internal operations. For example, rather than vest management of the LLC in its members, as the Act provides, the members may elect that the LLC be managed by one or more managers. Corp C §17150; see §§6.8-6.14. Different *classes* of members may be established, with different rights, powers, and duties. Corp C §17102; see §§6.17-6.20. As long as the modifications are made in a *written* operating agreement or in the articles, the following operating matters can also be tailored to the members' preferences:

- Voting rights (Corp C §17103; see §§9.55, 13.19);
- Meetings of members (Corp C §17104; see §§9.56-9.63, 13.20-13.34);
- Election, term, removal, or resignation of managers (Corp C §17152; see §§6.11-6.14, 9.39-9.40);
- Appointment of officers (Corp C §17154; see §§6.15, 9.45);
- Indemnification of members, managers, officers, employees, or agents (Corp C §17155; see §§6.41, 9.64); and
- Compensation for members or managers who wind up the affairs of the company (Corp C §17352(c); see §6.16).

Members are also free to contract about financial aspects of the LLC, including contributions of capital, the allocation of its profits and losses, and the distribution of its assets. See, *e.g.,* Corp C §§17200, 17202, 17250. See also §§9.14-9.37.

In larger terms, provisions of the Act relating to the following business arrangements may be modified by the articles of organization or operating agreement, but only to the extent expressly provided in the indicated chapters of the Act (Corp C §17005(c)):

- Formation (chap 2);
- Dissolution (chap 8);
- Operation of a foreign LLC (chap 10);
- Class actions and derivative actions (chap 11);
- Merger (chap 12); and
- Dissenting members' exercise of rights (chap 13).

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§6.6 4. Act's Mandatory Provisions

The Beverly-Killea Limited Liability Company Act does not give members an unfettered right to define their business relationships, however. Neither the articles of organization nor the operating agreement may do the following (Corp C §17005(b)):

(1) Vary the following definitions found in Corp C §17001, except those that are italicized:

Acknowledged

Articles of organization

Bankrupt or bankruptcy

Capital account

Constituent limited liability company

Constituent other business entity

Contribution

Disappearing limited liability company

Disappearing other business entity

Distribution

Domestic

Domestic corporation

Domestic limited liability company

Domestic limited partnership

Economic interest

Foreign corporation

Foreign limited liability company

Foreign limited partnership

Foreign other business entity

Limited liability company

Mail

Majority in interest of the members

Manager

Member

Member of record

Membership interest

Officer

Operating agreement

Other business entity

Parent

Person

Proxy

Return of capital

State

Subsidiary of a specified limited liability company

Surviving limited liability company

Surviving other business entity

Time a notice is given or sent

Transact intrastate business

Vote

Voting power

Withdrawal

Written or writing

(2) Eliminate a member's right to object under Corp C §17100(c) to unreasonable operating agreement provisions governing the termination of a member's interest and return of a member's contribution;

(3) Change the requirement of Corp C §17103(b) for at least majority-in-interest approval by members to amend the articles of organization;

(4) Vary a member's right under Corp C §17103(c) to vote on dissolution or merger of the LLC;

(5) Abridge a member's right to information regarding the LLC under Corp C §17106; and

(6) Vary the rights of members in foreign "quasi-California" LLCs under Corp C §17453.

A client for whom some of the above mandates are troublesome may wish to consider forming the LLC in another jurisdiction. See chap 14.

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III. MANAGEMENT

§6.7 A. By Members

Unless the articles of organization vest management in one or more managers, the business and affairs of the LLC are managed by all of its members. Corp C §17150. Further, unless otherwise provided in the articles or the operating agreement, every member is an agent of the company for the purpose of its business or affairs, and the act of any member for the apparent purpose of carrying on in the usual way the business or affairs of the company binds the LLC, unless the member has no authority to act in the particular matter and the person with whom the member is dealing has actual knowledge that the member has no such authority. Corp C §17157(a).

If the members of a member-managed LLC do not intend for each member to have an ability to bind the company, counsel should include alternative provisions in the articles or the operating agreement. As these provisions are being included, counsel should also consider how to reduce the likelihood of disputes or deadlocks among the members. If the number or interests of the members make it difficult to include such provisions (*e.g.,* two members who each have a 50-percent interest), counsel should consider including a mechanism for alternative dispute resolution with respect to business decisions of the company in the operating agreement. See chaps 9-10 for form LLC operating agreements.

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B. By Manager

§6.8 1. Number of Managers

Instead of being managed by all of the members, an LLC may be managed by one or more managers who may, but need not, be members. Corp C §17151(a). If the company is to be managed by one or more managers, and not by all of its members, the articles of organization must contain a statement to that effect. Corp C §17151(b). In that event, no member (acting solely in the capacity of a member) is an agent of the company or has power to bind, or execute any instrument on behalf of, the company. Corp C §17157(b)(1).

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§6.9 2. Method of Management

An LLC may be managed by any method chosen by its members. If no management procedures are set forth in the operating agreement, each manager is an agent of the company for the purpose of its business and affairs, and the act of any manager for apparently carrying on in the usual way the business or affairs of the company binds the LLC, unless the manager in fact has no authority to act in the particular matter and the person with whom the manager is dealing has actual knowledge that the manager has no such authority. Corp C §17157(b)(2).

Unless otherwise provided in the articles of organization or the operating agreement, the managers are to make decisions either by majority vote of the managers at a meeting or by unanimous written consent. Corp C §17156. To give the managers maximum flexibility for making decisions without the necessity of formal meetings, the operating agreement may provide for managers to make decisions through a written consent signed by a *majority* of the managers.

The Beverly-Killea Limited Liability Company Act does not establish any requirements regarding meetings of managers other than that the failure to observe formalities pertaining to the calling or conduct of a meeting will be considered a factor tending to establish that members have personal liability for the obligations of the LLC *if* the articles or operating agreement require the holding of meetings. Corp C §17101(b). On the grounds for establishing alter-ego liability, see §§6.24-6.30.

Members are free to agree in the operating agreement about all matters relating to the methods by which managers make decisions, including:

- Whether meetings are required;
- The authority of any manager or officer to call a meeting;
- The time required for the notice of the meeting;
- The method of delivery of the notice;
- Whether the notice must specify the purpose of the meeting;
- The ability of managers to waive notice and consent to holding the meeting;
- Quorum requirements;
- The number of managers required to adjourn a meeting;
- Whether notice of adjournment must be given to managers who are not present at the time of adjournment;
- The location of the meeting;
- The ability of managers to participate in a meeting through the use of conference telephone equipment; and
- The ability of managers to appoint committees and the actions that may be undertaken by those committees.

If the members choose representative management like a corporation's board of directors, the operating agreement may be drafted to establish a group of managers who would operate like a board. With multiple managers, each manager may be given a specified area of management authority. Alternatively, if the members choose to operate the LLC like a limited partnership with a single general partner, counsel may draft the operating agreement to designate a single manager who would have absolute authority to manage the business and affairs of the company (absent any restrictions that may be placed on that authority under the Act or in the articles or the operating agreement).

Third parties without knowledge of the authority of the LLC's managers may conclusively presume that such authority exists, if a note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance, or other instrument in writing (and any assignment or endorsement of the same) entered into between the LLC and the third party is signed by at least two managers (or by one manager if the company is managed by a single manager). Corp C §17157(d).

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§6.10 3. Qualifications

The articles of organization or operating agreement may establish qualifications for the managers. Corp C §17151(c). Qualifications may include membership (or ownership of a specified minimum interest in the LLC), California residency, or that the manager be an individual. If the articles and operating agreement do not contain any qualification requirements, none will be imposed by the Beverly-Killea Limited Liability Company Act, and any party, including nonmembers, foreign citizens, partnerships, corporations, other LLCs, or other entities may serve as a manager.

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§6.11 4. Election

Unless otherwise provided in the articles of organization or a written operating agreement, the election of managers to fill initial positions must occur by the affirmative vote of a majority in interest of the members. Corp C §§17005(b), 17152(a). The election should occur as soon as feasible after the LLC is organized, to avoid issues such as (a) what the status is of the LLC's members if it is doing business but no managers have yet been elected, and (b) whether the LLC is "duly organized" for purposes of rendering a legal opinion, if it does not yet have managers. If elections are not held within 90 days after filing the articles of organization, the information statement that is required to be filed with the Secretary of State (see §13.3) must disclose the name and address of each member of the LLC. Corp C §17060(a)(4). For all the above reasons, it is a good practice for the managers to be elected and then identified in the operating agreement.

Unless the articles or operating agreement provide otherwise, managers hold office until the expiration of the term for which they were elected or, if no term is specified, until their successors have been elected and qualified. Corp C §§17005(b), 17152(d). If the members wish new managers to be elected at specified intervals, the operating agreement can so provide.

If the operating agreement calls for annual elections, the failure to hold them may be taken into account in deciding whether any of the members should have personal liability for the obligations of the LLC on an alter-ego theory. See §§6.24-6.30.

If the members desire a management structure in which the manager or managers, once appointed, are *not* subject to replacement by election (such as in most limited partnerships), the operating agreement may provide for that instead. Corp C §§17005(b), 17152(d).

If the LLC is to have more than one manager, the members may want to ensure that they will be able to elect their representatives as managers. These election rights may be provided for in the operating agreement in a number of ways. Different classes of membership interests may be established, with each class having the right to elect a specified number of managers, or certain classes having no right to elect managers. The operating agreement also could provide for the initial managers and require a supermajority voting requirement to elect any additional managers except in the event of a vacancy.

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§6.12 5. Vacancies

Unless otherwise provided in the articles of organization or the operating agreement, the election of managers to fill vacancies is by the affirmative vote of a majority in interest of the members. Corp C §§17005(b), 17152(a). An alternative to the statutory default provision is that the manager or managers would have authority to fill any vacancies, as long as at least one manager remains. Another alternative is that if the members fail to reach agreement on filling a vacancy within a specified period of time, the remaining managers would have authority to fill that vacancy.

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§6.13 6. Removal

Unless otherwise provided in the articles of organization or written operating agreement, a manager may be removed, with or without cause, by the vote of a majority in interest of the members at a meeting called expressly for that purpose. Corp C §§17152(b), 17005(b). A majority in interest of the members also may remove a manager by executing a written consent in lieu of a meeting. Corp C §17104(i). In either event, the removal will be without prejudice to the rights, if any, of a manager under any employment contract. Corp C §17152(b).

Removal of a manager who is also a member may be a preferred alternative to expelling that person from the LLC. If the company is obligated to purchase the interests of expelled members, the mere removal of that member from the position of manager (without also terminating the member's interest) will not require the purchase of that member's interest.

If the members choose to eliminate the removal right or limit that right (such as requiring a supermajority vote to remove a manager or permitting removal only for cause), the elimination or limitation must be set forth in the written operating agreement. Corp C §17005(b).

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§6.14 7. Resignation

Unless otherwise provided in the articles of organization or operating agreement, a manager may resign at any time on written notice to the LLC, without prejudice to the rights, if any, of the company under any employment contract with the manager. Corp C §§17005(b), 17152(c).

The Beverly-Killea Limited Liability Company Act does not provide for any additional consequences of the removal or resignation of a manager who is also a member. If the members are concerned that the business of the LLC may suffer greatly if a certain manager ceases performing services for the company, they may provide for a right to dissolve the LLC in that instance (and may require a supermajority vote to continue the business in that event).

The members also may provide for a right to purchase the membership interest held by any member who resigns or is removed as the manager. If the resignation is in breach of the operating agreement, the buyout provision may include remedies for the breach of the agreement. Corp C §17252(a).

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§6.15 C. Officers

An LLC is not required to have officers. However, in recognition of the fact that third parties transacting business with an LLC may be unclear about the authority of a "manager," the Beverly-Killea Limited Liability Company Act permits the operating agreement to authorize the appointment of officers. Corp C §17154(a).

The officers may include a chairperson, president, secretary, chief financial officer, or any other officer. The titles, powers, and duties of the officers may be specified in the articles of organization or the operating agreement or subsequently determined by the members or managers. Any number of offices may be held by the same person and the Act does not establish any qualifications for holding office. However, the operating agreement could establish qualifications, such as a requirement that all or some of the officers be members or managers of the LLC. Corp C §§17005(b), 17154(a).

Officers are appointed in accordance with the operating agreement. If the agreement provides for appointment, but fails to specify the method, the Act provides that the officers will be appointed by, and serve at the pleasure of, the managers, subject only to the rights, if any, of an officer under any employment contract. Corp C §17154(b). Officers may resign at any time on written notice to the LLC without prejudice to the rights, if any, of the LLC under any employment contract with the officer. Corp C §17154(b). If the officers are members or managers, the operating agreement could provide that the resignation of an officer will result in the termination of the officer's status as a manager or would trigger a right of the company or its remaining members to acquire the resigning officer's membership interest. Corp C §17005(a)-(b).

If an officer's authority is intended to be subordinate to the authority of the LLC's managers, LLC managers should take care to appoint nonmanagers as officers. Third parties dealing with a nonmanager officer are entitled to assume that he or she has whatever authority is appropriate to the officer's position, absent knowledge to the contrary. Specifically, third parties without knowledge of the limits of an officer's authority may *conclusively presume* that authority exists if a note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance, or other instrument in writing (and any assignment or endorsement of the same) entered into between the LLC and the third party is signed by the chairperson, the president or any vice president, and any secretary, any assistant secretary, the chief financial officer, or any assistant treasurer of the company. Corp C §17154(c).

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§6.16 D. Compensation

Unless the member is winding up the affairs of the company, the Beverly-Killea Limited Liability Company Act does not require that a member receive compensation for acting on behalf of the LLC. Corp C §§17004(b), 17352(c). Accordingly, if any member is entitled to receive any form of compensation for acting on behalf of the LLC, the right to receive such compensation must be set forth in the operating agreement or another agreement among all the members. Corp C §17004(b).

For winding up the affairs of the company, Corp C §17352(c) provides that members who do so are entitled to reasonable compensation for their efforts unless otherwise provided in the articles or a written operating agreement. Accordingly, if a member should not receive compensation for services rendered in winding up, the articles or written operating agreement *must* so state.

Although Corp C §17352(c) provides that managers who wind up the affairs of the LLC are entitled to reasonable compensation for their efforts, neither Corp C §17004(b) nor any other section of the Act gives managers who are not members the right to receive compensation for acting in furtherance of the LLC business. To avoid any uncertainty, a company should enter into a written employment agreement with each manager who is not a member.

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IV. MEMBERS' RIGHTS

§6.17 A. Rights That Cannot Be Modified

Corporations Code §17005 places some limitations on the members' ability to freely contract regarding internal operations of the LLC. These limitations include the following:

(1) A member must have the right to assert that a provision in the operating agreement governing the termination of that member's interest and the return of that member's contribution was unreasonable under the circumstances existing at the time the agreement was made. Corp C §§17005(b)(2), 17100(c).

(2) An amendment to the articles of organization must be approved by at least a majority in interest of the members. Corp C §§17005(b)(3), 17103(b).

(3) The members must have the right, by the vote of a majority in interest (or such greater percentage of the voting interests as may be specified in the articles of organization or written operating agreement), to dissolve the LLC. Corp C §§17005(b)(3), 17103(c), 17350(b).

(4) The members must have the right to approve an agreement of merger in the manner specified in Corp C §17551. Corp C §§17005(b)(3), 17103(c). On the right to approve a merger, see §§11.51-11.54.

(5) The members' rights to receive certain financial and other information as required by the Beverly-Killea Limited Liability Company Act and their rights to inspect the books and records relating to the company as required by the Act may not be varied. Corp C §§17005(b)(4), 17106, 17453.

(6) A manager's fiduciary duties to the company and its members may be modified only in a written operating agreement with the informed consent of the members. Corp C §17005(d).

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§6.18 B. Amendment of Articles or Operating Agreement

An amendment to the articles of organization or a written operating agreement must be approved by at least a majority in interest of the members. Corp C §§17005(b)(3), 17103(b). However, if there is no voting provision regarding amendment in the articles or operating agreement, the unanimous consent of all the members is required for any amendment to the articles or operating agreement. Corp C §17103(a)(2).

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§6.19 C. Transfers of Membership Interests

Unless otherwise provided in the articles of organization or operating agreement, the consent of a majority in interest of the other members is required to admit an assignee as a member. Corp C §17303(a). Thus, members may vary the Beverly-Killea Limited Liability Company Act's majority-in-interest default rule for admission of a transferee.

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§6.20 D. Other Rights

Except as described in §§6.17-6.19, the Beverly-Killea Limited Liability Company Act does not require that members of a manager-managed LLC have any right to participate in the management of the company. However, the articles of organization or operating agreement may contain such additional rights as the members deem appropriate. Because members, unlike limited partners of a limited partnership, are not subject to personal liability resulting from their right to participate in management, members may freely take part in the management of the company without endangering their limited liability status. A practical effect of this rule is that a nonmanager member can succeed a manager who is removed—something that cannot be done in a limited partnership without risking loss of limited liability status. See Advising California Partnerships §5.17 (3d ed Cal CEB 1999).

The drafter of an LLC operating agreement should consider providing members with approval rights for any business transaction, including

- The sale of all or substantially all of the assets of the LLC;
- Financing transactions;
- The granting of a security interest or deed of trust on company property;
- The execution of contracts or incurring of obligations in excess of a specified amount; or
- The company's annual budget.

See §6.15 concerning a third party's right to rely on the authority of an officer to conclude some of the above transactions.

Other default member voting and approval rights provisions in the Act include:

- Issuance of membership interests by the company (Corp C §17100(a)(1));
- Election of managers to fill initial positions or vacancies (Corp C §17152(a));
- Removal, with or without cause, of any or all of the managers (Corp C §17152(b)); and
- Compromise of a member's obligation to make a contribution or return an improper distribution (Corp C §17201(b)(1)).

If these rights are deemed not in the LLC's interest, its operating agreement may eliminate or modify them.

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§6.21 E. Expulsion of Member

An operating agreement may provide for the expulsion of a member and the termination in whole or part of a membership or economic interest in the LLC. The terminated member is entitled to receive a return of his or her contribution. However, the valuation of the contribution and the timing of its return will be subject to provisions in the agreement governing the termination, unless the terminated member establishes that the provision was unreasonable under the circumstances existing at the time the agreement was signed. Corp C §17100(c). To reduce the likelihood that such a provision might be contested, the members may wish to include in the operating agreement a specific acknowledgment that the provision is reasonable under the circumstances existing at the time the agreement is signed.

On the termination of a membership interest, the LLC must amend the list of members it is required to maintain. Corp C §17100(c). See §13.16.

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§6.22 F. Method of Determining Voting Approval

If no voting provision is contained in the articles of organization or a written operating agreement, the members vote in proportion to their interest in current profits of the LLC. When a member has assigned his or her entire economic interest in the company to a person who has not yet been admitted as a member, the assigning member votes in proportion to the interest in current profits he or she *would have had* if the assignment had not been made. Corp C §17103(a)(1). The members may wish to consider limiting the voting rights of an assignor member with a reduced (or no) economic interest in the LLC.

The articles or operating agreement may set forth any approval rights desired by the members. The right to approve any matter may be vested in all of the members or in a specified class or group of members. Members may have the right to vote separately or with any class or group of members on any matter and certain members may not have any approval rights whatsoever. Corp C §17103(a). The operating agreement also may require a supermajority vote for the approval of any matter.

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V. LIABILITY

A. Liability to Third Parties

1. Members

§6.23 a. General Rule

No member of an LLC is personally liable under a court judgment or in any other manner for any obligation of the company, whether that obligation arises in contract, tort, or otherwise, solely by reason of being a member of the LLC. Corp C §17101(a). Thus, under normal circumstances, the members' personal liability for the obligations of the company are limited to their investment in the LLC.

A member of an LLC may agree to be obligated personally for any or all of the debts of the LLC as long as that agreement is set forth in either the articles or a written operating agreement that specifically references Corp C §17101(e).

Corporations Code §17101(c) will not limit a member's personal liability for the obligations of the LLC if the member *assumes liability for*, or *guarantees*, those obligations. As many business creditors often require the principals of small start-up businesses to guarantee the business's obligations, the members may provide in the operating agreement for a right of contribution or indemnification if any of the members are required to provide a guaranty to a business creditor and payment is made under that guaranty.

Although members generally are not personally liable for the obligations of the LLC solely by reason of their status as members, those liability limitations are not to be construed to affect the liability of a member to third parties for the member's *participation* in tortious conduct, or under the terms of a written guarantee or other contractual obligation entered into by the member. Corp C §17101(c).

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§6.24 b. Alter-Ego Doctrine

An exception to the general limitation on the personal liability of a member for the obligations of an LLC is set forth in Corp C §17101(b). Except for the failure to hold meetings or observe formalities, Corp C §17101(b) provides that a member will generally be liable under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable and also under the common law governing alter-ego liability.

As discussed in §§6.25-6.30, the common law governing alter-ego liability is part of the analysis in determining potential liability of shareholders. Accordingly, to determine the potential liability of a member for the obligations of the LLC, the potential liability of shareholders for a corporation's obligations should be analyzed. Under normal circumstances, shareholders' liability is limited to their investment in the corporation. This protection from personal liability may be lost, however, if the courts find a basis for invoking the alter-ego doctrine. Under this doctrine, if it would be inequitable not to do so, the courts may disregard the legal fiction of a corporation's separate existence distinct from that of its shareholders, and find them personally liable for corporate debts and obligations.

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§6.25 (1) Reasons for Invoking Doctrine

A common reason for invoking the alter-ego doctrine is that failure to do so would work an injustice on the corporation's creditors or other third parties; in other words, to prevent the shareholders from attempting to use the corporation as a shield against liabilities that would otherwise inure to them personally. See, *e.g.,* *Minton v Cavaney* (1961) 56 C2d 576, 15 CR 641 (tort claims); *Minifie v Rowley* (1921) 187 C 481, 202 P 673 (contractual obligations); *People v Clawson* (1964) 231 CA2d 374, 41 CR 691 (tax liabilities).

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§6.26 (2) Two-Pronged Test

As stated by the California Supreme Court in *Automotriz del Golfo de Cal. v Resnick* (1957) 47 C2d 792, 796, 306 P2d 1,

the two requirements for application of this doctrine are (1) that there be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow.

Because the alter-ego doctrine is equitable, its application varies according to the circumstances in each case. Although the doctrine does not depend on the presence of actual fraud, bad faith is an underlying consideration, and is found in some form or another whenever the trial court has been justified in disregarding the corporate entity. *Associated Vendors, Inc. v Oakland Meat Co.* (1962) 210 CA2d 825, 26 CR 806. See §6.27.

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§6.27 (3) Typical Fact Patterns

In *Associated Vendors, Inc. v Oakland Meat Co.* (1962) 210 CA2d 825, 838, 26 CR 806, the court reviewed and analyzed a number of cases in which the trial court had been upheld in disregarding the corporate entity, and produced the following list of factual circumstances, which can serve as a checklist for determining whether the alter-ego doctrine might be applicable (210 CA2d at 838):

- Commingling of funds and other assets, failure to segregate funds of the separate entities, and unauthorized diversion of corporate funds or assets to other than corporate uses;
- Treatment by an individual of the assets of the corporation as his or her own;
- Failure to obtain authority to issue stock or to subscribe to or issue the same;
- Holding out by an individual that he or she is personally liable for the debts of the corporation;
- Failure to maintain minutes or adequate corporate records and confusion of the records of the separate entities;
- Having identical equitable ownership in the two entities, identical individuals having domination and control of the two entities, identical directors and officers of the two entities in supervision and management, or sole ownership of all of the stock in a corporation by one individual or the members of a family;
- Use of the same office or business location or employment of the same employees or attorney;
- Failure to adequately capitalize the corporation, or the total absence of corporate assets;
- Use of a corporation as a mere shell, instrumentality, or conduit for a single venture or the business of an individual or another corporation;
- Concealment and misrepresentation of the identity of the responsible ownership, management, and financial interests or concealment of personal business activities;
- Disregard of legal formalities and failure to maintain arm's length relationships among related entities;
- Use of the corporate entity to procure labor, services, or merchandise for another person or entity;
- Diversion of assets from a corporation by or to a stockholder or other person or entity, to the detriment of creditors, or manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another;
- Contracting with another with intent to avoid performance by use of a corporate entity as a shield against personal liability or use of a corporation as a subterfuge for illegal transactions; and
- Formation and use of a corporation to transfer to it the existing liability of another person or entity.

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§6.28 (4) Source and Adequacy of Funding

If the LLC members have made an equity investment or provided other sources of funding for the company's initial operations sufficient to permit it to operate as a viable business entity, the adequacy of funding requirement is ordinarily considered met. The initial funding of the company need not be solely through equity investments. A key test is whether the company had funds available (either as equity or debt) for a sufficient period of time to enable it to begin its business and develop it to the point of economic viability. See 2 Marsh, Finkle & Sonsini, Marsh's California Corporation Law §16.22 (4th ed 2000).
Undercapitalization is commonly found in alter-ego cases. See, *e.g.*, *Minton v Cavaney* (1961) 56 C2d 576, 15 CR 641; *Nilsson, Robbins, Dalgarn, Berliner, Carson & Wurst v Louisiana Hydrolec* (9th Cir 1988) 854 F2d 1538, 1544 (applying California law).

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§6.29 (5) Segregation of Personal and Company Affairs

Counsel should advise LLC members to keep their personal business carefully segregated from the company's business. Personal funds or other assets of members should never be commingled with those of the company, and all dealings between members and the company should be at arm's length and properly documented. See generally *Associated Vendors, Inc. v Oakland Meat Co.* (1962) 210 CA2d 825, 26 CR 806. It is particularly important that company assets not be used by the members for their personal benefit. See *Riddle v Leuschner* (1959) 51 C2d 574, 335 P2d 107.

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§6.30 (6) Observing Formalities

In the corporate alter-ego context, a common trap for shareholders is neglecting corporate formalities. The sole or majority shareholder who runs the corporation "out of his back pocket" fails to hold meetings, and does not keep adequate books and records is especially vulnerable. If such a corporation becomes unable to meet its obligations promptly, creditors may discover and use this disregard of corporate formalities as a significant reason for invoking the alter-ego doctrine and obtaining a judgment against the shareholder. See *Temple v Bodega Bay Fisheries, Inc.* (1960) 180 CA2d 279, 4 CR 300. See also Counseling California Corporations §3.86 (3d ed Cal CEB 2008) for a sample attorney-client letter containing a checklist for avoiding alter-ego liability.

If the operating agreement does *not* require that meetings of members or managers be held, the failure to hold meetings or to observe certain formalities pertaining to the calling or conducting of meetings cannot be a reason for invoking the alter-ego doctrine. Corp C §17101(b). Thus, unless members have a strong need for requiring meetings to be held at certain times, the drafting attorney should consider the benefit of a provision that allows for meetings to be held on an "as needed" basis. In any event, the company should maintain adequate books and records, not only to reduce the risk of a successful alter-ego claim, but also to satisfy its statutory requirements. See Corp C §17058(a)(7). See also §13.16 about books and records.

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§6.31 c. Forced Contributions

Any person with a claim against an LLC may enforce an existing obligation of a member to make a contribution to the LLC, or to return to the LLC money or other property paid or distributed to the member. Corp C §17201(b)(2). See §§6.45-6.52 about a member's obligation to make capital contributions. See §§6.53-6.58 about distributions to members.

However, a creditor cannot enforce a *conditional* obligation of a member, such as an obligation to make a capital contribution following a discretionary call if the call has not occurred, unless the conditions have been satisfied or waived. Corp C §17201(c).

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§6.32 d. Return of Improper Distributions

Members are obligated to return distributions from an LLC if (1) the member had actual knowledge of facts indicating the impropriety of the distribution and (2) immediately after the distribution, all liabilities of the LLC exceed the fair market value of the LLC's assets. Corp C §17254(e). This rule is derived from the obligations of partners under the former California Revised Limited Partnership Act to return improper distributions. See former Corp C §15666.

Excluded from that obligation are liabilities to members on account of their interests in the company and liabilities to creditors whose recourse is limited to specified property of the company. However, the fair market value of any property subject to a liability for which recourse is limited is included in the company's assets *only to the extent* that the fair market value of the property exceeds the liability. Corp C §17254(e).

An action to enforce an obligation to return a distribution must be brought within 4 years after the distribution is made. Corp C §17254(f).

Creditors have the right to enforce the obligations of members to return improper distributions. See §6.31.

On required capital contributions, see §§6.46-6.52.

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§6.33 e. After Dissolution

Members of a dissolved LLC are subject to liability for causes of action against the dissolved company whether the cause of action arose before or after the dissolution of the company. A member's liability is limited to the company assets distributed to the member on dissolution. However, it is not limited to the member's prorata share of the claim. Corp C §17355(a)(1).

If the amount of distributed assets that a member is required to return exceeds the sum of that member's prorata share of the claim and the amount for which the member could otherwise be held liable under the Beverly-Killea Limited Liability Company Act for receiving an improper distribution, the member has the right to seek contribution for the excess from the other members or managers. See Corp C §17355(a)(1)(B).

Any action against a member of a dissolved LLC to return assets distributed on dissolution of the company must commence before the earlier of (1) the expiration of the statute of limitations applicable to the cause of action, or (2) 4 years after the effective date of the dissolution of the LLC. Corp C §17355(a)(2).

The liability of members after dissolution is derived from provisions of the California General Corporation Law. See Corp C §§2009, 2011.

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§6.34 2. Managers and Officers

No person who is a manager or officer of an LLC will be personally liable under any court judgment or otherwise for any obligation of the LLC, whether that obligation arises in contract, tort, or otherwise, solely by reason of being a manager or officer. Corp C §17158(a). This liability limitation is substantially similar to the one provided in the Beverly-Killea Limited Liability Company Act for the benefit of members of an LLC. See Corp C §17101(a).

A manager of an LLC may agree to be obligated personally for any or all of the debts of the LLC as long as the agreement to be so obligated is set forth in either the articles or a written operating agreement that specifically references Corp C §17158(b)(1). Corporations Code §17158(b)(2) provides that a manager may agree to be personally liable under the terms of a written guarantee or other contractual obligation.

Corporations Code §17101(c) provides that nothing in Corp C §17101 shall be construed to affect the liability of a member to third parties for the member's own participation in tortious conduct. The Act does not contain a similar provision with respect to the tort liability of managers or officers.

Although this raises the question of whether the failure to include such a provision was intended to somehow limit the liability of managers and officers to third parties for their own tortious conduct, it seems unlikely that courts would read such a liability limitation into the Act. See, *e.g.*, *People v Pacific Landmark, LLC* (2005) 129 CA4th 1203, 29 CR3d 193 (LLC's manager was subject to personal liability for participating in criminal activity while performing his managerial duties; LLC had leased premises to an illegal business and allowed it to persist; court held that manager was not insulated from liability by virtue of Corp C §17158(a) for his personal involvement in aiding and abetting public nuisance and for failing to abate it, which forced city to bring red light abatement action).

As protection against a member, manager, or officer incurring such personal liability, the articles of organization or operating agreement may provide for indemnification of the member, manager, or officer against judgments, settlements, penalties, fines, or expenses of any kind incurred as a result of acting in that capacity, unless the liability results from a breach of his or her fiduciary duties. Corp C §17155(a).

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B. Liability to Members and Company

§6.35 1. Fiduciary Duties of Manager Are Same as Those of Partner

A manager owes the same fiduciary duties to an LLC and its members as are owed by a partner to the partnership and other partners. Corp C §17153. These fiduciary duties may be modified only in a written operating agreement with the informed consent of the members. Corp C §17005(d).

The fiduciary duties a partner owes to the partnership and other partners are a duty of loyalty and a duty of care. Corp C §16404(a). The Uniform Limited Partnership Act of 2008 (Corp C §§15900-15912.06) specifically identifies those duties with reference to the general partner, but limits their application and does not establish any other fiduciary duties for partners. Corp C §15904.08.

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§6.36 a. Duty of Loyalty

There are three duties of loyalty. First, there is the duty to account to the partnership for any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property or information, including the appropriation of a partnership opportunity. Second, there is the duty to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership. Corp C §16401(b)(2). Finally, there is the duty to refrain from competition with the partnership in the conduct of the partnership business before the dissolution of the partnership. Corp C §16404(b)(3).

The duty of loyalty is not violated, however, merely because the partner's conduct furthers the partner's own interests. Corp C §16404(e). In *Jones v Wagner* (2001) 90 CA4th 466, 108 CR2d 669, the court held that the duty of loyalty did not require partners to pay mortgage obligations of other partners on partnership real property. Further, no statutory provision prohibited the partners from purchasing the property at a foreclosure sale.

In *GAB Bus. Servs., Inc. v Lindsey & Newsom Claim Servs., Inc.* (2000) 83 CA4th 409, 99 CR2d 665, disapproved on other grounds in *Reeves v Hanlon* (2004) 33 C4th 1140, 1154, 17 CR3d 289, the court held that a corporate officer who enlisted other employees to defect with him to a rival company owed a fiduciary duty of loyalty to the corporation because he exercised discretionary authority and participated in the management of the corporation. The same principle also may apply to LLC managers and officers.

The duty of loyalty may not be eliminated by agreement. In *BT-1 v Equitable Life Assur. Soc'y* (1999) 75 CA4th 1406, 89 CR2d 811, the court held that the fiduciary duty of a general partner not to purchase partnership debt and foreclose on the assets of a limited partnership may not be contracted away in the partnership agreement. However, if not "manifestly unreasonable," the partners may by agreement identify specific types or categories of activities that do not violate the duty of loyalty. The partners also may authorize or ratify, after full disclosure of all material facts, a specified act or transaction that otherwise would violate the duty of loyalty. Corp C §16103(b)(3).

Because the fiduciary duty set forth in Corp C §16404 should also apply to a manager of an LLC, the manager should, as long as the consent of the members is obtained, be able to engage in transactions that might otherwise be prohibited. However, Corp C §17005(d) provides that the fiduciary duties of a manager may be modified only in a written operating agreement with the informed consent of the members. Thus, managers, unlike partners, may not be able to engage in transactions that might otherwise violate that manager's fiduciary duties based on oral consents given by members. To avoid any potential problems, managers should always obtain written consents (and make full disclosures in soliciting consents) to any transaction that might be viewed as violating Corp C §16404(b).

Managers who do not devote full-time efforts to the company should obtain the members' consent to the manner in which management will occur. In the absence of a partner's agreement to commit a specific portion of his or her time and efforts to the partnership business, the partner is generally free to engage in other business activities in which the partnership has no interest, without accounting to the partnership for profits. See *Neilsen v Holmes* (1947) 82 CA2d 315, 186 P2d 197. A partner who undertakes to commit his or her time to partnership endeavors, however, or one whose outside activities are adverse to the partnership or involve business opportunities that are within the specific purposes of the partnership, may be accountable to the partnership for profits derived from those activities. See *Dennis v Gordon* (1912) 163 C 427, 125 P 1063; *Olivet v Frischling* (1980) 104 CA3d 831, 164 CR 87, disapproved on other grounds in *Applied Equip. Corp. v Litton Saudi Arabia Ltd.* (1994) 7 C4th 503, 521, 28 CR2d 475.

To reduce the possibility that managers might be found to have breached their fiduciary duties by engaging in transactions without the members' informed written consent, the operating agreement may provide that:

- A manager is not obliged to commit a specific portion of his or her time to the business of the LLC;
- A manager is free to engage in other business activities in which the LLC has no interest;
- A manager is free to engage in business activities that compete with the LLC (although disclosure of the nature and extent of those activities may be required); and
- A manager need not offer business opportunities to the LLC and may take advantage of those opportunities for his or her own account, and neither the LLC nor any member has a right to any income derived by the manager from those

activities.

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§6.37 b. Duty of Care

A partner's duty of care to the partnership and the partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law. Corp C §16404(c). Although the partners may vary their duties by agreement, the partnership agreement cannot unreasonably reduce this duty of care. Corp C §16103(b)(4).

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§6.38 c. Obligation of Good Faith and Fair Dealing

A partner must discharge its duties to the partnership and the other partners under Corp C §16404(a)-(c) or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing. Corp C §16404(d). The partnership agreement cannot eliminate the obligation of good faith and fair dealing, but it can prescribe the standards by which the performance of the obligation is to be measured, as long as the standards are not manifestly unreasonable. Corp C §16103(b)(5). A partner does not violate a duty or obligation under Corp C §16404(a)-(c) or the partnership agreement merely because the partner's conduct furthers the partner's own interest. Corp C §16404(e). This obligation of good faith and fair dealing may be interpreted as applying to managers of an LLC.

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§6.39 2. Fiduciary Duties of Members Who Are Not Managers

The Beverly-Killea Limited Liability Company Act does not establish any fiduciary duties for nonmanager members. Instead, it specifically provides that members may lend money to and transact other business with the LLC and, subject to other applicable law, have the same rights and obligations with respect to those transactions as a person who is not a member. Corp C §17004(a).

Nonetheless, the obligation of good faith and fair dealing or the fiduciary obligation of majority shareholders to act in good faith and with inherent fairness toward minority shareholders may be imposed on members who hold a majority interest or otherwise control an LLC. See, *e.g.*, *Stephenson v Drever* (1997) 16 C4th 1167, 69 CR2d 764; *Jones v H. F. Ahmanson & Co.* (1969) 1 C3d 93, 81 CR 592; *Smith v TeleCommunication, Inc.* (1982) 134 CA3d 338, 184 CR 571; *Crain v Electronic Memories & Magnetics Corp.* (1975) 50 CA3d 509, 123 CR 419. On controlling shareholders' obligations, see 1 Marsh, Finkle & Sonsini, Marsh's California Corporation Law §§11.14-11.21 (4th ed 2000). If the members want to waive or modify these duties, they could include an appropriate provision in the operating agreement, but it is unclear whether such a waiver or modification would be enforceable.

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§6.40 3. Liability for Authorizing Improper Distributions

A member or manager who votes for a distribution in violation of the operating agreement or the Beverly-Killea Limited Liability Company Act is personally liable to the LLC for the amount of the distribution that exceeds what could have been distributed without violating the Act or the agreement. Corp C §17255(a). On when a distribution is improper, see §6.53.

Each member or manager who is held liable for authorizing an improper distribution may compel contribution from (Corp C §17255(b)(1)-(2)):

- Each other member or manager who also could be found liable for authorizing an improper distribution and
- Each member for the amount the member received with knowledge of facts indicating the improper distribution.

A proceeding to recover the amount of an improper distribution from the member or manager who authorized it must be commenced within 4 years after the date on which the effect of the distribution is measured under the Act. Corp C §17255(c).

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§6.41 C. Indemnification

Except for a breach of a manager's fiduciary duties, the articles of organization or operating agreement may provide for indemnification of any manager, member, officer, employee, or agent of the LLC against judgments, settlements, penalties, fines, or expenses of any kind incurred as a result of acting in that capacity. Corp C §17155(a).

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§6.42 D. Insurance

An LLC is authorized under Corp C §17155(b) to purchase and maintain insurance for any manager, member, officer, employee, or other agent of the company acting in those capacities (1) against any liability asserted against them and (2) against any liability incurred by them.

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VI. CAPITAL STRUCTURE

§6.43 A. Number and Type of Member Classes

The articles of organization or operating agreement may provide for the creation of any number of classes of members. Each class will have those rights, powers, and duties specified in the articles or operating agreement, including rights, powers, and duties that may be senior to other classes of members. Corp C §17102.

The profits and losses of an LLC will be allocated among the members, and among classes of members, in the manner provided in the operating agreement. If the operating agreement is silent, however, profits and losses will be allocated in proportion to the contributions of each member. Corp C §17202. On methods of allocating profits and losses, see §§9.23-9.33.

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§6.44 B. Admission of New Members

The LLC's articles of organization or operating agreement may provide for how a person may acquire a membership interest directly from the LLC. If no such provisions are contained in the LLC's governing instruments, a person may be admitted only by the vote of a majority in interest of the members and becoming a party to the operating agreement. Corp C §17100(a)(1).

Similarly, unless otherwise provided in the articles of organization or the operating agreement, for an assignee of a membership interest to become a member requires approval of a majority in interest of the members. Corp C §§17100(a)(2), 17303(a). On the admission of substitute members, see §§9.73-9.74.

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VII. FINANCE

§6.45 A. Initial Capital Contributions

A member's capital contribution may be in the form of money, property, services, or an *obligation* to contribute money or property or render services. Corp C §17200(a). On the tax consequences of receiving a capital contribution for services rendered and the valuation of contributed property, see §§4.18-4.19.

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Source: Business Law/Forming and Operating California Limited Liability Companies/6 Nontax Factors in Structuring the Limited Liability Company/ B. Additional Funding/§6.46 1. No Provision for Members to Make Additional Contributions

B. Additional Funding

§6.46 1. No Provision for Members to Make Additional Contributions

Unless the articles of organization or operating agreement provide otherwise, no member is required to make any additional contributions to the LLC. Corp C §17200(b).

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§6.47 2. Additional Capital Contributions Required

The articles of organization or operating agreement may require all or some of the members to make additional capital contributions to the LLC. If any member will be required to make additional contributions, the operating agreement should clearly specify the conditions under which the member is so obligated. Such conditions might include:

- A determination that the company does not have a specified amount of working capital, is unable to pay all or some of its debts in a timely manner, or will not be able to satisfy financial or other covenants in an agreement with a third party;
- A vote to require additional contributions;
- A request by another member for additional contributions;
- Notice requirements for any demand for additional contributions or any vote on whether such a demand will be made; and
- The time period allowed to members for making additional capital contributions.

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§6.48 3. Borrowing Options

Whether or not members are required to make additional contributions, an LLC always has the power to borrow money or to issue notes, bonds, or other evidence of indebtedness. Corp C §17003(d), (h). Unless the operating agreement provides otherwise, the company may borrow money from any member. Corp C §§17004(a), 17005(b).

Business creditors often require the principals of small start-up companies to assume liability or guarantee the company's obligations. Counsel should tell clients to expect these demands as a condition of receiving loans or an extension of credit. The client may wish to address this possibility in the operating agreement by requiring members to proportionately indemnify any member who makes a payment under a guaranty of the company's obligations (or to limit such indemnification only to guaranties approved by the other members).

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Source: Business Law/Forming and Operating California Limited Liability Companies/6 Nontax Factors in Structuring the Limited Liability Company/§6.49 C. Failure to Make Required Contributions

§6.49 C. Failure to Make Required Contributions

Subject to the terms of the articles of organization or the operating agreement, a member is not excused from making a capital contribution to the LLC because of death, disability, dissolution, or any other reason. Corp C §17201(a)(1).

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§6.50 1. Collection Action

If a member fails to make any required capital contribution, the LLC may bring a collection action against that member. Additionally, if a member fails to make a required contribution of property or services, the LLC may elect to demand cash instead, in an amount equal to the fair market value (or agreed value as stated in writing and signed by the company and the member) of any contribution that has not been made. Corp C §17201(a)(2).

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§6.51 2. Additional Remedies Permitted by the Beverly-Killea Limited Liability Company Act

The Beverly-Killea Limited Liability Company Act specifies a number of remedies available to an LLC when a member fails to make any contribution or other required payment. Remedies under Corp C §17201(a)(3) are:

- Removal of the defaulting member's voting, approval, or other rights;
- Removal of the defaulting member's right to participate actively in the management and operations of the company;
- Liquidated damages; or
- Reduction of the defaulting member's economic rights, *e.g.,* under Corp C §17201(a)(3)(A)-(F), by
- Diluting, reducing, or eliminating the defaulting member's proportionate interest in the company;
- Subordinating the defaulting member's interest in the company to that of nondefaulting members;
- Permitting a forced sale of the defaulting member's membership interest;
- Permitting other members to lend or contribute the amount necessary to meet the defaulting member's commitment;
- Adjusting interest rates or other rates of return—preferred, priority, or otherwise—for contributions by or capital accounts of the other members; and
- Fixing the value of the defaulting member's interest in the company by appraisal or by formula and redeeming or selling that member's interest at a percentage of the value fixed.

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§6.52 3. Reasonableness of Remedies

A provision containing any of the remedies described in §6.51 is enforceable in accordance with its terms unless the member seeking to invalidate it establishes that the provision was unreasonable under the circumstances existing at the time the operating agreement was signed. Corp C §17201(a)(3). To reduce the likelihood that such a provision might be contested, the members may wish to include in the operating agreement a specific acknowledgment that the provision is reasonable at the time the agreement is signed. The fact that the remedies are specifically provided for by statute would make this a difficult argument for the member to make in any event.

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VIII. DISTRIBUTIONS

§6.53 A. Constraints on LLC's Ability to Make Distributions

An LLC may not make a distribution if, after making the distribution (Corp C §17254(a)):

- The LLC would not be able to pay its debts as they become due in the usual course of business; or
- The LLC's total assets would be less than the sum of its total liabilities *plus* (unless the operating agreement provides otherwise) the amount that would be needed—if the company were to be dissolved at the time of the distribution—to satisfy the preferential rights of other members on dissolution that are superior to the rights of the members receiving the distribution.

The company may base its determination that a distribution is not prohibited on (Corp C §17254(b)):

- Any financial statements prepared using accounting practices and principles that are reasonable in the circumstances;
- A fair valuation; or
- Any other method that is reasonable in the circumstances.

There is no requirement that financial statements be prepared in accordance with generally accepted accounting principles (which would require accrual accounting and other methods that may not be appropriate for an LLC).

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B. Liability for Authorizing and Receiving Improper Distributions

§6.54 1. Voting for Improper Distributions

A member or manager who votes for a distribution in violation of the operating agreement or the Beverly-Killea Limited Liability Company Act is personally liable to the LLC for the amount of the distribution that exceeds what could have been distributed without violating the Act or the agreement, if it is shown that the member or manager did not act in compliance with the Act (specifically, Com C §17254 or §17353) in making his or her determination to permit a distribution. Corp C §17255(a). See §6.32.

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§6.55 2. Receipt of Improper Distributions

Members may be obligated to return improper distributions. Corp C §17254(e). See §6.32.

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§6.56 C. Types of Distributions

Distributions of an LLC's money or property may be made to members or to any class of members in the manner provided in the operating agreement. Corp C §17250. Customary distribution provisions include:

(1) Distributions are made only when approved by the members or managers;

(2) Distributions are required to be made on a monthly or quarterly basis;

(3) Distributions are made whenever working capital exceeds a specified amount;

(4) Different distribution provisions apply for net cash from operations and for net proceeds from financing or capital transactions; and

(5) Priority distributions are made to certain classes of members.

If a distribution is not improper at the time a member becomes entitled to receive it, the member has the status of, and is entitled to all remedies available to, a creditor of the LLC with respect to the distribution. Corp C §17250.

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§6.57 D. Distributions in Kind

Unless the operating agreement provides otherwise, a member has no right to demand and receive a distribution in any form other than money, even if the member contributed specified property to the LLC. Corp C §17253(a). Thus, if a member contributes property to an LLC and wants that property distributed to him or her on dissolution or the occurrence of any other event, that distribution right must be set forth in the operating agreement.

A member may not be compelled to accept a distribution of any asset in kind in lieu of a proportionate distribution of money being made to other members. Corp C §17253(b). However, on the dissolution and winding up of an LLC, a member may be compelled to accept a distribution in kind. Corp C §17253(c).

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§6.58 E. Method of Determining Distributions

If the operating agreement does not set forth a method for calculating each member's share of distributions, the Beverly-Killea Limited Liability Company Act requires that distributions that are a return of capital are to be made in proportion to the contributions made by each member, while all other distributions are to be made in proportion to the allocation of profits. Corp C §17250. Any other method of allocating distributions among members that the client may want (*e.g.*, preferred returns for different classes or distributions based on capital accounts rather than contributions) must be set forth in the operating agreement. See Corp C §§17254-17255 regarding improper distributions. The operating agreement may provide for the establishment of a record date for distributions. Corp C §17250.

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IX. WITHDRAWAL OF MEMBERSHIP

§6.59 A. Withdrawal

Members may withdraw from the LLC in the manner specified in the articles of organization or operating agreement. The written operating agreement may provide that a member may not have the right to withdraw. However, notwithstanding any restriction on the right of a member to withdraw, Corp C §17252(a) provides that a member may withdraw from an LLC at any time by giving written notice to the other members.

On a member's withdrawal, the list of members that the LLC is required to maintain must be amended. Corp C §17252(b). See §13.16.

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§6.60 B. Status Following Withdrawal

Unless the articles or a written operating agreement provide otherwise, the withdrawn member is not entitled to payment for the member's interest in the LLC, and, beginning on the date of the withdrawal, the withdrawn member has only the right of a holder of an economic interest with respect to his or her own interest in the LLC (and then only for distributions to which a holder of an economic interest is entitled under the operating agreement), and the withdrawn member will no longer be a member of the LLC. Corp C §17252(a).

If the withdrawal is in violation of the operating agreement, the LLC has the right to offset any damages for the breach of the operating agreement from amounts otherwise distributable to the withdrawn member with respect to his or her economic interest. Corp C §17252(a).

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X. TRANSFER OF MEMBERSHIP INTERESTS

A. Restrictions on Transfer

§6.61 1. Statutory

Except as provided in the articles or operating agreement, membership interests and economic interests are freely assignable in whole or in part. Corp C §17301(a)(1). However, unless the articles or the operating agreement provide otherwise, an assignee of a membership interest may become a member only if a majority in interest of the other members vote in favor of the assignee's admission to the LLC as a member. Corp C §17303(a).

Any transfer of a membership interest or economic interest that is a security may be subject also to compliance with applicable securities laws. See chap 12 regarding securities restrictions.

On the assignment of all or part of a membership or an economic interest, the list of members and economic interest holders that the LLC is required to maintain must be amended. Corp C §17301(a)(4). See §13.16.

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§6.62 2. Contractual

LLC members often find it desirable to obtain contractual transfer restrictions on the right to purchase other members' interests. Members have great flexibility under the Beverly-Killea Limited Liability Company Act to create restrictions on assignment of membership or economic interests. For example, the transfer of these interests may require the unanimous consent of the members, the consent of members holding a specified percentage of the membership interests, or the consent of managers. Alternatively, interests may be freely transferable, transferable only to specified parties, or any other variation selected by the members.

NOTE: If the members wish the LLC interests to be entitled to a valuation discount for estate tax purposes, they should consult with a tax attorney before adopting any right to transfer a membership interest and admit the assignee as a member, admission being conditioned on obtaining the consent of no less than a majority in interest of the remaining members. See §4.37.

Although members ordinarily may grant security interests in or liens or other encumbrances against their membership interests without affecting their rights in the LLC, the operating agreement may place restrictions on their granting of liens against those interests.

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§6.63 B. Effects of Transfer

Unless the articles of organization or operating agreement provide otherwise, the assignor of a membership interest is not released from liability as a member solely as a result of the assignment. Corp C §17301(b). Similarly, the admission of the assignee as a member does not release the assignor from any obligation to make capital contributions or return improper distributions. Corp C §17303(c). If neither the articles nor the operating agreement release an assignor from such liability, an assignor must obtain the agreement of the LLC to be released. On release of a member's obligations, see §§6.20, 6.31.

An assignment of an economic interest does not of itself dissolve the LLC or, unless the articles or operating agreement so provide, entitle the assignee to vote or participate in the management and affairs of the company or to become, or exercise any rights of, a member. Instead, an assignee of an economic interest is entitled, merely to the extent assigned, to the distributions and allocations to which the assignor would have been entitled. Corp C §17301(a)(2)-(3).

Unless the articles or operating agreement provide otherwise, an assignee may become a member only if a majority in interest of the other members vote in favor of the assignee's admission. Corp C §17303(a). Until the assignee is admitted as a *member,* the assignee will have no liability to the LLC to make contributions or return distributions (unless the assignee agreed to assume those obligations with respect to the assignment of the interest). Corp C §17301(b). An assignee who is admitted as a member has, to the extent assigned, the same rights and powers, and is subject to the same restrictions and liabilities, of other members. An assignee who is admitted as a member also is liable for the obligations of the assignor to make contributions and to return unlawful distributions, except that the assignee is not obligated for liabilities that were unknown to the assignee at the time he or she became a member and that could not be ascertained from the articles or operating agreement. Corp C §17303(b).

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§6.64 C. Noncompetition

The members may agree that on a sale of any of their interests in the LLC (or on or in anticipation of a dissolution of the company), selling members will not carry on a similar business within a specified geographic area where the company business has been transacted as long as any other member, or any person deriving title to the business or its goodwill from any other member, carries on a like business in any of those places. Bus & P C §16602.5. The members should consider whether a particular form of noncompetition or confidentiality restriction is appropriate for their business. See §9.79 for a sample form of such a restriction. See generally California Business Litigation, chap 3 (Cal CEB 2002); Advising California Employers and Employees, chap 11 (Cal CEB 2005).

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7

Filing Requirements for Forming a Limited Liability Company

Edward S. Merrill
Kiran C. Jain

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.1 I. SCOPE OF CHAPTER

§7.1 I. SCOPE OF CHAPTER

Once the parties decide to form a California limited liability company (LLC), they must file appropriate documents. This chapter discusses the requirements for selecting the name of the LLC and the filing requirements for forming the LLC imposed by the Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17656). The requisite Secretary of State forms for filing and amending the articles of organization are reproduced in this chapter.

PRACTICE TIP: It is always a good idea to consult the website maintained by the Secretary of State (see this book's Directory) to be sure you have the latest forms, the latest filing fees, and other relevant updates.

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II. STATUTORY PREREQUISITES

§7.2 A. Selection of Name

The importance of the name selected for the LLC will vary, depending on the type of business in which the LLC is engaged. If the company will be providing a service or selling goods to the public, the LLC would likely choose its name more carefully and protect it more conscientiously than it would if it were, *e.g.,* developing a parcel of real estate.

The filing of articles of organization assures the LLC that it has exclusive rights to its name only insofar as names of LLCs are concerned. Filing does not preclude another business from filing articles of incorporation or a certificate of limited partnership under the same or a similar name, and the filing of articles does not, by itself, confer any trademark or service mark rights. Consequently, the LLC may wish to take steps to ensure the name's exclusivity and protectability.

The name of the LLC may include the name of one or more of its members. Corp C §17052(b). Beyond that, the choice of the LLC's name is limited by the requirements and prohibitions imposed by the Beverly-Killea Limited Liability Company Act and by other constraints imposed by state, federal, and common law. See §§7.3-7.5.

See Advising California Partnerships §§10.2-10.23 (3d ed Cal CEB 1999) for additional discussion of the business and legal factors involved in the selection of a name.

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§7.3 1. Mandatory and Prohibited Elements of Name

The name of an LLC must include at the end the words "limited liability company" or a permitted abbreviation of these words. The word "limited" may be abbreviated to "Ltd.," and the word "company" may be abbreviated to "Co." The term "limited liability company" may be abbreviated to "LLC" or "L.L.C." Corp C §17052(a). According to the Secretary of State's website, for indexing reasons, the name may not contain Roman numerals or symbols, but only English letters and Arabic numerals.

The name of the LLC may not contain the words "bank," "insurer," or "insurance company," or any other words suggesting that it is in the business of issuing insurance policies and assuming insurance risk. The name of the LLC also may not contain the words "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." Corp C §17052(d). Names suggesting governmental affiliation will be rejected.

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2. Availability of Name

§7.4 a. Secretary of State's Determination

Once the parties select a name that conforms with statutory constraints, they must find out whether that name is available in California for the organization of an LLC. A preliminary check of the availability of an LLC name can be made by mailing a name availability inquiry letter to the Secretary of State's office in Sacramento. The Secretary of State's website has a form of the letter that can be filled in online and printed from a computer. The Secretary of State's office does not accept e-mail or online name availability inquiries. Attorneys having a recurring need to check for the availability of LLC names may establish a prepaid account with the Secretary of State's office, and make inquiries over the telephone for a fee of $4 per search. (Note: It takes about two weeks to establish an account.) See the Directory at the end of this book for contact information.

Checking the availability of a limited liability company name does not reserve the name and has no binding effect on the Secretary of State, nor does it confer any rights to a name.

NOTE: It is advisable to seek confirmation of the availability of more than one name and, when inquiring by letter about availability, also to *reserve* the name. See §7.6.

Corporations Code §17052(c) sets forth a three-part standard for the Secretary of State's determination of whether a name may be used:

(1) The name may not be one likely to mislead the public, as determined by the Secretary of State;

(2) The name may not be the same as the name of another LLC that has organized, registered, or reserved a name in California; and

(3) The name may not resemble the name of another LLC that has organized, registered, or reserved a name in California so closely as to tend to deceive the public.

However, a new LLC may take substantially the same name as, but not identical to, an existing LLC if the existing LLC consents and the Secretary of State finds that, under the circumstances, the public is not likely to be misled. Corp C §17052(c). This arrangement is most often used by related companies with similar names.

Note that the Secretary of State's acceptance of an LLC's articles of organization for filing does not preclude a subsequent injunction to prevent the use of the name if it violates the provisions of Corp C §17052. Corp C §17052(e). The green light from the Secretary of State means only that there are no domestic or foreign LLCs qualified to do business in California with what the Secretary of State has determined to be a confusingly similar name. Corporate and limited partnership name records are separately maintained and are not checked in an LLC name search.

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§7.5 b. Other Constraints on Name Availability

The determination by the Secretary of State's office that a name is available for registration does not mean that the name may be used with impunity. There may be trade name or trademark problems with existing businesses in areas where the LLC intends to operate. See Advising California Partnerships, chap 10 (3d ed Cal CEB 1999) and California Business Litigation, chap 6 (Cal CEB 2002).

If the parties intend to qualify in another state, counsel should check that state's statutory requirements to verify that the name selected can be used in both California and the other jurisdiction.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.6 3. Reservation of Name

§7.6 3. Reservation of Name

A party may reserve a name or names with the Secretary of State for 60 days, by written request for reservation accompanied by payment of a $10 fee for each name the party wants to reserve. Corp C §17053; Govt C §12190(a). Each name requires its own Name Reservation Request Form. See §7.7.

NOTE: If the name reservation request is made over the counter, an additional $10 fee is charged. This fee must be paid by separate check.

The name may be reserved for one 60-day period only. The Secretary of State will not issue certificates reserving the same name for two or more consecutive 60-day periods to the same applicant or for the use or benefit of the same person; nor will consecutive reservations be made for names so similar that they fall within the prohibitions of Corp C §17052(c). Corp C §17053. However, a request may be renewed after the name has been available to the public for one full business day.

If the parties desire to confirm name availability in writing, it is advisable to seek confirmation of the availability of more than one name, in order of preference, and to request in the same writing that the Secretary reserve the first available name. The Secretary of State will consider the availability of up to three names per request.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.7 4. Form: Name Reservation Request Form

§7.7 4. Form: Name Reservation Request Form



Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 95814

Business Entities
(916) 657-5448

Name Reservation Request Form

(Corporation, Limited Liability Company, or Limited Partnership Names)

The proposed name is being reserved for use by:

Your Name: _____ Phone #: _____

Firm Name (if any): _____ Fax #: _____

Address: _____

City/State/Zip: _____

Type of Entity (Select the applicable entity type. Only one type may be selected. **Note:** If the "Limited Partnership" type is selected, see page 2 of this Name Reservation Request Form for an additional requirement.)

☐ Corporation ☐ Limited Liability Company ☐ Limited Partnership

Name To Be Reserved (Enter the name to be reserved. Only one reservation will be made per Name Reservation Request Form. You may list up to three names, in order of preference, and the first available name will be reserved for a period of 60 days. The remaining names will not be researched.)

1st Choice: _____

____ *is available.* ____ *is available only with consent from:* ____ *is not available. We have:*

2nd Choice: _____

is available. *is available only with consent from:* *is not available. We have:*

3rd Choice: _____

is available. *is available only with consent from:* *is not available. We have:*

Suspended/Forfeited Entity

☐ If the proposed name is being reserved for the purpose of reviving a suspended or forfeited entity, check the box and include the entity number. _____ Entity Number

Mail Back Response

☐ If the Name Reservation Request Form is submitted in person **and** if you would like the reservation to be mailed back, check the box and include a self-addressed envelope.

Fees (Please make check(s) payable to the Secretary of State.)

Reservation Fee: The fee for reserving a corporation, limited liability company or limited partnership name is $10.00 (per reserved name).

Special Handling Fee:

- In addition to the reservation fee, a $10.00 special handling fee is applicable for processing each Name Reservation Request Form delivered in person (drop off) to the Secretary of State's office.
- The $10.00 special handling fee must be remitted by separate check and will be retained whether the proposed name is accepted or denied for reservation.
- The special handling fee does not apply to name reservation requests submitted by mail.

THE SPACE BELOW IS RESERVED FOR OFFICE USE ONLY

Date:	Amt Rec'd:	R #:	By:

❑ **Corporation Names:**

A corporation name must not be a name that is "likely to mislead the public or the same as, or resembling so closely as to tend to deceive," the name of a California or foreign corporation that has registered with this office or a name that has been reserved by another party. Note: Names are considered deceptive if the only difference is a corporate ending. (California Corporations Code section 201(b) and 2106(b).) A Corporation name is reserved pursuant to California Corporations Code section 201(c).

❑ **Limited Liability Company (LLC) Names:**

An LLC name: (1) must not be a name that is "likely to mislead the public or which is the same as, or resembles so closely as to tend to deceive," the name of a California or foreign LLC that has registered with this office or a name that has been reserved by another party. Note: Names are considered deceptive if the only difference is an LLC ending; (2) must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively; (3) may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.;" and (4) must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks. (California Corporations Code section 17052 and 17452.) An LLC name is reserved pursuant to California Corporations Code section 17053.

❑ **Limited Partnership (LP) Names:**

An LP name: (1) must be distinguishable in the records of the Secretary of State from the name of an existing LP or an LP name that has been reserved by another party. Note: Names are not considered distinguishable if the only difference is a limited partnership ending; (2) must end with the phrase "Limited Partnership" or the abbreviation "LP" or "L.P."; and (3) may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." Note: If entity is a foreign LP that is a foreign limited liability LP, the name must contain the phrase "limited liability limited partnership," or the abbreviation "LLLP" or "L.L.L.P." and may not contain the abbreviation "LP" or "L.P." (California Corporations Code section 15901.08, 15909.05.) An LP name is reserved pursuant to California Corporations Code section 15901.09.

Additional Requirement - Limited Partnership Names

In addition to completing the information on page 1 of this Name Reservation Request Form, a request to reserve a limited partnership name also must state the eligibility for the reservation as required by California Corporations Code section 15901.09. **Please select the applicable statement below** and attach this page to page 1 of this request form. Note: Only one statement may be selected.

The exclusive right to the use of the proposed limited partnership name is being reserved by:

☐ a person intending to organize a limited partnership under Chapter 5.5 of the California Corporations Code and adopt the name.

☐ a domestic (California) limited partnership or a foreign (out-of-state or out-of-country) limited partnership authorized to transact business in California intending to adopt the name.

☐ a foreign limited partnership intending to obtain a certificate of registration to transact business in California and adopt the name.

☐ a person intending to organize a foreign limited partnership in the foreign jurisdiction and intending to have it obtain a certificate of registration to transact business in California and adopt the name.

☐ a foreign limited partnership formed in the foreign jurisdiction under the name.

☐ a foreign limited partnership formed in the foreign jurisdiction under a name that does not comply with the requirements of California Corporations Code section 15901.08(b) or 15901.08(c), but the name to be reserved may differ from the foreign limited partnership's actual name only to the extent necessary to comply with California Corporations Code section 15901.08(b) or 15901.08(c).

Print

Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 95814

Business Entities
(916) 657-5448

Name Reservation Request

(Corporation, Limited Liability Company, or Limited Partnership Names)

To request the reservation of a corporation, limited liability company or limited partnership name, complete the Name Reservation Request Form on the following page, attach a check in the amount of $10.00 (made payable to the Secretary of State) and submit the request:

- **By mail**, along with a self-addressed envelope, to Secretary of State, Name Availability Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. Please refer to our Mail Processing Times webpage at www.sos.ca.gov/business/be/mail-processing-times.htm for current mail processing times.
- **In person (drop off)** at the Secretary of State's office in Sacramento. *Corporation* names also can be reserved, in person, at any of the Secretary of State's regional office locations. Please refer to our Regional Offices webpage at www.sos.ca.gov/business/regional.htm for regional office locations and addresses. A special handling fee of $10.00 is applicable for each name reserved in person. The special handling fee must be remitted separately and will be retained whether the proposed name is accepted or denied for reservation. The special handling fee is not applicable to requests submitted by mail.

Only one reservation will be made per request form. You may list up to three names, in order of preference, and the first available name will be reserved for a period of 60 days. The remaining names will not be researched.

A name reservation is made for a period of 60 days. The name reservation can be renewed to the same applicant or for the benefit of the same party, but not for consecutive periods.

E-mail and/or online requests for name reservations cannot be accepted at this time. Please complete the Name Reservation Request Form on the following page.

Note: The reservation of a proposed corporation, limited liability company or limited partnership name does not guarantee that the reserved name complies with all federal and state laws. At the time of filing the document containing the reserved name, it is your responsibility to ensure that you have complied with all federal and state laws, including specific name requirements. In some circumstances, the reserved name may require additional approval/consent pursuant to applicable law at the time of filing. Name styles for particular types of business entities and the need for consent/approval required by law are not considered at the time of the name reservation. Therefore, no financial commitment relating to the proposed name should be made based on the reservation, since the business entity record is not created/qualified/amended until the appropriate documents have been submitted to and filed by the Secretary of State.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.8 B. One or More Members

§7.8 B. One or More Members

A California LLC may have only one member. Corp C §17050(b). See also Corp C §17001(t) (defining an LLC). The member or members may be foreign or domestic individuals, partnerships, limited partnerships, trusts, estates, associations, corporations, other LLCs, or other entities. Corp C §17001(x), (ae).

NOTE: Under the check-the-box regulations (Regs §§301.7701-1—301.7701-3), a single-member LLC is treated as a sole proprietorship for federal income tax purposes unless the LLC elects to be treated as a corporation. Under California's check-the-box regulations (18 Cal Code Regs §§23038(b)-1—23038(b)-3), a single-member LLC doing business in California is disregarded for California income and franchise tax purposes.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.9 C. Articles of Organization

§7.9 C. Articles of Organization

Unlike a general partnership, the LLC is a creature of statute and does not exist unless the articles of organization have been duly filed with the Secretary of State, and the members have entered into an operating agreement. Corp C §17050(a). The existence of an LLC begins with the filing of the articles of organization. Corp C §17050(c). A certified copy of the articles is conclusive evidence of the formation of the LLC and prima facie evidence of its existence. Corp C §17050(c).

The articles must be filed on the Secretary of State's Form LLC-1. Form LLC-1 is reproduced in §7.15 and discussed in detail in §§7.16-7.23. Although the form is straightforward, always review the accompanying directions, because there are a few nuances to clarify. The Secretary of State's office reviews LLC-1s very carefully for compliance with the law.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.10 D. Operating Agreement

§7.10 D. Operating Agreement

The members of an LLC must enter into an operating agreement, either before or after the filing of the articles of organization. Corp C §17050(a). Absent some special reason, the operating agreement is not filed with the Secretary of State.

The operating agreement may be written or oral. Corp C §17001(ab). An oral operating agreement can be as simple as agreeing to form an LLC, with nothing more, in which case the default provisions of the Beverly-Killea Limited Liability Company Act govern the LLC. Corp C §17001(ab).

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.11 E. Payment of Filing Fee

§7.11 E. Payment of Filing Fee

The filing fee for the articles of organization is $70. Govt C §12190. If the fee is paid by check and the check is dishonored, the Secretary of State may cancel the filing of the articles retroactively after notice. Corp C §17051(e). Section 17051(e) sets forth the procedure:

> Upon receiving written notification that the item presented for payment has not been honored for payment, the Secretary of State shall give a first written notice of the applicability of this section to the agent for service of process or to the person submitting the instrument. Thereafter, if the amount has not been paid by cashier's check or equivalent, the Secretary of State shall give a second written notice of cancellation and the cancellation shall be effective at that time. The second notice shall be given 20 days or more after the first notice and 90 days or less after the original filing.

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F. Lawful Business Activity

§7.12 1. Some Financial Services Excepted

An LLC may engage in any lawful business activity, whether or not for profit, except the banking, insurance, or trust company business, subject to any limitations contained in the articles of organization or imposed by other applicable laws. Corp C §17002(a).

However, an LLC may operate as a health care service plan licensed under Health & S C §1340 if the LLC is established as a subsidiary of a parent health care services plan for the purpose of carrying on an existing line of business. Corp C §17002(b).

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.13 2. Professional Services Excepted

§7.13 2. Professional Services Excepted

Corporations Code §17375 provides:

> Nothing in this title shall be construed to permit a domestic or foreign limited liability company to render professional services, as defined in subdivision (a) of Section 13401 and in Section 13401.3, in this state.

Section 17375 may have a broader effect than originally intended because of the uncertainty engendered by referring to the definition of "professional services" set forth in Corp C §13401(a), which defines "professional services" to mean "any type of professional services which may be lawfully rendered only under a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act."

There are over 40 occupations that require a license, certification, or registration under the Business and Professions Code, such as barber, locksmith, contractor, private detective, alarm company, structural pest control operator, electronic and appliance repair shop, and many others. If those businesses were deemed to be providing "professional services," they would be ineligible to organize their businesses as an LLC because their services require a license, certification, or registration under the Business and Professions Code.

Corporations Code §13401(a) is part of the Moscone-Knox Professional Corporation Act (Corp C §§13400-13410), which was passed to allow professions to practice through professional corporations. It is unlikely that the reference to "professional services" in Corp C §13401(a) was intended to encompass the services of contractors and the like since those businesses were already authorized to form corporations.

In light of the foregoing, it seems likely that the legislature intended to preclude from using the LLC as a form of organization only those professions that could practice in corporate form only through a professional corporation under the Moscone-Knox Professional Corporation Act. On the other hand, Corp C §17375 also refers to Corp C §13401.3, and that section uses the term "professional services" in connection with yacht and ship brokers. This is the reasoning adopted by the California Attorney General on this issue (87 Ops Cal Atty Gen 109 (2004)), which distinguishes between professional and nonprofessional licenses on the basis of the requirements of the license. If the license focuses on moral and financial issues, but not on education, training or testing, it is a nonprofessional license (*e.g.,* automobile salesmen or food processors). If the license focuses on training, education or skills, it is a professional license. Doctors, lawyers, chiropractors, pharmacists, marriage and family counselors and the like are easy calls for professions ineligible for the LLC form of organization.

Because of the uncertainty of the scope of Corp C §17375, counsel should be cautious in advising clients that they can use the LLC form of organization for any business that requires a license, certification, or registration under the Business and Professions Code.

NOTE: The legal effect of an LLC rendering professional services it is not permitted to render is not clear. Certainly, a regulatory agency might refuse to license, certify, or register such an LLC. Some agency may apply the rule indirectly as well. For example the California State Contractor's License Board has a policy of not allowing partnerships to apply for a license if the general partner is an LLC. The worst case would be that an LLC that renders professional services would not be recognized as an LLC and the members of the LLC might be treated as a general partners. A better reading is that §17375 only goes to authorized activities of an already organized domestic or foreign LLC and not to their proper organization.

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III. FILING ARTICLES OF ORGANIZATION

A. Guidelines for Completing Form LLC-1

§7.14 1. Online Availability of Forms

All Secretary of State LLC forms are available on the Secretary of State's website. See the Directory for the website's URL.

The forms are created with the Adobe Acrobat program in Portable Document Format (.pdf) and are easy to obtain and use. The forms may be filled out online and the completed form printed locally. They also may be viewed and printed out using a web browser, or they may be downloaded and printed out locally.

For those who do not have Adobe Acrobat but wish to view and print out files in pdf format, Adobe distributes its Reader program free of charge online (http://www.adobe.com).

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.15 2. Form: Limited Liability Company Articles of Organization (Secretary of State Form LLC-1)

§7.15 2. Form: Limited Liability Company Articles of Organization (Secretary of State Form LLC-1)



LLC-1 File # _____

State of California
Secretary of State

LIMITED LIABILITY COMPANY ARTICLES OF ORGANIZATION

A $70.00 filing fee must accompany this form.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

ENTITY NAME (End the name with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively.)

1. NAME OF LIMITED LIABILITY COMPANY

PURPOSE (The following statement is required by statute and should not be altered.)

2. THE PURPOSE OF THE LIMITED LIABILITY COMPANY IS TO ENGAGE IN ANY LAWFUL ACT OR ACTIVITY FOR WHICH A LIMITED LIABILITY COMPANY MAY BE ORGANIZED UNDER THE BEVERLY-KILLEA LIMITED LIABILITY COMPANY ACT.

INITIAL AGENT FOR SERVICE OF PROCESS (If the agent is an individual, the agent must reside in California and both Items 3 and 4 must be completed. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 3 must be completed (leave Item 4 blank).

3. NAME OF INITIAL AGENT FOR SERVICE OF PROCESS

4. IF AN INDIVIDUAL, ADDRESS OF INITIAL AGENT FOR SERVICE OF PROCESS IN CALIFORNIA | CITY | STATE | ZIP CODE

CA

MANAGEMENT (Check only one)

5. THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY:

- ☐ ONE MANAGER
- ☐ MORE THAN ONE MANAGER
- ☐ ALL LIMITED LIABILITY COMPANY MEMBER(S)

ADDITIONAL INFORMATION

6. ADDITIONAL INFORMATION SET FORTH ON THE ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE A PART OF THIS CERTIFICATE.

EXECUTION

7. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

_____ DATE

_____ SIGNATURE OF ORGANIZER

_____ TYPE OR PRINT NAME OF ORGANIZER

Print

INSTRUCTIONS FOR COMPLETING THE ARTICLES OF ORGANIZATION (FORM LLC-1)

For easier completion, this form is available on the Secretary of State's website at http://www.sos.ca.gov/business/ and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Statutory filing requirements are found in California Corporations Code sections 17051 and 17052. All statutory references are to the California Corporations Code, unless otherwise stated.

FEES: The fee for filing Form LLC-1 is $70.00. There is an additional $15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at http://www.sos.ca.gov/business/precexp.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

COPIES: The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the $8.00 per copy certification fee.

Pursuant to Section 17375, a domestic limited liability company may not render professional services, as defined in Sections 13401(a) and 13401.3. Professional services are defined as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act. If your business is required to be licensed, certified or registered, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional.

Filing this document shall obligate most limited liability companies to pay an annual minimum tax of $800.00 to the Franchise Tax Board pursuant to Revenue and Taxation Code section 17941.

Complete the Articles of Organization (Form LLC-1) as follows:

Item 1. Enter the name of the limited liability company. The name must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks.

Item 2. This statement is required by statute and should not be altered. Provisions limiting or restricting the business of the limited liability company may be included as an attachment.

Items 3 & 4 Enter the name of the agent for service of process in California. An agent is an individual, whether or not affiliated with the limited liability company, who resides in California or a corporation designated to accept service of process if the company is sued. The agent should agree to accept service of process on behalf of the limited liability company prior to designation.

If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, **a limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.

If an individual is designated as agent, complete Items 3 and 4. If a corporation is designated as agent, complete Item 3 and proceed to Item 5 (do not complete Item 4).

Item 5. Check the appropriate provision indicating whether the limited liability company is to be managed by one manager, more than one manager or all limited liability company members. Only one box may be checked.

Item 6. Attach any other information to be included in Form LLC-1, provided that the information is not inconsistent with law.

Item 7. Form LLC-1 must be signed by the organizer. The person signing Form LLC-1 need not be a member or manager of the limited liability company.

- If Form LLC-1 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of person)."
- If Form LLC-1 is signed by an entity, the person who signs on behalf of the entity should note their name and position/title and the entity name. Example: If a limited liability company ("Smith LLC") is the organizer, the signature of the person signing on behalf of the Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Organizer.
- If Form LLC-1 is signed by a trust, the trustee should sign as follows:_____, trustee for _____ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T 5-1-94).

Any attachments to Form LLC-1 are incorporated by reference. All attachments should be 8 ½" x 11", one-sided and legible.

Print

Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 94244-2300

Business Entities
(916) 657-5448

LIMITED LIABILITY COMPANIES

California Tax Information

Registration of a limited liability company with the California Secretary of State will obligate a limited liability company that is not taxed as a corporation to pay to the Franchise Tax Board an annual minimum tax of $800.00 and a fee based on the annual total income of the entity. The tax and fee are required to be paid for the taxable year of registration and each taxable year, or part thereof, until a Certificate of Cancellation is filed with the California Secretary of State. (Rev. and Tax. Code §§ 17941 and 17942.)

A limited liability company is not subject to the taxes and fees imposed by Revenue and Taxation Code sections 17941 and 17942 if the limited liability company did no business in California during the taxable year and the taxable year was 15 days or less. (Rev. and Tax. Code § 17946.)

For further information, please contact the Franchise Tax Board at:

From within the United States (toll free) .....(800) 852-5711
From outside the United States (not toll free).....(916) 845-6500
Automated Toll Free Phone Service.....(800) 338-0505

Professional Services Information

Pursuant to California Corporations Code section 17375, a domestic or foreign limited liability company may not render professional services, as defined in Corporations Code sections 13401(a) and 13401.3. Professional services are defined as:

> Any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act.

If your business is required to be licensed, registered or certified, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional.

LLC Info (REV 03/2005)

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.16 a. Entering LLC Name

§7.16 a. Entering LLC Name

Once a name is selected that complies with statutory requirements and restrictions, it should be placed in the space for Item 1 of the form. If the name was reserved before filing, the certificate of name reservation should be attached to the articles of organization.

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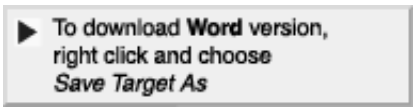
§7.17 b. Stating Latest Dissolution Date

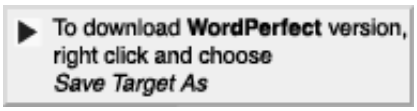
The articles of organization may, but are not required to, state a date on which the LLC is to dissolve. Corp C §17051(c)(3). Form LLC-1 does not provide a space for a latest dissolution date and the date must be set forth on separate attached pages. See §7.21. The law as originally enacted did require that a dissolution date be stated (out of concern that it was required by former regulations of the IRS if the LLC were to be treated as a partnership for income tax purposes). LLCs that stated a dissolution date in the articles of organization may file a certificate of amendment or restated articles of organization to change or delete the date. See §§7.31, 7.35.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.18 c. Describing LLC's Purpose

§7.18 c. Describing LLC's Purpose





The purpose of the LLC must be stated exactly as prescribed by the Beverly-Killea Limited Liability Company Act. Corp C §17051(a)(2). The following statutory statement of purpose, preprinted as Item 2 of Form LLC-1, is mandatory and may not be modified:

The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act.

Under Corp C §17051(c)(1), the business of the LLC may be limited or restricted, but that must be indicated in an attachment to Form LLC-1. See §§7.28-7.30 for discussion of nonstatutory additions to the articles.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.19 d. Designating Agent for Service of Process

§7.19 d. Designating Agent for Service of Process

The agent for service of process must be designated in Item 3 of Form LLC-1. The agent may be a natural person or a corporation that has filed with the Secretary of State a certificate relating to its acting as a corporate agent for service of process under Corp C §1505. Note that a California corporation is not eligible, simply by virtue of being a California corporation, to act as a corporate agent for service of process; it must first file a certificate under Corp C §1505. A foreign corporation that has filed the certificate under Corp C §1505 may also act as a corporate agent for service of process. Only an individual or a corporation that has filed a certificate under Corp C §1505 may act as a service agent for an LLC, which means that a law firm that is a partnership or LLP may not under any circumstances be designated as an agent for service of process in Item 3 of Form LLC-1.

If the agent is an individual, that individual must reside in California and the articles must specify either the individual's residence or business address in Item 4 of the form. Corp C §17061(d)(1). Neither a post office box nor an address "in care of" another may be specified. Note that no address is required in Item 4 if a corporate agent is designated.

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§7.20 e. Indicating Type of Management

Item 5 of Form LLC-1, which indicates the management of the LLC, requires only that the filing party check a box, but doing so has significant consequences for the LLC. Unless the parties indicate otherwise, an LLC will be managed by all of its members. Corp C §§17051(a)(6), 17151(b). In this case, the LLC is commonly referred to as being "member-managed."

If the box for "one manager" or "more than one manager" is checked, the LLC is commonly referred to as being "manager-managed." For a manager-managed LLC, the following business arrangements, among others, will obtain:

(1) The ostensible agency power to bind the LLC in the ordinary course of business is vested in the manager or managers rather than the members. Corp C §17157(b).

(2) Certain provisions regarding the election, removal, resignation, and term of managers are in effect. Corp C §17152.

(3) The interests of the members will be characterized as "securities" for California law purposes, unless the person claiming exemption proves that all members are actively engaged in the management of the LLC. Corp C §25019. See §12.44.

If the "one manager" box is checked, then the signature of the single manager on any note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance, or other instrument is binding on the LLC, absent actual knowledge by a third party of the lack of authority. If the "more than one manager" box is checked, the signature of any two managers on any instrument is binding on the LLC even if it is outside the ordinary course of business and even if the third party has actual knowledge of a restriction on the authority of the manager provided the third party has no actual knowledge of a lack of authority to execute the instrument. Corp C §17157(b), (d).

If the "all limited liability company members" or "single member limited liability company" box is checked (*i.e.*, the LLC is member managed), then each member or the single member of the LLC has the ostensible agency power to bind the LLC in the ordinary course of business. Any two members (or the single member) executing an instrument on behalf of the LLC will have the power to bind the LLC, even outside the ordinary course of business, to the same extent as two managers (or the single manager) executing an instrument on behalf of a manager-managed LLC. Corp C §§17001(w), 17157(d).

Both member-managed and manager-managed LLCs may have officers. Corp C §17154. Instruments are binding on the LLC when signed by two LLC officers, as specified in the Beverly-Killea Limited Liability Company Act, absent actual knowledge of a lack of authority. See Corp C §17154(c).

The management aspects of the member/manager choice are discussed in more detail in chap 13.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.21 f. Attachments

§7.21 f. Attachments

Item 6 of Form LLC-1 states that other matters to be included in the articles of organization may be set forth on separate attached pages. If additional provisions are to be included, they should be typed on one side of 8 1/2-inch by 11-inch paper. See §§7.28-7.30. Additional provisions included in the articles of organization do not constitute constructive notice to third parties. See §7.29. Recording a certified copy of the articles of organization may create a conclusive presumption in favor of a bona fide purchaser or encumbrancer of the LLC's real property in the county where the certified copy has been recorded. Corp C §17052(f).

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.22 g. Signatures

§7.22 g. Signatures

Item 7 of Form LLC-1 provides for a signature by the "organizer" of the LLC. Previously, all Forms LLC-1 were required to have an original ink signature; copies and facsimiles were not permitted. As of January 1, 2004, however, the Secretary of State is required to accept facsimile signatures on documents that are delivered by mail or by hand. Corp C §17.1(c). The signatory must maintain the originally signed document for at least 5 years from the date of filing. Corp C §17.1(d). The individual signing the Form LLC-1 may be, but need not be, a member or a manager. The individual signing Form LLC-1 is *not* the equivalent of the corporate incorporator, because the individual is not empowered to take any other actions on behalf of the LLC. Once Form LLC-1 has been filed, an individual signatory who is not a manager has no further authority to execute documents to be filed with the Secretary of State. See Corp C §§17157, 17056(a)(1). The LLC comes to legal life only when the members enter into the operating agreement, and it is the operating agreement that gives authority to act on behalf of the LLC. Thus, the use of a nonmember or nonmanager signatory on Form LLC-1 enables the members to enter into the operating agreement after the filing of the articles of organization.

The articles of organization (and other documents) may be executed by the attorney-in-fact of any person authorized to sign. The power of attorney need not be sworn to, verified, or acknowledged, and does not need to be filed with the Secretary of State. Corp C §17056(b). However, it must be retained as a part of the LLC's records. Corp C §17058(a)(3).

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.23 h. Return of Filed Form LLC-1

§7.23 h. Return of Filed Form LLC-1

Item 8 of Form LLC-1, which contains a block for information regarding the return of the acknowledgment of filing, must be completed at the time of filing. The Secretary of State has rejected articles of organization when this return address has not been completed. After filing, the Secretary of State will return a certified copy of the filed articles of organization to the person or entity designated to receive the acknowledgment.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.24 3. Fax and Electronic Filing of Forms

§7.24 3. Fax and Electronic Filing of Forms

The Secretary of State has been authorized to adopt procedures permitting the direct presentation for filing of documents in facsimile or electronic form, but is not required to accept fax or electronic filings until the procedures are in place. Corp C §17.1(e). As of March 2009, these procedures are not imminent.

The requirement that the Secretary of State accept facsimile signatures on documents that are delivered by mail or by hand (see §7.22) enables practitioners to transmit fax filings to a service company, which will file such filings over the counter.

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§7.25 4. Preclearance and Expedited Filing Services

Effective September 15, 2008, the Secretary of State expanded its preclearance and expedited filing services to include same-day service for filing business entity documents in person at the Sacramento office, and various levels of service for other business entity filing and order requests. See §§7.26-7.27.

For the most current information on both services, see the Secretary of State's website. See this book's Directory for the specific URL.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.26 a. Preclearance Procedures

§7.26 a. Preclearance Procedures

The preclearance service provides a filer the opportunity to submit a document in person at the public counter of the Secretary of State's Sacramento office before filing (see Directory for address and hours), to determine if it conforms to law and to receive a preclearance response within a guaranteed time frame, as outlined in the table below.

PRECLEARANCE SERVICE

Level of Service	Response Time	Fee	Examples
Class I Service	24 hours	$500	Document submitted Monday at 9:00 a.m.; preclearance response available Tuesday by 9:00 a.m.
Class II Service	72 hours	$400	Document submitted Tuesday at 11:00 a.m.; preclearance response available Friday by 11:00 a.m.
Class III Service	5 business days	$300	Document submitted Wednesday at 2:00 p.m.; preclearance response available the following Wednesday by 2:00 p.m.
Class IV Service	10 business days	$250	Document submitted Friday at 8:00 a.m.; preclearance response available by 8:00 a.m. the second Friday following submittal.

A document submitted to the Secretary of State for preclearance must contain the name of the business entity. Preclearance approval does not guarantee name availability of a proposed LLC at the time of filing. While not required, a request to reserve a proposed name for a period of 60 days (see §7.6), along with a $20 name reservation fee, can be included with the preclearance request and the applicable preclearance fee. A document may be submitted with designated blank spaces for information that does not affect the Secretary of State's determination of whether the eligible document will conform to law. Such information may include, but is not limited to, names of executing officers, required signatures, and dollar amounts.

If the preclearance is denied, the preclearance response will state the reason(s) for the denial. A filer may request delivery of the preclearance response by customer pickup, email, fax, first class mail, or overnight courier (a prepaid, preaddressed overnight courier envelope must be included).

Preclearance requests must include:

- The document, in the form for which preclearance is sought (personally delivered to the Secretary of State's Sacramento office);
- The applicable preclearance fee;
- Instructions for the class of service requested and the preferred means of delivery of the preclearance response; and
- The name and telephone number of the person to whom any questions regarding the document or service requested may be directed.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.27 b. Expedited Filing Procedures

§7.27 b. Expedited Filing Procedures

Filing and order requests submitted by mail to the Secretary of State's Sacramento office are generally processed within 10 to 20 business days and do not require payment of a special handling fee.

Filing requests submitted in person to the Sacramento or any regional office (located in Fresno, San Francisco, and Los Angeles) along with a $15 special handling fee and applicable filing fee will be processed in priority over documents submitted by mail. The average processing time for drop-off services is 3 to 7 business days.

Expedited filing provides a filer with the opportunity to submit a business entity document and to receive a filing response within a guaranteed time frame, as outlined in the table below.

EXPEDITED FILING SERVICE

Level of Service	Response Time	Expedite Fee*	Examples
Class A Service (Preclearance approval required)	4 hours	$500	Document submitted Monday at 10:00 a.m.; filing confirmation or filing response available Monday by 2:00 p.m.
Class B Service	Same day	$750	Document submitted by 9:30 a.m.; filing confirmation or filing response available same day by 4:00 p.m.
Class C Service	24 hours	$350	Document submitted Tuesday at 11:00 a.m.; filing confirmation or filing response available Wednesday by 11:00 a.m.

Expedited filing requests must be delivered in person at the public counter of the Secretary of State's Sacramento office. See Directory for address and hours.

A document submitted to the Secretary of State for expedited filing will be reviewed and a filing response will be provided within the time frame requested, indicating whether the document has been filed or rejected. Note that a document must be precleared and approved to be eligible for Class A Service.

If the document is rejected, the filing response will state the reason(s) for the rejection. A filer may request delivery of the preclearance response by customer pickup, email, fax, first class mail, or overnight courier (a prepaid, preaddressed overnight courier envelope must be included).

Expedited filing requests must include:

- The document, containing required signatures (personally delivered to the Secretary of State's Sacramento office);
- Two copies of the document;
- A copy of the approved preclearance response, if Class A Service is requested;
- The applicable filing fee;
- The applicable expedite fee (see table above);

NOTE: The expedite fee must be remitted by separate check and will be retained whether the document is filed or rejected.

- Instructions for the class of service requested and the preferred means of delivery of the filing confirmation or filing response; and
- The name and telephone number of the person to whom any questions regarding the document or service

requested may be directed.

See generally 2 Cal Code Regs §§21903, 21905, 21905.5.

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§7.28 B. Filing Supplemental Information With the Articles

Practitioners differ on whether it is advisable to file supplemental materials with the articles of organization. There are, of course, many special situations in which it might be a good idea or a mistake to include a special provision in the articles of organization, but two basic reasons justify attaching supplemental provisions to the articles: (1) attempting to affect the rights of third parties vis-à-vis an LLC (see §7.29) and (2) attempting to affect the rights of members among themselves, particularly to alter their contract or to protect against inadvertent changes that may affect the LLC's tax status (see §7.30).

The Beverly-Killea Limited Liability Company Act permits the articles to contain any provision "not inconsistent with law." By way of illustration, the Act enumerates the following examples of supplemental material:

- Provisions limiting the business or powers of the LLC (Corp C §17051(c)(1));
- Provisions governing the admission of members to the LLC (Corp C §17051(c)(2));
- A time at which the LLC is to dissolve (Corp C §17051(c)(3));
- Provisions listing events that will cause the dissolution of the LLC under Corp C §17350(a) (Corp C §17051(c)(4));
- A statement of any limitations on the authority of managers or members to bind the LLC (Corp C §17051(c)(5)); and
- The names of the managers of the LLC (Corp C §17051(c)(6)).

NOTE: The disadvantage of including supplemental provisions in the articles of organization is that they become part of a public record.

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§7.29 1. Provisions Affecting Rights of Third Parties

Even though the Beverly-Killea Limited Liability Company Act permits filing parties to include provisions that constrain the LLC's business activities or restrict the authority of its members or managers, the Act severely restricts the effect of any such provisions on third parties (Corp C §17051(d)):

> No limitation upon the business, purposes, or powers of the limited liability company contained in or implied by the articles of organization or by the operating agreement may be asserted by any person, except in one of the following types of proceedings: (1) In a proceeding by a member or the state to enjoin the doing of unauthorized business by the limited liability company or its managers or officers, if third parties have not acquired rights thereby. (2) In a proceeding to dissolve the limited liability company. (3) In a derivative proceeding by the limited liability company or by a member suing on the company's behalf against the officers or managers of the limited liability company for violation of their authority. However, the limitation may not be asserted if the person asserting the limitation had actual knowledge of the limitation at the time of the act or event complained of.

Corporations Code §17052(f) permits an LLC to record a certified copy of the articles of organization, including any exhibits or attachments, in a county recorder's office. It is common for counsel representing potential buyers of real property (or lenders who are lending against the security of real property) to review all documents that are recorded against a property. Even in transactions that do not involve real estate, third parties or their counsel may choose to review an LLC's articles of organization or its operating agreement to verify the authority of signatories. Corporations Code §17051(d) does not preclude the limitations from operating as actual notice to third parties of a lack of authority. A third party who reads a limitation in the articles of organization will have actual knowledge of a limitation on authority sufficient to nullify the ostensible authority of a member (Corp C §17157(a)) or manager (Corp C §17157(b)(2)).

If the limitation on authority is read as a lack of authority to execute the instrument, a limitation in the articles of organization known to a third party may nullify the effect of an instrument having been executed by two or more managers (or two or more members, in the case of a member-managed LLC) when the signatories lack actual authority to execute the instrument. Corp C §17157(d).

If there is a particular need to narrow the scope of the LLC's business or to constrain the authority of managers or members to undertake certain obligations on behalf of the LLC, the parties should consider including restrictive provisions in the articles of organization. The provisions will not constitute *constructive notice,* but if they are read by the third parties or their attorneys, they should be sufficient to give *actual notice* to third parties.

Even if a certified copy of the articles of organization containing a restriction on authority is recorded in the county recorder's office, such recordation will not constitute constructive notice of the restrictions to a potential purchaser (or encumbrancer) of the LLC's real property in that county. The recordation of an instrument that is not a conveyance creates constructive notice only if a statute expressly provides that it creates constructive notice. *Owens v Palos Verdes Monaco* (1983) 142 CA3d 855, 191 CR 381, disapproved on other grounds in *Applied Equip. Corp. v Litton Saudi Arabia Ltd.* (1994) 7 C4th 503, 521, 28 CR2d 475. Corporations Code §17052(f) provides that the recording creates a conclusive presumption "in favor of" bona fide purchasers and lenders. The statute does not provide that restrictions on authority set forth in a certified copy of the articles of organization that has been recorded with the county recorder will be effective *against* such purchasers and lenders. Compare this with Corp C §16303(e), which expressly provides that other persons are deemed to know of a limitation on the authority of a partner in a statement of partnership.

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§7.30 2. Provisions Affecting Rights of Members

The rights of members of LLCs are almost exclusively creatures of contract (as embodied in the articles of organization and the operating agreement), and there are few restrictions on the members' ability to alter their contract. Most of these restrictions are contained in Corp C §17005. See §§6.4-6.6, 6.17.

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IV. MODIFYING ARTICLES OF ORGANIZATION

§7.31 A. Amendment: Procedure and Requirements

The members may amend the articles of organization at any time and in any manner that they see fit, as long as the articles, as amended, contain only provisions whose inclusion is lawful at the time of the amendment. The entire articles are evaluated as of the date of the amendment; it does not matter if the provisions of the amendment were impermissible at the time the original articles were filed. Corp C §17054(a).

Amendments to the articles must be properly filed with the Secretary of State before they take effect. They must be executed by at least one manager or, if so stated in the articles of organization, by the number of managers specified in the articles. Corp C §17054(b). In a member-managed LLC, each member is a manager (Corp C §17001(w)); therefore, an amendment to the articles of organization must be executed by at least one member.

To amend the articles of organization, Form LLC-2 must be filed with the Secretary of State along with the appropriate filing fee (currently $30). Govt C §12190. See §7.32 for a copy of Form LLC-2. The parties may state an effective date of the amendment that is not more than 90 days later than the filing date. The parties must list on Form LLC-2 the LLC's name and file number with the Secretary of State, so that the amendment can be related to the original articles. Corp C §17054(b). The file number is the number stamped by the Secretary of State on the initial articles on filing, which will appear on the certified copy in the large box in the upper right-hand corner of the form, above the file stamp.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.32 1. Form: Limited Liability Company Certificate of Amendment (Secretary of State Form LLC-2)

§7.32 1. Form: Limited Liability Company Certificate of Amendment (Secretary of State Form LLC-2)



State of California
Secretary of State

LIMITED LIABILITY COMPANY
CERTIFICATE OF AMENDMENT

A $30.00 filing fee must accompany this form.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

1. **SECRETARY OF STATE FILE NUMBER**

2. **NAME OF LIMITED LIABILITY COMPANY**

3. **COMPLETE ONLY THE SECTIONS WHERE INFORMATION IS BEING CHANGED. ADDITIONAL PAGES MAY BE ATTACHED IF NECESSARY.**

   A. **LIMITED LIABILITY COMPANY NAME** (END THE NAME WITH THE WORDS "LIMITED LIABILITY COMPANY," "LTD. LIABILITY CO." OR THE ABBREVIATIONS "LLC" OR "L.L.C.")

   _____

   B. **THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY (CHECK ONE):**

   ☐ ONE MANAGER
   ☐ MORE THAN ONE MANAGER
   ☐ ALL LIMITED LIABILITY COMPANY MEMBER(S)

   C. **AMENDMENT TO TEXT OF THE ARTICLES OF ORGANIZATION:**

   D. **OTHER MATTERS TO BE INCLUDED IN THIS CERTIFICATE MAY BE SET FORTH ON SEPARATE ATTACHED PAGES AND ARE MADE A PART OF THIS CERTIFICATE. OTHER MATTERS MAY INCLUDE A CHANGE IN THE LATEST DATE ON WHICH THE LIMITED LIABILITY COMPANY IS TO DISSOLVE OR ANY CHANGE IN THE EVENTS THAT WILL CAUSE THE DISSOLUTION.**

4. **FUTURE EFFECTIVE DATE, IF ANY:** **MONTH** **DAY** **YEAR**

5. **NUMBER OF PAGES ATTACHED, IF ANY:**

6. **IT IS HEREBY DECLARED THAT I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.**

   _____ _____
   SIGNATURE OF AUTHORIZED PERSON DATE

   _____
   TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

7. **RETURN TO:**

   NAME
   FIRM
   ADDRESS
   CITY/STATE
   ZIP CODE

Print

INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF AMENDMENT (LLC-2)

For easier completion, this form is available in a "fillable" version online at the Secretary of State's website at http://www.ss.ca.gov/business/business.htm. The form can be filled in on your computer, printed and mailed to the Secretary of State, Document Filing Support Unit, P O Box 944228, Sacramento, CA 94244-2280 or can be delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink.

FILING FEE: The filing fee is $30.00. Make the check(s) payable to the Secretary of State and send the executed document and filing fee to the address stated above.

Statutory filing provisions can be found in California Corporations Code section **17054**. All statutory references are to the California Corporations Code, unless otherwise stated.

- A Certificate of Amendment (LLC-2) shall be filed within thirty (30) days after any information set forth in the Articles of Organization (LLC-1) or a previously filed Certificate of Amendment (LLC-2) or Restated Articles of Organization (LLC-10), becomes inaccurate, or in order to add information to the Articles of Organization (LLC-1), a previously filed Certificate of Amendment (LLC-2) or a Restated Certificate of Articles of Organization (LLC-10).

- The Certificate of Amendment (LLC-2) may become effective not more than ninety (90) days after filing the Certificate of Amendment (LLC-2). (Section **17056 (c)**.)

Complete the Certificate of Amendment (Form LLC-2) as follows:

Item 1. Enter the file number issued by the California Secretary of State.

Item 2. Enter the name of the limited liability company as filed with the California Secretary of State.

Item 3. Enter only the information which is being amended. Provide the text of each amendment adopted, using the A-D space provided or attaching additional pages.

Item 4. Enter the future effective date of the Certificate of Amendment (LLC-2), if any. If none is indicated, the amendment shall be effective upon filing with the California Secretary of State.

Item 5. Enter the number of pages attached, if any. All attachments should be 81/2" X 11", one-sided and legible.

Item 6. The Certificate of Amendment (LLC-2) shall be executed, with an original signature and title, of at least one manager unless a greater number is provided for in the Articles of Organization.

If an entity is designated as a manager or member, the person who signs for the entity must note the exact entity name, his/her name, and his/her position/title.

If a trust is designated as a manager or member, the certificate must be signed by a trustee as follows:_____, trustee for _____trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

Item 7. Enter the name and address of the person or firm to whom a copy of the certificate should be returned.

- For further information contact the Business Filings Section at (916) 657-5448.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.33 2. Changes That May Be Effected Only by Amending the Articles

§7.33 2. Changes That May Be Effected Only by Amending the Articles

Under Corp C §17054(c), certain changes to the LLC articles of organization, including the following, may be effected only by filing Form LLC-2:

- The name of the LLC;
- The designation of the existence or number of managers;
- The stated time for dissolution; and
- The events that will result in a dissolution of the LLC.

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§7.34 3. Amendments to Correct Errors

The managers *must* file a certificate of amendment, Form LLC-2, within 30 days of discovery of any materially false or erroneous statement contained in any existing articles of organization. Corp C §17054(d). If a manager becomes aware of a need for an amendment and fails to properly file one, the manager is liable to a person suffering loss in reliance on the erroneous statement in the existing articles of organization. See Corp C §17054(e).

In the case of a member-managed LLC, each member is a manager (Corp C §17001(w)), and therefore any member discovering a materially false or erroneous statement in the articles of organization may have a responsibility to amend the articles.

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B. Restatement

§7.35 1. Procedure and Requirements

The Beverly-Killea Limited Liability Company Act permits restated articles of organization to be filed. Corp C §17054(f). The restatement must be filed on Form LLC-10. See §7.36 for a copy of Form LLC-10. Some practitioners prefer to use a restated certificate for all amendments, because then all applicable provisions are contained in a single integrated document. The filing fee for a restatement is $30, the same amount required for an amendment. Govt C §12190.

All Secretary of State LLC forms are available on the Secretary of State's website. See this book's Directory for the URL.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.36 2. Form: Limited Liability Company Restated Articles of Organization (Secretary of State Form LLC-10)

§7.36 2. Form: Limited Liability Company Restated Articles of Organization (Secretary of State Form LLC-10)



State of California
Secretary of State

LIMITED LIABILITY COMPANY
RESTATED ARTICLES OF ORGANIZATION

A $30.00 filing fee must accompany this form.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

1. **SECRETARY OF STATE FILE NUMBER**

2. **NAME OF LIMITED LIABILITY COMPANY:**

3. **NAME OF LIMITED LIABILITY COMPANY IF DIFFERENT FROM ITEM 2.** (END THE NAME WITH THE WORDS "LIMITED LIABILITY COMPANY" OR "LTD. LIABILITY CO." OR THE ABBREVIATIONS "LLC OR L.L.C.")

4. **FUTURE EFFECTIVE DATE, IF ANY:**

MONTH: **DAY:** **YEAR:**

5. **THE PURPOSE OF THE LIMITED LIABILITY COMPANY IS TO ENGAGE IN ANY LAWFUL ACT OR ACTIVITY FOR WHICH A LIMITED LIABILITY COMPANY MAY BE ORGANIZED UNDER THE BEVERLY-KILLEA LIMITED LIABILITY COMPANY ACT.**

6. **CHECK THE APPROPRIATE PROVISION BELOW AND NAME THE AGENT FOR SERVICE OF PROCESS**

☐ AN INDIVIDUAL RESIDING IN CALIFORNIA. PROCEED TO ITEM 7
☐ A CORPORATION WHICH HAS FILED A CERTIFICATE PURSUANT TO SECTION 1505. PROCEED TO ITEM 8.

AGENT'S NAME: _____

_____

7. **CALIFORNIA ADDRESS OF THE AGENT FOR SERVICE OF PROCESS. COMPLETE ONLY IF AN INDIVIDUAL.**

ADDRESS

CITY STATE: **CA** ZIP CODE:

8. **THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY: (CHECK ONE)**

☐ ONE MANAGER
☐ MORE THAN ONE MANAGER
☐ ALL LIMITED LIABILITY COMPANY MEMBER(S)

9. **OTHER MATTERS TO BE INCLUDED IN THIS CERTIFICATE MAY BE SET FORTH ON SEPARATE ATTACHED PAGES AND ARE MADE A PART OF THIS CERTIFICATE. OTHER MATTERS MAY INCLUDE THE LATEST DATE ON WHICH THE LIMITED LIABILITY IS TO DISSOLVE.**

10. **TOTAL NUMBER OF PAGES ATTACHED, IF ANY:**

11. **IT IS HEREBY DECLARED THAT I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.**

_____ _____
SIGNATURE OF AUTHORIZED PERSON DATE

_____
TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

12. **RETURN TO:**

NAME
FIRM
ADDRESS
CITY/STATE
ZIP CODE

Print

INSTRUCTIONS FOR COMPLETING RESTATED ARTICLES OF ORGANIZATION (LLC-10)

For easier completion, this form is available in a "fillable" version online at the Secretary of State's website at http://www.ss.ca.gov/business/business.htm. The form can be filled in on your computer, printed and mailed to the Secretary of State, Document Filing Support Unit, P O Box 944228, Sacramento, CA 94244-2280 or can be delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink.

FILING FEE: The filing fee is $30.00. Make the check(s) payable to the Secretary of State and send the executed document and filing fee to the address stated above.

Statutory filing provisions can be found in California Corporations Code section **17054(f)**. All statutory references are to the California Corporations Code, unless otherwise stated.

Complete the Restated Articles of Organization (Form LLC-10) as follows:

Item 1. Enter the file number issued by the California Secretary of State.

Item 2. Enter the name of the limited liability company as filed with the California Secretary of State.

Item 3. If the name of the limited liability company is being amended, the name shall contain the words "Limited Liability Company", "Ltd. Liability Co." or the abbreviation "LLC" or "L.L.C." at the end. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and shall not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks. (Section **17052**.)

Item 4. Enter the future effective date of the Restated Articles of Organization (LLC-10), if any. If none is indicated, the Restated Articles of Organization (LLC-10) shall be effective upon filing with the California Secretary of State.

Item 5. Execution of this document confirms the following statement which has been preprinted on the form and may not be altered: "The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act." Provisions limiting or restricting the business of the limited liability company may be included as an attachment.

Item 6. Enter the name of the agent for service of process in this state. Check the appropriate provision indicating whether the agent is an individual residing in California or a corporation which has filed a certificate pursuant to Section **1505** of the California Corporations Code. If an individual is designated as agent, proceed to item 7. If a corporation is designated, proceed to item 8.

Item 7. If an individual is designated as the agent for service of process, enter an address in California. Do not enter "in care of" (c/o) or abbreviate the name of the city. DO NOT enter an address if a corporation is designated as the agent for service of process.

Item 8. Check the appropriate provision indicating whether the limited liability company is to be managed by one manager, more than one manager, or all the limited liability company member(s). (Section **17051(a)(5)**.)

Item 9. The Restated Articles of Organization (LLC-10) may include other matters that the person filing the certificate determines to include. Other matters may include the latest date on which the limited liability company is to dissolve. If other matters are to be included, attach one or more pages setting forth the other matters.

Item 10. Enter the number of pages attached, if any. All attachments should be 8½" x 11", one-sided and legible.

Item 11. The Restated Articles of Organization shall be executed, with an original signature and title, of at least one manager unless a greater number is provided for in the Articles of Organization.

If the Restated Articles of Organization (LLC-10) are signed by an entity, the person who signs for the entity must note the exact entity name, his/her name, and his/her position/title.

If the Restated Articles of Organization (LLC-10) are signed by a trust, the certificate must be signed by a trustee as follows: _____, trustee for_____ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

Item 12. Enter the name and address of the person or firm to whom a copy of the filing should be mailed.

- For further information contact the Business Filings Section at (916) 657-5448.

Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 95814

Business Entities
(916) 657-5448

EXPANSION OF PRECLEARANCE AND EXPEDITED FILING SERVICES
(Effective Monday, October 2, 2006)

We are pleased to announce that our preclearance and expedited filing services have been expanded to include all business entity documents filed with the Secretary of State pursuant to the California Corporations Code, the California Financial Code or the California Insurance Code. These services, previously offered only for specified corporate documents, are now available for all corporate, limited liability company and limited partnership documents, including interspecies mergers and conversions, and for all other documents filed by other entity types. In addition, the number of copies required to be submitted for the preclearance service has been reduced from two to one.

Preclearance service provides a customer with the opportunity to submit a business entity document in person to the Secretary of State's Sacramento office prior to filing to determine if the document conforms to law and to receive a preclearance response within a guaranteed time frame.

Expedited filing service provides a customer with the opportunity to submit for filing a business entity document in person to the Secretary of State's Sacramento office and to receive a filing response within a guaranteed time frame.

Please refer to the Secretary of State's website at http://www.ss.ca.gov/business/precexp.htm for detailed information regarding the preclearance and expedited filing services.

Authority cited: Title 2, California Code of Regulations, sections 21904 and 21905; and Government Code section 12182.

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C. Correction

§7.37 1. Procedure and Requirements

A certificate of correction can be filed to correct technical errors in an instrument previously filed with the Secretary of State, such as a typographical error, transcription error, or defect in execution. Corp C §17055. A certificate of correction, unlike an amendment, operates retroactively and does not change the effective date of the documents being corrected. Corp C §17055(e)(1).

The certificate of correction may not be used to make any change that would not have complied in all respects with the requirements in effect at the time the original instrument was filed with the Secretary of State.

The Secretary of State has provided a prescribed form for a certificate of correction, Form LLC-11. See §7.38 for a copy of Form LLC-11. A $30 filing fee is required. Govt C §12190(g). The certificate of correction must provide a significant amount of information (Corp C §17055(b)); *e.g.*:

- State the name of the LLC and the Secretary of State file number to ensure that it is properly filed;
- Identify the title and the date of the document being corrected, and every party to the document;
- Set out the text of the provision in the original document being corrected and the full text of the corrected provision; and
- If there was a defect in execution, describe the nature of the defect.

All Secretary of State LLC forms are available on the Secretary of State's website. See this book's Directory for the URL.

The certificate of correction must be executed in exactly the same manner that the document being corrected was required to be executed. Corp C §17055(d).

PRACTICE NOTE: The Secretary of State's office uses the information to make a substantive determination of whether the filer is entitled to file a certificate of correction or must instead file an amendment to the articles of organization.

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Source: Business Law/Forming and Operating California Limited Liability Companies/7 Filing Requirements for Forming a Limited Liability Company/§7.38 2. Form: Limited Liability Company Certificate of Correction (Secretary of State Form LLC-11)

§7.38 2. Form: Limited Liability Company Certificate of Correction (Secretary of State Form LLC-11)



LLC-11

State of California
Secretary of State

LIMITED LIABILITY COMPANY
CERTIFICATE OF CORRECTION

A $30.00 filing fee must accompany this form.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

FILE NUMBER	**ENTITY NAME** (Enter the exact name of the limited liability company.)
1. SECRETARY OF STATE FILE NUMBER	2. NAME OF LIMITED LIABILITY COMPANY

DOCUMENT TITLE (Enter the title of the document being corrected.)

3. TITLE OF DOCUMENT BEING CORRECTED

PARTIES TO THE DOCUMENT (Enter the name of each party to the document being corrected.)

4. NAME OF EACH PARTY TO THE DOCUMENT BEING CORRECTED

DOCUMENT FILE DATE (Enter the date the document being corrected was filed with the Secretary of State.)

5. FILE DATE OF DOCUMENT BEING CORRECTED ____ - ____ - ____
(MONTH) (DAY) (YEAR)

DOCUMENT PROVISION (Item 6: Enter the provision in the document as previously filed and, if the execution of the document was defective, indicate the manner in which it was defective. Item 7: Enter the provision in the document as corrected. Attach additional pages if necessary. Additional information set forth on attached pages, if any, is incorporated herein by this reference and made a part of this certificate.)

6. PROVISION IN DOCUMENT AS PREVIOUSLY FILED

7. PROVISION IN DOCUMENT AS CORRECTED

EXECUTION (Form LLC-11 must be executed in the same manner in which the document being corrected was required to be executed.)

8. I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT THE FOREGOING IS TRUE AND CORRECT OF MY OWN KNOWLEDGE. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

SIGNATURE OF AUTHORIZED PERSON DATE TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

SIGNATURE OF AUTHORIZED PERSON DATE TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

RETURN TO (Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.)

9. NAME

FIRM (if any)

ADDRESS

CITY/STATE/ZIP

Print

INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF CORRECTION (FORM LLC-11)

For easier completion, this form is available on the Secretary of State's website at http://www.ss.ca.gov/business and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered. This form is only filed in the Sacramento office.

Statutory filing provisions are found in California Corporations Code section 17055. All statutory references are to the California Corporations Code, unless otherwise stated.

If any document filed with the Secretary of State under the Beverly-Killea Limited Liability Company Act contains any typographical error, error of transcription, other technical error, or has been defectively executed, the document may be corrected by filing Form LLC-11. Form LLC-11 may not be used to:

- make any other change or amendment that would not have complied in all respects with the requirements of the Beverly-Killea Limited Liability Company Act at the time of the document being corrected was filed; or
- change the effective date of the document being corrected; or
- affect any right or liability accrued or incurred before its filing, except that any right or liability accrued or incurred by reason of the error or defect being corrected shall be extinguished by the filing if the person having the right or to whom the liability is owed has not detrimentally relied on the original document.

FEES: The fee for filing Form LLC-11 is $30.00. However, there is a $15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at http://www.ss.ca.gov/business/precexp.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

COPIES: The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the $8.00 per copy certification fee.

Complete Form LLC-11 as follows:

Item 1. Enter the file number issued to the limited liability company by the California Secretary of State.

Item 2. Enter the name of the limited liability company exactly as it is of record with the California Secretary of State, including the entity ending.

Item 3. Enter the title of the document being corrected.

Item 4. Enter the name of each party that signed the document being corrected. Note: If the document was signed by a person on behalf of the party to the document (e.g., attorney-in-fact), enter the name of that person and the capacity under which they signed the document (e.g.,"(name of attorney-in fact), attorney-in-fact for (name of party to the document)").

Item 5. Enter the date (month/day/year) the document being corrected was filed with the California Secretary of State.

Item 6. Enter the provision in the document as previously filed. If the execution of the document was defective indicate the manner in which it was defective. Attach additional pages if necessary.

Item 7. Enter the provision in the document as corrected. Attach additional pages if necessary.

Item 8. Form LLC-11 must be executed in the same manner in which the document being corrected was required to be executed. If additional signature space is necessary, the signatures may be made on an attachment to the certificate.

- If Form LLC-11 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of person)."
- If Form LLC-11 is signed by an entity, the person who signs on behalf of the entity should note their name and position/title, the exact entity name and the entity's relation to the limited liability company. Example: If a limited liability company ("Smith LLC") is the manager of the limited liability company named in Item 2, the signature of the person signing on behalf of Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Manager.
- If Form LLC-11 is signed by a trust, the trustee should sign as follows: _____, trustee for _____trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

Item 9. Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.

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§7.39 3. Limits on Retroactive Application

A certificate of correction extinguishes any right or liability of a third party incurred by reason of the error or defect being corrected, other than a right of or liability to a person who detrimentally relied on the original document. Corp C §17055(e)(2). Although the Beverly-Killea Limited Liability Company Act does not so state, presumably the burden of proof would be on the person claiming detrimental reliance on the incorrect original instrument. Note that there is no requirement that the detrimental reliance be reasonable. Therefore, third parties arguably are entitled to be strictly literal in relying on instruments on file with the Secretary of State's office.

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V. OTHER FILING ISSUES

§7.40 A. Delayed Filing; Delayed Effective Date

An LLC instrument, *e.g.,* the articles of organization, a certificate of amendment, or a certificate of correction, is deemed filed with the Secretary of State on receipt by the Secretary of State of the instrument and the filing fee. Corp C §17062. Ordinarily, the filing date for an LLC instrument in proper form will be the date of its receipt by the Secretary of State.

At the request of the party filing the instrument, any LLC instrument may be withheld from filing for up to 90 days after receipt by the Secretary of State. Corp C §17062.

According to the Secretary of State, if a future date for an LLC filing is desired, one can simply inform the Secretary of State in a cover letter of the specific date on which the filing is to occur. A delay in the filing of an LLC instrument under §17062 is referred in this chapter as a "delayed filing."

Here are further details about the procedure from Corp C §17062:

> The date of filing shall be the date the instrument is received by the Secretary of State unless the instrument is withheld from filing for a period of time not to exceed 90 days pursuant to a request by the party submitting it for filing or unless, in the judgment of the Secretary of State, the filing is intended to be coordinated with the filing of some other document that cannot be filed. The Secretary of State shall file a document as of any requested future date not more than 90 days after its receipt, including a Saturday, Sunday, or legal holiday, if that document is received in the Secretary of State's office at least one business day prior to the requested date of filing.

Another section in the Beverly-Killea Limited Liability Company Act allows filings to be made that *take effect* after filing. Any LLC instrument may provide that it is to become effective up to 90 days after its filing date. Corp C §17056(c). A delay in the effect of a filing under Corp C §17056(c) is referred to in this chapter as "delayed effectiveness."

In other words, under Corp C §17062, the instrument is not filed for up to 90 days even though the instrument has been received with the proper fee by the Secretary of State; once it is filed it will ordinarily become effective immediately. Under Corp C §17056(c), the instrument is filed immediately on receipt with the proper fee but does not become effective for up to 90 days after filing.

One substantive difference between the two sections is that one can do a delayed filing of the LLC's original articles of organization (Corp C §17062), but one cannot file the articles and request a delayed effective date (Corp C §17056(c)).

NOTE: The Secretary of State has taken the position that a statement of conversion is similar to the original articles and is not eligible for a delayed effective date.

A couple of practical advantages of the delayed filing are that nothing appears of record until the date for filing arrives, and if the delayed filing is revoked, there is less confusion over the effect of the filing.

There appears to be nothing to prevent a request for a delayed filing for 90 days even though the LLC instrument to be filed provides that it is not to become effective until 90 days after it has been filed. It therefore appears that these two sections could be combined to delay a filing from taking effect for up to 180 days.

If the LLC instrument is to have a delayed filing, the person filing the LLC instruments should inform the Secretary of State by cover letter that the filing is to be delayed under Corp C §17062. See the form in §7.41.

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§7.41 B. Form: Transmittal Letter to Secretary of State Requesting Delayed Filing or Effectiveness

▶ To download **Word** version, right click and choose *Save Target As*

▶ To download **WordPerfect** version, right click and choose *Save Target As*

7.41-1 Transmittal letter to Secretary of State requesting delayed filing or effectiveness

Secretary of State
Document Filing Support Unit
P.O. Box 944228
Sacramento, CA 94244-2280

Re: _ _[*Name of LLC*]_ _

Dear Sir or Madam,

Enclosed please find a _ _[*e.g., Certificate of Amendment of the articles of organization*]_ _ **for** _ _[*name of LLC*]_ _**.**

[*Alternative 1: Delayed filing*]

Please delay the filing of this _ _[*e.g., Certificate of Amendment*]_ _ **until** _ _[*date*]_ _**.**

[*Alternative 2: Delayed effective date*]

Under Corporations Code section _ _[*e.g., 17056(c)*]_ _**, please file this on** _ _[*date/receipt*]_ _**, with a future effective date of** _ _[*date*]_ _**.**

Thank you.

Sincerely,

__[*Signature*]__

_ _[*Typed name*]_ _

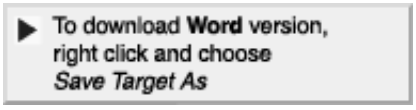
Attorney for _ _[*name*]_ _

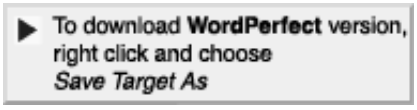
Comment: The transmittal letter should state the month, day, and year on which the filing is to take place. It should not refer to a particular number of days after the receipt of the instrument. The specified date for the filing must be no more than 90 days after the Secretary of State receives the instrument.

If the LLC instrument is to be filed but have a delayed effective date, a different approach is needed. The public should be put on notice that a filed LLC instrument is not yet effective, and a cover letter to the Secretary of State does not serve this function. Some of the LLC forms have a space on the face of the form for a future effective date, though most do not. The public can be put on notice of delayed effectiveness by using an attachment to the LLC instrument that states that the effective date of the instrument will be a specified date (specifying month, day, and year and not by reference to a number of days after the filing date of the instrument). The specified date for the effectiveness of the filing should be no more than 90 days after the filing date. The Secretary of State should be informed by cover letter that the filing is to be made on receipt but that the effectiveness is delayed under Corp C §17056(c) (and not Corp C §17062).

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§7.42 C. Form: Letter to Secretary of State Revoking Previously Requested Delayed Filing





7.42-1 Letter to Secretary of State revoking previously requested delayed filing

Secretary of State
Document Filing Support Unit
P.O. Box 944228
Sacramento, CA 94244-2280

Re: _ _[*Name of LLC*]_ _

Dear Sir or Madam,

By letter dated _ _[*date*]_ _**, we submitted to your office a** _ _[*e.g., Certificate of Amendment of the articles of organization*]_ _ **for** _ _[*name of LLC*]_ _**, and requested that filing of that instrument be delayed until** _ _[*date*]_ _**.**

Please be advised that appropriate action has been taken _ _[*e.g., by the managing members of the LLC*]_ _**, and that instrument has been revoked. Please do not file the** _ _[*e.g., Certificate of Amendment*]_ _**, but instead, return it to us in the enclosed self-addressed envelope.**

Thank you for your attention to this matter.

Sincerely,

__[*Signature*]__

_ _[*Typed name*]_ _

Attorney for _ _[*name*]_ _

Comment: An instrument submitted for delayed filing may be prevented from being filed by notifying the Limited Liability Company Unit of the Secretary of State's office by letter stating that appropriate action to revoke the instrument has been taken and that the instrument has been revoked. The letter of revocation is to be executed in the same manner as the original instrument that is being revoked and must be received by the Secretary of State's office before the future filing date that was specified for the instrument being revoked. See §7.42 for a sample letter revoking a "delayed filing" instrument.

A filed instrument that has a delayed effective date may be prevented from becoming effective by filing a certificate stating that appropriate action to revoke the instrument has been taken and that the instrument has been revoked. Corp C §17056(c). The certificate must be executed in the same manner as the original instrument that is being revoked and must be filed before the specified effective date. The Secretary of State does not have a form to file to reflect the revocation (before the effective date) of a filed instrument with a delayed effective date. To avoid confusion over the effect of a filed instrument that was revoked before becoming effective, it is advisable to file with the Secretary of State a certificate of amendment attaching a copy of the revocation, or a restated set of articles (LLC-10) at the same time as submitting to the Secretary of State the revocation of the instrument.

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§7.43 D. Resubmission After Rejection

The Secretary of State's determination with respect to the legality of the name of a domestic or foreign LLC, the ability to reserve a name, and registration of a foreign LLC is conclusive. Otherwise, if a document submitted for filing is rejected by the Secretary of State for failing to comply with the law, the instrument may be resubmitted for filing without change if accompanied by a written opinion of a member of the state bar that the instrument conforms to state law. The opinion must state the points and authorities on which the opinion is based. Corp C §17056(d). The Secretary of State is required to rely on the written opinion.

This provision is similar to Corp C §§110(b) and 15902.06(d), which apply to corporations and limited partnerships, respectively.

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§7.44 E. Mergers and Conversions; Dissolution

For filing requirements related to mergers and conversions involving LLCs, see chap 11. For filing requirements related to dissolving LLCs, see chap 16.

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8

Preliminary Considerations in Drafting the Operating Agreement

Leonard E. Castro

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II. NATURE AND PURPOSE OF OPERATING AGREEMENT

A. Prerequisite to Formation §8.2

B. Adoption and Amendment §8.3

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2. The Beverly-Killea Limited Liability Company Act's Restrictive Provisions §8.5

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A. Management Considerations §8.6

B. Tax Allocation and Distribution Considerations §8.7

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§8.1 I. SCOPE OF CHAPTER

This chapter introduces the form operating agreements found in chaps 9 and 10. It explains the flexibility afforded by the default provisions in the Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17656) and sets forth the exceptions to that flexibility, *i.e.*, the restricted provisions enumerated in §8.5. Finally, a few principles that should assist the drafter in choosing to follow either the long-form model operating agreement in chap 9 or the short forms in chap 10 are discussed. These include tax planning considerations, operational aspects, and other business issues.

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II. NATURE AND PURPOSE OF OPERATING AGREEMENT

§8.2 A. Prerequisite to Formation

Under Corp C §17050(a), a limited liability company is formed when:

(1) The articles of organization have been filed with the Secretary of State (see chap 7); and

(2) All the members have entered into an operating agreement.

The Beverly-Killea Limited Liability Company Act defines an operating agreement as "any agreement, written or oral, between all of the members as to the affairs of a [LLC] and the conduct of its business." Corp C §17001(ab). The operating agreement may be entered into before or after the articles of organization are filed with the Secretary of State. An operating agreement may merely be an agreement between all the members to organize an LLC. Corp C §17001(ab). As discussed below, an oral or minimal operating agreement is generally not advisable. This chapter provides a guide for the drafting of a comprehensive operating agreement.

An LLC may have only one member. Corp C §17050(b). An operating agreement may seem an absurdity, even a legal impossibility, for a one-member LLC. However, it should be noted that Corp C §17101(b) states:

a member of a limited liability company shall be subject to liability under the common law governing alter ego liability, and shall also be personally liable… under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable.

Accordingly, to insulate the sole member of the LLC to the highest possible extent under the Act, it would be prudent to demonstrate that the LLC is a structure used for the purpose of carrying on a business, distinct from the personal life or other business activities of the member. The operating agreement can be viewed in the same light as the bylaws of a single-shareholder, single-director corporation, and serve as evidence of the distinct business activity.

For a discussion of alter-ego liability, see §§6.24-6.30.

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§8.3 B. Adoption and Amendment

The Beverly-Killea Limited Liability Company Act does not specify any formal requirements for the adoption of an operating agreement, and general contract principles should apply. For guidance on general contract drafting techniques, including suggestions on format and execution, see Drafting Business Contracts: Principles, Techniques & Forms, chaps 1-5, 18 (Cal CEB 1994). The Act does not require filing of the operating agreement with the Secretary of State or elsewhere, but does require that a copy of the operating agreement and any amendments, together with any powers of attorney from members under which any operating agreement or any amendments to it were executed by a manager, be maintained at the LLC's designated office (Corp C §17058(a)(5)) and furnished to a member on request (Corp C §17106(a), (d)).

PRACTICE NOTE: The request should include language from Corp C §17106(a).

Under Corp C §17059, the power to adopt, alter, amend, or repeal the operating agreement is vested in the members. The operating agreement may prescribe the manner in which it may be altered, amended, or repealed. The provisions of Corp C §17059 may be varied only by the articles of organization or a *written* operating agreement. Corp C §17005(b). If no voting provision is contained in the articles of organization or written operating agreement, any amendment to the operating agreement requires the unanimous vote of the members. Corp C §17103(a)(2).

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C. Drafting Guidelines

§8.4 1. Flexibility Provided by the Beverly-Killea Limited Liability Company Act

Although the Beverly-Killea Limited Liability Company Act sets forth a number of rules to govern members' relations to each other and to the LLC, it expressly permits the members to "vary" most of these rules by provisions in the articles of organization or operating agreement. Corporations Code §17005 enumerates the rules that may not be altered, or that may be modified only in a specified way (see §8.5). Otherwise, the parties have a free hand. Except for those enumerated rules, the Act expressly permits the parties to modify a rule even if the rule is contained in an Act section that does not contain the phrase "unless otherwise provided in the articles of organization or operating agreement." Corp C §17005(e).

For a discussion of whether particular provisions should be included in the articles of organization, operating agreement, or both, see §§7.28-7.30.

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§8.5 2. The Beverly-Killea Limited Liability Company Act's Restrictive Provisions

In drafting an operating agreement, counsel must consider the following restrictions and conditions:

(a) The operating agreement cannot contain provisions inconsistent with the articles of organization. Corp C §17001(ab). If there is a conflict, the articles of organization control. Corp C §17005(f).

(b) Neither the operating agreement nor the articles of organization may:

- Deviate from the definitions in the Beverly-Killea Limited Liability Company Act's definitions section, Corp C §17001, except as specifically provided otherwise in that section (Corp C §17005(b)(1); see §6.6);
- Eliminate a member's right under Corp C §17100(c) to assert the unreasonableness of a provision in the operating agreement governing termination of the member's interest (Corp C §17005(b)(2));
- Change the voting requirements or rights set forth in Corp C §17103(b)-(c) dealing with, respectively, amendment of the articles of organization and voting on dissolution or merger (Corp C §17005(b)(3)); or
- Alter a member's rights to information under Corp C §§17106 and 17453 allowing a member to inspect, among other things, the LLC's books, records, and tax returns (Corp C §17005(b)(4)).

(c) Provisions of the Act in chap 2 (Formation), chap 8 (Dissolution), chap 10 (Foreign LLCs), chap 11 (Class Actions), chap 12 (Merger), and chap 13 (Dissenters' Rights) may be modified by the articles of organization or a written operating agreement, but only to the extent expressly provided in those chapters. Corp C §17005(c).

(d) Except as noted in (a) through (c), the articles of organization or an operating agreement may vary provisions of the Act whether or not the words "unless otherwise provided" or words of similar effect appear in those provisions. Corp C §17005(e).

(e) The articles of organization or a *written* operating agreement may vary the provisions of (*i.e.*, the following provisions may *not* be varied by an *oral* operating agreement) (Corp C §17005(b)):

- Corp C §17059 (members' power to adopt or amend operating agreement);
- Corp C §17103 (voting rights);
- Corp C §17104 (members' meetings);
- Corp C §17152 (election and removal of managers);
- Corp C §17154 (appointment of officers); and
- Corp C §17155 (indemnification).

(f) A manager's fiduciary duty to the members and the LLC may be varied only by a written operating agreement with the informed consent of the members. Corp C §17005(d).

In all other cases, either a written or oral operating agreement may vary the provisions of the Act. See Corp C §17005(a).

If a provision of the Act has not been varied by an operating agreement or the articles of organization, the Act governs. Corp C §17005(a). Because the provisions of the Act apply in default of an agreement of the members to change them, they are sometimes referred to as the "default provisions."

NOTE: The Act permits significant latitude in the governance of an LLC and in defining the relative economic and other rights of members. Because oral agreements are more limited in the extent to which departures from the Act are permitted, and create a significant risk of misunderstanding and difficulty of proof, using a written operating agreement not only permits a wider variety of choice, but also is better practice.

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III. SELECTING THE APPROPRIATE FORM OF OPERATING AGREEMENT

§8.6 A. Management Considerations

The Beverly-Killea Limited Liability Company Act allows considerable flexibility in drafting operating agreements to suit the particular needs of clients wishing to operate as an LLC. This book provides two form operating agreements, a long form (see chap 9) and a short form (see chap 10), neither of which should be regarded as fill-in-the-blank documents that will be suitable in all situations. The forms must be adapted to suit the LLC's particular circumstances.

The short-form operating agreement provides for member management, and its provisions can be adapted for use in manager-managed LLCs as well.

The long-form operating agreement can be adapted for use in member-managed or manager-managed LLCs. For member-managed LLCs, the provisions relating to managers should be modified as necessary to vest managerial powers in the members, and the provisions relating to appointment, removal, and powers of a manager should be omitted. The long form is appropriate, with suitable modifications, for ventures of any size and any type of business permitted to operate in LLC form.

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§8.7 B. Tax Allocation and Distribution Considerations

The long form contains provisions designed to comply with Internal Revenue Code provisions and regulations dealing with the "substantial economic effect" of specified tax allocations. These provisions deal with:

- Qualified income offsets,
- Nonrecourse debt, and
- Minimum gain,

all of which are discussed in the annotations to the form in chap 9 and in chap 5. The issue of "substantial economic effect" arises when members share income, gain, loss, deduction, or credit, or any item within these categories, in a manner different from the members' interests in the LLC. For example, substantial economic effect issues can arise when the overall profit and loss sharing is not proportionate to the members' capital accounts, a particular item is allocated to a member, or allocations change in accordance with specified events.

The short-form operating agreement is designed for use in single-member LLCs and in smaller LLCs (including so-called mom and pop situations) in which there are no special allocation provisions, the members themselves manage the LLC, and there are no preferential distributions.

NOTE: Despite the complexity of the long-form operating agreement, the author advises that it be used in all but the simplest of situations (*i.e.,* in all but a "mom and pop" or similar enterprise). Its use will ensure that the LLC is in compliance with the Internal Revenue Code and regulations, even if there are changed circumstances or overlooked issues.

FURTHER NOTE: Because a single-member LLC would have no allocations, the drafter should eliminate the language regarding tax allocation from a single-member operating agreement. See §§9.23-9.31, 10.82.

The author recommends that drafters using the long form consult with a tax expert if they are not fully familiar with the special allocation regulations and other tax aspects of LLC formation and operations.

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9

Annotated Long-Form Operating Agreement

Leonard E. Castro

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§9.1 I. INTRODUCTORY COMMENT

This long-form operating agreement is appropriate, with suitable modifications, for ventures of any size and type of business permitted to operate as an LLC. Although this form contains provisions for management by a manager, it can be adapted for use in member-managed LLCs by modifying as necessary the provisions relating to the manager to vest managerial powers in the members, and omitting the provisions relating to appointment, removal, and powers of a manager. This long-form operating agreement contains provisions designed to comply with Internal Revenue Code provisions and regulations dealing with the substantial economic effect of specified tax allocations.

For convenience, some practitioners include investment representations and warranties in the operating agreement. These are designed to give the LLC assurances from prospective members that they meet certain requirements so the LLC will qualify for an exemption from registration and qualification under federal and California securities laws. That is not the case with the following form of operating agreement. See in this regard the discussion of the limited offering exemption and related forms in §§12.54-12.66. For an example of an LLC operating agreement that does include investment representations and warranties, see Selecting and Forming Business Entities (2d ed Cal CEB 2007).

See the Appendix for an unannotated version of this operating agreement form.

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II. PROVISIONS UNDER LONG-FORM OPERATING AGREEMENT

A. Introductory Clauses

§9.2 1. Form: Parties and Date

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.2-1 Parties and date

OPERATING AGREEMENT for _ _[*NAME*]_ _**,** _ _[*e.g., LLC/a limited liability company*]_ _

A. This operating agreement is entered into as of _ _[*date*]_ _ **by** _ _[*names*]_ _ **(referred to individually as a Member and collectively as the Members).**

Comment: The name of an LLC must contain the words "limited liability company" or the abbreviations "L.L.C." or "LLC." The words "limited" and "company" may be abbreviated as, respectively, "Ltd." and "Co." Corp C §17052(a).

A California LLC may have one or more members. Corp C §17050(b). This agreement is intended for LLCs having more than one member. For a sample form of operating agreement more suitable for a single-member LLC, see chap 10. A member is a "person" who has been admitted to the LLC in accordance with its articles of organization or operating agreement. Corp C §17001(x). A "person" is an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign. Corp C §17001(ae). If there are to be nonmember managers, the nonmember managers should be parties to the operating agreement and identified as such in the above provision. If there are too many members to list conveniently in the opening sentence of the agreement, the names can be listed in an exhibit that can be referred to in that sentence. See form provision in §9.12.

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§9.3 2. Form: Recitals

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.3-1 Recitals

[*Use one of the following alternatives*]

[*Alternative 1: LLC not yet formed*]

B. The Members desire to form a limited liability company (Company) under the Beverly-Killea Limited Liability Company Act.

C. The Members enter into this Agreement to form and provide for the governance of the Company and the conduct of its business, and to specify their relative rights and obligations.

[*Alternative 2: LLC already formed by filing articles of organization*]

B. The Members have formed a limited liability company under the Beverly-Killea Limited Liability Company Act. The Articles of Organization of the Company filed with the California Secretary of State on _ _[*date*]_ _, are adopted and approved by the Members.

C. The Members enter into this Agreement to provide for the governance of the Company and the conduct of its business, and to specify their relative rights and obligations.

[*Continue*]

Now therefore, the Members agree as follows:

Comment: The operating agreement may be entered into before or after the articles of organization are filed with the Secretary of State. Corp C §17050(a). The operating agreement can thus serve as a preformation agreement, as provided in Alternative 1. On filing the articles of organization, see §§7.14-7.30.

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§9.4 B. Form: Definitions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.4-1 Definitions

ARTICLE I: DEFINITIONS

Capitalized terms used in this Agreement have the meanings specified in this Article or elsewhere in this Agreement and when not so defined will have the meanings set forth in California Corporations Code §17001.

1.1. "Act" means the Beverly-Killea Limited Liability Company Act (California Corporations Code §§17000-17656), including amendments from time to time.

1.2. "Adjusted Capital Contribution" is defined in Article IV, Section 4.6(a).

1.3. "Adjusted Capital Account Deficit" is defined in Article IV, Section 4.3(a).

1.4. "Affiliate" of a Member or Manager means any Person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Member or Manager. The term "control" (including the terms "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Person, whether through membership, ownership of voting securities, by contract, or otherwise.

1.5. "Agreement" means this operating agreement, as originally executed and as amended from time to time.

1.6. "Articles of Organization" is defined in Corporations Code §17001(b) as applied to this Company.

1.7. "Assignee" means a Person who has acquired a Member's Economic Interest in the Company, by way of a Transfer in accordance with the terms of this Agreement, but who has not become a Member.

1.8. "Assigning Member" means a Member who by means of a Transfer has transferred an Economic Interest in the Company to an Assignee.

1.9. "Available Cash" means all net revenues from the Company's operations, including net proceeds from all sales, refinancings, and other dispositions of Company property that the Manager, in the Manager's sole discretion, deems in excess of the amount reasonably necessary for the operating requirements of the Company, including debt reduction and Reserves.

1.10. "Book Adjustments" means, for any item of Company property for a given fiscal year, adjustments with respect to Book Value for depreciation, cost recovery, or other amortization deduction or gain or loss computed in accordance with Treasury Reg §1.704-1(b)(2)(iv)(g), including Book Depreciation.

1.11. "Book Depreciation" means, for any item of Company property for a given fiscal year, a percentage of depreciation or other cost recovery deduction allowable for federal income tax purposes for that item during that fiscal year equal to the result (expressed as a percentage) obtained by dividing (1) the Gross Asset Value of that item at the beginning of the fiscal year (or the acquisition date during the fiscal year) by (2) the federal adjusted tax basis of the item at the beginning of the fiscal year (or the acquisition date during the fiscal year). If the adjusted tax basis of an item is zero, the Manager may determine Book Depreciation, provided that he or she does so in a reasonable and consistent manner.

1.12. "Capital Account" means, with respect to any Member, the account reflecting the capital interest of the

Member in the Company, consisting of the Member's initial Capital Contribution maintained and adjusted in accordance with Article III, Section 3.5.

1.13. "Capital Contribution" means, with respect to any Member, the amount of money _ _[*, or services rendered or to be rendered,*]_ _ and the fair market value of any property contributed to the Company (net of liabilities secured by the contributed property that the Company is considered to assume or take "subject to" under Internal Revenue Code §752) in consideration of a Percentage Interest held by that Member. A Capital Contribution will not be deemed a loan.

1.14. "Capital Event" means a sale or disposition of any of the Company's capital assets, the receipt of insurance and other proceeds on account of an involuntary conversion of Company property, the receipt of proceeds from a refinancing of Company property, or a similar event with respect to Company property or assets.

1.15. "Company" means the company named in Article II, Section 2.2 of this Agreement.

1.16. "Company Minimum Gain" is defined in Article IV, Section 4.3(b).

1.17. "Confidential Information" is defined in Article X, Section 10.2.

1.18. "Corporations Code" ("Corp C") means the California Corporations Code.

1.19. "Economic Interest" means a Person's right to share in the income, gains, losses, deductions, credit, or similar items of the Company, and to receive distributions from the Company under this Agreement or under the Act, but does not include any other rights of a Member, including the right to vote, the right to participate in the management of the Company, or, except as provided in Corp C §17106, any right to information concerning the business and affairs of the Company.

1.20. "Electronic transmission by the Company" and "electronic transmission to the Company" have the meanings set out in Corp C §17001(o)(1)-(2).

1.21. "Encumber" means the act of creating or purporting to create an Encumbrance, whether or not perfected under applicable law.

1.22. "Encumbrance" means, with respect to any Membership Interest, or any part of it, a mortgage, pledge, security interest, lien, proxy coupled with an interest (other than as contemplated in this Agreement), option, or preferential right to purchase.

1.23. "Gross Asset Value" means, for any item of property of the Company, the item's adjusted basis for federal income tax purposes, except:

(a) The initial Gross Asset Value of any item of property contributed by a Member to the Company will be the fair market value of that property, as mutually agreed by the contributing Member and the Company;

(b) The Gross Asset Value of any item of Company property will be adjusted as of the following times: (1) the acquisition of an interest or additional interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (2) the distribution of money or other property (other than a de minimis amount) by the Company to a Member as consideration for an Economic Interest in the Company; and (3) the liquidation of the Company within the meaning of Treasury Reg §1.704-1(b)(2)(ii)(g); provided, however, that adjustments under clauses (1) and (2) above will be made only if the Members have determined that the Company must revalue its assets in accordance with Treasury Reg §1.704-1(b)(2)(iv)(f);

(c) The Gross Asset Value of any Company asset distributed to any Member will be the book value of that asset on the date of distribution; and

(d) The Gross Asset Value of Company assets will be increased (or decreased) to reflect any adjustments to the adjusted tax basis of those assets under IRC §734(b) or 743(b), subject to the limitations imposed by IRC §755 and only to the extent that those adjustments are taken into account in determining Capital Accounts under Treasury Reg §1.704-1(b)(2)(iv)(m), and if the Gross Asset Value of an asset has been determined or adjusted under paragraph (a), (b), or (d) of this Section 1.23, that Gross Asset Value will thereafter be adjusted

by the Book Adjustments, if any, taken into account for the asset for purposes of computing Profits and Losses.

1.24. "Initial Members" means those Persons whose names are set forth _ _[*in the first sentence of/in Exhibit A to*]_ _ this Agreement.

1.25. "Involuntary Transfer" means, with respect to any Membership Interest, or any part of it, any Transfer or Encumbrance, whether by operation of law, under court order, foreclosure of a security interest, execution of a judgment or other legal process, or otherwise, including a purported transfer to or from a trustee in bankruptcy, receiver, or assignee for the benefit of creditors.

1.26. "IRC" means the Internal Revenue Code of 1986, as amended, and any successor provision.

1.27. "Losses." See Article IV, Section 4.2.

1.28. "Majority of Members" means a Member or Members whose Percentage Interests represent more than 50 percent of the Percentage Interests of all the Members.

1.29. "Manager" means the Person named in Article II, Section 2.9, or the Person who from time to time succeeds any Person as a Manager and who, in either case, is serving at the relevant time as a Manager.

1.30. "Member" means an Initial Member or a Person who otherwise acquires a Membership Interest, as permitted under this Agreement, and who has not ceased to be a Member under Article VIII or for any other reason.

1.31. "Member Nonrecourse Debt" is defined in Article IV, Section 4.3(c).

1.32. "Member Nonrecourse Debt Minimum Gain" is defined in Article IV, Section 4.3(d).

1.33. "Member Nonrecourse Deductions" is defined in Article IV, Section 4.3(e).

1.34. "Membership Interest" means a Member's entire interest and rights in the Company, collectively, including the Member's Economic Interest, any right to Vote or participate in management, and any right to information concerning the business and affairs of the Company.

1.35. "Nonrecourse Deductions" is defined in Article IV, Section 4.3(f).

1.36. "Nonrecourse Liability" is defined in Article IV, Section 4.3(g).

1.37. "Notice" means a notice in writing required or permitted under this Agreement. A notice will be deemed given or sent when deposited, as certified mail or for overnight delivery, postage and fees prepaid, in the United States mails; when delivered to Federal Express, United Parcel Service, DHL WorldWide Express, or Airborne Express, for overnight delivery, charges prepaid or charged to the sender's account; when personally delivered to the recipient; when transmitted by electronic transmission by or to the Company (see §1.20); or when delivered to the home or office of a recipient in the care of a person whom the deliverer has reason to believe will promptly communicate the notice to the recipient.

Addresses for the purpose of giving notice are as follows:

_ _[*Name of party*]_ _: _ _[*address*]_ _ _ _[*e-mail*]_ _ _ _[*fax number*]_ _

_ _[*Name of party*]_ _: _ _[*address*]_ _ _ _[*e-mail*]_ _ _ _[*fax number*]_ _

_ _[*Name of party*]_ _: _ _[*address*]_ _ _ _[*e-mail*]_ _ _ _[*fax number*]_ _

Any correctly addressed notice that is refused, unclaimed, or undeliverable because of an act or omission of the party to be notified will be deemed effective as of the first date that the notice was refused, unclaimed, or deemed undeliverable by the postal authorities, messenger, or overnight delivery service.

Any party may change its address, electronic mail address, or fax number by giving the Manager Notice of the change.

1.38. "Percent of the Members" means the specified total of Percentage Interests of all the Members.

1.39. "Percentage Interest" means a fraction, expressed as a percentage, the numerator of which is the total of a Member's Capital Account and the denominator of which is the total of all Capital Accounts of all Members.

1.40. "Person" means an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign.

1.41. "Profits" and "Losses" are defined in Article IV, Section 4.2.

1.42. "Proxy" has the meaning set forth in the first paragraph of Corp C §17001(ai). A Proxy may not be transmitted orally.

1.43. "Regulations" ("Reg" or "Treasury Reg") means the income tax regulations promulgated by the United States Department of the Treasury and published in the Federal Register for the purpose of interpreting and applying the provisions of the Code, as those Regulations may be amended from time to time, including corresponding provisions of applicable successor regulations.

1.44. "Reserves" means the aggregate of reserve accounts that the Manager, in the Manager's sole discretion, deems reasonably necessary to meet accrued or contingent liabilities of the Company, reasonably anticipated operating expenses, and working capital requirements.

1.45. "Successor in Interest" means an Assignee, a successor of a Person by merger or otherwise by operation of law, or a transferee of all or substantially all of the business or assets of a Person.

1.46. "Tax Item" means each item of income, gain, loss, deduction, or credit of the Company.

1.47. "Tax Matters Partner" means the Person designated under Article VI, Section 6.6.

1.48. "Transfer" means any sale, assignment, gift, Involuntary Transfer, Encumbrance, or other disposition of a Membership Interest or any part of a Membership Interest, directly or indirectly, other than an Encumbrance that is expressly permitted under this Agreement.

1.49. "Triggering Event" is defined in Article VIII, Section 8.4.

1.50. "Vote" means a written consent or approval, a ballot cast at a meeting, or a voice vote.

1.51. "Voting Interest" means, with respect to a Member, the right to Vote or participate in management and any right to information concerning the business and affairs of the Company provided under the Act, except as limited by the provisions of this Agreement. A Member's Voting Interest will be directly proportional to that Member's Percentage Interest.

1.52. "Writing" includes any form of recorded message capable of comprehension by ordinary visual means, and when used to describe communications between the Company and its Members, "writing" will include electronic transmissions by and to the Company as defined in Corp C §17001(o)(1)-(2).

1.53. "Written" or "in writing" includes facsimile and other electronic communication authorized by the Corporations Code.

Comment: Defined terms allow the use of short-form references for names, terms, and concepts in an agreement. They can save space, improve readability, and ensure consistency in the agreement. Grouping definitions at the beginning of an agreement is generally appropriate for terms that recur throughout the agreement. Definitions peculiar to a single article of an agreement may be defined in context in that article or grouped together in an introductory section of that article. The latter approach is particularly appropriate when the definitions are technical or complex. See

Drafting Business Contracts: Principles, Techniques & Forms §§5.23-5.35 (Cal CEB 1994). All these methods are used in this form. Definitions relating to special tax allocations, for example, are grouped together in form 9.24-1, which deals with allocations and distributions. "Confidential information" is defined in context in form 9.79-1, the only provision that uses this term.

The Act includes numerous terms defined in Corp C §17001, and these should be acceptable to the drafter in most cases. The approach taken in this agreement generally is to incorporate the Act's default definitions when they are not varied by the operating agreement. For an example of a variance from the Act's definitions, compare the definition of "proxy" (Corp C §17001(ai)) with the definition provided in this section. The operating agreement cannot vary the definitions set forth in Corp C §17001, except as specifically provided in that section. Corp C §17005(b)(1).

The definition of "Act" is based on Corp C §17000. The definition of "affiliate" is based on Corp C §§150, 160.

The Act distinguishes between an "economic interest" (Corp C §17001(n)) and a "membership interest," which includes an economic interest as well as voting and other member rights. Corp C §17001(z). The definition of "assignee," together with the definitions of "assigning member," "encumbrance," "involuntary transfer," and "transfer" facilitate implementation of the transfer restrictions contained in §§9.65-9.75.

Subject to contrary provisions in the articles of organization or the operating agreement, a membership interest is assignable in whole or in part. The provision in §9.66 restricts assignment of any part of a membership interest, which includes an economic interest and voting rights. See Corp C §17001(z). See also the definition of "voting interest."

The definition of "capital account" is adapted from Corp C §17001(d). Provisions regarding adjustments and special allocations are set forth in §§9.18, 9.23-9.31.

The definition of "capital contribution" is adapted from Corp C §17001(g) and follows Treas Reg §1.704-1(b)(2)(iv)(b). This agreement includes optional language for capital contributions in the form of services rendered or to be rendered, which are permitted under the Act. See Corp C §§17001(g), 17200(a).

The definition of "economic interest" is based on Corp C §17001(n).

Under Corp C §17001(v), the term "majority in interest of the members" means more than 50 percent of the interests of members in current profits, unless otherwise provided in the operating agreement. The term "current profits" is not defined in the Act.

The definition of "membership interest" is derived from Corp C §17001(z).

The definition of "notice" is rather general. See Corp C §17001(ao) about the time a notice is given or sent.

In defining the number of members required for a given action other than a Majority of Members, various approaches may be taken, *e.g.,* "sharing ratios," "interests," or other criteria, as defined by the agreement. The approach taken here, reflected in the definition of "percent of the members," is analogous to the corporate concept of percentage of shares held.

As used in this agreement, a "percentage interest" is proportionate to capital accounts.

The definition of "person" is based on Corp C §17001(ae).

The definition of "proxy" does not allow oral transmission, as contemplated by Corp C §§17001(ai) and 178. Oral transmission of a proxy can create problems better avoided in the LLC context.

On the definition of "tax matters partner," see the Comment following the form provision in §9.53.

A "transfer" could also be defined to exclude an encumbrance. The Act provides that the granting of an encumbrance against a member's membership interest "will not cause the member to cease to be a member or to grant to anyone else the power to exercise any rights or powers of member." See Corp C §17301(c).

The definition of "vote" is based on Corp C §17001(aq). As used in this agreement, "voting interest" is proportionate to "percentage interest" as defined. Members can key voting to their shares in profits, their respective capital accounts, or to any other benchmark. Alternatively, members can provide for equal voting rights, irrespective of their profit shares or capital accounts, although this would be unusual.

Effective January 1, 2005, the Corporations Code was amended to recognize modern forms of electronic communication, including communications by means of video screens. Thus, the older definitions of "in writing" and "written" have been expanded to include these modern concepts. It should be noted that an electronic transmission by a limited liability company to an individual member is not authorized unless, in addition to satisfying the requirements of Corp C §17001(o)(1)-(2), the transmission satisfies the requirements of the Electronic Signatures in Global and National Commerce Act ("E-Sign Act") (15 USC §7001(c)(1)). For discussion of those requirements, see California UCC Sales and Leases §§2.50A-2.50D (Cal CEB 2002).

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C. Formation

§9.5 1. Form: Filing Articles of Organization

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.5-1 Filing articles of organization

ARTICLE II: ARTICLES OF ORGANIZATION

[*Use one of the following alternatives*]

[*Alternative 1: Articles not yet filed*]

2.1. Promptly following execution of this Agreement, the Manager will cause Articles of Organization, in the form attached to this Agreement as Exhibit _ _ _, to be filed with the California Secretary of State.

[*Alternative 2: Articles already filed*]

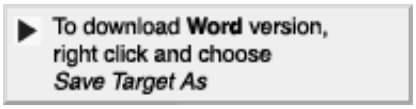
2.1. The Articles of Organization were filed with the California Secretary of State on _ _[*date*]_ _, File Number _ _ _ _ _ _. A copy of the Articles of Organization as filed is attached to this Agreement as Exhibit _ _ _.

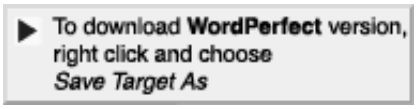
Comment: The operating agreement may be entered into before or after the articles of organization are filed with the Secretary of State. Corp C §17050(a). Attaching a draft or preexecution copy of the articles of organization as an exhibit to the operating agreement will help avoid a dispute over whether the organizer was authorized to make the statements contained in the articles of organization. The operating agreement cannot contradict the articles of organization; if there is a conflict, the latter prevails. Corp C §17005(f). On filing the articles of organization, see §§7.14-7.30.

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§9.6 2. Form: Name of Company

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9.6-1 Name of company

[*Use one of the following alternatives*]

[*Alternative 1: Articles not yet filed*]

2.2. The name of the Company will be _ _[*name*]_ _. The business of the Company may be conducted under that name, or, on compliance with applicable laws, any other name that the Manager deems appropriate.

[*Alternative 2: Articles already filed*]

2.2. The name of the Company is _ _[*name*]_ _. The business of the Company may be conducted under that name, or, on compliance with applicable laws, any other name that the Manager deems appropriate.

Comment: This statement should be consistent with the articles of organization, which must set forth the name of the LLC. Corp C §§17051(a)(1), 17052(a).

On naming an LLC, see §§7.2-7.7. On the use of fictitious business names, see §13.4.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.7 3. Form: Address of Company

§9.7 3. Form: Address of Company

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9.7-1 Address of company

2.3. The principal executive office of the Company will be at _ _[*address*]_ _, California _ _[*zip code*]_ _, or any other place or places determined by the Manager from time to time.

Comment: An LLC must continuously maintain in California an office for maintenance of records specified in Corp C §17058. Corp C §17057(a). See §13.16.

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§9.8 4. Form: Agent for Service of Process

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.8-1 Agent for service of process

2.4. The initial agent for service of process on the Company will be _ _[*name*]_ _, whose address is _ _[*address*]_ _, California _ _[*zip code*]_ _. The Manager may from time to time change the Company's agent for service of process. If the agent ceases to act as such for any reason, the Manager will promptly designate a replacement agent and notify the Secretary of State of the change.

Comment: This statement should be consistent with the articles of organization. See Corp C §17051(a)(4). An agent for service of process must be continuously maintained in California. Corp C §17057. The Act does not specify whether members or managers have the power to appoint or replace the agent. Presumably, the members may delegate the exercise of that power to the manager. On when an address need not be specified, see §7.19.

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§9.9 5. Form: Business Purposes

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9.9-1 Business purposes

2.5. The Company will engage in the business of _ _[*description of business*]_ _.

Comment: The statement of business purpose in the operating agreement should be consistent but need not be identical with the corresponding provisions of the articles of organization. Under Corp C §17051(a)(2), the articles of organization must contain the following language: "The purpose of the limited liability company is to engage in any lawful act or activity for which a limited liability company may be organized under the Beverly-Killea Limited Liability Company Act." Although this statement may not be altered in the articles of organization, restrictions on the business of the LLC may be incorporated into the articles by attaching to the articles a page containing the restrictions. See Corp C §17051(c); §7.18.

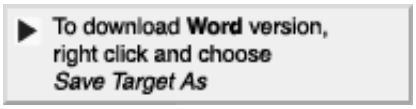
Restrictions on the business, purposes or powers of an LLC do not give rise to an ultra vires defense. See Corp C §17051(d).

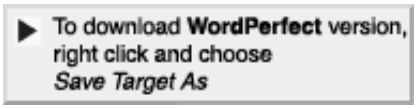
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.10 6. Form: Limited Liability Company

§9.10 6. Form: Limited Liability Company

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9.10-1 Limited liability company

2.6. The Members intend the Company to be a limited liability company under the Act, classified as a partnership for federal and, to the maximum extent possible, state income taxes. The rights and liabilities of the Members and Manager will be determined under the Act and this Agreement. To the extent that the rights or obligations of any Member or Manager are different because of any provision of this Agreement than those rights and obligations would be in the absence of that provision, this Agreement will control to the extent permitted by the Act. Neither the Manager nor any Member will take any action inconsistent with the express intent of the parties to this Agreement.

Comment: On Treas Reg §301.7701-1—301.7701-3, see §§4.2-4.10; on 18 Cal Code Regs §§23038(b)-1—23038(b)-3, federal and California check-the-box regulations governing tax status elections, see §§4.11-4.16.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.11 7. Form: Term of Company's Existence

§9.11 7. Form: Term of Company's Existence

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9.11-1 Term of company's existence

2.7. The term of existence of the Company will commence on the effective date of filing of Articles of Organization with the California Secretary of State, and will continue until terminated by the provisions of this Agreement or as provided by law.

Comment: The existence of an LLC begins on the filing of the articles of organization. Corp C §17050(c). Corporations Code §17051(a)(2) no longer requires that the LLC state a dissolution date in its articles of organization. Therefore, it is no longer necessary to specify a term of existence for the LLC unless the drafter chooses to do so. A limited term of existence is also no longer required for tax purposes. This clause assumes that the articles of organization do not specify a dissolution date. If the articles of organization specify a dissolution date, the operating agreement may state that the term of existence will "continue to the date specified in the articles of organization." See §7.17.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.12 8. Form: Initial Members

§9.12 8. Form: Initial Members

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9.12-1 Initial members

2.8. The names and addresses of the Initial Members are as set forth in Exhibit _ _ _.

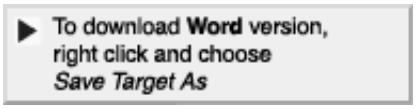
Comment: This form should be used if there are more names than can conveniently be listed at the beginning of the agreement. The drafter may want to specify that the members' addresses are set forth on the signature page of the operating agreement. This allows members to write in their own addresses and eliminates the need for a separate exhibit.

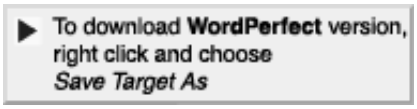
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.13 9. Form: Manager

§9.13 9. Form: Manager

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9.13-1 Manager

[*Use one of the following alternatives*]

[*Alternative 1: Manager to be other than all members*]

2.9. The Manager of the Company will be _ _[*name*]_ _, whose address is _ _[*address*]_ _, California _ _[*zip code*]_ _.

[*Alternative 2: All members are to be managers*]

2.9. The Members will be the Managers of the Company.

Comment: The statement regarding managers of the company should be consistent with the articles of organization. See Corp C §17151. On member-managed and manager-managed LLCs, see §§6.7-6.14.

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D. Capital and Capital Contributions

§9.14 1. Form: Initial Capital Contributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.14-1 Initial capital contributions

ARTICLE III: CAPITAL AND CAPITAL CONTRIBUTIONS

3.1. Each Member will contribute to the capital of the Company as the Member's initial Capital Contribution the money or property _ _[*or services*]_ _ specified in Exhibit _ _ _. The initial Fair Market Value of each item of contributed property (net of liabilities secured by that property) which the Company is considered to assume or to take "subject to" under IRC §752, is also set forth in Exhibit _ _ _, together with the description and amount of these liabilities. If a Member fails to make the initial Capital Contributions specified in this Section 3.1 within 30 days after the effective date of this Agreement, that Member's entire Membership Interest will terminate, and that Member will indemnify and hold the Company and the other Members harmless from any loss, cost, or expense, including reasonable attorney fees caused by the failure to make the initial Capital Contribution.

Comment: This provision can be drafted in a variety of ways to reflect specific items of property, agreed values, part sales and part contributions to capital, services to be rendered in lieu of contributions of money or property, assumptions of debt or other liabilities, and other matters as necessary to reflect the agreement of the parties. Corp C §17200(a); §§6.45-6.52. On the income tax ramifications of contributions of property to an LLC, see §§4.17-4.31, 5.24. In a complex transaction involving the conveyance of property as a contribution to the LLC, the drafter may wish to provide in the body of the operating agreement, or in a referenced attachment or exhibit, for appropriate escrows, closings, representations, and warranties regarding title, and other matters as necessary to effect the conveyance.

Subject to the terms of the articles of organization or operating agreement, a member is not excused from making an agreed contribution because of death, disability, dissolution, or any other reason. Corp C §17201(a). A member's contribution obligations may be compromised only by the unanimous vote of the members, unless otherwise provided in the operating agreement. Corp C §17200(b). A compromise may not be effective with respect to a creditor who extended credit before the compromise. Corp C §17201(b)(2).

The operating agreement may provide for the termination of the membership or economic interest of a member who fails to make a required capital contribution. See Corp C §17100(c).

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§9.15 2. Form: Additional Contributions

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9.15-1 Additional contributions

[*Use one of the following alternatives*]

[*Alternative 1: Additional contributions not required*]

3.2. No Member will be required to make any additional Capital Contributions. No Member may voluntarily make any additional Capital Contribution.

[*Alternative 2: Additional contributions are required*]

3.2. The Manager may determine from time to time that Capital Contributions in addition to the Members' initial Capital Contributions are needed to enable the Company to conduct its business. On making such a determination, the Manager will give notice to all Members in writing at least 90 days before the date on which the additional Capital Contribution is due. The Notice will set forth the amount of additional Capital Contribution needed, the purpose for which it is needed, and the date by which the Members will contribute. Each Member will be required to make an additional Capital Contribution in an amount that bears the same proportion to the total additional Capital Contribution that the Member's Capital Account balance bears to the total Capital Account balances of all Members. No Member may voluntarily make any additional Capital Contribution.

[*If appropriate, add the following option*]

[*Option: Capital calls are limited*]

The maximum amount of additional Capital Contributions that a Member may be required to make is _ _[*number*]_ _ percent of the amount of the Member's initial Capital Contribution under Section 3.1 of this Agreement.

Comment: Unless the articles of organization or operating agreement otherwise provide, no member may be required to contribute additional capital. Corp C §17200(b). If additional capital contributions are authorized, the failure of a member to make additional capital contributions could constitute a breach and default. See the alternate enforcement provisions in §§9.16-9.17.

The members may wish to retain the right to vote on the manager's decision to make a capital call or to limit capital calls to a specified fraction or multiplier of a member's initial capital contribution.

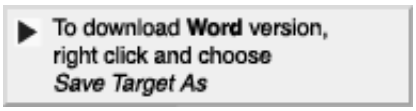
Business creditors often require the principals of small "start-up" companies to assume liability or guarantee the company's obligations. Clients should be told to expect these demands as a condition of receiving loans or an extension of credit. The client may wish to address this possibility in the operating agreement by requiring members to proportionately indemnify any member who makes a payment under a guaranty of the company's obligations (or to limit such indemnification only to guaranties approved by the other members).

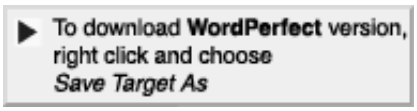
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3. Remedies When Member Fails to Make Additional Capital Contributions

§9.16 a. Form: Dilution to Make Up Shortfall

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103





9.16-1 Dilution to make up shortfall

3.3. If a Member fails to make an additional Capital Contribution required under Section 3.2 of this Agreement within 30 days after it is required to be made (a Defaulting Member), the Manager will within 5 days after that failure notify each other Member (a Nondefaulting Member) in writing of the total amount of Defaulting Member Capital Contributions not made (the Additional Capital Shortfall), and will specify a number of days within which each Nondefaulting Member may make an additional Capital Contribution, which will not be less than an amount bearing the same ratio to the amount of Additional Capital Shortfall as the Nondefaulting Member's Capital Account balance bears to the total Capital Accounts of all Nondefaulting Members. If the total amount of Additional Capital Shortfall is not so contributed, the Manager may use any reasonable method to provide Members the opportunity to make additional Capital Contributions, until the Additional Capital Shortfall is as fully contributed as possible. Following the Nondefaulting Members' making of those additional Capital Contributions, each Member's Percentage Interest will be adjusted to reflect the ratio that the Member's Capital Account bears to the total Capital Accounts of all Members.

Comment: The above provision does not penalize a noncontributing member, but gives the other members the right to make up the noncontributing member's failed additional contribution. The provision should be varied as necessary to reflect the parties' intent and to include any adjustments required to prevent reallocations under the IRS's special allocation regulations. See §§9.24-9.31. The provision in §9.17 provides for enforcing contributions and penalizing a noncontributing member.

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§9.17 b. Form: Enforcement; Penalizing Defaulting Member

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9.17-1 Enforcement; penalizing defaulting member

3.4. If a Member fails for 30 days to make an additional Capital Contribution required under Section 3.2:

(a) The Defaulting Member will indemnify and hold the Company and the other Members harmless from any loss, cost, or expense, including reasonable attorney fees caused by the failure to make the additional Capital Contribution. In this Agreement, those additional Capital Contributions that are not made by a Defaulting Member are referred to as Additional Capital Shortfall. A Member who makes the required additional Capital Contributions (Nondefaulting Member) will have the right, but not the obligation, to advance an amount bearing the same ratio to the total amount of the Additional Capital Shortfall as a Nondefaulting Member's Capital Account bears to the total Capital Accounts of all Nondefaulting Members. A Member advancing an additional Capital Contribution for a Defaulting Member under this Section 3.4(a) will (1) be paid interest by the Defaulting Member on the amount of the advance at an annual rate, from the date of the advance until paid, equal to the floating rate of _ _[*number*]_ _ percent over the prime rate charged by _ _[*name*]_ _ Bank, or the highest rate permitted by applicable law, whichever rate is lower, and (2) receive all distributions that the Defaulting Member would otherwise be entitled to receive under the provisions of this Agreement as though the advances by the Nondefaulting Member were Capital Contributions made by the Nondefaulting Member, which distributions will be applied first to attorney fees, costs, and expenses, if any; then to accrued and unpaid interest; and, finally, in reduction of the principal amount of the advance. The Defaulting Member grants any Nondefaulting Members who make advances to the Company in accordance with this Section 3.4(a) a security interest in the Defaulting Member's Membership Interest to secure the Defaulting Member's obligations under this Section 3.4(a). The Defaulting Member will, within 5 days of written notice, execute any documents or instruments reasonably necessary to enable Nondefaulting Members who make advances under this Section to perfect the foregoing security interests. Each Member irrevocably appoints each other Member, and any one of them acting alone, as his, her, or its attorney-in-fact for the limited purpose of executing, on behalf of the Member, if the Member becomes a Defaulting Member, any of the foregoing documents or instruments.

(b) If the Defaulting Member fails to pay all sums due and owing to any Members who make advances under Section 3.4(a), for a period of 180 days after the advance, each Member who has made advances under Section 3.4(a) may foreclose on any security interest granted under this Section 3.4 by causing the principal amount of the advance to be transferred from the Defaulting Member's Capital Account and added to the Capital Account of the Member who has made the advances, with a corresponding adjustment in that Member's and the Defaulting Member's Percentage Interests. Accrued and unpaid interest and other amounts owed to Members who have made those advances (the Noncapital Costs) will also be paid out of the Defaulting Member's Capital Account, and if the Capital Account is not sufficient to fully pay Noncapital Costs, the available balance will be shared pro rata in accordance with the amounts of the Nondefaulting Members' respective advances. The Defaulting Member's Percentage Interest will be further adjusted (but not below zero) following application to Noncapital Costs. All Members agree that the foregoing constitutes and will constitute a disposition of collateral in a commercially reasonable manner within the meaning of California Commercial Code §9610. Reduction of a Defaulting Member's Capital Account to satisfy that member's repayment obligations under this Section 3.4(b) will be deemed a return of capital to that Member to the extent of the reduction.

(c) On the occurrence of, and for the duration of, a Default by any Member, the Defaulting Member will not have any right to vote the Defaulting Member's Membership Interest or otherwise participate in the management or control of the business and affairs of the Company, and any and all provisions of this Agreement relating to management and control will be implemented without including the Membership Interest of the Defaulting Member. The foregoing provisions will be in addition to the Company's remedies under Corporations Code §17201(a)(2). On satisfaction of a Defaulting Member's obligations (whether by enforcement of a remedy or otherwise) under Section 3.4(b), that Member will be restored to full membership status to the extent of any

remaining Percentage Interest.

Comment: A variety of enforcement procedures and remedies—including forced sales—can be included in the operating agreement, subject to a defaulting member's defense that the provision was unreasonable under the circumstances existing at the time the operating agreement was made. See Corp C §17201(a)(3).

Under Corp C §17201(a)(2), if a member does not make a required contribution of property or services, the LLC has the option to require the member to contribute cash equal to that portion of the fair market value of the contribution that has not been made.

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§9.18 4. Form: Capital Accounts

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.18-1 Capital accounts

3.5. An individual Capital Account for each Member will be maintained in accordance with the requirements of Treasury Reg §1.704-1(b)(2)(iv) and adjusted in accordance with the following provisions:

(a) A Member's Capital Account will be increased by that Member's Capital Contributions, that Member's share of Profits, and any items in the nature of income or gain that are specially allocated to that Member under Article IV.

(b) A Member's Capital Account will be increased by the amount of any Company liabilities assumed by that Member subject to and in accordance with the provisions of Treasury Reg §1.704-1(b)(2)(iv)(c).

(c) A Member's Capital Account will be decreased by (a) the amount of cash distributed to that Member; (b) the Fair Market Value of any property of the Company so distributed, net of liabilities secured by the distributed property that the distributee Member is considered to assume or to be subject to under IRC §752; and (c) the amount of any items in the nature of expenses or losses that are specially allocated to that Member under Article IV.

(d) A Member's Capital Account will be reduced by the Member's share of any expenditures of the Company described in IRC §705(a)(2)(B) or that are treated as IRC §705(a)(2)(B) expenditures under Treasury Reg §1.704-1(b)(2)(iv)(i) (including syndication expenses and losses nondeductible under IRC §267(a)(1) or 707(b)).

(e) If any Economic Interest (or portion thereof) is Transferred, the transferee of the Economic Interest or portion will succeed to the transferor's Capital Account corresponding to the interest or portion.

(f) The principal amount of a promissory note that is not readily traded on an established securities market and that is contributed to the Company by the maker of the note will not be included in the Capital Account of any Person until the Company makes a taxable disposition of the note or until (and to the extent) principal payments are made on the note, all in accordance with Treasury Reg §1.704-1(b)(2)(iv)(d)(2).

(g) Each Member's Capital Account will be increased or decreased as necessary to reflect a revaluation of the Company's property assets in accordance with the requirements of Treasury Reg §§1.704-1(b)(2)(iv)(f) and 1.704-1(b)(2)(iv)(g), including the special rules under Treasury Reg §1.701-1(b)(4), as applicable. The provisions of this Agreement respecting the maintenance of Capital Accounts are intended to comply with Treasury Reg §1.704-1(b) and will be interpreted and applied in a manner consistent with those Regulations.

Comment: The Beverly-Killea Limited Liability Company Act does not require the establishment of capital accounts. However, capital accounts must be maintained for federal income tax purposes. See §§5.7-5.22. The basic rules for capital account maintenance are set forth in Treas Reg §1.704-1(b)(2)(iv). Internal Revenue Code §752 deals with increases and decreases in a partner's liabilities. Internal Revenue Code §705(a)(2)(B) refers to a partnership's expenditures that are not deductible in computing its taxable income and not properly chargeable to a partner's capital account.

The reference in subsection 3.5(g) to Treas Reg §1.704-1(b)(2)(iv)(g) is intended to be cautionary. Under that section and related regulations, great care must be taken if LLC property is reflected on the books at a value (book value) that is different from the adjusted tax basis of that property. Under those circumstances, capital accounts that are not adjusted as specified will not be considered to be maintained in accordance with Treas Reg §1.704-1(b)(2)(iv) and,

therefore, allocations of tax items to a member other than in accordance with the member's interest in the LLC will not have substantial economic effect, resulting in a possible reallocation for tax purposes.

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§9.19 5. Form: Withdrawals

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9.19-1 Withdrawals

3.6. A Member will not be entitled to withdraw any part of the Member's Capital Contribution or to receive any distributions, whether of money or property, from the Company except as provided in this Agreement.

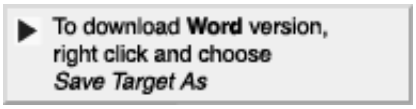
Comment: The operating agreement may provide that a member may withdraw from the LLC on the happening of specified events, or that the member will not have the right to withdraw from the LLC. Corp C §17252(a). Notwithstanding any restriction on the right to withdraw, the member may withdraw from the LLC at any time by giving written notice to the other members, but the withdrawn member will have only the rights of a holder of an economic interest under the agreement. If the parties intend that a withdrawing member may withdraw the member's capital, the agreement should specify this. In the absence of such a provision, the withdrawn member is not entitled to payment for the member's interest. Corp C §17252(a). See §9.65 for additional withdrawal provisions.

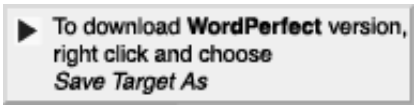
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.20 6. Form: Interest

§9.20 6. Form: Interest

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9.20-1 Interest

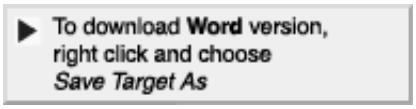
3.7. No interest will be paid on Capital Contributions or on the balance of a Member's Capital Account.

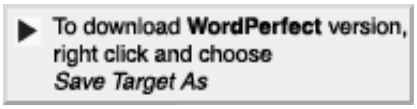
Comment: This provision may be drafted to provide for the payment of interest.

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§9.21 7. Form: Limited Liability

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9.21-1 Limited liability

3.8. A Member will not be bound by, or be personally liable for, the expenses, liabilities, or obligations of the Company except as otherwise provided in the Act or in this Agreement.

Comment: See Corp C §17101(a)-(b). In general, a member is personally liable to the same extent as a shareholder of a corporation. Corp C §17101(b). A member's obligation to make contributions is enforceable by creditors of the LLC in most cases. See Corp C §17201(b). A member is also liable under Corp C §17254(e) for restoration of unlawful distributions.

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§9.22 8. Form: No Priority of Treatment

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9.22-1 No priority of treatment

3.9. _ _[*Except as otherwise expressly provided in this Agreement, no/No*]_ _ **Member will have priority over any other Member with respect to the return of a Capital Contribution or distributions or allocations of income, gain, losses, deductions, credits, or items thereof.**

Comment: The bracketed language should be included or omitted as appropriate. It is not unusual to provide for priority of allocations, or distributions, or both, *e.g.,* an agreement to distribute profits to a member until the sum of the distributions equals the member's initial capital contribution. Special allocations are contemplated in Article IV of this form operating agreement. See §§9.24-9.31.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/ E. Allocations and Distributions/ 1. Allocation of Profits and Losses/§9.23 a. Form: Priority of Allocations

E. Allocations and Distributions

1. Allocation of Profits and Losses

§9.23 a. Form: Priority of Allocations

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9.23-1 Priority of allocations

ARTICLE IV: ALLOCATIONS AND DISTRIBUTIONS

[*Use one of the following alternatives*]

[*Alternative 1: No priority—Allocation according to members' interests*]

4.1. The Profits and Losses of the Company and all items of Company income, gain, loss, deduction, or credit will be allocated, for Company book purposes and for tax purposes, to each Member in accordance with that Member's Percentage Interest.

[*Alternative 2: Disproportionate allocation of profits and losses based on book values*]

4.1. The Profits and Losses of the Company and items of Company income, gain, loss, deduction, or credit will be allocated for Company book purposes in the manner set forth in Exhibit _ _ _ to this Agreement.

[*Alternative 3: Preferential allocation of losses*]

4.1. The Profits of the Company and all items of income, gain, or credit will be allocated, for Company book purposes and for tax purposes, to the Members in accordance with their respective Percentage Interests. Losses of the Company and all items of loss or deduction will be allocated as set forth in Exhibit _ _ _ to this Agreement.

[*Alternative 4: Preferential allocation of profits*]

4.1. The Profits and Losses of the Company and all items of Company income, gain, loss, deduction, or credit will be allocated, for Company book purposes and for tax purposes, to a Member in accordance with the Member's Percentage Interest; provided that Profits, including Profits from Capital Events will first be allocated to those Members whose names are set forth in Exhibit _ _ _, attached to this Agreement, pro rata in accordance with their respective Percentage Interests, until they each have received distributions equal to _ _[*number*]_ _ percent of their initial Capital Contribution.

[*Alternative 5: Preferential allocation of profits and losses*]

4.1. The Profits and Losses of the Company and items of Company income, gain, loss, deduction, or credit will be allocated as set forth in Exhibit _ _ _ attached to this Agreement. Notwithstanding the foregoing sentence, those Members listed in Exhibit _ _ _ who are identified as Priority Members will receive all Company distributions of Profits and Losses before any distributions are made to any other Members until each Priority Member has received total distributions equal to that Member's initial Capital Contribution.

[*Continue*]

4.2 As used in this Agreement, "Profits and Losses" means, for each fiscal year or other period specified in this Agreement, an amount equal to the Company's taxable income or loss for that year or period, determined in accordance with IRC §703(a), including all Tax Items required to be stated separately under IRC §703(a)(1), with the following adjustments:

(a) Any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Profits or Losses will be added to taxable income or loss;

(b) Any expenditures of the Company described in IRC §705(a)(2)(B) or treated as IRC §705(a)(2)(B) expenditures under Treasury Reg §1.704-1(b)(2)(iv)(i) and not otherwise taken into account in computing Profits or Losses will be subtracted from taxable income or will increase that loss; _ _[*and*]_ _

[*Add the following subsections when book values are to be used*]

[(c)] Gain or loss resulting from any disposition of Company property with respect to which gain or loss is recognized for federal income tax purposes will be computed by reference to the Fair Market Value of the property disposed of, notwithstanding that the adjusted tax basis of the property differs from its Fair Market Value;

[(d)] In lieu of depreciation, amortization, and other cost recovery deductions taken into account in computing taxable income or loss, there will be taken into account Book Depreciation for that fiscal year or other period, computed in accordance with the definition of "Book Depreciation" in Section 1.11; and

[*Continue*]

[(e)] Notwithstanding the foregoing provisions of this Section 4.2, any items of income, gain, loss, or deduction that are specially allocated will not be taken into account in computing Profits or Losses under Section 4.1.

Comment: The operating agreement may provide for any agreed allocation of profits and losses. Corp C §17202. The allocation provisions will generally be based on the economic business arrangement among the members, and, as discussed below, must have "substantial economic effect" to be respected by the IRS for federal income tax purposes. Variations from the suggested language in the above provision should be considered in connection with the special allocation provisions in §§9.24-9.31 and other tax-related provisions of this form operating agreement.

The term "special allocation" is generally understood to mean an allocation of income, gain, loss, deduction, or credit (or any item thereof) in a manner different from a partner's interest in the partnership. Because a partner's interest can vary with respect to different items, "the comparison should be made with respect to the economic arrangement of the partners as to the item involved." 1 Willis, Pennell & Postlewaite, Partnership Taxation ¶10.01[3][c] (6th ed 1997).

Special allocations can take the form of, *e.g.,* profit and loss sharing that is not proportionate to the members' capital accounts, allocation of a particular item to a member, or allocations that change in accordance with specified events.

Alternative 1 provides that (1) allocations are to be made identically for book and tax purposes, *i.e.,* the book values and tax basis values of company property are identical, and (2) profits and losses are allocated in accordance with percentage interests. Alternatively, allocations based on book value may be used (see Alternative 2). Different methods of allocating or prioritizing profits and losses can be employed as in the variations provided in Alternatives 3-5. As long as the LLC complies with IRC §704(b) and related regulations—notably, the capital account maintenance rules of Treas Reg §1.704-1(b)(2)(iv) and the rules requiring specified adjustments when book values are used (Treas Reg §1.704-1(b)(2)(iv)(g))—those allocations should have substantial economic effect and thereby avoid reallocation by the IRS. See Comment following form provision in §9.24.

The choice of provisions above permits great freedom in allocating LLC items. For example, a member may wish to be allocated a disproportionate share of losses if the member's income tax situation permits the member to benefit from those losses. Other members may bargain for and receive a disproportionate share of profits on the theory that the amount or timing of their contributions make their contributions more valuable—as in the case of a venture capital investment. The disproportionate allocations can be reduced or eliminated on the happening of a specified, event, *e.g.,* attaining a targeted level of profitability or net worth.

The operating agreement can provide for allocations based on the book values of company property. The book value of property may differ from its income tax basis when, for example, book depreciation is different from depreciation for income tax purposes. An LLC may choose to use book values rather than income tax basis values for purposes of allocations when book values more closely approximate economic reality. A business may choose accelerated depreciation for tax purposes because of tax savings, but may wish to use straight line depreciation for financial statement purposes because of higher asset values.

Alternative 3, specifying preferential allocation of losses, illustrates still another variation. This language provides that losses are allocated in proportions varying from the members' percentage interests. Although the special allocation provisions in Article IV of this form operating agreement should permit special allocations of losses to have substantial economic effect, the drafter who is not a tax expert should consult with a qualified tax adviser. Alternative 4, providing for preferential allocations, authorizes prioritization in allocating and distributing profits, with a cutoff. Priority features often terminate when investors have received specified levels of priority distributions, *e.g.,* when the investor has received an amount equal to his or her initial capital contribution.

Alternative 5 authorizes prioritizing all distributions. If the LLC sustains losses, the disproportionate allocation of losses to priority members can result in negative capital account balances for those members.

When an LLC utilizes book values for company property, and these values differ from the adjusted tax basis of the property, profit and loss calculations for allocation purposes should include the adjustments set forth in the provisions in Section 4.2(c)-(d) of this form to account for differences in gain or loss on disposition between book values and tax basis values. There will also be differences in depreciation and other cost recovery deductions between book and tax return values, and these differences should also be considered.

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b. Special Allocations

§9.24 (1) Form: Definitions Relating to Special Allocations

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9.24-1 Definitions relating to special allocations

4.3. The following definitions will apply with respect to this Article IV.

(a) "Adjusted Capital Account Deficit" means, with respect to any Member, the deficit balance, if any, in the Member's Capital Account as of the end of the relevant fiscal year of the Company, after the Member's Capital Account has been adjusted as follows: (1) increased by the amount of the Member's share of Company Minimum Gain and Member Nonrecourse Debt Minimum Gain, and (2) decreased by the amount of the items described in Treasury Reg §1.704-1(b)(2)(ii)(d)(4)-(6).

This definition of Adjusted Capital Account Deficit is intended to comply with the provisions of Treasury Reg §1.704-1(b)(2)(ii)(d) and will be interpreted consistently with that Regulation.

(b) "Company Minimum Gain" has the meaning set forth in Treasury Reg §1.704-2(d)(1).

(c) "Member Nonrecourse Debt" is defined in Treasury Reg §1.704-2(b)(4).

(d) "Member Nonrecourse Debt Minimum Gain" for a fiscal year of the Company means the net increase in Minimum Gain attributable to Member Nonrecourse Debt, determined as set forth in Treasury Reg §1.704-2(i)(2).

(e) "Member Nonrecourse Deductions" has the meaning set forth in Treasury Reg §1.704-2(i)(2). For any Company fiscal year, the amount of Member Nonrecourse Deductions with respect to a Member Nonrecourse Debt equals the net increase during that fiscal year in Member Nonrecourse Debt Minimum Gain attributable to that Member Nonrecourse Debt during that fiscal year, reduced (but not below zero) by the amount of any distributions during that year to the Member bearing the economic risk of loss for Member Nonrecourse Debt if the distributions are both from the proceeds of the Member Nonrecourse Debt and are allocable to an increase in Member Nonrecourse Debt Minimum Gain attributable to the Member Nonrecourse Debt, all as determined according to the provisions of Treasury Reg §1.704-2(i)(2). In determining Member Nonrecourse Deductions, the ordering rules of Treasury Reg §1.704-2(j) will be followed.

(f) "Nonrecourse Deductions" has the meaning set forth in Treasury Reg §1.704-2(c). The amount of Nonrecourse Deductions for a Company fiscal year equals the net increase in the amount of Company Minimum Gain during that fiscal year, reduced (but not below zero) by the aggregate amount of any distributions during that fiscal year of proceeds of a Nonrecourse Liability that are allocable to an increase in Company Minimum Gain.

(g) "Nonrecourse Liability" has the meaning set forth in Treasury Reg §1.752-1(a)(2).

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.25 (2) Form: Certain Special Allocations

§9.25 (2) Form: Certain Special Allocations

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9.25-1 Certain special allocations

4.4. The following special allocations will be made in the following order:

(a) *Company Minimum Gain Chargeback*. If there is a net decrease in Company Minimum Gain during a fiscal year, each Member will be allocated, before any other allocation under this Section, items of Company income and gain for the fiscal year equal to that Member's share of the net decrease in Company Minimum Gain as determined in accordance with Treasury Reg §1.704-2(g)(2).

(b) *Member Nonrecourse Debt Minimum Gain Chargeback.* If there is a net decrease in Member Nonrecourse Debt Minimum Gain during a fiscal year (as defined in the Regulations), any Member with a share of the Member Nonrecourse Debt Minimum Gain attributable to that Member's Nonrecourse Debt as of the beginning of the fiscal year should be allocated items of Company income and gain for that year (and, if necessary, subsequent years) equal to that Member's share of the net decrease in Member Nonrecourse Debt Minimum Gain. A Member's share of net decrease in Member Nonrecourse Debt Minimum Gain will be determined under Treasury Reg §1.704-2(g)(2). A Member will not be subject to the foregoing chargeback to the extent permitted under Treasury Reg §1.704-2(i)(4).

(c) *Qualified Income Offset*. If any Member unexpectedly receives an adjustment, allocation, or distribution described in Treasury Reg §1.704-1(b)(2)(ii)(d)(4), (5), or (6), that Member will be allocated items of Company income and gain (consisting of a prorata portion of each item of Company income, including gross income and gain for that fiscal year) in an amount and manner sufficient to eliminate, to the extent required by the Regulations, the Adjusted Capital Account Deficit of that Member as quickly as possible; provided that an allocation under this Section 4.4(c) will be made only if and to the extent that the Member would have an Adjusted Capital Account Deficit after all other allocations provided for in this Agreement have been made as if this Section 4.4(c) were not in the Agreement.

(d) *Gross Income Allocation.* In the event any Member has a deficit Capital Account at the end of any Company fiscal year in excess of the sum of:

(1) The amount the Member is obligated to restore under any provision of this Agreement, and

(2) The amount the Member is deemed to be obligated to restore under Treasury Reg §1.704-2(g)(1), (i)(5),

each such Member will be specially allocated items of Company income in the amount of the excess as quickly as possible; except that an allocation under this Section 4.4(d) will be made only if and to the extent that the Member would have a deficit Capital Account in excess of that sum after all other allocations provided for in this Article 4 have been made as if Section 4.4(c) and this Section 4.4(d) were not in the Agreement.

(e) *Member Nonrecourse Deductions.* Any Member Nonrecourse Deductions for any Company fiscal year will be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which those Member Nonrecourse Deductions are attributable in accordance with Treasury Reg §1.704-2(i)(1).

(f) *Nonrecourse Deductions*. Nonrecourse Deductions for any fiscal year will be specially allocated in proportion to their respective allocations of Profits for that fiscal year.

(g) *Section 754 Adjustments*. To the extent an adjustment to the adjusted tax basis of any Company asset

under IRC §734(b) or 743(b) is required under Treasury Reg §1.704-1(b)(2)(iv)(m)(2) or 1.704-1(b)(2)(iv)(m)(4) to be taken into account in determining Capital Accounts as the result of a distribution to a Member in complete liquidation of the Member's interest in the Company, the amount of the adjustment to Capital Accounts will be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases the basis), and the gain or loss will be specially allocated to the Members in accordance with their interests in the Company in the event that Treasury Reg §1.704-1(b)(2)(iv)(m)(2) applies, or to the Partner to whom the distribution was made in the event that Treasury Reg §1.704-1(b)(2)(iv)(m)(4) applies.

Comment: **Substantial Economic Effect.** Under IRC §704(a)*,* a partner's distributive share of income, gain, loss, deduction, or credit, or any item within these categories, is determined by the partnership agreement. However, a partner's distributive share of the foregoing categories, or item within these categories, is determined in accordance with the partner's interest in the partnership; determined by taking into account all facts and circumstances if (1) the partnership agreement fails to specify the partner's distributive share or item of income, gain, loss, deduction, or credit, or (2) the allocation of any of these classifications or items under the partnership agreement does not have substantial economic effect. Complex regulations promulgated under IRC §704 define substantial economic effect with respect to a partner's distributive share (Treas Reg §1.704-1) and allocations with respect to nonrecourse liabilities (Treas Reg §1.704-2). See §§5.35-5.57.

Under Treas Reg §1.704-1(b)(2), an allocation has economic effect if (1) the partnership maintains capital accounts for the partners in accordance with the allocation regulations; (2) on liquidation of the partnership or a partner's interest in the partnership, distributions are made in accordance with the positive capital balances of the partners; and (3) if a partner has a deficit balance in the partner's capital account following liquidation, the partner is unconditionally required to restore the deficit to the partnership by the end of the taxable year (or, if later, within 90 days after the date of liquidation). Treas Reg §1.704-1(b)(2)(ii)(b).

Qualified Income Offset. The regulations provide an alternate test for the deficit restoration component of the economic effect test. Under Treas Reg §1.704-1(b)(2)(ii)(d), the partnership agreement can provide a "qualified income offset" instead of a deficit restoration obligation. Under this provision, a partner who unexpectedly receives an adjustment, allocation, or distribution described in Treas Reg §1.704-1(b)(2)(ii)(d)(4) (oil and gas depletion allowance), (d)(5) (certain allocations of loss and deduction), or (d)(6) (certain distributions) must be allocated items of income and gain in an amount and manner sufficient to eliminate the deficit balance as quickly as possible. Because a deficit restoration obligation creates an exposure to unlimited liability that is contrary to the limited liability feature of an LLC, use of the qualified income offset is recommended for LLCs and is used in this form.

The substantiality requirement is satisfied if there is a reasonable possibility that the allocation in question will affect substantially the dollar amounts to be received by the partners from the partnership, independent of tax consequences. Treas Reg §1.704-1(b)(2)(iii)(a).

Nonrecourse Debt. Allocations of deductions or losses attributable to nonrecourse liabilities cannot have economic effect because the creditor, rather than any partner or member, bears any economic risk that corresponds to the loss or deduction allocations. Treas Reg §1.704-2(b)(1). A partner's share of those items must therefore be determined in accordance with the partner's interest in the partnership, taking into account all facts and circumstances. IRC §704(b). Under Treas Reg §§1.704-2(b) and 1.704-2(e) allocations of nonrecourse deductions are deemed to be in accordance with the partners' interests in the partnership if: (1) the partnership maintains capital accounts for the partners in accordance with the allocation regulations; (2) on liquidation of the partnership or a partner's interest in the partnership, distributions are made in accordance with the positive capital balances of the partners; (3) the partners have a negative capital account deficit-restoration obligation or agree to a qualified income offset; (4) nonrecourse deductions are allocated among the partners in a manner that is reasonably consistent with allocations that have substantial economic effect of some other significant partnership item attributable to the property securing the nonrecourse liabilities; (5) the partnership agreement contains a "minimum gain chargeback" provision; and (6) all other material allocations and capital account adjustments are valid.

Minimum Gain. Minimum gain is the amount of gain that would be realized by the partnership if it disposed of the property subject to the nonrecourse liability for an amount equal to the outstanding balance of the nonrecourse liability. Treas Reg §1.704-2(d). Partnership minimum gain increases as additional liability is incurred with respect to encumbered property, and as the adjusted basis of the property decreases, *e.g.,* through depreciation. Treas Reg §1.704-2(b)(2). Partnership minimum gain decreases when there is a decrease in the amount by which the

nonrecourse liability exceeds the adjusted tax basis of the property encumbered by the liability. Treas Reg §1.704-2(b)(2). A minimum gain chargeback is an allocation of gain attributable to a decrease in partnership minimum gain. Allocations under a minimum gain chargeback must be made to the partners that either were allocated nonrecourse deductions or received distributions of proceeds attributable to nonrecourse borrowing. Treas Reg §1.704-2(b)(2), (f).

Member Nonrecourse Debt Minimum Gain. Special rules apply when one or more partners bear the economic risk of a particular partner nonrecourse liability. These rules are set forth in Treas Reg §1.704-2(b)(4) (definition of partner nonrecourse debt or liability) and §1.704-2(i) (allocation of partner nonrecourse debts or liabilities; nonrecourse debt minimum gain).

Order of Allocations. The order in which allocations are to be made is set forth in Treas Reg §1.704-2(j).

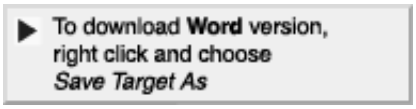
Book Depreciation. The definition of book depreciation in §1.11 follows Treas Reg §1.704-1(b)(2)(iv)(g)(3). Property may be reflected on the books of an LLC at a value that differs from the adjusted tax basis of that property. Unless the LLC complies with the special allocation regulations, the Members' capital accounts will not be considered to be maintained in accordance with Treas Reg §1.704-1(b) and special allocations of book items will therefore not have substantial economic effect and may be subject to reallocation by the IRS.

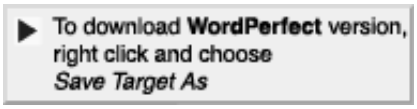
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.26 (a) Form: Allocations of Member Nonrecourse Deductions

§9.26 (a) Form: Allocations of Member Nonrecourse Deductions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103





9.26-1 Allocations of member nonrecourse deductions

4.5. Member Nonrecourse Deductions for any fiscal year of the Company will be allocated to the Members in the same proportion as Profits are allocated under Section 4.1, provided that any Member Nonrecourse Deductions for any fiscal year or other period will be allocated to the Member who bears (or is deemed to bear) the economic risk of loss with respect to the Member Nonrecourse Debt to which those Member Nonrecourse Deductions are attributable in accordance with Treasury Reg §1.704-2(i)(2).

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.27 (b) Form: Allocation of Profits From Capital Events

§9.27 (b) Form: Allocation of Profits From Capital Events

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9.27-1 Allocation of profits from capital events

4.6. In any fiscal year of the Company, Profits in excess of Losses of the Company resulting from a Capital Event in that fiscal year will be allocated to the Members in the following order:

(a) To Members whose Adjusted Capital Contributions are in excess of their Capital Accounts, in proportion to those excesses, until all of those excesses have been eliminated. "Adjusted Capital Contributions" means, with respect to each Member, the excess of that Member's contribution to the capital of the Company over all prior distributions to the Member that have resulted from Capital Events.

(b) Among the Members in the proportion that the Capital Contribution of each Member bears to the total Capital Contributions of all Members.

Comment: Subsection (b) could provide for allocation to members in accordance with their percentage interests. The method of allocation is a subject for negotiation among the members. This form views net proceeds of a capital event as a return of capital.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.28 (c) Form: Allocation of Losses From Capital Events

§9.28 (c) Form: Allocation of Losses From Capital Events

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9.28-1 Allocation of losses from capital events

4.7. In any Company fiscal year, Losses in excess of Profits of the Company, resulting from a Capital Event in that fiscal year, will be allocated to the Members with positive Capital Accounts, in proportion to their positive Capital Account balances, until no Member has a positive Capital Account. For this purpose, Capital Accounts will be reduced by the adjustments set forth in Treasury Reg §1.704-1(b)(2)(ii)(d)(4)-(6).

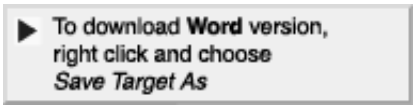
Comment: The capital account adjustments specified in Treas Reg §1.704-1(b)(2)(ii)(d)(4)-(6) are part of the requirements for establishing a qualified income offset. See Comment regarding qualified income offset following form provision in §9.25.

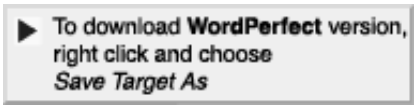
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.29 (d) Form: Allocations Respecting Asset Distributions

§9.29 (d) Form: Allocations Respecting Asset Distributions

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9.29-1 Allocations respecting asset distributions

4.8. Any Unrealized Appreciation or Unrealized Depreciation in the values of Company property distributed in kind to all the Members will be treated in accordance with applicable law.

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§9.30 (e) Form: Allocations Respecting Contributed Property

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9.30-1 Allocations respecting contributed property

4.9. Any item of income, gain, loss, or deduction with respect to any property (other than cash) that has been contributed by a Member to the capital of the Company, or that has been revalued under the provisions of Article III, Section 3.5(g), and that is required or permitted to be allocated to the Member for income tax purposes under IRC §704(c) so as to take into account the variation between the tax basis of the property and its Fair Market Value at the time of its contribution, will be allocated solely for income tax purposes in the manner required or permitted under IRC §704(c) using the "traditional" method described in Treasury Reg §1.704-3(b), except that any other method allowable under applicable Regulations may be used for any contribution of property with respect to which there is agreement among the contributing Member and the Manager (and, if the Manager and the contributing Member are Affiliates, a Majority of Members who are not Affiliates of the Manager).

Comment: Under IRC §704(c)(1)(A), income, gain, loss, and deduction with respect to property contributed to a partnership by a partner will be shared among the partners in a manner that takes into account the variation between the basis of the property to the partnership and its fair market value at the time of contribution. The purpose of IRC §704(c) is to prevent the shifting of tax consequences among partners for precontribution gain or loss. Treas Reg §1.704-3(a)(1). Under Treas Reg §1.704-3(b), the "traditional" method of making the requisite IRC §704(c) allocations specifies that when a partnership has income, gain, loss, or deduction attributable to IRC §704(c) property, it must make appropriate allocations to the partners to avoid shifting the tax consequences of the built-in gain or loss. For example, if the partnership sells the property, the built-in gain or loss on the property is allocable to the contributing partner. See also Treas Reg §1.704-1(b)(2)(iv)(d)(3).

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.31 (f) Form: Allocations Between Assignor and Assignee

§9.31 (f) Form: Allocations Between Assignor and Assignee

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9.31-1 Allocations between assignor and assignee

4.10. In the case of a Transfer of an Economic Interest during any fiscal year of the Company, the Assigning Member and Assignee will each be allocated Profits or Losses based on the number of days each held the Economic Interest during that fiscal year. If the Assigning Member and Assignee agree to a different proration and advise the Manager of the agreed proration before the date of the Transfer, Profits or Losses from a Capital Event during that fiscal year will be allocated to the holder of the Interest on the day the Capital Event occurred. If an Assignee makes a subsequent Assignment, the Assignee will be considered an "Assigning Member" with respect to the subsequent Assignee for purposes of these allocations.

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§9.32 c. Form: Revaluation of Company Assets

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9.32-1 Revaluation of company assets

4.11. (a) The Gross Asset Value of all Company property will be adjusted at the following times: (1) on the acquisition of an interest or additional interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (2) on the distribution of money or other property (other than a de minimis amount) by the Company to a Member as consideration for an Economic Interest in the Company; and (3) on the liquidation of the Company within the meaning of Treasury Reg §1.704-1(b)(2)(ii)(g), provided, however, that adjustments under clauses (1) and (2) above will be made only in the event of a revaluation of Company property under Article III, Section 3.5(g) in accordance with Treasury Reg §1.704-1(b)(2)(iv)(f).

(b) The Gross Asset Value of Company property will be increased or decreased to reflect adjustments to the adjusted tax basis of the property under IRC §§732, 733, or 743, subject to the limitations imposed by IRC §755 and Treasury Reg §1.704-1(b)(2)(iv)(m).

(c) If the Gross Asset Value of an item of property has been determined or adjusted under Article I, Section 1.24, or subsection (a) or (b) of this Section 4.11, the Gross Asset Value will be adjusted by the Book Depreciation, if any, taken into account with respect to that property for purposes of computing Profits and Losses.

Comment: These provisions are based on the capital account maintenance requirements of Treas Reg §1.704-1(b)(2)(iv). The provision in (c) may be omitted if the LLC does not maintain book values different from adjusted tax basis.

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§9.33 d. Form: Compliance With Law and Regulations

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9.33-1 Compliance with law and regulations

4.12. It is the intent of the Members that each Member's allocated share of Company Tax Items be determined in accordance with this Agreement to the fullest extent permitted by IRC §704(b)-(c). Notwithstanding anything to the contrary in this Agreement, if the Company is advised that, as a result of the adoption of new or amended regulations under IRC §704(b)-(c), or the issuance of authorized interpretations, the allocations provided in this Agreement are unlikely to be respected for federal income tax purposes, the Manager is granted the power to amend the allocation provisions of this Agreement, on advice of accountants and legal counsel, to the minimum extent necessary for the allocation provisions to be respected for federal income tax purposes.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/ 2. Distributions/§9.34 a. Form: Available Cash From Business Operations

2. Distributions

§9.34 a. Form: Available Cash From Business Operations

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9.34-1 Available cash from business operations

4.13. All Available Cash, other than revenues or proceeds from a Capital Event or the dissolution of the Company, will be distributed among the Members in the same manner as Profits. The parties intend that Available Cash will be distributed as soon as practicable following the Manager's determination that cash is available for distribution. The parties acknowledge that no assurances can be given about when or whether cash will be available for distributions to the Members.

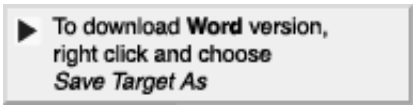
Comment: This provision "reminds" the manager to distribute available cash from business operations as promptly as possible to ensure that members will have cash to satisfy tax liabilities on allocated distributable income of the LLC. Note that the operating agreement can be drafted to give the manager considerable discretion in determining what constitutes cash available for distribution. Because of the reference to the manner in which profits are distributed, there is no need to repeat the allocation provisions set forth in §9.23.

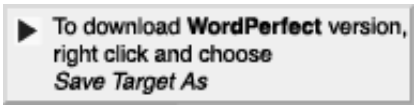
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.35 b. Form: Available Cash From Capital Events

§9.35 b. Form: Available Cash From Capital Events

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9.35-1 Available cash from capital events

4.14. All Available Cash resulting from a Capital Event (as distinguished from normal business operations or the dissolution of the Company) will be distributed to the Members in accordance with their respective Percentage Interests as soon as practicable following the Manager's determination that cash is available for distribution.

Comment: If special allocations or priority returns are contemplated, this clause should be revised accordingly. Proceeds of a capital event can be shared by percentage interests or by reference to capital contributions, as the parties may agree.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.36 c. Form: Noncash Proceeds

§9.36 c. Form: Noncash Proceeds

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9.36-1 Noncash proceeds

4.15. If the proceeds from a sale or other disposition of an item of Company property consist of property other than cash, the value of that property will be as determined by the Manager. If noncash proceeds are subsequently reduced to cash, that cash will be taken into account by the Manager in determining Available Cash and the Manager will determine whether the cash has resulted from operations or from a Capital Event.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.37 d. Form: Liquidating Proceeds

§9.37 d. Form: Liquidating Proceeds

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9.37-1 Liquidating proceeds

4.16. Notwithstanding any other provisions of this Agreement to the contrary, when there is a distribution in liquidation of the Company, or when any Member's interest is liquidated, all items of income and loss first will be allocated to the Members' Capital Accounts under this Article IV, and other credits and deductions to the Members' Capital Accounts will be made before the final distribution is made. The final distribution to the Members will be made as provided in Article IX, Section 9.2(d) of this Agreement. The provisions of this Section 4.16 and Article IX, Section 9.2(d), will be construed in accordance with the requirements of Treasury Reg §1.704-1(b)(2)(ii)(b)(2).

Comment: This form is derived from Treas Reg §1.704-1(b)(2)(ii)(b)(2), which deals with the economic effect of allocation provisions on liquidation of a partnership or any partner's interest in the partnership. Corporations Code §17254 imposes restrictions on distributions to members.

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F. Management of Company

§9.38 1. Form: Number of Managers

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9.38-1 Number of managers

ARTICLE V: MANAGEMENT

[*Use one of the following alternatives*]

[*Alternative 1: Single manager*]

5.1. The business of the Company will be managed by the Manager named in Article II, Section 2.9, or a successor Manager selected in the manner provided in Article V, Section 5.3. Except as otherwise set forth in this Agreement, all decisions concerning the management of the Company's business will be made by the Manager.

[*Alternative 2: More than one manager (member or nonmember) but fewer than all members are managers*]

5.1. The business of the Company will be managed by the Persons named as Managers in Article II, Section 2.9, or any successors, selected as provided in Section 5.3. Except as otherwise provided in this Agreement, all decisions concerning the management of the Company's business will be made by the Vote of a majority, by number, of the Managers.

[*Alternative 3: All members are managers*]

5.1. The business of the Company will be managed by all the Members. A Member will be a Manager only during the time the Member is a Member of the Company. All decisions concerning the management of the Company's business will be made by the Vote of a Majority of Members.

Comment: Unless the articles of organization provide otherwise, an LLC will be managed by its members, and each member will have the same rights and duties as a manager under the Act. Corp C §17150. If an LLC is to be managed by one or more managers rather than by all the members, the articles of organization must contain a statement to that effect. Corp C §§17150, 17151(b); see §7.20. A manager does not need to be a member (Corp C §17151(a)) and need not be a natural person (Corp C §17151(c)). If the articles of organization provide for managers, a member who is not a manager has no authority to act on the LLC's behalf. Corp C §17157(b)(1).

Consideration might be given to weighting the managers' votes depending on whether they are members. The approach taken here is more akin to corporate governance. See Corp C §307(a)(8) (act or decision by majority of directors constitutes act of board). Unless the operating agreement or articles of organization provide otherwise, decisions of the managers must be made by majority vote of the managers or by unanimous written consent. Corp C §17156.

There is no need to link the provision on all-member management above to the successorship provisions in §9.40 because members will automatically lose their status as managers if they are no longer members, and new members will automatically become managers. On member-managed versus manager-managed LLCs, see §§6.7-6.14.

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§9.39 2. Form: Term of Manager

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9.39-1 Term of manager

5.2. _ _[*The manager/Each manager*]_ _ **will serve until the earlier of (1) the Manager's resignation, retirement, death, or disability; (2) the Manager's removal by the Members; and (3) the expiration of the Manager's term as Manager, if a term has been designated by a Majority of Members. A new Manager will be appointed by a Majority of Members on the occurrence of any of the foregoing events.**

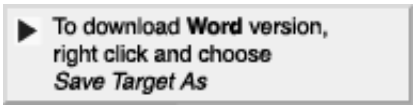
Comment: See Corp C §17152 (election, removal, and resignation of managers). This provision should be eliminated if all members are to serve as managers. Consideration might be given to having a vacancy filled by the remaining managers, by analogy to a corporate board of directors. See Corp C §305.

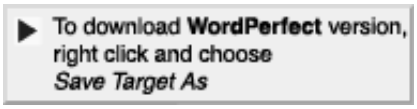
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.40 3. Form: Appointment and Removal of Managers

§9.40 3. Form: Appointment and Removal of Managers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103





9.40-1 Appointment and removal of managers

5.3. Each Manager will be appointed by a Majority of Members for (a) a term expiring with the appointment of a successor, or (b) a term expiring at a definite time specified by a Majority of Members in connection with the appointment. A Manager who is not also a Member may be removed with or without cause at any time by action of a Majority of Members. A Manager who is a Member may be removed only on the Vote of all other Members.

Comment: See Corp C §17152 (election, removal, and resignation of managers). This provision should be eliminated if all members are to serve as managers. This provision limits the right of the members to remove a manager who is also a member. See §6.13.

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§9.41 4. Form: Duties of Manager

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9.41-1 Duties of manager

5.4. The Manager, who will be the President of the Company, will have the powers and duties described in Section 5.8 of this Agreement and any other powers and duties that may be prescribed in this Agreement or by the Members. Notwithstanding the foregoing, the Manager will not take any of the following actions on behalf of the Company unless a Majority of Members has consented to the taking of that action.

(a) Any act that would make it impossible to carry on the ordinary business of the Company;

(b) Any confession of a judgment against the Company;

(c) The dissolution of the Company;

(d) The disposition of all or a substantial part of the Company's assets not in the ordinary course of business;

(e) The incurring of any debt not in the ordinary course of business;

(f) A change in the nature of the principal business of the Company;

(g) The incurring of any contractual obligation or the making of any capital expenditure with a total cost of more than _ _[*dollar amount*]_ _;

(h) The filing of a petition in bankruptcy or entering into an arrangement among the Company's creditors; and

(i) The entering into, on behalf of the Company, of any transaction constituting a "reorganization" within the meaning of Corp C §17600.

Comment: If there are multiple managers, the members may wish to provide that the managers are to act as a committee rather than through a president. Every manager is an agent of the LLC for purposes of its business and affairs. Corp C §17157(b)(2). Although the operating agreement may circumscribe the power of a manager, the LLC will be bound to third parties who have no actual knowledge of the restrictions on a manager's authority. A manager may bind the LLC by any act "for apparently carrying on in the usual way the business or affairs" of the LLC. See Corp C §17157(b)(2). A reorganization triggers dissenters' rights under Corp C §17601. In lieu of dissenters' rights, an operating agreement may specify the amounts (or methods of determining amounts) to be paid to members on reorganization. See Corp C §17612(b).

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§9.42 5. Form: Procedure for Action by Managers

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9.42-1 Procedure for action by managers

[*Use when the LLC has more than one manager*]

5.5. Actions of the Managers will be taken at meetings or as otherwise provided in this Section 5.5 by a majority. No regular meetings of the Managers need be held. Any two Managers may call a meeting of the Managers by giving Notice of the time and place of the meeting at least 48 hours before the time of the holding of the meeting. The Notice need not specify the purpose of the meeting, nor the location if the meeting is to be held at the principal executive office of the Company.

A majority of Managers will constitute a quorum for the transaction of business at any meeting of the Managers.

The transactions of the Managers at any meeting, however called or noticed, or wherever held, will be as valid as though transacted at a meeting duly held after call and notice if a quorum is present and if, either before or after the meeting, each Manager not present signs a written waiver of notice or a consent to the holding of the meeting or an approval of the minutes of the meeting.

Any action required or permitted to be taken by the Managers under this Agreement may be taken without a meeting if a majority of the Managers individually or collectively consent in writing to the action.

Managers may participate in the meeting through the use of a conference telephone or similar communications equipment, provided that all Managers participating in the meeting can hear one another.

The Managers will keep or cause to be kept with the books and records of the Company full and accurate minutes of all meetings, notices and waivers of notices of meetings, and all written consents to actions of the Managers.

Comment: This form is designed for use when there are multiple managers and is intended to be illustrative only. This form does not require the managers to hold meetings. Under Corp C §17101(b), which imports into the Act the corporate notion of "piercing the corporate veil," the failure to hold meetings of members or managers or the failure to observe formalities pertaining to the calling or conduct of meetings will not be considered a factor tending to establish that the members have personal liability for the obligations of the LLC when the articles of organization or operating agreement do not expressly require the holding of meetings of members or managers. A clause that requires managers to meet could cause a failure to observe formalities to become a factor in establishing that the members have personal liability for the obligations of the LLC.

This form alters the rule in Corp C §17156 requiring a written consent to be unanimous.

The drafter should assess the need for more elaborate provisions requiring, for example, regular meetings, annual organizational meetings at which officers are selected, and other corporate-style formalities. See Corp C §307 for analogous corporate provisions.

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§9.43 6. Form: Time Devoted to the Company

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9.43-1 Time devoted to the company

5.6. It is acknowledged that the Manager has other business interests to which the Manager devotes part of the Manager's time. The Manager will devote as much time to the conduct of the business of the Company as the Manager, in the Manager's own good faith and discretion, deems necessary.

Comment: The language of this provision should reflect the members' understanding about the manager's time. The language can be modified as necessary to deal with multiple managers or different requirements among managers. A manager owes an LLC and its members the same fiduciary duties that a partner owes to a partnership and its partners. Corp C §17153. Those fiduciary duties may be modified only by a written operating agreement with the informed consent of the members. Corp C §17005(d). A member who is a manager has the same rights and duties as a manager who is not a member. Corp C §17150.

To reduce the possibility that managers might be found to have breached their fiduciary duties by engaging in transactions without the members' informed written consent, the operating agreement may provide as follows:

(1) A manager is not obligated to commit a specific portion of his or her time to the business of the LLC;

(2) A manager is free to engage in other business activities in which the LLC has no interest;

(3) A manager is free to engage in business activities that compete with the LLC (although disclosure of the nature and extent of those activities may be required); and

(4) A manager need not offer business opportunities to the LLC and may take advantage of those opportunities for his or her own account, and neither the LLC nor any member has a right to any income derived by the manager from those activities.

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§9.44 7. Form: Compensation

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9.44-1 Compensation

5.7. The Manager will be entitled to compensation for the Manager's services as determined by the Members, and to reimbursement for all expenses reasonably incurred by the Manager in the performance of the Manager's duties.

Comment: Any compensation to managers who are also members must be set forth in the operating agreement or articles of organization, because the Act does not provide for remuneration to a member for acting in the LLC's business, except with respect to reasonable compensation allowed under Corp C §17352 for services as a member or manager in winding up the affairs of the LLC. Compensation may not necessarily be appropriate for postformation management services, *e.g.,* when the manager already has received compensation by allocation of a membership interest in consideration for services to be performed.

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§9.45 8. Form: Officers of the Company

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9.45-1 Officers of the company

5.8. The Company will have a President, who will be a Manager. The President will be the chief executive officer of the Company and will have general supervision of the business and affairs of the Company, will preside at all meetings of Members and of Managers, and will have any other powers and duties usually vested in a chief executive officer. A Majority of the Members may provide for additional officers of the Company, may alter the powers and duties of the President, and will establish the powers and duties of all other officers and the compensation of all Company officers.

Comment: Officers may be provided for in both member-managed and manager-managed companies by appropriate provisions in the articles of organization or in a written operating agreement. Corp C §17154. By analogy to corporate governance, major officers, if any, such as a vice president, treasurer, or secretary, and their powers and duties, could be left to the members' vote, with subordinate officers' selection left to the managers. See Corp C §312. The nature of the LLC's officers will depend mainly on the size of the business, the number of managers, and whether all of the members are managers. Unless the operating agreement or articles of organization provide otherwise, managers are entitled to appoint officers. Corp C §17154(b).

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.46 9. Form: Title to Assets

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9.46-1 Title to assets

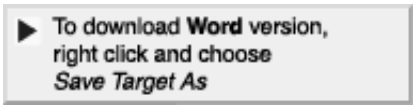
5.9. The Manager will cause all assets of the Company, whether real or personal, to be held in the name of the Company.

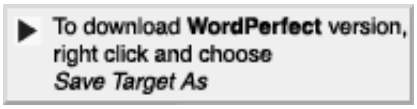
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.47 10. Form: Banking

§9.47 10. Form: Banking

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9.47-1 Banking

5.10. All funds of the Company will be deposited in one or more accounts with one or more recognized financial institutions in the name of the Company, at locations determined by the Manager. Withdrawal from those accounts will require only the signature of the Manager or any other person or persons as the Manager may designate.

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G. Financial Records; Tax Matters Partner

§9.48 1. Form: Accounts

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9.48-1 Accounts

ARTICLE VI: ACCOUNTS AND ACCOUNTING

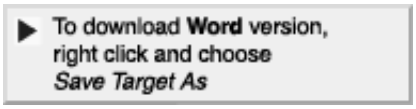
6.1. Complete books of account of the Company's business, in which each Company transaction will be fully and accurately entered, will be kept at the Company's principal executive office and at other locations that the Manager will determine from time to time, and will be open to inspection and copying on reasonable Notice by any Member or the Member's authorized representatives during normal business hours. The costs of inspection and copying will be borne by the Member.

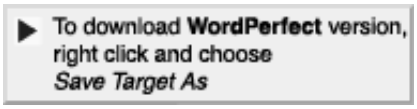
Comment: See Corp C §17058(a)(7) (maintenance of records at principal executive office), Corp C §17106(b)(1) (member's right to inspect and copy records); §13.16.

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§9.49 2. Form: Accounting

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9.49-1 Accounting

6.2. Financial books and records of the Company will be kept on the _ _[*accrual/cash*]**_ _ method of accounting, _ _**[*which will be the method of accounting followed by the Company for federal income tax purposes*]**_ _. The financial statements of the Company _ _**[*will be prepared in accordance with generally accepted accounting principles and*]**_ _ will be appropriate and adequate for the Company's business and for carrying out the provisions of this Agreement. The fiscal year of the Company will be January 1 through December 31.**

Comment: On whether an LLC may adopt a fiscal year other than the calendar year, see §5.11. On whether an LLC can utilize the cash receipts method of accounting, see §§5.12-5.14. If audited financial statements are desired or required, this form should be modified by including the bracketed language regarding generally accepted accounting principles. Compare the form provision in §9.51, which contemplates audited financial statements. "Generally accepted accounting principles" (commonly referred to as "GAAP") require adherence to numerous technical standards and the presentation of financial statements in a specified form. Although GAAP requirements can be met without using a certified public accountant, lack of a CPA's expertise may make compliance with GAAP difficult.

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§9.50 3. Form: Records

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9.50-1 Records

6.3. At all times during the term of existence of the Company, and beyond that term if the Manager deems it necessary, the Manager will keep or cause to be kept the books of account referred to in Section 6.2, together with:

(a) A current list of the full name and last known business or residence address of each Member, together with the Capital Contribution and the share in Profits and Losses of each Member;

(b) A current list of the full name and business or residence address of each Manager;

(c) A copy of the Articles of Organization, as amended;

(d) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years;

(e) An original executed copy or counterparts of this Agreement, as amended;

(f) Any powers of attorney under which the Articles of Organization or any amendments to said articles were executed;

(g) Financial statements of the Company for the six most recent fiscal years; and

(h) The books and Records of the Company as they relate to the Company's internal affairs for the current and past four fiscal years.

If the Manager deems that any of the foregoing items will be kept beyond the term of existence of the Company, the repository of those items will be as designated by the Manager.

Comment: See Corp C §17058; §13.16.

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§9.51 4. Form: Financial Statements

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9.51-1 Financial statements

6.4. At the end of each fiscal year, the books of the Company will be closed and examined, statements reflecting the financial condition of the Company and its Profits or Losses will be prepared, and a report about those matters will be issued by the Company's certified public accountants. Copies of the financial statements will be given to all Members. In addition, all Members will receive, not less frequently than at the end of each calendar quarter, copies of such financial statements regarding the previous calendar quarter as may be prepared in the ordinary course of business by the Manager or accountants selected by the Manager. The Manager will cause an annual report to be sent to each Member within 120 days after the end of the fiscal year of the Company. The annual report may be sent by electronic transmission by the Company and will include:

(a) A balance sheet and income statement, and a statement of cash flows of the Company as of the close of the fiscal year; and

(b) A statement showing the Capital Account of each Member as of the close of the fiscal year and the distributions, if any, made to each Member during the fiscal year. Members representing at least 30 percent of the Members, by number, may request interim balance sheets and income statements, and may, at their own discretion and expense, obtain an audit of the Company books by certified public accountants selected by them; provided, however, that not more than one such audit will be made during any fiscal year of the Company.

Comment: See Corp C §17106(b). Under Corp C §17106(c), the manager of an LLC with more than 35 members must cause an annual report to be sent to each member not later than 120 days after the close of the fiscal year. The annual report must contain a balance sheet, income statement, and statement of cash flows for the fiscal year. Members representing at least 5 percent of the voting interests of members, or three or more members, may request interim financial statements. Corp C §17106(c)(1)-(2).

The financial statements specified in Corp C §17106(c) need not be audited. This form provides for the right of one or more members to request that the company's financial statements be audited at the requesting members' expense.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.52 5. Form: Income Tax Returns

§9.52 5. Form: Income Tax Returns

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9.52-1 Income tax returns

6.5. Within 90 days after the end of each taxable year of the Company, the Manager will send to each of the Members all information necessary for the Members to complete their federal and state income tax or information returns and a copy of the Company's federal, state, and local income tax or information returns for that year.

Comment: See Corp C §17106(e). The requirement of sending copies of company tax returns to members is mandatory for an LLC with 35 or fewer members.

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6. Tax Matters Partner

§9.53 a. Form: Manager as Tax Matters Partner

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9.53-1 Manager as tax matters partner

[*Use one of the following alternatives*]

[*Alternative 1: Sole manager to serve as tax matters partner*]

6.6. The Manager will act as Tax Matters Partner of the Company under IRC §6231(a)(7).

[*Alternative 2: One among multiple managers to serve as tax matters partner*]

6.6. _ _[*Name*]**_ _ will act as Tax Matters Partner of the Company under IRC §6231(a)(7).**

Comment: Alternative 1 should be used if there is a single manager. The term "tax matters partner" is used because Treas Reg §301.6231(a)(7)-2(c) applies this usage even if an LLC and not a partnership is the entity. In general, a tax matters designate is not required if an entity has ten or fewer partners, all of whom are natural persons. IRC §6231(a)(1)(B).

One individual must be designated as tax matters partner under IRC §6231(a)(7). Under Treas Reg §301.6231(a)(7)-2, only a member-manager is treated as a general partner for purposes of designation as tax matters partner. Most likely, a manager-managed LLC would name one of its managers (or its sole manager) as tax matters partner.

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§9.54 b. Form: Authority to Be Exercised by Tax Matters Partner

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9.54-1 Authority to be exercised by tax matters partner

6.7. The Tax Matters Partner is authorized to do the following:

(a) Keep the Members informed of administrative and judicial proceedings for the adjustment of Company items (as defined in IRC §6231(a)(3)) at the Company level, as required under IRC §6223(g) and the implementing Regulations;

(b) Enter into settlement agreements under IRC §6224(c)(3) and applicable Regulations with the Internal Revenue Service or the Secretary of the Treasury (the Secretary) with respect to any tax audit or judicial review, in which agreement the Tax Matters Partner may expressly state that the agreement will bind the other Members, except that the settlement agreement will not bind any Member who (within the time prescribed under the Code and Regulations) files a statement with the Secretary providing that the Tax Matters Partner will not have the authority to enter into a settlement agreement on behalf of that Member;

(c) On receipt of a notice of a final Company administrative adjustment, to file a petition for readjustment of the Company items with the Tax Court, the District Court of the United States for the district in which the Company's principal place of business is located, or the United States Court of Federal Claims, all as contemplated under IRC §6226(a) and applicable Regulations;

(d) File requests for administrative adjustment of Company items on Company tax returns under IRC §6227(b) and applicable Regulations; and, to the extent those requests are not allowed in full, file a petition for adjustment with the Tax Court, the District Court of the United States for the district in which the Company's principal place of business is located, or the United States Court of Federal Claims, all as contemplated under IRC §6228(a); and

(e) To take any other action on behalf of the Members or the Company in connection with any administrative or judicial tax proceeding to the extent permitted by law or regulations, including retaining tax advisers (at the expense of the Company) to whom the Tax Matters Partner may delegate such rights and duties as deemed necessary and appropriate.

Comment: See Comment following form provision in §9.53 for rationale for using the term "tax matters partner."

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H. Membership

§9.55 1. Form: Members and Voting Rights

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9.55-1 Members and voting rights

ARTICLE VII: MEMBERSHIP—MEETINGS, VOTING, INDEMNITY

7.1. There will be only one class of membership and no Member will have any rights or preferences in addition to or different from those possessed by any other Member, except as specifically provided in Article IV. Members will have the right and power to appoint, remove, and replace Managers and officers of the Company and the right to Vote on all other matters with respect to which this Agreement or the Act requires or permits Member action. Each Member will Vote in proportion to the Member's Percentage Interest as of the governing record date, determined in accordance with Section 7.2. If a Member has assigned all or part of the Member's Economic Interest to a person who has not been admitted as a Member, the Assigning Member will Vote in proportion to the Percentage Interest that the Assigning Member would have had if the assignment had not been made.

Without limiting the foregoing, all of the following acts will require the unanimous Vote of the Members:

(a) The Transfer of a Membership Interest and the admission of the Assignee as a Member of the Company;

(b) Any amendment of the articles of organization or this Agreement; and

(c) A compromise of the obligation of a Member to make a Capital Contribution under Article III.

Comment: The articles of organization or a written operating agreement may provide for classes of membership and for voting on a per capita, number, financial interest, class, group, or other basis. Corp C §17103(a). The articles of organization cannot be amended by a vote of less than a majority in interest of the members. Corp C §17103(b). Similarly, a vote of at least a majority in interest of the members is required to dissolve an LLC (Corp C §§17103(c), 17350(b)) or to approve an agreement of merger (Corp C §§17103(c), 17551(a)). See also Corp C §17152(b) (election and removal of managers by vote of majority in interest of members). The obligation of a member to make a capital contribution may be compromised by less than a unanimous vote if the articles of organization or operating agreement so provides. Corp C §17201(b)(1). The vote of a majority in interest of the other members may approve the transfer of a membership interest and the admission of an assignee as a member unless the articles of organization or operating agreement provides otherwise. Corp C §17303(a). The form assumes that the entity is composed of only a few members and that each would want to approve or disapprove the admission of a new member.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.56 2. Form: Record Dates

§9.56 2. Form: Record Dates

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9.56-1 Record dates

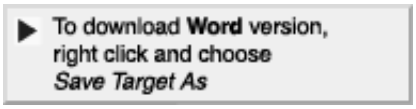
7.2. The record date for determining the Members entitled to receive Notice of any meeting, to Vote, to receive any distribution, or to exercise any right in respect of any other lawful action, will be the date set by the Manager or by a Majority of Members; provided that the record date will not be more than 60, or less than 10 calendar days before the date of the meeting and not more than 60 calendar days before any other action. In the absence of any action setting a record date, the record date will be determined in accordance with Corp C §17104(k).

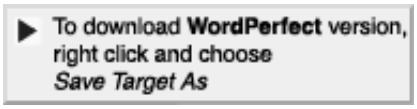
Comment: This form generally incorporates the Act's default rule set forth in Corp C §17104(k), which may be varied by the members in the operating agreement.

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§9.57 3. Form: Membership Certificates

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103





9.57-1 Membership certificates

7.3. The Company may, but is not required to, issue certificates evidencing Membership Interests (Membership Interest Certificates) to Members of the Company. Once Membership Interest Certificates have been issued, they will continue to be issued as necessary to reflect current Membership Interests held by Members. Membership Interest Certificates will be in a form approved by the Manager, will be manually signed by the Manager, and will bear conspicuous legends evidencing the restrictions on Transfer and the purchase rights of the Company and Members set forth in Article VIII. All issuances, reissuances, exchanges, and other transactions in Membership Interests involving Members will be recorded in a permanent ledger as part of the books and records of the Company.

Comment: A certificate is optional, but if issued it must meet the requirements of Corp C §17105(a). The Company may be required to provide a legend on the certificate to comply with applicable federal and state securities laws exemptions. See chap 12 for discussion of securities laws aspects of LLCs. Because of the substantial restrictions on transfer of membership interests, it may be preferable not to provide for membership certificates. Certificates, however, may serve to facilitate pledges or encumbrances of membership interests under the Uniform Commercial Code.

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§9.58 4. Form: Meetings: Call, Notice, and Quorum

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.58-1 Meetings: Call, notice, and quorum

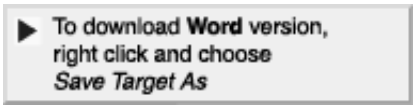
7.4. Meetings of the Members may be called at any time by the Manager, or by Members representing more than 10 percent of the Interests of the Members, for the purpose of addressing any matters on which the Members may Vote. If a meeting of the Members is called by the Members, Notice of the call will be delivered to the Manager. Meetings may be held at the principal executive office of the Company or at any other location designated by the Manager. Following the call of a meeting, the Manager will give Notice of the meeting not less than 10, nor more than 60 calendar days before the meeting date to all Members entitled to Vote at the meeting. The Notice will state the place, date, and hour of the meeting, the means of electronic transmission by and to the Company or electronic video screen communication, if any, and the general nature of business to be transacted. No other business may be transacted at the meeting. A quorum at any meeting of Members will consist of a Majority of Members, represented in person or by Proxy. The Members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of a sufficient number of Members to leave less than a quorum, if the action taken, other than adjournment, is approved by the requisite Percentage of Members as specified in this Agreement or the Act.

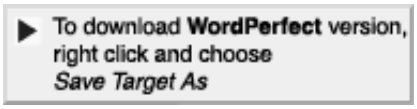
Comment: This provision generally parallels Corp C §17104(a)-(c), (h). Counsel should carefully review Corp C §17104 if circumstances include electronic transmissions of notices.

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§9.59 5. Form: Adjournment of Meetings

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103





9.59-1 Adjournment of meetings

7.5. A meeting of Members at which a quorum is present may be adjourned to another time or place and any business that might have been transacted at the original meeting may be transacted at the adjourned meeting. If a quorum is not present at an original meeting, that meeting may be adjourned by the Vote of a majority of Voting Interests represented either in person or by Proxy. Notice of the adjourned meeting need not be given to Members entitled to Notice if the time and place of the adjourned meeting are announced at the meeting at which the adjournment is taken, unless (a) the adjournment is for more than 45 days, or (b) after the adjournment, a new record date is fixed for the adjourned meeting. In the situations described in clauses (a) and (b), Notice of the adjourned meeting will be given to each Member of record entitled to Vote at the adjourned meeting.

Comment: See Corp C §17104(h).

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.60 6. Form: Waiver of Notice

§9.60 6. Form: Waiver of Notice

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9.60-1 Waiver of notice

7.6. The transactions of any meeting of Members, however called and noticed, and wherever held, will be as valid as though consummated at a meeting duly held after regular call and notice, if (a) a quorum is present at that meeting, either in person or by Proxy, and (b) either before or after the meeting, each of the persons entitled to Vote, not present in person or by Proxy, signs either a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. Attendance of a Member at a meeting will constitute waiver of notice, unless that Member objects, at the beginning of the meeting, to the transaction of any business on the ground that the meeting was not lawfully called or convened. Attendance at a meeting is not a waiver of any right to object to the consideration of matters required to be described in the notice of the meeting and not so included, if the objection is expressly made at the meeting.

Comment: See Corp C §17104(e).

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.61 7. Form: Proxies

§9.61 7. Form: Proxies

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9.61-1 Proxies

7.7. At all meetings of Members, a Member may Vote in person or by Proxy. The Proxy will be filed with the Manager before or at the time of the meeting, and may be filed by facsimile transmission to the Manager at the principal executive office of the Company or any other address given by the Manager to the Members for those purposes.

Comment: Corporations Code §17104(j) provides that the "use of proxies… will be governed in the same manner as in the case of corporations formed under the General Corporation Law."

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§9.62 8. Form: Participation in Meetings by Electronic Means

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9.62-1 Participation in meetings by electronic means

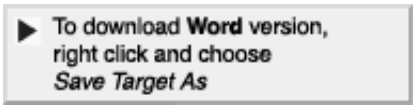
7.8. A meeting of the Members may be conducted, in whole or in part, by electronic transmission by and to the Company or by electronic video screen communication if (1) the Company implements reasonable measures to provide Members (in person or by Proxy) a reasonable opportunity to participate in the meeting and to vote on matters submitted to the Members, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with those proceedings, and if (2) any Member Votes or takes other action at the meeting by means of electronic transmission to the Company or electronic video screen communication, a record of that vote or action is maintained by the Company.

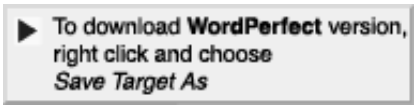
Comment: This provision conforms to the statutory recognition of video conferencing as exemplified in Corp C §§17001 and 17104, as amended, effective January 1, 2005.

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§9.63 9. Form: Action by Members Without a Meeting

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9.63-1 Action by members without a meeting

7.9. Any action that may be taken at any meeting of the Members may be taken without a meeting if a consent in writing, setting forth the action so taken, is signed by Members having not less than the minimum number of Votes that would be necessary to authorize or take that action at a meeting at which all Members entitled to Vote were present and voted. If the Members are requested to consent to a matter without a meeting, each Member will be given notice of the matter to be voted on in the manner described in Section 7.4. Any action taken without a meeting will be effective when the required minimum number of Votes have been received. Prompt Notice of the action taken will be given to all Members who have not consented to the action.

Comment: See Corp C §17104(i).

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§9.64 10. Form: No Agency; Indemnification

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9.64-1 No agency; indemnification

7.10. No Member acting solely in the capacity of a Member is an agent of the Company, nor can any Member acting solely in the capacity of a Member bind the Company or execute any instrument on behalf of the Company. Accordingly, each Member will indemnify, defend, and hold harmless each other Member and the Company from and against any and all loss, cost, expense, liability, or damage arising from or out of any claim based on any action by the Member in contravention of the first sentence of this Section 7.10.

Comment: This provision is designed for a manager-managed LLC operating agreement. It should not be used in a member-managed LLC. See Corp C §§17157, 17150.

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I. Transfers of Membership Interests

§9.65 1. Form: Withdrawal of Members

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.65-1 Withdrawal of members

ARTICLE VIII: TRANSFERS OF MEMBERSHIP INTERESTS

[*Use one of the following alternatives*]

[*Alternative 1: Right to withdraw*]

8.1. A Member may withdraw from the Company at any time by giving Notice of withdrawal to _ _[*all other Members/the Managers*]**_ _ at least 180 calendar days before the effective date of withdrawal. Withdrawal will not release a Member from any obligations and liabilities under this Agreement accrued or incurred before the effective date of withdrawal. A withdrawing Member will divest the Member's entire Membership Interest before the effective date of withdrawal in accordance with and subject to the provisions of this Article VIII.**

[*Alternative 2: No right to withdraw*]

8.1. A Member may not withdraw from the Company without the written consents of all remaining Members. Withdrawal will not release a Member from any obligations and liabilities under this Agreement accrued or incurred before the effective date of withdrawal. A withdrawing Member will have only the rights of a holder of an Economic Interest in the Company in respect of the Member's Membership Interest in the Company. Unless all remaining Members consent to the withdrawal, the withdrawing Member will not be entitled to a distribution of its Economic Interest until the dissolution and liquidation of the Company. For purposes of this Section 8.1, the term "Economic Interest" will not mean or include any right to share in the income, gains, losses, deductions, credits, or similar items of the Company attributable to any period following withdrawal, or any right to information concerning the business and affairs of the Company, except as provided in Corporations Code §17106.

Comment: Under Corp C §17252(a), a member may withdraw from an LLC on the happening of events specified in the articles of organization or operating agreement. Notwithstanding any restriction in the operating agreement or articles of organization, a member may withdraw at any time by giving written notice to the other members. If that withdrawal is in breach of the operating agreement, damages for that breach can be set off from amounts otherwise distributable to the member by reason of the member's economic interest in the company. Finally, if the operating agreement or articles of organization do not otherwise provide, a withdrawn member becomes, as of the date of withdrawal, only the holder of an economic interest with whatever rights that holder has under the operating agreement. The alternatives suggested above reflect the extremes. Alternative 1 grants an absolute right to withdraw. Alternative 2 grants no right to withdraw and imposes severe consequences for a wrongful withdrawal: lock-in of capital and no rights to share in future distributions.

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§9.66 2. Form: Restrictions on Transfer

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9.66-1 Restrictions on transfer

8.2. Except as expressly provided in this Agreement, a Member will not Transfer any part of the Member's Membership Interest in the Company, whether now owned or later acquired, unless (a) the other Members unanimously approve the transferee's admission to the Company as a Member on that Transfer and (b) the Membership Interest to be Transferred, when added to the total of all other Membership Interests Transferred in the preceding 12 months, will not cause the termination of the Company under the Code. No Member may Encumber or permit or suffer any Encumbrance of all or any part of the Member's Membership Interest in the Company unless the Encumbrance has been approved in writing by the Manager. Approval may be granted or withheld in the Manager's sole discretion. Any Transfer or Encumbrance of a Membership Interest without that approval will be void. Notwithstanding any other provision of this Agreement to the contrary, a Member who is a natural person may Transfer all or any portion of his or her Membership Interest to any revocable trust created for the benefit of the Member, or any combination between or among the Member, the Member's spouse or domestic partner, and the Member's issue, provided that the Member retains a beneficial interest in the trust and all of the Voting Interest included in the Membership Interest. A Transfer of a Member's beneficial interest in the trust, or failure to retain the Voting Interest, will be deemed a Transfer of a Membership Interest.

Comment: This provision may be modified or eliminated as required to reflect the parties' business needs. As drafted, it is intended to prohibit all transfers of membership interests other than transfers to commonly used revocable grantor trusts so as to keep the LLC closely held.

Depending on the number of members, approval by a majority of the members (as defined under the agreement) may be more appropriate than the unanimity required in this form provision.

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§9.67 3. Form: Right of First Refusal

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9.67-1 Right of first refusal

8.3. If a Member wishes to Transfer any or all of the Member's Membership Interest in the Company under a Bona Fide Offer (as defined below), the Member will give Notice to _ _[*the Manager/all other Members*]_ _ at least 30 days in advance of the proposed sale or Transfer, indicating the terms of the Bona Fide Offer and the identity of the offeror. The Company and the other Members will have the option to purchase the Membership Interest proposed to be transferred at the price and on the terms provided in this Agreement. If the price for the Membership Interest is other than cash, the fair value in dollars of the price will be as established in good faith by the Company. For purposes of this Agreement, "Bona Fide Offer" means an offer in writing setting forth all relevant terms and conditions of purchase from an offeror who is ready, willing, and able to consummate the purchase and who is not an Affiliate of the selling Member. For 30 days after the Notice is given, the Company will have the right to purchase the Membership Interest offered, on the terms stated in the Notice, for the lesser of (a) the price stated in the Notice (or the price plus the dollar value of noncash consideration, as the case may be) and (b) the price determined under the appraisal procedures set forth in Section 8.8.

If the Company does not exercise the right to purchase all of the Membership Interest, then, with respect to the portion of the Membership Interest that the Company does not elect to purchase, that right will be given to the other Members for an additional 30-day period, beginning on the day that the Company's right to purchase expires. Each of the other Members will have the right to purchase, on the same terms, a part of the interest of the offering Member in the proportion that the Member's Percentage Interest bears to the total Percentage Interests of all of the Members who choose to participate in the purchase; provided, however, that the Company and the participating Members may not, in the aggregate, purchase less than the entire interest to be sold by the offering Member.

If the Company and the other Members do not exercise their rights to purchase all of the Membership Interest, the offering Member may, within 90 days from the date the Notice is given and on the terms and conditions stated in the Notice, sell or exchange that Membership Interest to the offeror named in the Notice. Unless the requirements of Section 8.2 are met, the offeror under this Section 8.3 will become an Assignee, and will be entitled to receive only the share of Profits or other compensation and the return of Capital Contribution to which the assigning Member would have been entitled.

Comment: This provision requires an "all or nothing" exercise of the right to purchase. Without such a requirement, the member who desires to sell may be left with a small interest of doubtful value. On the other hand, the parties may wish to place precisely that impediment on the sale of a membership interest. Many right-of-first-refusal variations are possible. For example, if less than all of the offered membership interest is subscribed, members may be given the right to indicate the amount by which they would offer to oversubscribe to portions of the offered interest. If less than all of the offered interest is subscribed, the "oversubscribers" can be allocated the remaining interest pro rata on the basis of their capital accounts or interests in profits or on the basis of their relative oversubscriptions. These allocations could progress in successive stages until the entire offered interest is taken up or until it becomes apparent that the "all or nothing" requirement cannot be met. For additional guidance, see Business Buy-Sell Agreements §§4.49-4.52 (Cal CEB 1991).

Most often, the purchase price for the LLC and its members will be the same as the price initially offered to the selling member. Although this approach is commonly followed, sometimes the parties believe that a member should be required to sell at the lower of the bona fide offer price or a price specified in the agreement. The price under this provision is the lower of the bona fide offer obtained by the member choosing to sell or "fair market value" as

determined under the provision of the form in §9.72. The parties must agree at the outset on what would constitute fair treatment in these circumstances for the selling member, the LLC, and the other members.

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§9.68 4. Form: Triggering Events

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9.68-1 Triggering events

8.4. On the happening of any of the following events (Triggering Events), the Company and the other Members will have the option to purchase the Membership Interest of a Member (Selling Member) at the price and on the terms provided in Section 8.8 of this Agreement:

(a) The death, incapacity, bankruptcy, or withdrawal of a Member, or the winding up and dissolution of a corporate Member, or the merger or other corporate reorganization of a corporate Member as a result of which the corporate Member does not survive as an entity.

(b) The failure of a Member to make the Member's Capital Contribution under the provisions of Article III of this Agreement.

(c) The occurrence of any other event that is, or that would cause, a Transfer in contravention of this Agreement.

Each Member agrees to promptly give Notice of a Triggering Event to _ _[*the Managers/all other Members*]_ _.

Comment: Although Corp C §17350 no longer provides for the dissolution of the LLC on the death, bankruptcy, retirement, resignation, expulsion, or dissolution of a member, the agreement may provide that one or more of these events is a triggering event for the option to purchase. Unless otherwise provided in the agreement, the subject member or member's successor on these events will have only an economic interest in the LLC. See Corp C §17301.

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§9.69 5. Form: Marital Dissolution or Death of a Spouse

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.69-1 Marital dissolution or death of a spouse

8.5. Notwithstanding any other provisions of this Agreement:

[*Use one of the following alternatives*]

[*Alternative 1: Right to purchase membership interest*]

(a) If, in connection with the divorce or dissolution of the marriage of a Member, any court issues a decree or order that transfers, confirms, or awards a Membership Interest, or any portion of it, to that Member's spouse (an "Award"), then, notwithstanding that the transfer would constitute an unpermitted Transfer under this Agreement, that Member will have the right to purchase from his or her former spouse the Membership Interest, or portion of it, that was so transferred, and the former spouse will sell the Membership Interest or portion of it to that Member at the price set forth below in Section 8.8 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the court Award (the Expiration Date), the Company and the other Members will have the option to purchase from the former spouse the Membership Interest or portion of it under Section 8.6 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the Award.

[*Alternative 2: Transfer of economic interest*]

(a) In the event of a dissolution of marriage of any married Member decreed by a court of competent jurisdiction, the Membership Interest will be allocated and distributed between the Member and the Member's spouse as the court may decree; provided, however, that:

(1) No spouse will become a Member by virtue of any allocation or distribution of the Membership Interest in any dissolution proceeding;

(2) The spouse will have only the status of an assignee of the Member's right to receive Profits and Losses under Corp C §17301;

(3) As between the Member and the Member's spouse, the Member will continue to have the exclusive right and authority to act as a Member on behalf of and bind the Company as specified in this Agreement; and

(4) Any action, consent, or approval taken or given or any document or instrument executed by the Member on his or her own behalf (and on behalf of the Member's spouse as an assignee under this Agreement) will be binding on the Member and the Member's spouse, and the other Members and any third party will be entitled to rely on any action so taken by that Member in accordance with this Agreement.

[*Continue*]

(b) If, by reason of the death of a spouse of a Member, any portion of a Membership Interest is transferred to a Transferee other than (1) that Member or (2) a trust created for the benefit of that Member (or for the benefit of that Member and any combination between or among the Member and the Member's issue) in which the Member is the sole Trustee and the Member, as Trustee or individually possesses all of the Voting Interest included in that Membership Interest, then the Member will have the right to purchase the Membership Interest or portion of it from the estate or other successor of his or her deceased spouse or Transferee of the deceased spouse, and the estate, successor, or Transferee will sell the Membership Interest or portion of it at the price set forth in Section 8.8 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the date of death (the Expiration Date), the Company and the other Members will have the option to

purchase from the estate or other successor of the deceased spouse the Membership Interest or portion of it under Section 8.6 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the death.

Comment: This provision is intended to permit a member to acquire a spouse's interest on a preemptive basis on marital dissolution (under Alternative 1) or on the death of the spouse. If the member fails to acquire that interest, death or marital dissolution results in a transfer subject to the option rights of the LLC and the other members under the provision in §9.70. A possible alternative to this provision in the marital dissolution context would be to provide that a membership interest is not subject to transfer, although an economic interest can be transferred. Or, the members can omit these provisions and take their chances with each other's former spouses or successors. For an alternative form that would allow the former spouse of a member to retain only an economic interest in the LLC, use Alternative 2. For a similar form to use in a partnership context, see Advising California Partnerships §17.72 (3d ed Cal CEB 1999).

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§9.70 6. Form: Option Periods

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9.70-1 Option periods

8.6. On the receipt of Notice by the Manager and the other Members as contemplated by Sections 8.1, 8.3, and 8.5, and on receipt of actual notice of any Triggering Event as determined in good faith by the Manager (the date of the receipt is hereinafter referred to as the "Option Date"), the Manager will promptly cause a Notice of the occurrence of a Triggering Event to be sent to all Members, and the Company will have the option, for a period ending 30 calendar days following the determination of the purchase price as provided in Section 8.8, to purchase the Membership Interest in the Company to which the option relates, at the price and on the terms set forth in Section 8.8 of this Agreement, and the other Members, pro rata in accordance with their prior Membership Interests in the Company, will then have the option, for a period of 30 days thereafter, to purchase the Membership Interest in the Company not purchased by the Company, on the same terms and conditions as apply to the Company. If all other Members do not elect to purchase the entire remaining Membership Interest in the Company, then the Members electing to purchase will have the right, pro rata in accordance with their prior Membership Interests in the Company, to purchase the additional Membership Interest in the Company available for purchase. The transferee of the Membership Interest in the Company that is not purchased will hold the Membership Interest in the Company subject to all of the provisions of this Agreement.

Comment: For illustrative purposes, unlike the provisions of the form in §9.67, this one does not require an "all or nothing" purchase. In practice, however, it is recommended that the forms be consistent and that, if an "all or nothing" approach is taken for purposes of a right of first refusal, the same approach should be taken for purposes of purchase following a triggering event.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.71 7. Form: Nonparticipation of Interested Member

§9.71 7. Form: Nonparticipation of Interested Member

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9.71-1 Nonparticipation of interested member

8.7. Neither the Member whose interest is subject to purchase under this Article, nor that Member's Affiliate, will participate in any Vote or discussion of any matter pertaining to the disposition of the Member's Membership Interest in the Company under this Agreement.

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§9.72 8. Form: Option Purchase Price

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §9.2 and ends in §9.103

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9.72-1 Option purchase price

8.8. The purchase price of the Membership Interest that is the subject of an option under Section 8.6. will be the "Fair Option Price" of the interest as determined under this Section 8.8. "Fair Option Price" means the cash price that a willing buyer would pay to a willing seller when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts on the Option Date. Each of the selling and purchasing parties will use his, her, or its best efforts to mutually agree on the Fair Option Price. If the parties are unable to so agree within 30 days of the Option Date, the selling party will appoint, within 40 days of the Option Date, one appraiser, and the purchasing party will appoint within 40 days of the Option Date, one appraiser. The two appraisers will within a period of 5 additional days, agree on and appoint an additional appraiser. The three appraisers will, within 60 days after the appointment of the third appraiser, determine the Fair Option Price of the Membership Interest in writing and submit their report to all the parties.

The Fair Option Price will be determined by disregarding the appraiser's valuation that diverges the most from each of the other two appraisers' valuations, and the arithmetic mean of the remaining two appraisers' valuations will be the Fair Option Price. Each purchasing party will pay for the services of the appraiser selected by it, plus one-half of the fee charged by the third appraiser, and one-half of all other costs relating to the determination of Fair Option Price. The Fair Option Price as so determined will be payable in cash.

Comment: This form reflects an attempt to establish a fair market value for membership interests subject to purchase. The "willing buyer" language is a common formulation, derived here from tax law. See, *e.g.,* Treas Reg §§20.2031-1(b), 25.2512-1; Business Buy-Sell Agreements §5.5 (Cal CEB 1991).

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§9.73 9. Form: Substituted Member

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9.73-1 Substituted member

8.9. Except as expressly permitted under Section 8.2, a prospective transferee (other than an existing Member) of a Membership Interest may be admitted as a Member with respect to the Membership Interest (Substituted Member) only (a) on the unanimous Vote of the other Members in favor of the prospective transferee's admission as a Member, and (b) on the prospective transferee's executing a counterpart of this Agreement as a party to it. Any prospective transferee of a Membership Interest will be deemed an Assignee, and, therefore, the owner of only an Economic Interest until the prospective transferee has been admitted as a Substituted Member. Except as otherwise permitted in the Act, any such Assignee will be entitled only to receive allocations and distributions under this Agreement with respect to the Membership Interest and will have no right to Vote or exercise any rights of a Member until the Assignee has been admitted as a Substituted Member. Until the Assignee becomes a Substituted Member, the Assigning Member will continue to be a Member and have the power to exercise any rights and powers of a Member under this Agreement, including the right to Vote in proportion to the Percentage Interest that the Assigning Member would have had if the assignment had not been made.

Comment: See Corp C §17100(a)(2). Only an economic interest may be assigned without the consent of the members to admit the assignee as a member, as provided in Corp C §17303. Corp C §17301(a). A holder of an economic interest is entitled to specified inspection and copying rights, and to obtain tax and other financial information. Corp C §17106. These rights may not be varied by the articles of organization or operating agreement. Corp C §17005(b)(4). The unanimity requirement in this form may be varied as permitted by Corp C §17303(a) without adverse tax consequences. The form assumes that the entity is composed of only a few members and that each would want to approve or disapprove the admission of a new member.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.74 10. Form: Duties of Substituted Member

§9.74 10. Form: Duties of Substituted Member

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9.74-1 Duties of substituted member

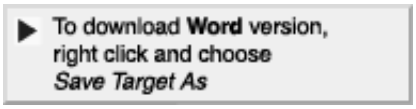
8.10. Any person admitted to the Company as a Substituted Member will be subject to all the provisions of this Agreement that apply to the Member from whom the Membership Interest was assigned, except that the assigning Member will not be released from liabilities as a Member solely as a result of the assignment, both with respect to obligations to the Company and to third parties incurred before the assignment.

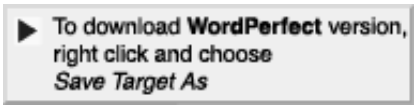
Comment: The assignor of a membership interest is not released from liability as a member solely as a result of the assignment. Corp C §17301(b). Whether or not an assignee of a membership interest becomes a member, the assignor is not released from liability to the LLC with respect to capital contributions and company distributions. Corp C §17303(c).

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§9.75 11. Form: Securities Laws

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9.75-1 Securities laws

8.11. The initial sale of Membership Interests in the Company to the Initial Members has not been qualified or registered under the securities laws of any state, including California, or registered under the Securities Act of 1933, in reliance on exemptions from the registration provisions of those laws. Notwithstanding any other provision of this Agreement, Membership Interests may not be Transferred unless registered or qualified under applicable state and federal securities laws unless, in the opinion of legal counsel satisfactory to the Company, qualification or registration is not required. A Member who desires to transfer a Membership Interest will be responsible for all legal fees incurred in connection with that opinion.

Comment: On the securities laws aspects of issuance and transfer of LLC interests, see chap 12.

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J. Dissolution and Winding Up

§9.76 1. Form: Events of Dissolution

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9.76-1 Events of dissolution

ARTICLE IX: DISSOLUTION AND WINDING UP

9.1. The Company will be dissolved on the first to occur of the following events:

(a) The written agreement of a Majority of Members to dissolve the Company.

(b) The sale or other disposition of substantially all of the Company's assets.

(c) Entry of a decree of judicial dissolution under Corporations Code §17351.

Comment: The drafter may provide other dissolution events to suit the particular circumstances. Corp C §17350(a). See §§16.8-16.12. For a definition of "Majority of Members," see §9.4. The drafter may wish to require a greater or unanimous vote for dissolution.

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§9.77 2. Form: Winding Up

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9.77-1 Winding up

9.2. On the dissolution of the Company, the Company will engage in no further business other than that necessary to wind up the business and affairs of the Company. The Manager or, if there is no Manager, the Members, will wind up the affairs of the Company. The Manager or Members winding up the affairs of the Company will give Notice of the commencement of winding up by mail to all known creditors and claimants against the Company whose addresses appear in the records of the Company. After paying or adequately providing for the payment of all known debts of the Company (except debts owing to Members), the remaining assets of the Company will be distributed or applied in the following order:

(a) To pay the expenses of liquidation;

(b) To the establishment of reasonable reserves for contingent liabilities or obligations of the Company. On the determination that reserves are no longer necessary, they will be distributed as provided in this Section 9.2;

(c) To repay outstanding loans to Members. If there are insufficient funds to pay those loans in full, each Member will be repaid in the ratio that the Member's loan, together with accrued and unpaid interest, bears to the total of all loans from Members, including all accrued and unpaid interest. Repayment will first be credited to unpaid principal and the remainder will be credited to accrued and unpaid interest; and

(d) Among the Members with Positive Capital Account Balances as provided in Article IV, Section 4.16.

Comment: This form deals with voluntary dissolution and is based on Corp C §§17352-17354, which may be varied by the articles of organization or operating agreement. The managers or members winding up the affairs of an LLC are entitled to reasonable compensation unless the articles of organization or operating agreement otherwise provide. Corp C §17352(c). See Corp C §17351 for provisions relating to judicial dissolution.

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§9.78 3. Form: Deficits

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9.78-1 Deficits

9.3. Each Member will look solely to the assets of the Company for the return of the Member's investment, and if Company property remaining after the payment or discharge of the Company's debts and liabilities is insufficient to return the investment of each Member, the Member will have no recourse against any other Members for indemnification, contribution, or reimbursement, except as specifically provided in this Agreement.

Comment: If a deficit arises in a situation in which a member has failed to make a capital contribution, presumably the members will invoke the sanctions specified in this form agreement before dissolution. However, if necessary, enforcement could take place after completion of the dissolution if the obligation is preserved elsewhere. See §§9.16-9.17.

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§9.79 K. Form: Noncompetition and Confidentiality

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9.79-1 Noncompetition and confidentiality

ARTICLE X: NONCOMPETITION AND CONFIDENTIALITY

10.1. Each Member covenants with the Company and each other Member that on the Transfer of the Member's Membership Interest, whether voluntary, involuntary, by operation of law, or by reason of any provision of this Agreement, the Member will not, directly or indirectly, through an Affiliate or otherwise, in the following geographic area: _ _[*e.g., counties*]_ _, or elsewhere where the Company conducts its business, for a period of _ _[*number*]_ _ years following the date of the Transfer

(a) Engage in any business in any way similar to or competitive with the business of the Company;

(b) Enter into any agreement or understanding, written or oral, relating to the services of any employee of the Company;

(c) Solicit the business of, enter into any agreement, written or oral, or otherwise deal with any customers of the Company, who were customers at the time of the Transfer; or

(d) Use or disclose in any manner any Confidential Information.

10.2. "Confidential Information" means all trade secrets, "know-how," customer lists, pricing policies, operational methods, programs, and other business information of the Company created, developed, produced, or otherwise arising before the date of the Transfer.

10.3. Each Member stipulates that a breach of the provisions of this Article X will result in irreparable damage and injury to the Company for which no money damages could adequately compensate it. If the Member breaches the provisions of this Agreement, in addition to all other remedies to which the Company may be entitled, and notwithstanding the provisions of Article XI, Section 11.2, the Company will be entitled to an injunction to enforce the provisions of this Agreement, to be issued by any court of competent jurisdiction, to enjoin and restrain the Member and each and every Person concerned or acting in concert with the Member from the continuance of that breach. Each Member expressly waives any claim or defense that an adequate remedy at law might exist for any such breach.

10.4. If any provision in this Article X is deemed to exceed the time or geographic limits or any other limitation imposed by applicable law in any jurisdiction, that provision will be deemed reformed in that jurisdiction to the maximum extent permitted by applicable law.

Comment: It is difficult to do more than merely illustrate a noncompetition clause here, inasmuch as actual language would be controlled by negotiations and the nature of the LLC's business. See Bus & P C §16602.5, which allows a noncompetition covenant in connection with the sale or transfer of an LLC interest. See also the decision in *Vacco Indus., Inc. v Van Den Berg* (1992) 5 CA4th 34, 48 n13, 6 CR2d 602, which suggests that listing specific counties is unnecessary in a noncompetition agreement. For a similar form to use in a partnership context and further discussion, see Advising California Partnerships §17.67 (3d ed Cal CEB 1999).

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L. Indemnification and Arbitration

§9.80 1. Form: Indemnification

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9.80-1 Indemnification

ARTICLE XI: INDEMNIFICATION AND ARBITRATION

11.1. The Company will have the power to indemnify any Person who was or is a party, or who is threatened to be made a party, to any Proceeding by reason of the fact that the Person was or is a Member, Manager, officer, employee, or other agent of the Company, or was or is serving at the request of the Company as a director, officer, employee, or other Agent of another limited liability company, corporation, partnership, joint venture, trust, or other enterprise, against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred by that Person in connection with the proceeding, if that Person acted in good faith and in a manner that the Person reasonably believed to be in the best interests of the Company, and, in the case of a criminal proceeding, the Person had no reasonable cause to believe that the Person's conduct was unlawful. The termination of any proceeding by judgment, order, settlement, conviction, or on a plea of nolo contendere or its equivalent, will not, of itself, create a presumption that the Person did not act in good faith and in a manner that the Person reasonably believed to be in the best interests of the Company, or that the Person had reasonable cause to believe that the Person's conduct was unlawful.

To the extent that an agent of the Company has been successful on the merits in defense of any Proceeding, or in defense of any claim, issue, or matter in any Proceeding, the agent will be indemnified against expenses actually and reasonably incurred in connection with the Proceeding. In all other cases, indemnification will be provided by the Company only if authorized in the specific case by a Majority of Members.

"Agent," as used in this Section 11.1, will include a trustee or other fiduciary of a plan, trust, or other entity or arrangement described in Corp C §207(f).

"Proceeding," as used in this Section 11.1, means any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative.

Expenses of each Person indemnified under this Agreement actually and reasonably incurred in connection with the defense or settlement of a proceeding may be paid by the Company in advance of the final disposition of the proceeding, as authorized by the Managers who are not seeking indemnification or, if there are none, by a Majority of the Members, on receipt of an undertaking by that Person to repay that amount unless it will ultimately be determined that the Person is entitled to be indemnified by the Company. "Expenses," as used in this Section 11.1, includes, without limitation, attorney fees and expenses of establishing a right to indemnification, if any, under this Section 11.1.

Comment: Except for a breach of fiduciary duties by a manager (Corp C §17153), an LLC may provide in its articles of organization or operating agreement for the indemnification of managers, members, officers, and agents. Corp C §17155(a). The language in this form is based on Corp C §317.

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§9.81 2. Form: Arbitration

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9.81-1 Arbitration

11.2. Any action to enforce or interpret this Agreement, or to resolve disputes over this Agreement between the Company and a Member, or between or among the Members, will be settled by arbitration in accordance with the rules of the American Arbitration Association. Arbitration will be the exclusive dispute resolution process in the state of California, but arbitration will be a nonexclusive process elsewhere. Any party may commence arbitration by sending a written demand for arbitration to the other parties. The demand will set forth the nature of the matter to be resolved by arbitration. The Manager will select the place of arbitration. The substantive law of the state of California will be applied by the arbitrator to the resolution of the dispute. The parties will share equally all initial costs of arbitration. The prevailing party will be entitled to reimbursement of attorney fees, costs, and expenses incurred in connection with the arbitration. All decisions of the arbitrator will be final, binding, and conclusive on all parties. Judgment may be entered on any such decision in accordance with applicable law in any court having jurisdiction of it. The arbitrator (if permitted under applicable law) or the court may issue a writ of execution to enforce the arbitrator's decision.

Comment: Under Corp C §17061(g), a member may agree to arbitration as the exclusive remedy in California and the nonexclusive remedy in other states in a written operating agreement.

This provision is for illustration purposes only and should be varied in accordance with the parties' wishes. For alternatives, see Drafting Business Contracts: Principles, Techniques & Forms, chap 16 (Cal CEB 1994).

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§9.82 M. Form: Power of Attorney

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9.82-1 Power of attorney

ARTICLE XII: ATTORNEY-IN-FACT AND AGENT

12.1. Each Member, by execution of this Agreement, irrevocably constitutes and appoints each Manager and any of them acting alone as the Member's true and lawful attorney-in-fact and agent, with full power and authority in the Member's name, place, and stead to execute, acknowledge, and deliver, and to file or record in any appropriate public office: (a) any certificate or other instrument that may be necessary, desirable, or appropriate to qualify the Company as a limited liability company or to transact business as one in any jurisdiction in which the Company conducts business; (b) any certificate or amendment to the Company's articles of organization or to any certificate or other instrument that may be necessary, desirable, or appropriate to reflect an amendment approved by the Members in accordance with the provisions of this Agreement; (c) any certificates or instruments that may be necessary, desirable, or appropriate to reflect the dissolution and winding up of the Company; and (d) any certificates necessary to comply with the provisions of this Agreement. This power of attorney will be deemed to be coupled with an interest and will survive the Transfer of the Member's Economic Interest. Notwithstanding the existence of this power of attorney, each Member agrees to join in the execution, acknowledgment, and delivery of the instruments referred to above if requested to do so by a Manager. This power of attorney is a limited power of attorney and does not authorize any Manager to act on behalf of a Member except as described in this Article XII.

Comment: This is an optional provision designed for LLCs with many members, for which it could be difficult and time consuming to obtain all members' signatures for specified documents. Unless a power is coupled with an interest, generally the agency relationship so established may be revoked by the principal, and automatically will be terminated on the death or mental incapacity of the principal. CC §2356(a), (d). The power of attorney conferred under this form would survive the death or incapacity of a member and cannot be revoked.

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N. General Provisions

§9.83 1. Form: Entire Agreement; Amendment

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9.83-1 Entire agreement; amendment

ARTICLE XIII: GENERAL PROVISIONS

13.1. This Agreement constitutes the whole and entire agreement of the parties with respect to its subject matter, and it will not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the Members and Managers or any of them.

Comment: This provision is especially important in light of the fact that the Act allows oral operating agreements. Corp C §17001(ab).

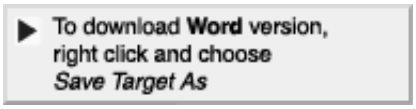
On the miscellaneous or general kinds of provisions that can be used in Article XIII, see Drafting Business Contracts: Principles, Techniques & Forms, chap 17 (Cal CEB 1994).

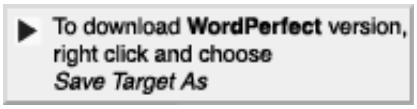
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.84 2. Form: Counterpart Executions

§9.84 2. Form: Counterpart Executions

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9.84-1 Counterpart executions

13.2. This Agreement may be executed in one or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.85 3. Form: Governing Law; Severability

§9.85 3. Form: Governing Law; Severability

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9.85-1 Governing law; severability

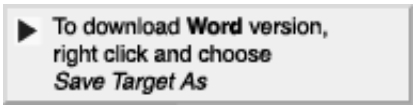
13.3. This Agreement will be construed and enforced in accordance with the laws of the state of California. If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision will, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid that invalidity, illegality, or unenforceability or, if that is not possible, the provision will, to the extent of that invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement will remain in effect.

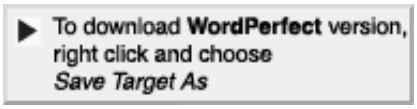
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.86 4. Form: Benefit

§9.86 4. Form: Benefit

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9.86-1 Benefit

13.4. This Agreement will be binding on and inure to the benefit of the parties and their heirs, personal representatives, and permitted successors and assigns.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.87 5. Form: Number and Gender

§9.87 5. Form: Number and Gender

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9.87-1 Number and gender

13.5. Whenever used in this Agreement, the singular will include the plural and the plural will include the singular, and the neuter gender will include the male and female as well as a trust, firm, company, or corporation, all as the context and meaning of this Agreement may require.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.88 6. Form: Further Assurances

§9.88 6. Form: Further Assurances

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9.88-1 Further assurances

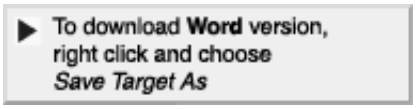
13.6. The parties to this Agreement will promptly execute and deliver any and all additional documents, instruments, notices, and other assurances, and will do any and all other acts and things reasonably necessary in connection with the performance of their respective obligations under this Agreement and to carry out the intent of the parties.

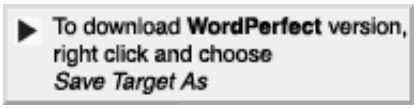
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.89 7. Form: Members' Other Business

§9.89 7. Form: Members' Other Business

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9.89-1 Members' other business

13.7. Except as provided in this Agreement, no provision of this Agreement will be construed to limit in any manner the Members in the carrying on of their own respective businesses or activities.

Comment: This is an optional provision and should be deleted if members are expected to devote all or a significant part of their business time to the affairs of the limited liability company. Generally, passive investments and civic and charitable activities would be specifically permitted.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.90 8. Form: Agent

§9.90 8. Form: Agent

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9.90-1 Agent

13.8. Except as provided in this Agreement, no provision of this Agreement will be construed to constitute a Member, in the Member's capacity as such, the agent of any other Member.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.91 9. Form: Authority to Contract

§9.91 9. Form: Authority to Contract

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9.91-1 Authority to contract

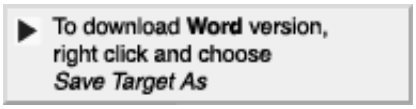
13.9. Each Member represents and warrants to the other Members that the Member has the capacity and authority to enter into this Agreement.

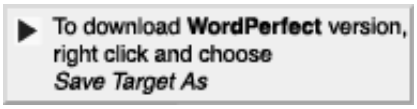
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.92 10. Form: Titles and Headings

§9.92 10. Form: Titles and Headings

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9.92-1 Titles and headings

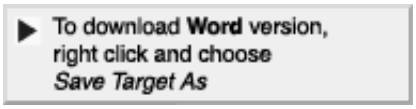
13.10. The article, section, and subsection titles and headings in this Agreement are inserted as matters of convenience and for ease of reference only and will be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

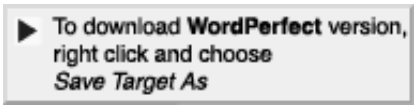
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.93 11. Form: Amendment

§9.93 11. Form: Amendment

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9.93-1 Amendment

13.11. This Agreement may be altered, amended, or repealed only by a writing signed by all of the Members.

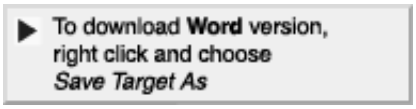
Comment: See Corp C §17059. Only the members may adopt, alter, amend, or repeal an operating agreement. A written operating agreement may specify the manner of accomplishing these acts.

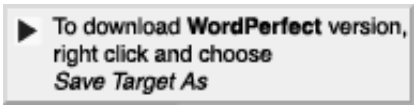
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§9.94 12. Form: Time of the Essence

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9.94-1 Time of the essence

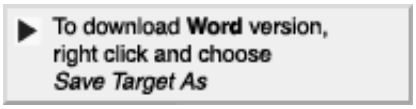
13.12. Time is of the essence for every provision of this Agreement that specifies a time for performance.

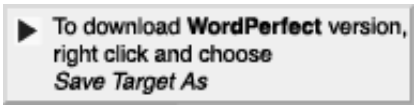
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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.95 13. Form: No Third Party Beneficiary Intended

§9.95 13. Form: No Third Party Beneficiary Intended

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9.95-1 No third party beneficiary intended

13.13. This Agreement is made solely for the benefit of the parties to this Agreement and their respective permitted successors and assigns, and no other person or entity will have or acquire any right by virtue of this Agreement.

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O. Execution and Signatures

§9.96 1. Form: Execution

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9.96-1 Execution

In witness whereof, the parties have executed or caused to be executed this Agreement on the day and year first above written.

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/ 2. Signatures/§9.97 a. Form: Signatures of Individual Members

2. Signatures

§9.97 a. Form: Signatures of Individual Members

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9.97-1 Individual signatures

__[*Signature*]__
_ _[*Typed or printed name*]_ _
Member

[*Additional signature(s); repeat above block as necessary*]

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.98 b. Form: Partnership Signature by Individual General Partner

§9.98 b. Form: Partnership Signature by Individual General Partner

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9.98-1 Partnership signature by individual general partner

_ _[*Name of partnership*]_ _
By: __[*Signature*]__
_ _[*Typed or printed name*]_ _
Its: General Partner

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.99 c. Form: Partnership Signature by Corporate General Partner

§9.99 c. Form: Partnership Signature by Corporate General Partner

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9.99-1 Partnership signature by corporate general partner

_ _[*Name of partnership*]_ _
By: _ _[*Name of corporation*]_ _**, General Partner**

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _
Its: President

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _
Its: Secretary

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.100 d. Form: Signature for Corporation

§9.100 d. Form: Signature for Corporation

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9.100-1 Signature for corporation

_ _[*Name of partnership*]_ _
By: _ _[*Name of corporation*]_ _**, General Partner**

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _**,**
Its: President

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _**,**
Its: Secretary

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Source: Business Law/Forming and Operating California Limited Liability Companies/9 Annotated Long-Form Operating Agreement/§9.101 e. Form: Signature for Trust

§9.101 e. Form: Signature for Trust

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9.101-1 Signature for trust

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _,
Trustee of _ _[*Name of trust*]_ _, **u/t/d** _ _[*date*]_ _

Comment: The abbreviation "u/t/d" means "under trust dated."

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§9.102 f. Form: Signature for Estate

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9.102-1 Signature for estate

Estate of _ _[*name*]_ _, Deceased

__[*Signature*]__
_ _[*Typed or printed name*]_ _,
Executor

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§9.103 P. Form: Consent of Spouse or Domestic Partner

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9.103-1 Consent of spouse or domestic partner

CONSENT OF SPOUSE OR DOMESTIC PARTNER

The undersigned is the spouse or registered domestic partner of _ _[*name*]_ _ and acknowledges that _ _[*he/she*]_ _ has read the foregoing Agreement dated _ _[*date*]_ _, and understands its provisions. The undersigned is aware that, by the provisions of the Agreement, _ _[*he/she*]_ _ and _ _[*his/her*]_ _ spouse or domestic partner have agreed to sell or transfer all _ _[*his/her*]_ _ Membership Interest in the Company, including any community property interest or quasi-community property interest, in accordance with the terms and provisions of the Agreement. The undersigned expressly approves of and agrees to be bound by the provisions of the Agreement in its entirety, including, but not limited to, those provisions relating to the sales and transfers of Membership Interests and the restrictions on them. If the undersigned predeceases _ _[*his/her*]_ _ spouse or domestic partner when _ _[*his/her*]_ _ spouse or domestic partner owns any Membership Interest in the Company, _ _[*he/she*]_ _ agrees not to devise or bequeath whatever community property interest or quasi-community property interest _ _[*he/she*]_ _ may have in the Company in contravention of the Agreement.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name*]_ _

Comment: The consent should be signed individually by each spouse or domestic partner of a signatory member.

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10

Annotated Short-Form and Single-Member Operating Agreements

Leonard E. Castro

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- B. Right-of-First-Refusal Provision Not Included §10.2
- C. Cross-Referrals to Long-Form Provisions §10.3

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G. Accounts and Records
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2. Form: Accounting §10.89
3. Form: Records §10.90

H. Form: Restrictions on Transfer §10.91

I. Dissolution and Winding Up
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2. Form: Winding Up §10.93

J. General Provisions
1. Form: Entire Agreement; Amendment §10.94
2. Form: Governing Law; Severability §10.95
3. Form: Titles and Headings §10.96

4. Form: Amendment §10.97
5. Form: Time of the Essence §10.98
6. Form: No Third Party Beneficiary Intended §10.99
7. Form: Limited Liability Company §10.100

K. Form: Execution Clause §10.101

L. Form: Consent of Spouse or Domestic Partner §10.102

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I. INTRODUCTION

§10.1 A. When Use Is Appropriate

The short-form operating agreement in §§10.4-10.70 is appropriate for use in smaller LLCs (including so-called mom and pop situations) in which there are no special allocation provisions, the members will manage the LLC, and there are no preferential distributions. The form assumes that articles of organization will be filed after the operating agreement is signed. The form can also be adapted for use in manager-managed LLCs in appropriate situations. For a simpler form for use with single-member LLCs, see §§10.71-10.102.

The short-form single-member operating agreement should be used only for a member who is an individual. In other circumstances, experienced tax counsel should be consulted.

For unannotated versions of the short-form multimember and short-form single-member operating agreements, see the Appendix.

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§10.2 B. Right-of-First-Refusal Provision Not Included

This short-form operating agreement does not include provision for a right of first refusal to purchase a membership interest that a member wants to sell to a third party. See long-form provision in §9.67. Drafters who choose to include such a provision in an agreement based on this short form should determine whether the members want to be obligated to meet the price and terms of third party offers, or whether the buyout price should be the fair market value of the membership interest, or another measure, *e.g.,* one based on book value or earnings. See Comment following the long-form provision in §9.67.

The short-form operating agreement's procedures for meetings of members (see §10.29) are simpler than those found in the long-form agreement (see §9.58); and the single-member form contains no meeting provisions. Unlike corporations, for which even a single shareholder/director must hold an "annual meeting," members of an LLC are not required to meet at all. See Comment following §9.42.

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§10.3 C. Cross-Referrals to Long-Form Provisions

This short-form operating agreement incorporates many of the same provisions as the long-form agreement presented in chap 9, albeit in a simplified form. The Comments to provisions set forth in this chapter cross-refer to the analogous provisions of the long-form operating agreement in chap 9.

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II. SHORT-FORM MULTIMEMBER OPERATING AGREEMENT

§10.4 A. Form: Parties and Date

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10.4-1 Parties and date

OPERATING AGREEMENT for _ _[*NAME*]_ _, _ _[*e.g., LLC/a limited liability company*]_ _

This Operating Agreement is entered into as of _ _[*date*]_ _**, by** _ _[*names*]_ _ **(referred to individually as a Member and collectively as the Members).**

Comment: The name of an LLC must contain the words "limited liability company" or the abbreviation "L.L.C." or "LLC." See the Comment following the form provision in §9.2.

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§10.5 B. Form: Recitals

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10.5-1 Recitals

A. The Members desire to form a limited liability company (Company) under the Beverly-Killea Limited Liability Company Act.

B. The Members enter into this Operating Agreement to form and provide for the governance of the Company and the conduct of its business and to specify their relative rights and obligations.

Now, therefore, the Members agree as follows:

Comment: See the Comment following the form provision in §9.3.

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§10.6 C. Form: Definitions

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10.6-1 Definitions

ARTICLE I: DEFINITIONS

The following capitalized terms used in this Agreement have the meanings specified in this Article or elsewhere in this Agreement and when not so defined will have the meanings set forth in California Corporations Code §17001.

1.1. "Act" means the Beverly-Killea Limited Liability Company Act (California Corporations Code §§17000-17656), including amendments from time to time.

1.2. "Agreement" means this operating agreement, as originally executed and as amended from time to time.

1.3. "Articles of Organization" is defined in California Corporations Code §17001(b) as applied to this Company.

1.4. "Assignee" means a Person who has acquired a Member's Economic Interest in the Company, by way of a Transfer in accordance with the terms of this Agreement, but who has not become a Member.

1.5. "Assigning Member" means a Member who by means of a Transfer has transferred an Economic Interest in the Company to an Assignee.

1.6. "Book Adjustments" means, for any item of Company property for a given fiscal year, adjustments with respect to Book Value for depreciation, cost recovery, or other amortization deduction or gain or loss computed in accordance with Treasury Reg §1.704-1(b)(2)(iv)(g), including Book Depreciation.

1.7. "Book Depreciation" means, for any item of Company property for a given fiscal year, a percentage of depreciation or other cost recovery deduction allowable for federal income tax purposes for that item during that fiscal year equal to the result (expressed as a percentage) obtained by dividing (1) the Gross Asset value of that item at the beginning of the fiscal year (or the acquisition date during the fiscal year) by (2) the federal adjusted tax basis of the item at the beginning of the fiscal year (or the acquisition date during the fiscal year). If the adjusted tax basis of an item is zero, the Company may determine Book Depreciation, provided that it is done in a reasonable and consistent manner.

1.8. "Capital Account" means, for any Member, a separate account maintained and adjusted in accordance with Article III, Section 3.3.

1.9. "Capital Contribution" means, with respect to any Member, the amount of money _ _[*, or services rendered or to be rendered,***]_ _ and the fair market value of any property contributed to the Company (net of liabilities secured by the contributed property that the Company is considered to assume or take "subject to" under IRC §752) in consideration of a Percentage Interest held by that Member. A Capital Contribution will not be deemed a loan.**

1.10. "Capital Event" means a sale or disposition of any of the Company's capital assets, the receipt of insurance and other proceeds on account of an involuntary conversion of Company property, the receipt of proceeds from a refinancing of Company property, or a similar event with respect to Company property or assets.

1.11. "Company" means the company named in Article II, Section 2.2.

1.12. "Corporations Code" ("Corp C") means the California Corporations Code.

1.13. "Economic Interest" means a Person's right to share in the income, gains, losses, deductions, credit, or similar items of the Company, and to receive distributions from the Company under this Agreement or under the Act, but does not include any other rights of a Member, including the right to vote, the right to participate in the management of the Company, or, except as provided in Corp C §17106, any right to information concerning the business and affairs of the Company.

1.14. "Electronic transmission by the Company" and "electronic transmission to the Company" have the meanings set out in California Corporations Code §17001(o)(1)-(2).

1.15. "Encumber" means the act of creating or purporting to create an Encumbrance, whether or not perfected under applicable law.

1.16. "Encumbrance" means, with respect to any Membership Interest, or any part of it, a mortgage, pledge, security interest, lien, proxy coupled with an interest (other than as contemplated in this Agreement), option, or preferential right to purchase.

1.17. "Gross Asset Value" means, with respect to any item of property of the Company, the item's adjusted basis for federal income tax purposes, except as follows:

(a) The Gross Asset Value of any item of property contributed by a Member to the Company will be the fair market value of that property, as mutually agreed by the contributing Member and the Company;

(b) The Gross Asset Value of any item of Company property will be adjusted as of the following times: (1) the acquisition of an interest or additional interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (2) the distribution of money or other property (other than a de minimis amount) by the Company to a Member as consideration for an Economic Interest in the Company; and (3) the liquidation of the Company within the meaning of Treasury Reg §1.704-1(b)(2)(ii)(g), provided, however, that adjustments under clauses (1) and (2) above will be made only if the Members have determined that the Company must revalue its assets in accordance with Treasury Reg §1.704-1(b)(2)(iv)(f);

(c) The Gross Asset Value of any Company asset distributed to any Member will be the fair market value of the asset on the date of distribution;

(d) The Gross Asset Value of Company assets will be increased (or decreased) to reflect any adjustments to the adjusted tax basis of the assets under Internal Revenue Code §734(b) or 743(b), subject to the limitations imposed by IRC §755 and only to the extent that the adjustments are taken into account in determining Capital Accounts under Treasury Reg §1.704-1(b)(2)(iv)(m), and if the Gross Asset Value of an asset has been determined or adjusted under paragraph (a), (b), or (d) of this Section 1.17, the Gross Asset Value will thereafter be adjusted by the Book Adjustments, if any, taken into account with respect to the asset for purposes of computing Profits and Losses.

1.18. "Initial Member" or "Initial Members" means those Persons whose names are set forth in _ _[*the first sentence of/in Exhibit A to*]_ _ this Agreement. A reference to an "Initial Member" means any of the Initial Members.

1.19. "Involuntary Transfer" means, with respect to any Membership Interest, or any part of it, any Transfer or Encumbrance, whether by operation of law, under court order, foreclosure of a security interest, execution of a judgment or other legal process, or otherwise, including a purported transfer to or from a trustee in bankruptcy, receiver, or assignee for the benefit of creditors.

1.20. "IRC" means the Internal Revenue Code of 1986, as amended, and any successor provision.

1.21. "Losses." See "Profits and Losses."

1.22. "Majority of Members" means a Member or Members whose Percentage Interests represent more than 50 percent of the Percentage Interests of all the Members.

1.23. "Meeting" is defined in Article V, Section 5.2.

1.24. "Member" means an Initial Member or a Person who otherwise acquires a Membership Interest, as permitted under this Agreement, and who remains a Member.

1.25. "Notice" means a written notice required or permitted under this Agreement. A notice will be deemed given or sent when deposited, as certified mail or for overnight delivery, postage and fees prepaid, in the United States mails; when delivered to Federal Express, United Parcel Service, DHL WorldWide Express, or Airborne Express, for overnight delivery, charges prepaid or charged to the sender's account; when personally delivered to the recipient; when transmitted by electronic transmission by or to the Company (see §1.14); or when delivered to the home or office of a recipient in the care of a person whom the deliverer has reason to believe will promptly communicate the notice to the recipient.

1.26. "Percentage Interest" means a fraction, expressed as a percentage, the numerator of which is the total of a Member's Capital Account and the denominator of which is the total of all Capital Accounts of all Members.

1.27. "Person" means an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign.

1.28. "Profits and Losses" means, for each fiscal year or other period specified in this Agreement, an amount equal to the Company's taxable income or loss for the year or period, determined in accordance with IRC §703(a).

1.29. "Proxy" has the meaning set forth in the first paragraph of California Corporations Code §17001(ai). A Proxy may not be transmitted orally.

1.30. "Regulations" ("Reg") means the income tax regulations promulgated by the United States Department of the Treasury and published in the Federal Register for the purpose of interpreting and applying the provisions of the Internal Revenue Code, as those Regulations may be amended from time to time, including corresponding provisions of applicable successor regulations.

1.31. "Substituted Member" is defined in Article VIII, Section 8.8.

1.32. "Successor in Interest" means an Assignee, a successor of a Person by merger or otherwise by operation of law, or a transferee of all or substantially all of the business or assets of a Person.

1.33. "Transfer" means any sale, assignment, gift, Involuntary Transfer, Encumbrance, or other disposition of a Membership Interest or any part of a Membership Interest, directly or indirectly, other than an Encumbrance that is expressly permitted under this Agreement.

1.34. "Triggering Event" is defined in Article VIII, Section 8.3.

1.35. "Vote" means a written consent or approval, a ballot cast at a Meeting, or a voice vote.

1.36. "Voting Interest" means, with respect to a Member, the right to Vote or participate in management and any right to information concerning the business and affairs of the Company provided under the Act, except as limited by the provisions of this Agreement. A Member's Voting Interest will be directly proportional to that Member's Percentage Interest.

1.37 "Writing" includes any form of recorded message capable of comprehension by ordinary visual means, and when used to describe communications between the Company and its Members, "writing" will include electronic transmissions by and to the Company as defined in California Corporations Code §17001(o)(1)-(2).

1.38. "Written" or "in writing" includes facsimile and other electronic communication authorized by the California Corporations Code.

Comment: The definition of "capital account" is the minimum required under Reg §§1.704-1(b), 1.704-2.

For the definitions of "assignee," "assigning member," "capital contributions," "economic interest," "majority of members," "notice," "person," "proxy," and "transfer," see the Comment following the form provision in §9.4.

The need for a proxy in a short-form agreement will depend on the number of members and their relationship to each other.

For the definition of "profits and losses," see the Comment following the form provision in §9.23 for discussion of language relating to certain adjustments when book income differs from taxable income.

In 2005, the Corporations Code was amended to recognize modern forms of electronic communication, including communications by means of video screens. Thus, the older definitions of "in writing" and "written" have been expanded to include these technological developments. It should be noted that electronic transmission by a limited liability company to an individual member is not authorized unless, in addition to satisfying the requirements of Corp C §17001(o)(1)-(2), the transmission also satisfies the requirements of the Electronic Signatures in Global and National Commerce Act (15 USC §7001(c)(1)). On those requirements, see California UCC Sales and Leases §§2.50A-2.50D (Cal CEB 2002).

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/ D. Formation/§10.7 1. Form: Filing of Articles of Organization

D. Formation

§10.7 1. Form: Filing of Articles of Organization

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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10.7-1 Filing of articles of organization

ARTICLE II: ARTICLES OF ORGANIZATION

2.1. Promptly following execution of this Agreement, the Members will cause Articles of Organization, in the form attached to this Agreement as Exhibit _ _[*letter/number*]**_ _, to be filed with the California Secretary of State.**

Comment: See the Comment following the form provision in §9.5.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.8 2. Form: Name

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10.8-1 Name

2.2. The name of the Company will be _ _[*name*]_ _.

Comment: See the Comment following the form provision in §9.6.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.9 3. Form: Address

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10.9-1 Address

2.3. The principal executive office of the Company will be at _ _[*address*]_ _, California _ _[*zip code*]_ _, or any other place or places determined by the Members from time to time.

Comment: See the Comment following the form provision in §9.7.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.10 4. Form: Agent for Service of Process

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10.10-1 Agent for service of process

2.4. The initial agent for service of process on the Company will be _ _[*name*]_ _. A Majority of Members may from time to time change the Company's agent for service of process.

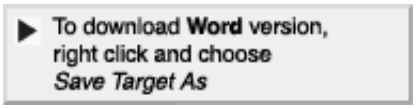
Comment: See the Comment following the form provision in §9.8.

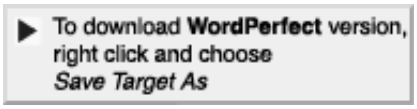
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.11 5. Form: Business Purposes

§10.11 5. Form: Business Purposes

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10.11-1 Business purposes

2.5. The Company will be formed for the purposes of engaging in the business of _ _[*description of business*]**_ _.**

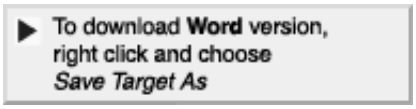
Comment: See the Comment following the form provision in §9.9.

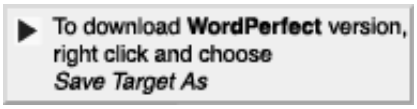
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.12 6. Form: Term of Company's Existence

§10.12 6. Form: Term of Company's Existence

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102





10.12-1 Term of company's existence

2.6. The term of existence of the Company will commence on the effective date of filing of Articles of Organization with the California Secretary of State, and will continue until terminated by the provisions of this Agreement or as provided by law.

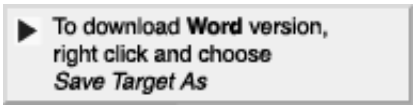
Comment: See the Comment following the form provision in §9.11.

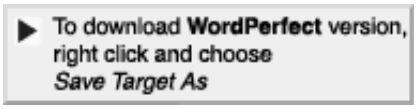
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.13 7. Form: Members as Managers

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10.13-1 Members as managers

2.7. The Members will be the managers of the Company.

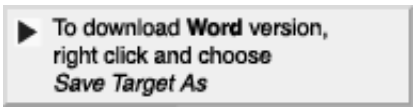
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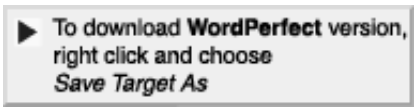
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E. Capital and Capital Contributions

§10.14 1. Form: Capital Contributions

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10.14-1 Capital contributions

ARTICLE III: CAPITALIZATION

3.1. Each Member will contribute to the capital of the Company as the Member's Capital Contribution the money or property specified in Exhibit _ _[*letter/number*]_ _ to this Agreement. The Fair Market Value of each item of contributed property as agreed between the Company and the Member contributing the property is set forth in Exhibit _ _[*letter/number*]_ _. Unless otherwise agreed in writing by all Members, no Member will be required to make additional Capital Contributions.

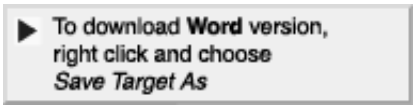
Comment: See the Comment following the form provision in §9.14.

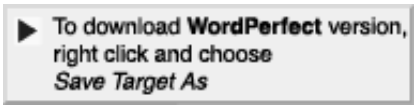
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.15 2. Form: Failure to Make Capital Contributions

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10.15-1 Failure to make capital contributions

3.2. If a Member fails to make a required Capital Contribution within 30 days after the effective date of this Agreement, that Member's entire Membership Interest will terminate and that Member will indemnify and hold the Company and the other Members harmless from any loss, cost, or expense, including reasonable attorney fees, caused by the failure to make that Capital Contribution.

Comment: Because additional capital contributions are not contemplated under this form (even though the members can otherwise agree), no remedies are specified for the failure to make contributions other than as set forth in this provision. The drafter could consider using the provisions in §9.16 or §9.17, which would add some complexity to the agreement.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.16 3. Form: Capital Accounts

§10.16 3. Form: Capital Accounts

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10.16-1 Capital accounts

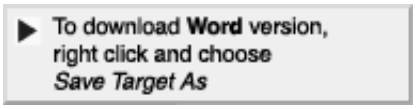
3.3. An individual Capital Account will be maintained for each Member consisting of that Member's Capital Contribution, (1) increased by that Member's share of Profits, (2) decreased by that Member's share of Losses, and (3) adjusted as required in accordance with applicable provisions of the Code and Regulations.

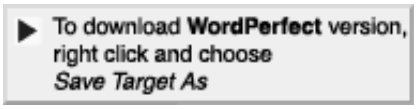
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.17 4. Form: Withdrawals

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10.17-1 Withdrawals

3.4. A Member will not be entitled to withdraw any part of the Member's Capital Contribution or to receive any distributions, whether of money or property from the Company except as provided in this Agreement.

Comment: See the Comment following the form provision in §9.19.

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§10.18 5. Form: Interest

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10.18-1 Interest

3.5. No interest will be paid on funds or property contributed to the capital of the Company or on the balance of a Member's Capital Account.

Comment: This provision may be drafted to provide for the payment of interest.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.19 6. Form: Limited Liability

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10.19-1 Limited liability

3.6. A Member will not be bound by, or be personally liable for, the expenses, liabilities, or obligations of the Company except as otherwise provided in the Act or in this Agreement.

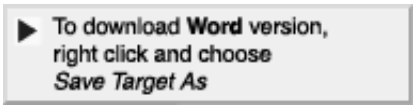
Comment: See the Comment following the form provision in §9.21.

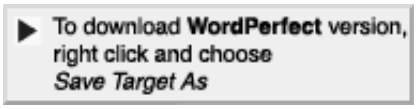
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.20 7. Form: No Priority of Treatment

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10.20-1 No priority of treatment

3.7. No Member will have priority over any other Member with respect to the return of a Capital Contribution or distributions or allocations of income, gain, losses, deductions, credits, or items thereof.

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F. Allocations and Distributions

§10.21 1. Form: Allocation of Profits and Losses

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10.21-1 Allocation of profits and losses

ARTICLE IV: ALLOCATIONS AND DISTRIBUTIONS

4.1. The Profits and Losses of the Company and all items of Company income, gain, loss, deduction, or credit will be allocated, for Company book purposes and for tax purposes, to each Member in accordance with that Member's Percentage Interest.

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§10.22 2. Form: Qualified Income Offset

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10.22-1 Qualified income offset

4.2. If any Member unexpectedly receives any adjustment, allocation, or distribution described in Treasury Reg §1.704-1(b)(2)(ii)(d)(4)-(6), items of Company gross income and gain will be specially allocated to that Member in an amount and manner sufficient to eliminate any deficit balance in the Member's Capital Account created by the adjustment, allocation, or distribution as quickly as possible. Any special allocation under this Section 4.2 will be taken into account in computing subsequent allocations of Profits and Losses, so that the net amount of allocations of income and loss and all other items will, to the extent possible, be equal to the net amount that would have been allocated if the unexpected adjustment, allocation, or distribution had not occurred. The provisions of this Section 4.2 and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Treasury Reg §§1.704-1(b) and 1.704-2 and will be interpreted and applied in a manner consistent with those Regulations.

Comment: This language is necessary to ensure that the allocations of profit and loss in accordance with the percentage interests of the members will be respected under federal income tax law and regulations. See the Comments following the form provisions in §§9.23 and 9.25.

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§10.23 3. Form: Allocations Respecting Asset Distributions

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10.23-1 Allocations respecting asset distributions

4.3. Any unrealized appreciation or unrealized depreciation in the values of Company property distributed in kind to all the Members will be treated in accordance with applicable law.

Comment: See the Comment following the form provision in §9.29.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.24 4. Form: Allocations Between Assignor and Assignee

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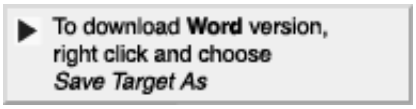
10.24-1 Allocations between assignor and assignee

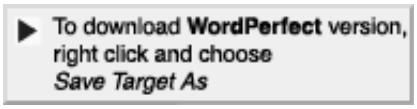
4.4. In the case of a Transfer of an Economic Interest during any fiscal year, the Assigning Member and Assignee will each be allocated the Economic Interest's share of Profits or Losses based on the number of days each held the Economic Interest during that fiscal year.

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§10.25 5. Form: Distributions

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10.25-1 Distributions

4.5. All cash resulting from the normal business operations of the Company and from a Capital Event will be distributed among the Members in proportion to their Percentage Interests at such times as the Members may agree.

Comment: Unlike the long-form provision in §9.34, this short-form provides that distributions are left entirely to the discretion of a majority of members and that cash from capital events is treated the same as cash from operations. The drafter could vary this language using the long-form provisions in §§9.34 and 9.35 as guides.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.26 6. Form: Noncash Proceeds

§10.26 6. Form: Noncash Proceeds

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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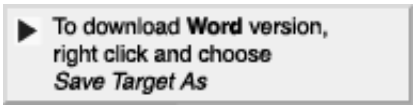
10.26-1 Noncash proceeds

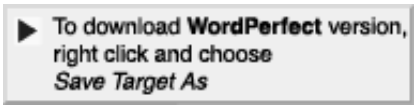
4.6. If the proceeds from a sale or other disposition of a Company asset consist of property other than cash, the value of the property will be as determined by the Members. Noncash proceeds will then be allocated among all the Members in proportion to their Percentage Interests. If noncash proceeds are subsequently reduced to cash, the cash will be distributed to each Member in accordance with Section 4.5.

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§10.27 7. Form: Liquidating Proceeds

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10.27-1 Liquidating proceeds

4.7. Notwithstanding any other provisions of this Agreement to the contrary, when there is a distribution in liquidation of the Company, or when any Member's Interest is liquidated, all items of income and loss first will be allocated to the Members' Capital Accounts under this Article IV, and other credits and deductions to the Members' Capital Accounts will be made before the final distribution is made. The final distribution to the Members will be made to the Members to the extent of and in proportion to their positive Capital Account balances.

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G. Management of Company

§10.28 1. Form: All Members as Managers

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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10.28-1 All members as managers

ARTICLE V: MANAGEMENT

5.1. The business of the Company will be managed by all the Members. A Member will be a manager only during the time the Member is a Member of the Company. Unless otherwise provided in this Agreement, all decisions concerning the management of the Company's business will be made by the Vote of a Majority of Members.

Comment: See the Comment following the form provision in §9.38.

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§10.29 2. Form: Procedure for Action by Members

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10.29-1 Procedure for action by members

5.2. The Members are not required to hold meetings, and decisions may be reached through one or more informal consultations followed by agreement among a Majority of Members, if all Members are consulted (although all Members need not be present during a particular consultation), or by a written consent signed by a Majority of Members. In the event that Members wish to hold a formal meeting (a "Meeting") for any reason, the following procedures will apply:

(1) Any two Members may call a Meeting of the Members by giving Notice of the time and place of the Meeting at least 48 hours beforehand. The Notice need not specify the purpose of the Meeting, or the location if the Meeting is to be held at the principal executive office of the Company.

(2) A majority of Members will constitute a quorum for the transaction of business at any Meeting of the Members.

(3) The transactions of the Members at any Meeting, however called or Noticed, or wherever held, will be as valid as though transacted at a Meeting duly held after call and Notice if a quorum is present and if, either before or after the Meeting, each Member not present signs a written waiver of Notice, a consent to the holding of the Meeting, or an approval of the minutes of the Meeting.

(4) Any action required or permitted to be taken by the Members under this Agreement may be taken without a Meeting if a Majority of the Members individually or collectively consent in writing to the action.

(5) A meeting of the Members may be conducted, in whole or in part, by electronic transmission by and to the Company or by electronic video screen communication if (1) the Company implements reasonable measures to provide Members (in person or by Proxy) a reasonable opportunity to participate in the meeting and to vote on matters submitted to the Members, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with those proceedings, and if (2) any Member Votes or takes other action at the meeting by means of electronic transmission to the Company or electronic video screen communication, a record of that vote or action is maintained by the Company.

(6) The Members will keep or cause to be kept with the books and records of the Company full and accurate minutes of all Meetings, Notices, and waivers of Notices of Meetings, and all written consents in lieu of Meetings.

Comment: See the Comments following the form provisions in §§9.42 (meeting of managers), 9.58-9.62.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.30 3. Form: Compensation

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10.30-1 Compensation

5.3. The Members as such and as managers will not be entitled to compensation for their services.

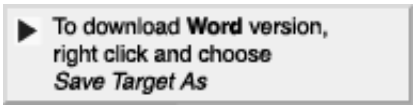
Comment: If the members so opt, the operating agreement may provide for compensation. The approach taken here is to compensate officers other than officer-members, as indicated in the provision in §10.31.

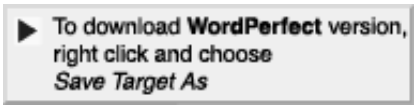
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.31 4. Form: Officers of the Company

§10.31 4. Form: Officers of the Company

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10.31-1 Officers of the company

5.4. The Company may have a President, who may be, but need not be, a Member. A Majority of the Members may provide for additional officers of the Company and for their election, and may alter the powers, duties, and compensation of the President and of all other officers. The President, if there is one, will attend any Meetings of Members called under Section 5.2(1)-(6).

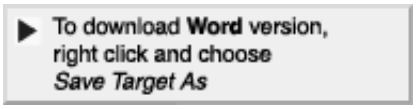
Comment: See the Comment following the form provision in §9.45.

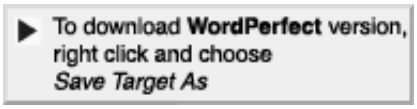
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.32 5. Form: Title to Assets

§10.32 5. Form: Title to Assets

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10.32-1 Title to assets

5.5. All assets of the Company, whether real or personal, will be held in the name of the Company.

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§10.33 6. Form: Banking

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10.33-1 Banking

5.6. All funds of the Company will be deposited in one or more accounts with one or more recognized financial institutions in the name of the Company, at locations determined by a Majority of Members. Withdrawal from those accounts will require the signature of the person or persons designated by a Majority of Members.

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H. Accounts and Records

§10.34 1. Form: Accounts

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10.34-1 Accounts

ARTICLE VI: ACCOUNTS AND RECORDS

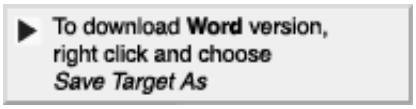
6.1. Complete books of account of the Company's business, in which each Company transaction will be fully and accurately entered, will be kept at the Company's principal executive office and will be open to inspection and copying by each Member or the Member's authorized representatives on reasonable Notice during normal business hours. The costs of inspection and copying will be borne by the Member.

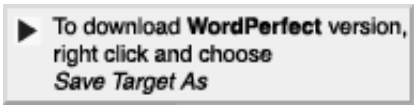
Comment: See the Comment following the form provision in §9.48.

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§10.35 2. Form: Accounting

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10.35-1 Accounting

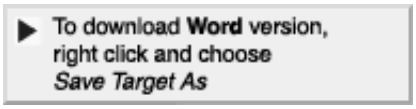
6.2. Financial books and records of the Company will be kept on the _ _[*accrual/cash*]_ _ method of accounting, which will be the method of accounting followed by the Company for federal income tax purposes. A balance sheet and income statement of the Company will be prepared promptly following the close of each fiscal year in a manner appropriate to and adequate for the Company's business and for carrying out the provisions of this Agreement. The fiscal year of the Company will be January 1 through December 31.

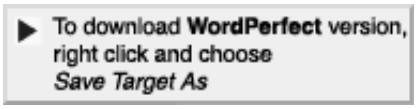
Comment: See the Comment following the form provision in §9.49. No certified public accountant is required under this provision of the short-form operating agreement, nor is there a requirement to comply with generally accepted accounting principles. Such requirements might unduly burden a small business.

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§10.36 3. Form: Records

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10.36-1 Records

6.3. At all times during the term of existence of the Company, and beyond that term if a Majority of the Members deem it necessary, the Members will keep or cause to be kept the books of account referred to in Section 6.2, and the following:

(a) A current list of the full name and last known business or residence address of each Member, together with the Capital Contribution and the share in Profits and Losses of each Member;

(b) A copy of the Articles of Organization, as amended;

(c) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years;

(d) Executed counterparts of this Agreement, as amended;

(e) Any powers of attorney under which the Articles of Organization or any amendments were executed;

(f) Financial statements of the Company for the six most recent fiscal years; and

(g) The books and records of the Company as they relate to the Company's internal affairs for the current and past four fiscal years.

If a Majority of Members deem that any of the foregoing items will be kept beyond the term of existence of the Company, the repository of those items will be as designated by a Majority of Members.

Comment: See Corp C §17058; §9.50.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.37 4. Form: Income Tax Returns

§10.37 4. Form: Income Tax Returns

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10.37-1 Income tax returns

6.4. Within 90 days after the end of each taxable year of the Company, the Company will send to each of the Members all information necessary for the Members to complete their federal and state income tax or information returns, and a copy of the Company's federal, state, and local income tax or information returns for that year.

Comment: Not included in this short-form provision are the additional reports specified under the long-form provision in §9.51 for delivery to members; see the Comment for §9.51. See also the Comment to the form provision in §9.52.

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I. Membership

§10.38 1. Form: Members and Voting Rights

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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10.38-1 Members and voting rights

ARTICLE VII: MEMBERS AND VOTING

7.1. There will be only one class of membership and no Member will have any rights or preferences in addition to or different from those possessed by any other Member. Each Member will Vote in proportion to the Member's Percentage Interest as of the governing record date, determined in accordance with Section 7.2. Any action that may or that must be taken by the Members will be by a Majority of Members, except that the following actions will all require the *unanimous* Vote of the Members:

(a) The transfer of a Membership Interest and the admission of the Assignee as a Member of the Company;

(b) Any amendment of the Articles of Organization or this Agreement; or

(c) Compromise of the obligation of a Member to make a Capital Contribution.

Comment: See the Comment following the form provision in §9.55.

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§10.39 2. Form: Record Dates

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10.39-1 Record dates

7.2. The record date for determining the Members entitled to Notice of any Meeting, to Vote, to receive any distribution, or to exercise any right in connection with any other lawful action, will be the date set by a Majority of Members, provided that the record date may not be more than 60, nor less than 10 days before the date of the Meeting, nor more than 60 days before any other action.

In the absence of any action setting a record date, the record date will be determined in accordance with California Corporations Code §17104(k).

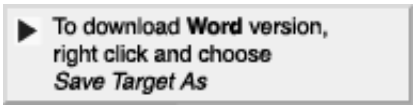
Comment: See the Comment following the form provision in §9.56.

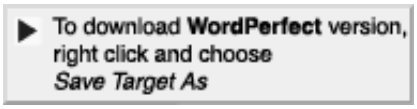
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.40 3. Form: Proxies

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10.40-1 Proxies

7.3. At all Meetings of Members, a Member may Vote in person or by Proxy. The Proxy will be filed with any Member before or at the time of the Meeting, and may be filed by facsimile transmission to a Member at the principal executive office of the Company or any other address given by a Majority of Members to the Members for that purpose.

Comment: See the Comment following the form provision in §9.61.

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J. Transfers of Membership Interests

§10.41 1. Form: Withdrawal of Members; Notice

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10.41-1 Withdrawal of members

ARTICLE VIII: TRANSFERS OF MEMBERSHIP INTERESTS

8.1. A Member may withdraw from the Company at any time by giving Notice of Withdrawal to all other Members at least 180 calendar days before the effective date of withdrawal. Withdrawal will not release a Member from any obligations and liabilities under this Agreement accrued or incurred before the effective date of withdrawal. A withdrawing Member will divest the Member's entire Membership Interest before the effective date of withdrawal in accordance with the transfer restrictions and option rights set forth below.

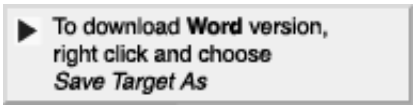
Comment: Particularly in a small LLC, the members may want to restrict a member's right to withdraw. For a discussion of permitted restrictions, see the Comment to the form provision in §9.65. The agreement could, for example, expressly negate a member's right to withdraw under the circumstances set forth in Corp C §17252(a):

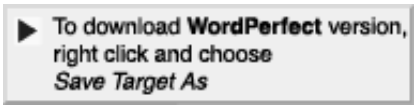
> (a) The articles of organization or a written operating agreement may provide that a member may withdraw, resign, or retire from a limited liability company at the time or upon the happening of events specified in the operating agreement or that the member shall not have the right to withdraw, resign, or retire as a member of a limited liability company. Notwithstanding any restriction upon the right of a member to withdraw, resign, or retire, a member may withdraw from a limited liability company at any time by giving written notice to the other members. However, unless the articles of organization or written operating agreement provide otherwise, the withdrawn member shall not be entitled to payment for the member's interest in the limited liability company, and, beginning on the date of the withdrawal, the withdrawn member shall have only the right of a holder of an economic interest with respect to that withdrawn member's interest in the limited liability company, and then only with respect to distributions, if any, to which a holder of an economic interest is entitled under the operating agreement of the limited liability company, and the withdrawn member shall no longer be a member of the limited liability company. If the withdrawal, resignation, or retirement is in violation of the operating agreement, the limited liability company shall have the right to offset any damages for the breach of the operating agreement from the amounts, if any, otherwise distributable to the withdrawn member with respect to the withdrawn member's economic interest in the limited liability company.

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§10.42 2. Form: Restrictions on Transfer

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10.42-1 Restrictions on transfer

8.2. Except as expressly provided in this Agreement, a Member will not Transfer any part of the Member's Membership Interest in the Company, whether now owned or later acquired, unless (1) the other Members unanimously approve the transferee's admission to the Company as a Member and (2) the Membership Interest to be Transferred, when added to the total of all other Membership Interests Transferred in the preceding 12 months, will not cause the termination of the Company under IRC §708(b)(1)(B). No Member may Encumber or permit or suffer any Encumbrance of all or any part of the Member's Membership Interest in the Company unless the Encumbrance has been approved in writing by all the other Members. Any Transfer or Encumbrance of a Membership Interest without that approval will be void. Notwithstanding any other provision of this Agreement to the contrary, a Member who is a natural person may transfer all or any portion of his or her Membership Interest to any revocable trust created for the benefit of the Member, or any combination between or among the Member, the Member's spouse or domestic partner, and the Member's issue if the Member retains a beneficial interest in the trust and all of the Voting Interest included in the Membership Interest. A transfer of a Member's entire beneficial interest in the trust or failure to retain a Voting Interest will be deemed a Transfer of a Membership Interest.

Comment: See the Comment following the form provision in §9.66.

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§10.43 3. Form: Triggering Events

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10.43-1 Triggering events

8.3. On the happening of any of the following events (Triggering Events) with respect to a Member, the Company and the other Members will have the option to purchase all or any portion of the Membership Interest in the Company of the Member (Selling Member) at the price and on the terms provided in Section 8.7 of this Agreement:

(a) The death or incapacity of a Member;

(b) The bankruptcy of a Member;

(c) The winding up and dissolution of a corporate Member, or the merger or other corporate reorganization of a corporate Member as a result of which the corporate Member does not survive as an entity;

(d) The withdrawal of a Member; or

(e) Except for the events stated in Section 8.4, the occurrence of any other event that is, or that would cause, a Transfer in contravention of this Agreement.

Each Member agrees to promptly give Notice of a Triggering Event to all other Members.

Comment: Under this short-form operating agreement, a buyout does not have to be on an "all or nothing" basis. See the Comments following the form provisions in §§9.67 and 9.68. Note that this short-form operating agreement does not provide for a right of first refusal. See §10.2.

The occurrence of a triggering event need not necessarily require a buyout. For example, the operating agreement can instead provide that, following a triggering event, the subject member's successor will have only an economic interest in the LLC.

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§10.44 4. Form: Marital Dissolution or Death of a Spouse

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10.44-1 Marital dissolution or death of a spouse

8.4. Notwithstanding any other provisions of this Agreement:

(a) If, in connection with the divorce or dissolution of the marriage of a Member, any court issues a decree or order that transfers, confirms, or awards a Membership Interest, or any portion of it, to that Member's spouse (an Award), then, notwithstanding that that transfer would constitute an unpermitted Transfer under this Agreement, that Member will have the right to purchase from his or her former spouse the Membership Interest, or portion of it, that was so transferred, and the former spouse will sell the Membership Interest or portion of it to that Member at the price set forth in Section 8.7 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the Award (the Expiration Date), the Company and the other Members will have the option to purchase from the former spouse the Membership Interest or portion of it under Section 8.5 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the Award.

(b) If, by reason of the death of a spouse of a Member, any portion of a Membership Interest is Transferred to a Transferee other than (1) that Member or (2) a trust created for the benefit of that Member (or for the benefit of that Member and any combination between or among the Member and the Member's issue) in which the Member is the sole Trustee and the Member, as Trustee or individually, possesses all of the Voting Interest included in that Membership Interest, then the Member will have the right to purchase the Membership Interest or portion of it from the estate or other successor of his or her deceased spouse or Transferee of his or her deceased spouse, and the estate, successor, or Transferee must sell the Membership Interest or portion of it at the price set forth in Section 8.7 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the date of death (the Expiration Date), the Company and the other Members will have the option to purchase from the estate or other successor or Transferee of the deceased spouse the Membership Interest or portion of it under Section 8.5 of this Agreement; provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the death.

Comment: See the Comment following the form provision in §9.69. The dissolution of a member's marriage need not necessarily require a buyout. For example, the operating agreement can instead provide that, following the dissolution of a member's marriage, the subject member's former spouse will have only an economic interest in the LLC.

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§10.45 5. Form: Option Periods

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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10.45-1 Option periods

8.5. On the receipt of Notice of any Triggering Event (the date of receipt being referred to in this Agreement as the Option Date), the Company will have the option, for a period ending 30 calendar days following the determination of the purchase price as provided in Section 8.7, to purchase the Membership Interest in the Company to which the option relates, at the price and on the terms provided in Section 8.7, and the other Members, pro rata in accordance with their prior Membership Interests in the Company, will then have the option, for a period of 30 days thereafter, to purchase the Membership Interest in the Company not purchased by the Company, on the same terms and conditions as apply to the Company. If all other Members do not elect to purchase the entire remaining Membership Interest in the Company, then the Members electing to purchase will have the right, pro rata in accordance with their prior Membership Interests in the Company, to purchase the additional Membership Interest in the Company available for purchase. The Transferee of the Membership Interest in the Company that is not purchased will hold the Membership Interest in the Company subject to all of the provisions of this Agreement.

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§10.46 6. Form: Nonparticipation of Interested Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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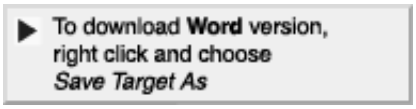
10.46-1 Nonparticipation of interested member

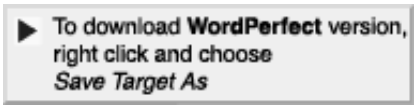
8.6. No Member will participate in any Vote or decision in any matter pertaining to the disposition of that Member's Membership Interest in the Company under this Agreement.

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§10.47 7. Form: Option Purchase Price

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102





10.47-1 Option purchase price

8.7. The purchase price of a Membership Interest that is the subject of an option under this Agreement will be the Fair Market Value of the Membership Interest as determined under this Section 8.7. Each of the selling and purchasing parties will use his, her, or its best efforts to mutually agree on the Fair Market Value. If the parties are unable to so agree within 30 days of the date on which the option is first exercisable (the Option Date; see Section 8.5), the selling party will appoint, within 40 days of the Option Date, one appraiser, and the purchasing party will appoint within 40 days of the Option Date, one appraiser. The two appraisers will within a period of 5 additional days, agree on and appoint an additional appraiser. The three appraisers will, within 60 days after the appointment of the third appraiser, determine the Fair Market Value of the Membership Interest in writing and submit their report to all the parties. The Fair Market Value will be determined by disregarding the appraiser's valuation that diverges the most from each of the other two appraisers' valuations, and the arithmetic mean of the remaining two appraisers' valuations will be the Fair Market Value. Each party will pay for the services of the appraiser selected by it, plus one-half of the fee charged by the third appraiser. The option purchase price as so determined will be payable in cash.

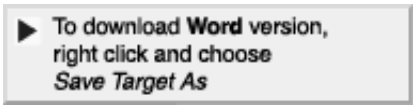
Comment: See the Comment following the form provision in §9.72.

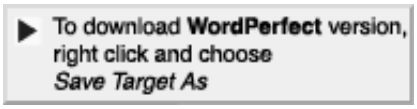
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.48 8. Form: Substituted Member

§10.48 8. Form: Substituted Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102





10.48-1 Substituted member

8.8. Except as expressly permitted under Section 8.2, a prospective Transferee (other than an existing Member) of a Membership Interest may be admitted as a Member with respect to the Membership Interest (Substituted Member) only (1) on the unanimous Vote of the other Members in favor of the prospective Transferee's admission as a Member, and (2) on the prospective Transferee's executing a counterpart of this Agreement as a party to it. Any prospective Transferee of a Membership Interest will be deemed an Assignee, and, therefore, the owner of only an Economic Interest until the prospective Transferee has been admitted as a Substituted Member.

Comment: See the Comment following the form provision in §9.73.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.49 9. Form: Duties of Substituted Member

§10.49 9. Form: Duties of Substituted Member

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10.49-1 Duties of substituted member

8.9. Any person admitted to the Company as a Substituted Member will be subject to all provisions of this Agreement.

Comment: See the Comment following the form provision in §9.74.

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§10.50 10. Form: Securities Laws

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10.50-1 Securities laws

8.10. The initial sale of Membership Interests in the Company to the initial Members has not been qualified or registered under the securities laws of any state, or registered under the Securities Act of 1933, as amended, in reliance on exemptions from the registration provisions of those laws. No attempt has been made to qualify the offering and sale of Membership Interests to Members under the California Corporate Securities Law of 1968, as amended, also in reliance on an exemption from the requirement that a permit for issuance of securities be procured. Notwithstanding any other provision of this Agreement, Membership Interests may not be Transferred or Encumbered unless registered or qualified under applicable state and federal securities laws or unless, in the opinion of legal counsel satisfactory to the Company, qualification or registration is not required. A Member who desires to transfer a Membership Interest will be responsible for all legal fees incurred in connection with that opinion.

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K. Dissolution and Winding Up

§10.51 1. Form: Events of Dissolution

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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10.51-1 Events of dissolution

ARTICLE IX: DISSOLUTION AND WINDING UP

9.1. The Company will be dissolved on the first to occur of the following events:

(a) The written agreement of a Majority of Members to dissolve the Company.

(b) The sale or other disposition of substantially all of the Company assets.

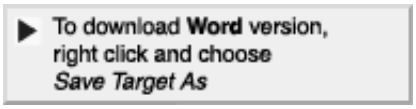
(c) Entry of a decree of judicial dissolution under California Corp C §17351.

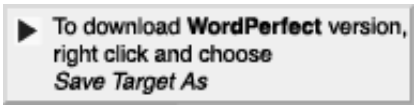
Comment: See the Comment following the form provision in §9.76. See §10.6 for a definition of "majority of members."

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§10.52 2. Form: Winding Up

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10.52-1 Winding up

9.2. On the dissolution of the Company, it will engage in no further business other than that necessary to wind up its business and affairs. The Members winding up the Company's affairs will give written Notice of the commencement of winding up by mail to all known creditors and claimants against the Company whose addresses appear in the Company's records. After paying or adequately providing for the payment of all known debts of the Company (except debts owing to Members) the remaining assets of the Company will be distributed or applied in the following order of priority:

(a) To pay the expenses of liquidation.

(b) To repay outstanding loans to Members. If there are insufficient funds to pay those loans in full, each Member will be repaid in the ratio that the Member's respective loan, together with accrued and unpaid interest, bears to the total of all those loans from Members, including all interest accrued and unpaid on those loans. Repayment will first be credited to unpaid principal and the remainder will be credited to accrued and unpaid interest.

(c) Among the Members in accordance with the provisions of Article IV, Section 4.7.

Comment: See the Comment following the form provision in §9.77.

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§10.53 3. Form: Deficits

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10.53-1 Deficits

9.3. Each Member will look solely to the assets of the Company for the return of the Member's investment, and if the Company property remaining after the payment or discharge of the debts and liabilities of the Company is insufficient to return the investment of any Member, the Member will have no recourse against any other Members for indemnification, contribution, or reimbursement.

Comment: See the form in §9.78 for language dealing with unpaid contributions by members at the time of dissolution.

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§10.54 L. Form: Arbitration

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10.54-1 Arbitration

ARTICLE X: ARBITRATION

10.1. Any action to enforce or interpret this Agreement, or to resolve disputes over this Agreement between the Company and a Member, or between or among the Members, will be settled by arbitration in accordance with the rules of the American Arbitration Association. Arbitration will be the exclusive dispute resolution process in the state of California, but arbitration will be a nonexclusive process elsewhere. Any party may commence arbitration by sending a written demand for arbitration to the other parties. The demand will set forth the nature of the matter to be resolved by arbitration. The Members will select the place of arbitration. The substantive law of the state of California will be applied by the arbitrator to the resolution of the dispute. The parties will share equally all initial costs of arbitration. The prevailing party will be entitled to reimbursement of attorney fees, costs, and expenses incurred in connection with the arbitration. All decisions of the arbitrator will be final, binding, and conclusive on all parties. Judgment may be entered on any such decision in accordance with applicable law in any court having jurisdiction of it. The arbitrator (if permitted under applicable law) or the court may issue a writ of execution to enforce the arbitrator's decision.

Comment: This short-form operating agreement does not include the noncompetition, indemnification, and power of attorney provisions included, respectively, in the long form at §§9.79-9.80, 9.82. The drafter could, of course, include some or all of those provisions if circumstances warrant.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/ M. General Provisions/§10.55 1. Form: Entire Agreement; Amendment

M. General Provisions

§10.55 1. Form: Entire Agreement; Amendment

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §10.4 and ends in §10.102

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10.55-1 Entire agreement; amendment

ARTICLE XI: GENERAL PROVISIONS

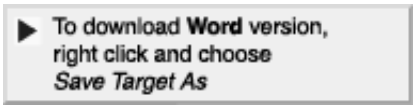
11.1. This Agreement constitutes the whole and entire agreement of the parties with respect to the subject matter of this Agreement, and it will not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the Members or any of them.

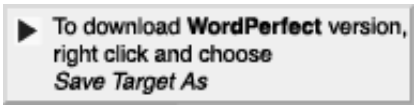
Comment: See the Comment following the form provision in §9.83.

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§10.56 2. Form: Counterpart Executions

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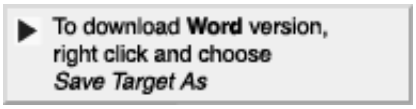
10.56-1 Counterpart executions

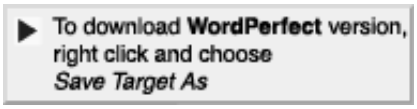
11.2. This Agreement may be executed in one or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

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§10.57 3. Form: Governing Law; Severability

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10.57-1 Governing law; severability

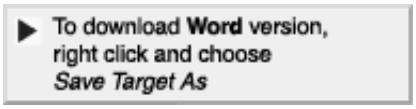
11.3. This Agreement will be construed and enforced in accordance with the laws of the state of California. If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision will, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid that invalidity, illegality, or unenforceability or, if that is not possible, the provision will, to the extent of that invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement will remain in effect.

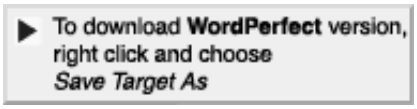
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.58 4. Form: Benefit

§10.58 4. Form: Benefit

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10.58-1 Benefit

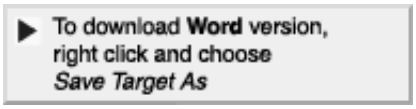
11.4. This Agreement will be binding on and inure to the benefit of the parties and their heirs, personal representatives, and permitted successors and assigns.

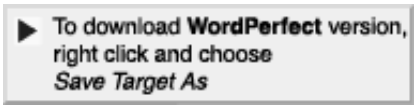
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.59 5. Form: Number and Gender

§10.59 5. Form: Number and Gender

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10.59-1 Number and gender

11.5. Whenever used in this Agreement, the singular will include the plural, the plural will include the singular, and the neuter gender will include the male and female as well as a trust, firm, company, or corporation, all as the context and meaning of this Agreement may require.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.60 6. Form: Further Assurances

§10.60 6. Form: Further Assurances

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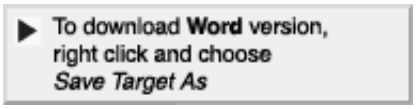
10.60-1 Further assurances

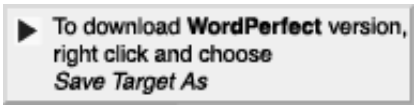
11.6. The parties to this Agreement will promptly execute and deliver any and all additional documents, instruments, notices, and other assurances, and will do any and all other acts and things reasonably necessary in connection with the performance of their respective obligations under this Agreement and to carry out the intent of the parties.

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§10.61 7. Form: Members' Other Business

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10.61-1 Members' other business

11.7. Except as provided in this Agreement, no provision of this Agreement will be construed to limit in any manner the Members in the carrying on of their own respective businesses or activities.

Comment: See the Comment following the form provision in §9.89.

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§10.62 8. Form: Agent

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10.62-1 Agent

11.8. Except as provided in this Agreement, no provision of this Agreement will be construed to constitute a Member, in the Member's capacity as such, the agent of any other Member.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.63 9. Form: Authority to Contract

§10.63 9. Form: Authority to Contract

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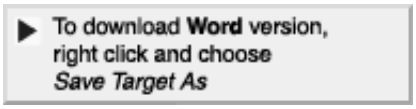
10.63-1 Authority to contract

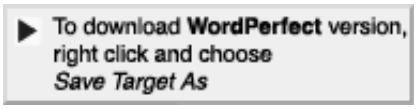
11.9. Each Member represents and warrants to the other Members that the Member has the capacity and authority to enter into this Agreement.

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§10.64 10. Form: Titles and Headings

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10.64-1 Titles and headings

11.10. The article, section, and subsection titles and headings contained in this Agreement are inserted as a matter of convenience and for ease of reference only and will be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.65 11. Form: Amendment

§10.65 11. Form: Amendment

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10.65-1 Amendment

11.11. This Agreement may be altered, amended, or repealed only by a writing signed by all of the Members.

Comment: See the Comment following the form provision in §9.93.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.66 12. Form: Time of the Essence

§10.66 12. Form: Time of the Essence

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10.66-1 Time of the essence

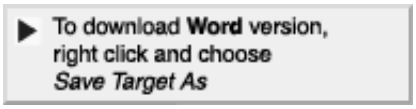
11.12. Time is of the essence of every provision of this Agreement that specifies a time for performance.

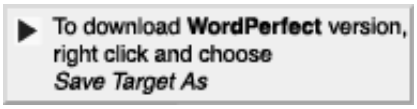
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.67 13. Form: No Third Party Beneficiary Intended

§10.67 13. Form: No Third Party Beneficiary Intended

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10.67-1 No third party beneficiary intended

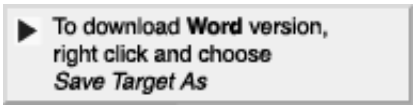
11.13. This Agreement is made solely for the benefit of the parties to this Agreement and their respective permitted successors and assigns, and no other person or entity will have or acquire any right by virtue of this Agreement.

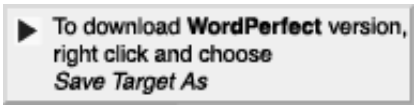
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.68 14. Form: Limited Liability Company

§10.68 14. Form: Limited Liability Company

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10.68-1 Limited liability company

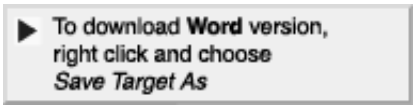
11.14. The Members intend the Company to be a limited liability company under the Act. No member will take any action inconsistent with the express intent of the parties to this agreement.

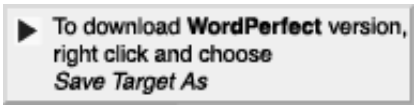
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.69 N. Form: Execution Clause

§10.69 N. Form: Execution Clause

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10.69-1 Execution clause

The parties hereby execute or cause to be executed this Agreement on _ _[*date*]_ _.

Comment: See §§9.97-9.102 for forms of signature blocks.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.70 O. Form: Consent of Spouse or Domestic Partner

§10.70 O. Form: Consent of Spouse or Domestic Partner

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10.70-1 Consent of spouse or domestic partner

CONSENT OF SPOUSE OR DOMESTIC PARTNER

The undersigned is the spouse or registered domestic partner of _ _[*name*]_ _ and acknowledges that _ _[*he/she*]_ _ has read the foregoing Agreement dated _ _[*date*]_ _, and understands its provisions. The undersigned is aware that, by the provisions of the Agreement, _ _[*he/she*]_ _ and _ _[*his/her*]_ _ spouse or domestic partner have agreed to sell or transfer all _ _[*his/her*]_ _ Membership Interest in the Company, including any community property interest or quasi-community property interest, in accordance with the terms and provisions of the Agreement. The undersigned expressly approves of and agrees to be bound by the provisions of the Agreement in its entirety, including, but not limited to, those provisions relating to the sales and transfers of Membership Interests and the restrictions on them. If the undersigned predeceases _ _[*his/her*]_ _ spouse or domestic partner when _ _[*his/her*]_ _ spouse or domestic partner owns any Membership Interest in the Company, _ _[*he/she*]_ _ agrees not to devise or bequeath whatever community property interest or quasi-community property interest _ _[*he/she*]_ _ may have in the Company in contravention of the Agreement.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name*]_ _

Comment: See the Comment following the form provision in §9.103.

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III. SINGLE-MEMBER OPERATING AGREEMENT

§10.71 A. Form: Parties and Date

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10.71-1 Parties and date

OPERATING AGREEMENT for _ _[*NAME*]_ _, _ _[*e.g., LLC /a limited liability company*]_ _

This Operating Agreement is made as of _ _[*date*]_ _, by _ _[*name*]_ _ (referred to as the Sole Member) with reference to the following facts:

Comment: The name of an LLC must contain the words "limited liability company" or the abbreviation "L.L.C." or "LLC." See the Comment following the form provision in §9.2.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.72 B. Form: Recitals

§10.72 B. Form: Recitals

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10.72-1 Recitals

A. The Sole Member desires to form a limited liability company (Company) under the Beverly-Killea Limited Liability Company Act (the Act) (California Corporations Code §§17100-17656).

B. The Member desires to execute this Operating Agreement in order to form and provide for the governance of the Company and the conduct of its business.

Now, therefore, the Sole Member declares the following to be the Operating Agreement of the Company:

Comment: See the Comment following the form provision in §9.3.

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C. Formation

§10.73 1. Form: Filing of Articles of Organization

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10.73-1 Filing of articles of organization

ARTICLE I: ARTICLES OF ORGANIZATION

1.1. Promptly following execution of this Agreement, the Sole Member will cause Articles of Organization, in the form attached to this Agreement as Exhibit _ _[*letter/number*]_ _, to be filed with the California Secretary of State.

Comment: See the Comment following the form provision in §9.5.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.74 2. Form: Name

§10.74 2. Form: Name

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10.74-1 Name

1.2. The name of the Company will be _ _[*name*]_ _.

Comment: See the Comment following the form provision in §9.6.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.75 3. Form: Address

§10.75 3. Form: Address

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10.75-1 Address

1.3. The principal executive office of the Company will be at _ _[*address*]_ _, California _ _[*zip code*]_ _, or any other place or places determined by the Sole Member from time to time.

Comment: See the Comment following the form provision in §9.7.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.76 4. Form: Agent for Service of Process

§10.76 4. Form: Agent for Service of Process

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10.76-1 Agent for service of process

1.4. The initial agent for service of process on the Company will be _ _[*name*]_ _. The Sole Member may from time to time change the Company's agent for service of process.

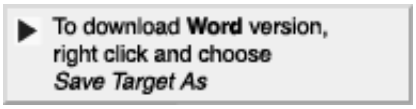
Comment: See the Comment following the long-form provision in §9.8.

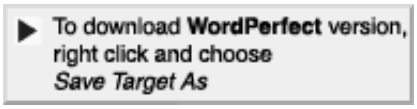
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.77 5. Form: Business Purposes

§10.77 5. Form: Business Purposes

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10.77-1 Business purposes

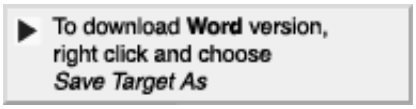
1.5. The Company will be formed for the purposes of engaging in the business of _ _[*description of business*]**_ _.**

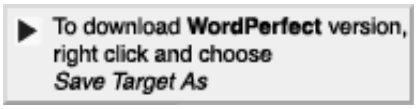
Comment: See the Comment following the form provision in §9.9.

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§10.78 6. Form: Term of Company's Existence

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10.78-1 Term of company's existence

1.6. The term of existence of the Company will commence on the effective date of filing of Articles of Organization with the California Secretary of State and will continue until terminated by the provisions of this Agreement or as provided by law.

Comment: See the Comment following the form provision in §9.11.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.79 7. Form: Member as Manager

§10.79 7. Form: Member as Manager

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10.79-1 Sole member as manager

1.7. The Sole Member will be the manager of the Company.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/ D. Capital and Capital Contributions/§10.80 1. Form: Capital Contributions

D. Capital and Capital Contributions

§10.80 1. Form: Capital Contributions

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10.80-1 Capital contributions

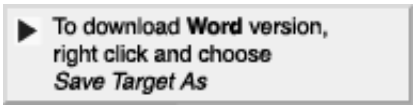
ARTICLE II: CAPITALIZATION

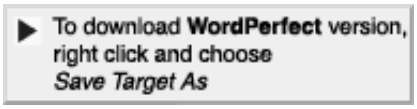
2.1. The Sole Member will contribute to the capital of the Company the money and property specified in Exhibit _ _[*letter/number*]_ _ to this Agreement. The Sole Member may from time to time and at any time contribute cash or property to the Company as the Sole Member may determine.

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§10.81 2. Form: Limited Liability

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10.81-1 Limited liability

2.2. The Sole Member will not be bound by, or be personally liable for, the expenses, liabilities, or obligations of the Company except as otherwise provided in the Act or in this Agreement.

Comment: See the Comment following the form provision in §9.21.

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E. Allocations and Distributions

§10.82 1. Form: Allocations Between Assignor and Assignee

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10.82-1 Allocations between assignor and assignee

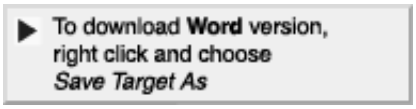
ARTICLE III: ALLOCATIONS AND DISTRIBUTIONS

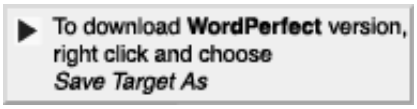
3.1. If any membership interest, or part of an interest, is assigned during any fiscal year in compliance with the provisions of this Article III, profits, losses, each item thereof, and all other items attributable to the membership interest for that fiscal year will be divided and allocated between the transferor and the transferee by taking into account their varying membership interests during the period in accordance with IRC §706(d), using any convention permitted by law selected by the Sole Member. All distributions on or before the date of the assignment will be made to the transferor, and all distributions thereafter will be made to the transferee. Solely for purposes of making the allocations and distributions, the Company will recognize the assignment not later than the end of the calendar month during which the assignment occurs. Neither the Company nor the Sole Member will incur any liability for making allocations and distributions in accordance with the provisions of this Section 3.1.

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§10.83 2. Form: Distributions

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10.83-1 Distributions

3.2. All cash resulting from the operations of the Company will be distributed to the Sole Member at such times as the Sole Member deems appropriate.

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F. Management of Company

§10.84 1. Form: Sole Member as Manager

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10.84-1 Sole member as manager

ARTICLE IV: MANAGEMENT

4.1. The business of the Company will be managed by the Sole Member. The Sole Member may appoint one or more nonmembers as comanagers or may resign as manager at any time and appoint a nonmember as the manager of the Company on such terms and conditions as the Sole Member and the manager may agree.

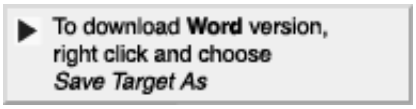
Comment: See the Comments following the form provisions in §§9.38-9.40.

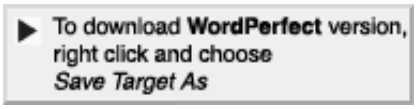
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.85 2. Form: Officers of the Company

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10.85-1 Officers of the company

4.2. The Company may have a President who may, but need not, be the Sole Member. The Sole Member may provide for additional officers of the Company and may alter the powers, duties, and compensation of the President and of any other officer.

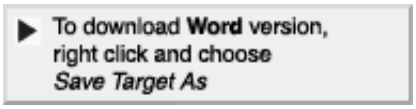
Comment: See the Comment following the form provision in §9.45.

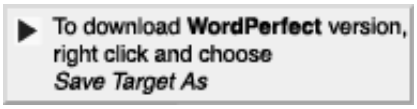
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.86 3. Form: Title to Assets

§10.86 3. Form: Title to Assets

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10.86-1 Title to assets

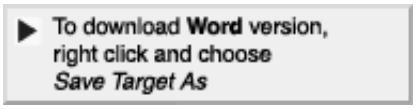
4.3. All Company assets, whether real or personal, will be held in the name of the Company.

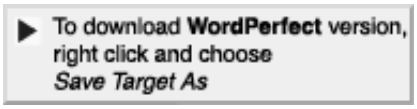
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.87 4. Form: Banking

§10.87 4. Form: Banking

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10.87-1 Banking

4.4. All Company funds will be deposited in one or more accounts with one or more recognized financial institutions in the name of the Company, at locations determined by the Sole Member. Withdrawal from those accounts will require the signature of the person or persons designated by the Sole Member.

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G. Accounts and Records

§10.88 1. Form: Accounts

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10.88-1 Accounts

ARTICLE V: ACCOUNTS AND RECORDS

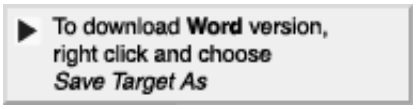
5.1. Complete books of account of the Company's business, in which each Company transaction will be fully and accurately entered, will be kept at the Company's principal executive office.

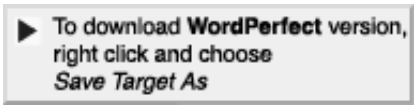
Comment: See the Comment following the form provision in §9.48.

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§10.89 2. Form: Accounting

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10.89-1 Accounting

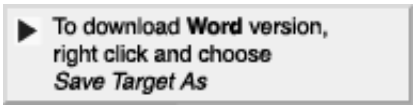
5.2. Financial books and records of the Company will be kept on the cash method of accounting. A balance sheet and income statement of the Company will be prepared promptly following the close of each fiscal year in a manner appropriate to and adequate for the Company's business and for carrying out the provisions of this Agreement. The fiscal year of the Company will be January 1 through December 31.

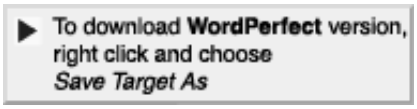
Comment: See the Comment following the form provision in §9.49. No certified public accountant is required in this provision of the single-member operating agreement, nor is there a requirement to comply with generally accepted accounting principles.

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§10.90 3. Form: Records

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10.90-1 Records

5.3. At all times during the Company's term of existence, and beyond that term if the Sole Member deems it necessary, the Sole Member will keep or cause to be kept the books of account referred to in Section 5.2, and the following:

(a) A current list of the full name and last known business or residence address of the Sole Member, together with the capital contributions and the share in profits and losses of the Sole Member;

(b) A copy of the Articles of Organization, as amended;

(c) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years;

(d) Executed counterparts of this Agreement, as amended;

(e) Any powers of attorney under which the Articles of Organization or any amendments to them were executed;

(f) Financial statements of the Company for the six most recent fiscal years; and

(g) The books and records of the Company as they relate to the Company's internal affairs for the current and past four fiscal years.

Comment: See Corp C §17058; §9.50.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.91 H. Form: Restrictions on Transfer

§10.91 H. Form: Restrictions on Transfer

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10.91-1 Restrictions on transfer

ARTICLE VI: RESTRICTIONS ON TRANSFER OF MEMBERSHIP INTEREST

6.1. The Sole Member will not transfer any part of the Sole Member's membership interest in the Company. Notwithstanding any other provision of this Agreement to the contrary, the Sole Member may transfer all or any portion of _ _[*his/her*]_ _ membership interest to any revocable trust created for the benefit of the Sole Member, or any combination between or among the Sole Member, the Sole Member's spouse or domestic partner, and the Sole Member's issue. A transfer of the Sole Member's entire beneficial interest in the trust will be deemed a transfer of _ _[*his/her*]_ _ membership interest in the Company.

Comment: This section is intended to be cautionary. It would be dangerous for the single-member operating agreement to end up serving more than one member, even with superficial conforming amendments. If additional members are likely, the short-form multimember form should be used.

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I. Dissolution and Winding Up

§10.92 1. Form: Events of Dissolution

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10.92-1 Events of dissolution

ARTICLE VII: DISSOLUTION AND WINDING UP

7.1. The Company will be dissolved on the first to occur of the following events:

(a) The decision of the Sole Member to dissolve the Company.

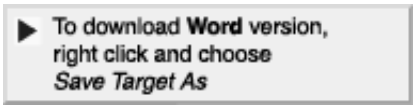
(b) The sale or other disposition of substantially all of the Company's assets.

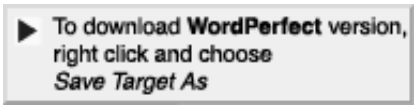
(c) Entry of a decree of judicial dissolution under California Corporations Code §17351.

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§10.93 2. Form: Winding Up

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10.93-1 Winding up

7.2. On the dissolution of the Company, it will engage in no further business other than that necessary to wind up its business and affairs. The Sole Member will wind up the affairs of the Company and give written Notice of the commencement of winding up by mail to all known creditors and claimants against the Company whose addresses appear in the records of the Company. After paying or adequately providing for the payment of all known debts of the Company (except debts owing to the Sole Member), the remaining assets of the Company will be distributed or applied in the following order of priority:

(a) To pay the expenses of liquidation.

(b) To repay outstanding loans to the Sole Member.

(c) To the Sole Member.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/ J. General Provisions/§10.94 1. Form: Entire Agreement; Amendment

J. General Provisions

§10.94 1. Form: Entire Agreement; Amendment

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10.94-1 Entire agreement; amendment

ARTICLE VIII: GENERAL PROVISIONS

8.1. This Agreement constitutes the whole and entire agreement with respect to the subject matter of this Agreement.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.95 2. Form: Governing Law; Severability

§10.95 2. Form: Governing Law; Severability

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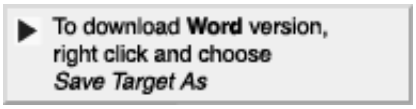
10.95-1 Governing law; severability

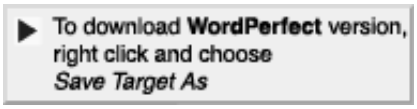
8.2. This Agreement will be construed and enforced in accordance with the laws of the state of California. If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision will, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid that invalidity, illegality, or unenforceability or, if that is not possible, that provision will, to the extent of that invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement will remain in effect.

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§10.96 3. Form: Titles and Headings

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10.96-1 Titles and headings

8.3. The article, section, and subsection titles and headings in this Agreement are inserted as a matter of convenience and for ease of reference only and will be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

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§10.97 4. Form: Amendment

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10.97-1 Amendment

8.4. This Agreement may be altered, amended, or repealed only by a writing signed by the Sole Member.

Comment: See the Comment following the form provision in §9.93.

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§10.98 5. Form: Time of the Essence

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10.98-1 Time of the essence

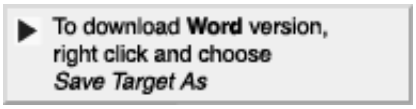
8.5. Time is of the essence for every provision of this Agreement that specifies a time for performance.

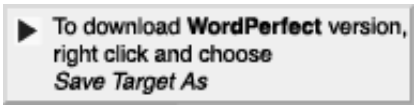
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.99 6. Form: No Third Party Beneficiary Intended

§10.99 6. Form: No Third Party Beneficiary Intended

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10.99-1 No third party beneficiary intended

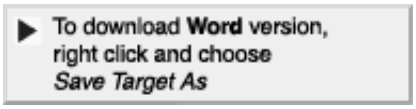
8.6. This Agreement is made solely for the benefit of the Sole Member and the Sole Member's permitted successors and assigns, and no other person or entity will have or acquire any right by virtue of this Agreement.

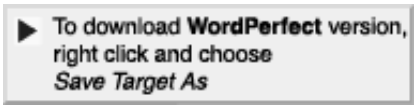
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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.100 7. Form: Limited Liability Company

§10.100 7. Form: Limited Liability Company

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10.100-1 Limited liability company

8.7. The Sole Member intends the Company to be a limited liability company under the Act.

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Source: Business Law/Forming and Operating California Limited Liability Companies/10 Annotated Short-Form and Single-Member Operating Agreements/§10.101 K. Form: Execution Clause

§10.101 K. Form: Execution Clause

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10.101-1 Execution clause

The Sole Member hereby executes or causes to be executed this Agreement on _ _[*date*]_ _.

__[*Signature*]__
_ _[*Typed or printed name*]_ _
Sole Member

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§10.102 L. Form: Consent of Spouse or Domestic Partner

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10.102-1 Consent of spouse or domestic partner

CONSENT OF SPOUSE OR DOMESTIC PARTNER

The undersigned is the spouse or registered domestic partner of _ _[*name*]_ _ and acknowledges that _ _[*he/she*]_ _ has read the foregoing Agreement dated _ _[*date*]_ _, and understands its provisions. The undersigned is aware that, by the provisions of the Agreement, _ _[*he/she*]_ _ and _ _[*his/her*]_ _ spouse or domestic partner have agreed to sell or transfer all _ _[*his/her*]_ _ membership interest in the Company, including any community property interest or quasi-community property interest, in accordance with the terms and provisions of the Agreement. The undersigned expressly approves of and agrees to be bound by the provisions of the Agreement in its entirety, including, but not limited to, those provisions relating to the sales and transfers of membership interests and the restrictions on them. If the undersigned predeceases _ _[*his/her*]_ _ spouse or domestic partner when _ _[*his/her*]_ _ spouse or domestic partner owns any membership interest in the Company, _ _[*he/she*]_ _ agrees not to devise or bequeath whatever community property interest or quasi-community property interest _ _[*he/she*]_ _ may have in the Company in contravention of the Agreement.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name*]_ _

Comment: See the Comment to the form provision in §9.103.

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11

Conversions and Mergers

David M. Greenberg
Paul L. Lion III

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1. Diagram: Exchanging Corporation Assets for LLC Membership Interests, Steps 1 and 2 §11.81
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§11.1 I. SCOPE OF CHAPTER

This chapter discusses the goals and methods of converting an existing business entity into a California LLC (§11.2), including how to accomplish this goal using the statutory provisions (§§11.24-11.40) or not using them (§§11.63-11.82). For purposes of this chapter, the term "conversion" is used broadly to mean any transaction or series of transactions adopted to change an entity into a California LLC, unless the context indicates otherwise.

This chapter also covers the goals and methods of merging one or more California business entities into a California LLC. See §§11.41-11.62.

This chapter briefly addresses the income tax and other considerations when choosing whether to convert an existing entity to a California LLC, or merge entities into a California LLC. See §§11.10-11.14, 11.19-11.23. Unless otherwise indicated, in this chapter the authors assume that the LLC formed as a result of the conversion or merger will be taxed as a partnership.

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II. PRELIMINARY CONSIDERATIONS FOR CONVERSIONS AND MERGERS

§11.2 A. Why Convert?

An existing entity ordinarily converts to an LLC to obtain both the corporate benefit of limited liability for its members and the partnership benefit of one level of income taxation. A manager of an LLC is also protected from liability more than a general partner of a partnership. In addition, the LLC form often allows greater simplicity and more flexibility than that permitted by limited partnership and corporation statutes, which impose more formal governance provisions than the Beverly-Killea Limited Liability Company Act (the Act) (Corp C §§17000-17656). Some practitioners may select the LLC form and elect corporate tax treatment solely to obtain the LLC governance rights.

To ensure that the client's objectives in converting to, or merging into, an LLC are satisfied in the manner provided in the partnership agreement or by law for amending partnership agreements, the practitioner must evaluate the various methods of conversion and merger as applied to the businesses involved, well as the federal income tax considerations (see §§11.10-11.14), securities issues (see §§11.15-11.18), and other state tax issues (see §§11.19-11.23).

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§11.3 B. Types of Conversions

In general, five different methods exist by which an entity may be converted into an LLC.

Statutory Conversion. An entity may convert directly into an LLC by obtaining a vote of the equity owners followed by the filing of a certificate with the Secretary of State. For reasons discussed later in this chapter, the statutory conversion has become the preferred conversion method. See §§11.24-11.40.

Statutory Merger. An entity may merge into a newly created LLC if authorized by the laws under which the entity is organized. On statutory mergers under California law, see §§11.41-11.62.

LLC Holding Company. The shareholders or partners in an existing corporation or partnership may contribute their shares or interests in the partnership to the LLC in exchange for LLC membership interests, and then dissolve the corporation or partnership.

Liquidation and Recontribution. A corporation or partnership may distribute its assets to the shareholders or partners in complete liquidation of their shares or partnership interests and the shareholders or partners may then contribute the assets to the newly formed LLC in exchange for membership interests.

Drop Down to LLC. Corporation or partnership assets may be contributed to a new LLC in exchange for membership interests followed by liquidation of the corporation or partnership and distribution of the LLC membership interests to the shareholders or partners.

The last three methods are discussed in §§11.63-11.72 (converting partnerships) and §§11.73-11.82 (converting corporations).

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§11.4 1. Statutory Conversion Provisions

The Beverly-Killea Limited Liability Company Act allows other business entities to convert to an LLC, provided that those entities are authorized to effect a conversion by the laws under which they are organized. Corp C §17540.8. California law permits a corporation, limited partnership, or general partnership to convert into a domestic LLC. Corp C §§1151, 15911.02, 16902. See §§11.24-11.40. A California limited partnership or general partnership may also convert into a foreign LLC if the foreign law expressly permits the creation of the new entity and if the partnership complies with the conversion law of the state of the LLC's organization. Corp C §§15911.02(b), 15911.05, 16905.

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§11.5 a. Converting Partnerships

The requirements for statutory conversion by partnerships into LLCs are (Corp C §§15911.02, 16902):

- Each of the partners of the converting partnership must receive a percentage interest in the profits and capital of the converted LLC equal to the partner's percentage interest in profits and capital of the converting partnership;
- The law under which the new LLC will exist must permit the formation of LLCs by a conversion; and
- The partnership must comply with the law of the state of the new LLC's organization applicable to conversions.

If permissible, converting an existing partnership to an LLC via the statutory conversion provisions is generally preferable to other conversion techniques, including statutory merger. Like a statutory merger (see §§11.7, 11.41-11.62), a statutory conversion in compliance with state law ensures that the conversion is legally valid, the conversion is accomplished without numerous conveyance documents, and the assets and liabilities of the partnership become the assets and liabilities of the LLC by operation of law. However, unlike a statutory merger, the converted LLC is treated as the same entity that existed before the conversion, thus avoiding conveyance or transfer taxes. Corp C §§15911.07, 15911.09(a), 16907, 16909(a). The conversion is not a change in ownership that triggers a real property tax reassessment (Rev & T C §60), nor is it a transfer between entities that will subject the LLC's real property to a reassessment when the original co-owners transfer more than 50 percent of their interests in the LLC in one or more future transactions. Rev & T C §62(a)(2); see §11.21. On the Beverly-Killea Limited Liability Company Act's conversion provisions, see §§11.24-11.40.

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§11.6 b. Converting Corporations

The requirements for statutory conversion by corporations into LLCs are (Corp C §1151):

- Unless all the shareholders of the class or series consent, each share of the same class or series of the converting corporation must be treated equally with respect to any cash, rights, securities, or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share, and nonredeemable common shares of the converting corporation will be converted only into nonredeemable membership interests of the converted entity unless all of the shareholders of the class consent;
- The law under which the new LLC will exist must permit the formation of LLCs under a conversion; and
- The corporation must comply with the law of the state of the new LLC's organization applicable to conversions.

The conversion of a corporation into an LLC also requires payment of a fee that may not exceed $150. Corp C §1160.

If permissible, converting an existing corporation to an LLC via the statutory conversion provisions is generally preferable to other conversion techniques, including statutory merger. Like a statutory merger, a statutory conversion in compliance with state law ensures that the conversion is legally valid, the conversion is accomplished without numerous conveyance documents, and the assets and liabilities of the corporation become the assets and liabilities of the LLC by operation of law. However, unlike the entities in a statutory merger, the converted LLC is treated as the same entity that existed before the conversion, thus avoiding conveyance or transfer taxes. Corp C §§1156, 1158(a). The conversion is not a change in ownership that triggers a real property tax reassessment (Rev & T C §60), nor is it a transfer between entities that will subject the LLC's real property to a reassessment when the original co-owners transfer more than 50 percent of their interests in the LLC in one or more future transactions. Rev & T C §62(a)(2); see §§11.20-11.22.

On the Beverly-Killea Limited Liability Company Act's conversion provisions, see §§11.24-11.40.

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§11.7 2. Using Act's Merger Provisions for Conversion

The Beverly-Killea Limited Liability Company Act allows other business entities to merge into an LLC, provided that any constituent California entities are authorized to effect a merger by the laws under which they were organized. Corp C §17550. California corporations, limited partnerships, and general partnerships are authorized to merge with existing LLCs. Corp C §§1113, 15911.10, 15911.11, and 16910. In a merger, the assets and liabilities of the disappearing business entity become the assets and liabilities of the surviving LLC by operation of law, without any further acts. Corp C §17554.

Merging a corporation or partnership into an LLC in compliance with the Act's merger provisions ensures that the merger will be legally valid. The merger can also be accomplished without numerous conveyance documents. On the Act's merger provisions, see §11.41-11.62.

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§11.8 3. Conversion Outside Act's Conversion and Merger Provisions

A general partnership, limited partnership, or corporation can convert to an LLC outside of the Beverly-Killea Limited Liability Company Act's conversion and merger provisions through an exchange (either of assets or equity) and dissolution of the old entity. See §§11.63-11.82.

The primary reasons for converting a corporation, limited partnership, or general partnership into an LLC by means other than the Act's conversion or merger provisions include the following:

- Avoidance of dissenters' rights or other remedies of nonconsenting partners in a merger (see Corp C §§1300-1312, 15911.20-15911.33, 16901-16917);
- Avoidance of supermajority consent requirements that exceed the consents necessary to amend the partnership agreement;
- Avoidance, in some cases, of the necessity and cost of obtaining a permit from the California Department of Corporations; and
- Simplicity of transfers and timing.

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§11.9 C. Why Merge?

Existing other business entities may merge into a California LLC to secure both the corporate benefit of limited liability for its members and the partnership benefit of one level of income taxation. See §§11.41-11.62. The LLC form often allows greater simplicity and more flexibility than permitted by partnership and corporation statutes that impose more formal governance provisions than the Beverly-Killea Limited Liability Company Act. Corp C §§17000-17655.

Two or more existing LLCs may merge into a single LLC. In this situation, merger may be desirable based on the individual business needs of the constituent LLCs.

NOTE: A discussion of the merger of two or more other business entities, or two or more LLCs, into another California or foreign other business entity is beyond the scope of this chapter. See generally Sales and Mergers of California Businesses (Cal CEB 2002).

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D. Federal Income Taxes

§11.10 1. Converting Partnerships

The conversion of a general or limited partnership into an LLC that will be taxed as a partnership for federal income tax purposes will ordinarily be income tax free if the members of the LLC continue to own their same proportionate ownership interests. See Rev Rul 95-37, 1995-1 Cum Bull 130, confirming that the tax consequences of a conversion of a partnership to an LLC are the same as those of a conversion of a general partnership to a limited partnership, as described in Rev Rul 84-52, 1984-1 Cum Bull 157.

Revenue Ruling 95-37 is important because it is the first revenue ruling providing guidance to taxpayers on the conversion of partnerships to LLCs. Revenue Ruling 95-37 also holds that the converting domestic partnership's taxable year does not close with respect to any or all partners, that the new LLC does not need a new taxpayer identification number, and that the federal income tax consequences are the same no matter which method of conversion is adopted.

Exceptions exist to the general rule that such conversions are income tax free. An LLC member's interest in the former partnership's debt may be decreased for tax purposes as a result of the conversion. A decrease in a partner's share of recourse debt is treated as a deemed distribution of cash to that partner. IRC §752(b). If the decrease in recourse debt exceeds the tax basis in the member's LLC interest, the member will recognize gain to that extent. IRC §§731(a), 752(b).

Normally, there is no such problem on conversion of a general partnership if the former general partners maintain the same share of all items and there are no different debt-sharing arrangements. However, if a limited partnership converts, the general partner's liability for recourse obligations may decline either immediately (if the general partner is actually released from liability for the obligations) or over a period of time (as recourse trade payables are replaced by nonrecourse trade payables). The former general partner's share of increased nonrecourse liabilities usually will be less, resulting in a net decrease in debt.

A recourse loan does not automatically become nonrecourse merely because the partnership converts to an LLC. The obligation may still be treated as recourse as to the general partners who signed the promissory note. Unless the lender executes a novation, the loan will be recourse under principles of equity and for purposes of IRC §752.

PRACTICE TIP: Counsel should ensure that an accountant or tax attorney will analyze these issues before the conversion to ascertain what the likely effect of conversion will be.

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§11.11 2. Converting Corporations

The conversion of a corporation to an LLC is treated as a two-step process for federal income tax purposes.

First, the corporation is deemed to be liquidated. This step is not ordinarily tax free, because a corporate level tax is assessed on deemed distributions of appreciated property. IRC §336. The taxable gain is measured by the difference between the fair market value of the property on the date of the distribution and the corporation's tax basis in the property distributed. Further, a shareholder-level tax is assessed on deemed distributions of appreciated property. IRC §331. The taxable gain is measured by the difference between the fair market value of the property distributed and the basis of the shareholder's stock.

Second, the corporate assets are deemed to be contributed to the LLC in exchange for LLC membership interests. This contribution of assets by the former shareholders to the LLC is ordinarily tax free. IRC §721.

Because of the double taxation involved in the first step's liquidation and distribution of corporate assets, the general rule should be that corporations do not convert to LLCs if there is significant income-tax exposure. In limited circumstances, however, conversion from the corporate form to the LLC form will not result in taxes, or it will make sense to pay the tax so that the shareholders can avail themselves of partnership tax classification.

PRACTICE TIP: Counsel, in consultation with the corporation's accountant, should analyze the time value of money and the projected future growth of the corporation's business and evaluate whether the tax costs and benefits of a conversion from a corporation to an LLC make conversion economically reasonable.

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§11.12 a. When Converting a Corporation Is Appropriate

The general rule is that converting corporations to LLCs may generate adverse tax consequences. Accordingly, corporations should not ordinarily disincorporate and convert to LLC status. However, this rule does not necessarily apply to the following situations:

- S or C corporations without built-in gain and with few or no appreciated assets (including goodwill).
- S corporations with shareholders whose tax bases in their stock exceed the value of the assets distributed, resulting in a capital loss sufficient to offset any gain from the deemed distribution (*e.g.,* if a shareholder purchased shares at a value greater than the proportionate share of the tax basis of the S corporation assets or acquired shares from a decedent shareholder and the tax basis of the acquired shares is "stepped up" under IRC §1014(a)(1)).

NOTE: S corporations cannot make the special election available to partnerships under IRC §754 to adjust the basis of assets of the S corporation in an amount attributable to the increased value of the stock paid by an acquiring shareholder.

- C corporations with little or no built-in gain or with sufficient net operating losses (NOLs) that offset any gain recognized under IRC §336 on the deemed liquidation of the corporation if (a) the fair market value of the corporation's assets do not exceed the shareholders' tax bases in the shares or (b) the shareholders have capital loss carryovers to offset the gain recognized from the deemed distribution under IRC §331.

NOTE: In general, for California tax purposes, only a portion of a net operating loss incurred in any income year is eligible for carryover, unless the taxpayer operates a new business or an eligible small business, as defined. The portion eligible for carryover is 65 percent for taxable years beginning on or after January 1, 2004. See Rev & T C §§17041, 17276-17276.6, 24416.1-24416.6, 25108, 25110.

Note further that the legislature suspended NOL carryovers for the 2008 and 2009 tax years. See §5.54.

- The shareholders intend the LLC to be taxed as a corporation for federal income tax purposes and the LLC makes a timely election to be taxed as a corporation on IRS Form 8832 under Treas Reg §301.7701-3(c). The conversion could then occur through a tax-free reorganization.
- An 80-percent-or-more-owned subsidiary of a C corporation merges into an LLC and the requirements of IRC §332(b) are met.

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§11.13 b. Special Situations: Converting S Corporations

The distribution of appreciated property to S corporation shareholders on liquidation of their shares results in a taxable gain to the corporation equal to the excess of the fair market value of the corporation's assets over the corporation's tax basis in the property. IRC §1371. If the S corporation has been an S corporation since its inception, gain is not subject to federal income tax at the S corporation level. Gain is passed through to the shareholders, resulting in a single tax at the shareholder level.

The S corporation issues are complicated if it has a C corporation history. It may have built-in gain (*i.e.,* gain that would have been recognized at the C corporation level if the corporation sold its assets before converting to an S corporation). The problem of built-in gain arises only if the S corporation converted to an LLC before the tenth anniversary of the change from a C corporation to an S corporation. In addition to the appreciation subject to the single level of tax, the corporation would recognize unrecognized built-in gain to the extent of the S corporation's income for its last taxable year. IRC §1374.

NOTE: For tax years beginning in 2009 or 2010, the 10-year "recognition period" has been shortened to 7 years, after which time no tax will be imposed on the net recognized built-in gain of an S corporation that liquidates or sells its assets after having converted from a C corporation.

The IRS could view the statutory conversion or merger of an S corporation into an LLC as either of the following:

- A liquidation of the corporation and distribution of the corporation's assets to its shareholders, followed by their contribution to the LLC; or
- A contribution of the corporation's assets to the LLC in exchange for LLC interests, which are then distributed to the shareholders in a liquidation distribution.

In IRS Letter Ruling 9543017, the IRS viewed a statutory merger of an S corporation into an LLC as a transfer by the corporation of its assets to the LLC in a nontaxable exchange for LLC interests under IRC §721, and then as a distribution of the LLC interests to the shareholder of the S corporation in complete liquidation of the corporation under IRC §331.

In IRS Letter Ruling 9636007, the IRS permitted an S corporation to convert to an LLC in a tax-free reorganization and retain its S corporation status, even though the LLC was not a corporation under local law. Although the LLC was treated as a corporation under former classification regulations, the same principle should apply to permit a converting S corporation to avoid a taxable distribution of appreciated property if the resulting LLC elects to be treated as a corporation under the current check-the-box regulations.

A discussion of the definition of built-in gain is beyond the scope of this chapter. Because of the complexity of these issues, counsel should consider consulting with tax counsel or an accountant.

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§11.14 c. Merger of Subsidiary Into LLC

In IRS Letter Ruling 9409014, no gain or loss was recognized by a parent corporation or its wholly owned subsidiary when the subsidiary merged into an LLC. The IRS ruled that the statutory merger of the subsidiary into the LLC under applicable state law will be treated as (1) a transfer by the subsidiary of its assets to the LLC in exchange for the LLC interests, followed by (2) a distribution of the LLC interests to the parent corporation in complete liquidation of the subsidiary under IRC §332. Under IRC §721, the deemed transfer of assets to the LLC did not result in a recognized gain or loss; under IRC §§332, 337, and 336(d)(3), no gain or loss was recognized for the parent corporation or the subsidiary on the deemed transfer of the LLC interests to the parent corporation on complete liquidation of the subsidiary.

Corporations may elect to be taxed as S corporations even if they have a wholly owned subsidiary. IRC §1361(b)(3)(A). The subsidiary must also elect to be treated as a qualified subchapter S subsidiary. IRC §1361(b)(3)(B)(ii).

The principles of IRS Letter Ruling 9409014 could be implemented to permit a "parent" corporation to be taxed as an S corporation for California tax purposes while preserving the separate entity of the subsidiary by causing the subsidiary to convert or merge into an LLC before the S election filing. Under IRS Letter Ruling 9409014, the merger of the subsidiary into an LLC could be tax free if the principles of IRC §§721, 332, and 337 are satisfied. Counsel should consult with qualified tax advisors before implementing any merger of subsidiaries into LLCs.

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§11.15 E. Securities Laws

If the LLC membership interest issued in a merger or conversion is a security, federal and state securities laws apply. See generally chap 12.

The definition of "security" found in federal law does *not* specifically include LLC membership interests. 15 USC §77b(a)(1). However, the interests may be classified as securities under the "investment contract" analysis found in *SEC v W. J. Howey Co.* (1946) 328 US 293, 90 L Ed 1244, 66 S Ct 1100. See §§12.12-12.17. If an LLC membership interest is treated as a security, the issuance of unregistered LLC interests violates the Securities Act of 1933 unless an exemption applies. See 15 USC §77c. See §§12.19-12.33 on federal exemptions.

LLC membership interests are securities under California law unless all members of the LLC are actively engaged in its management. Corp C §25019; see §§12.47-12.48. An LLC interest that is a security offered or sold in California must be "qualified" (the equivalent of "registration" under federal laws) with the Department of Corporations, unless an exemption from the qualifying requirements is available. On the available exemptions, see §§12.52-12.73.

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§11.16 1. General Partnerships

General partnership interests may or may not be securities under federal law. See *Matek v Murat* (9th Cir 1988) 862 F2d 720 (general partnership interest not found to be security); *Williamson v Tucker* (5th Cir 1981) 645 F2d 404 (general partnership interest found to be security). See also *Hocking v Dubois* (9th Cir 1989) 885 F2d 1449 (adopting *Williamson* test in Ninth Circuit). See §§12.13-12.15.

General partnership and LLC interests may or may not be securities under California law. See Corp C §25019. On when an LLC interest will be a security, see §§12.47-12.48.

If the converted or merged LLC membership interests are not securities, the conversion or merger can be effected by a statutory conversion or merger without a permit. See §12.34.

If the merged LLC membership interests are securities and the merging partnership interests are not securities, a merger can be viewed as an exchange of general partnership assets in exchange for LLC interests—a transaction more appropriately characterized as a Corp C §25110 issuer transaction and not a Corp C §25120 reorganization transaction. Hence, the transaction could be exempt if the requirements of Corp C §25102(f) are met. On the requirements of Corp C §25102(f), see §§12.55-12.66.

However, if interests received in an entity resulting from a statutory conversion are securities, the conversion is an "entity conversion transaction," which is considered a Corp C §25120 reorganization transaction. See Corp C §§25005.1, 25120. Consequently, the interests must be qualified or an exemption must be available. The exemption of Corp C §25103(h) generally would apply to the conversion if the transaction would have been exempt as an issuer transaction under Corp C §25102(f) (without giving effect to §25102(f)(3)). To satisfy the requirements of Corp C §25103(h), the general partnership interests must be subject to a state statute that provides for dissenters' rights (§25103(h)(1)(A)(iii)) or the transaction must be solely for the purposes of changing the partnership's state or form of organization (§25103(h)(1)(B)(i)).

A general partnership has dissenters' rights under Corp C §16909(e) and thus could come within the Corp C §25103(h)(1)(A) requirement. Under this alternative, the transaction must be approved by at least 75 percent of the membership interests and no more than 10 percent of the membership interests may vote against the transaction. Corp C §25103(h)(1)(A)(i)-(ii). The LLC is considered the same entity as the partnership "for all purposes" and thus may not represent a change in form of organization under Corp C §25103(h)(1)(B). Corp C §§16909(a), 17540.9(a).

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§11.17 2. Limited Partnerships

Limited partnership interests are generally presumed to be securities, under both federal and state securities laws, because limited partners are statutorily precluded from exercising significant control over the management of the entity. A private offering exemption under federal securities law will likely be available for the conversion if the limited partnership is not publicly held. 15 USC §77d(2). A statutory conversion is an "entity conversion transaction" and, if not exempted, the conversion must be qualified under California law. See Corp C §§25005.1, 25120. Changes to the rights, preferences, privileges, or restrictions accompanying a conversion from a limited partnership to an LLC constitute a "sale" and, if not exempted, the transaction must be qualified under California law.

Each of the possible methods of conversion may have different California securities law implications. Briefly, the issues are:

Statutory Conversion or Merger. For statutory conversions and mergers, the exemption of Corp C §25103(h) generally would apply. To qualify, the transaction must meet the requirements of a private placement transaction under Corp C §25102(f) (without giving effect to §25102(f)(3)). Either:

(a) It must be approved by at least 75 percent of the outstanding equity securities of both constituents; there may not be more than 10 percent dissenters; and each constituent entity must be subject to a law providing for dissenters' rights; or

(b) It must be solely for the purpose of changing the state or form of organization; all security holders of the same class must be treated equally or consent to inequal treatment; and holders of nonredeemable voting equity securities must receive nonredeemable voting equity securities. Corp C §25103(h)(1)(A)-(B). A limited partnership has dissenters' rights under Corp C §§15911.20-15911.33 and thus could come within the Corp C §25103(h)(1)(A) requirement.

LLC Holding Company. This structure does not meet the exact definition of a reorganization under Corp C §25120 and is probably better characterized as an issuer transaction under Corp C §25110. It would appear that the policy behind the protections afforded by the permit application process is unwarranted in this transaction because any one partner could prevent the conversion under this method by declining to transfer its partnership interest to the LLC. Alternatively, it could be considered an exchange of securities by the issuer exclusively with its existing security holders under 10 Cal Code Regs §260.103. In either case, the transaction should be exempt if it meets the private-placement requirements of Corp C §25102(f).

Liquidation and Recontribution. This transaction should be viewed as an issuer transaction under Corp C §25110 and subject to the private-placement exemption under Corp C §25102(f). A step-transaction argument could be applied to make the reorganization provisions of Corp C §25120 applicable, but the same step-transaction argument should make the provisions of 10 Cal Code Regs §260.103 available as discussed above.

Drop Down to LLC. Membership interests would be issued to the partnership in an exempt issuer transaction under Corp C §25102(f) and the issuance of the interests, which ultimately reach the partners, could either be an issuer transaction in which the partners of the partnership would be treated as the real offerees or, alternatively, an issuer transaction followed by an exchange of securities with existing security holders under 10 Cal Code Regs §260.103.

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§11.18 3. Corporations

An ownership interest in a corporation is a security under federal and state law. 15 USC §77b(a)(1); Corp C §25019. The issue of compliance with securities laws is therefore similar to the analysis triggered by a limited partnership's conversion to an LLC. See §11.17.

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§11.19 F. Sales and Use Taxes

Any transfer of substantially all of the property of a business is exempt from sales and use tax if the real or ultimate ownership of the property is substantially similar before and after the transfer. Rev & T C §§6006.5(b), 6367. Corporate statutory mergers are categorically exempt under 18 Cal Code Regs §1595(b)(3). Other transfers are exempt if 80 percent or more of the property of the business is transferred and 80 percent or more of the ownership is unchanged by the transfer. 18 Cal Code Regs §1595(b)(2).

A contribution of assets to a newly formed partnership or corporation in exchange only for an interest in the newly formed entity generally will not result in the imposition of sales tax. A sales tax could result, however, if the new LLC receives tangible personal property subject to debt and the LLC assumes the liabilities. See 18 Cal Code Regs §1595(b)(4); *Beatrice Co. v State Bd. of Equalization* (1993) 6 C4th 767, 25 CR2d 438 (formation of wholly owned subsidiary that received certain assets of parent corporation subject to debt triggered taxable sale to extent of debt attributable to tangible personal property transferred). This would not be the case in a statutory conversion of a corporation or partnership into an LLC, because the entity that converts into an LLC is treated as the same entity. Corp C §§1158, 15911.09, 16909(a).

On sales and use taxes, see §§4.26-4.29.

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§11.20 G. Real Property Transfer Taxes

Cities and counties in California may impose a tax on the transfer of real property. Rev & T C §11911. The county tax is known as a documentary transfer tax and is levied at the rate of $1.10 per $1000 of equity of the real property transferred. Many cities have conveyance taxes, which have their own unique rules and are levied generally at much higher rates than the county documentary transfer tax. The transfer of real property without consideration is exempt from real property transfer taxes. Most (but not all) counties in California, however, treat transfers to partnerships in exchange for partnership interests as "consideration" subject to transfer taxes.

A merger of two or more partnerships does not cause a termination of a partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership. IRC §708(b)(2)(A). The same rule should apply to a merger of a partnership and an LLC. See Rev Rul 95-37, 1995-1 Cum Bull 130; §11.5. If a partnership or other entity treated as a partnership for federal income tax purposes is terminated within the meaning of IRC §708, it is liable for transfer tax. If the partnership converting to an LLC (whether by merger or otherwise) is *not* treated as terminated within the meaning of IRC §708 and the LLC is taxed as a partnership for federal income tax purposes, arguably no county or city transfer taxes should be imposed on California real property as a result of the conversion. This position was adopted by the legislature with respect to county documentary transfer taxes. Rev & T C §11925(a).

The legislature has further exempted from county documentary transfer taxes transfers between legal entities that result solely in a change in the method of holding title and in which the proportional ownership interests remain the same immediately after the transfer. Rev & T C §11925(d).

To reduce the likelihood of rejection by the county recorder of a real property deed that does not state transfer taxes, any deed of conveyance from a partnership or corporation to an LLC recorded to change the title to the name of the LLC should contain a recital stating that no transfer tax is due because the grantee is treated as a continuing partnership within the meaning of IRC §708 and Rev & T C §11925(a) or because the transfer is treated as only a change in the method of holding title under Rev & T C §11925(d).

A statutory conversion of a partnership or corporation into an LLC should not result in the imposition of real property transfer taxes. The conversion statutes provide that an entity that converts to another entity in a statutory conversion is for all purposes the same entity that existed before the conversion. Corp C §§1158, 15911.09(a), 16909(a), 17540.9(a).

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H. Property Tax Reassessment

§11.21 1. When Real Property Is Reassessed

Real property is reassessed for tax purposes if there is a change in ownership as defined in Rev & T C §§60-69.5. See Cal Const art XIIIA, §2(a). Real property owned by a corporation will be reassessed even in tax-free corporate reorganizations under IRC §368 unless all the corporations participating in the reorganization are members of an affiliated group. Rev & T C §64(b).

However, conversion of partnership or corporate interests to LLC membership interests, so that the partners or shareholders retain the same economic percentage interests after the conversion, is deemed to be a change only in the *method* of ownership, and the conversion would not be considered a change of ownership causing a reassessment of real property owned by the partnership or corporation. Rev & T C §62(a); 18 Cal Code Regs §462.180(d)(2). This result parallels county assessors' offices' treatment of conversions of general partnerships into limited partnerships.

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§11.22 2. Exception to General Rule

The purchase or transfer of interests in a partnership or LLC generally will not constitute a transfer of the real property held by that entity. Rev & T C §64(a). That real property will be reassessed, however, if either a person or legal entity obtains more than a 50-percent capital and profits interest in the LLC through the purchase or transfer of ownership interests (Rev & T C §64(c)(1); 18 Cal Code Regs §462.180(d)(1)); or property is transferred to a partnership, LLC, or corporation in a transaction excluded from reassessment under Rev & T C §62(a), and cumulatively more than 50 percent of the total interests in the partnership, LLC, or corporation are transferred by the original co-owners in one or more transactions (Rev & T C §64(d); 18 Cal Code Regs §462.180(d)(2)). There is no change of ownership when the owner of a majority interest in a partnership obtains all of the remaining interests, subject to application of the step-transaction doctrine. Rev & T C §64(c)(2).

A partnership is not subject to the cumulative 50-percent transfer rule if either (a) it was formed and acquired real property (that did not result in a reassessment) before March 1, 1975, or (b) it was formed after March 1, 1975, and the real property acquired by the partnership was subject to a reassessment (*e.g.,* the partnership purchased the real property) as a result of Rev & T C §62(a). When a person obtains more than 50-percent interest in the partnership, however, the partnership's real property can be reassessed. To avoid this result, the conversion may have to be creatively restructured.

For conversions of general partnerships to limited partnerships, at least one county assessor has taken the position that if the general partnership was not subject to the cumulative 50-percent transfer rule (because it acquired the real property before March 1, 1975, or the acquisition of the real property resulted in a reassessment), the conversion to a limited partnership would be treated as a contribution to a new entity that does not result in a reassessment. In the future, however, the real property owned by the limited partnership at the time of conversion will be subject to reassessment if cumulatively more than 50 percent of the total interests in the limited partnership are transferred by the original co-owners in one or more transactions. The same analysis could apply to the conversion of a partnership to an LLC.

NOTE: Counsel should not convert a partnership to an LLC without considering the effect of losing the exemption from the cumulative 50-percent transfer rule if the partnership owns real property with assessed values less than fair market values. A conversion of a general partnership to an LLC may, however, not subject the entity to the current 50-percent transfer rule if a statutory conversion is used. This is because it is treated as the same entity for all purposes and there is no "transfer," which triggers the need for an exemption under Rev & T C §62(a)(2).

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§11.23 I. Franchise Tax Considerations

Conversion of an existing entity to an LLC requires the formation of an LLC and payment of the $800 franchise tax fee for the year. Rev & T C §§17941, 23153(d)(1). An LLC that was converted from a corporation or limited partnership is not entitled to a credit for the franchise tax that the corporation or limited partnership was required to pay when filing its final tax return. The corporation or limited partnership and the LLC each must pay franchise taxes for the year and file state tax returns.

A conversion of a corporation or limited partnership into an LLC, however, may not subject the entity to an additional tax if a statutory conversion is used, because it is treated as the same entity for all purposes.

To save duplicate franchise tax fees, practitioners not using a statutory conversion should consider converting a corporation or limited partnership to an LLC effective on the last day of the entity's taxable year.

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III. STATUTORY CONVERSIONS

§11.24 A. Acts Permit Conversion

The Beverly-Killea Limited Liability Company Act (Corp C §§17000-17655) permits an "other business entity," a "foreign other business entity," or a foreign LLC to convert into a California LLC if conversion is authorized by the statute under which the converting entity is organized. Corp C §17540.8. The California General Corporation Law (Corp C §§100-2319), the California Uniform Partnership Act of 1994 (RUPA) (Corp C §§16100-16962), and the Uniform Limited Partnership Act of 2008 (Corp C §§15900-15912.06) contain provisions authorizing corporations, general partnerships, and limited partnerships to convert to other business entities or foreign other business entities. The Beverly-Killea Act also permits an LLC to convert into an "other business entity," a "foreign other business entity," or a foreign LLC. Corp C §17540.2.

The conversion process enables a corporation, general partnership, limited partnership, or LLC to change its legal structure while not changing property ownership, contract rights and obligations, or relationships with creditors and debtors.

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§11.25 1. Conversion Entities

A limited partnership may convert into an "other business entity" (defined to include a corporation, general partnership, limited liability company, business trust, real estate investment trust, or an unincorporated association other than a nonprofit association), a "foreign other business entity," or a foreign limited partnership. Corp C §§15901.02(k)-(*l*), (u). An LLC may convert to an "other business entity" (defined to include a general partnership, a limited partnership, and a corporation), a "foreign other business entity," or a foreign limited liability company. Corp C §§17001(s), 17001(ac), 17540.2. A general partnership may convert into a limited partnership, limited liability company, corporation, or "foreign other business entity." Corp C §16902. A corporation may convert into a "domestic other business entity" (defined to include a general partnership, a limited partnership, and a limited liability company organized under the laws of the state of California). Corp C §§167.7, 1150-1151. Differences in the statutes are that a general partnership cannot convert to a general partnership even if the entities were formed in different states and that a domestic corporation may not convert into foreign other-business entities.

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§11.26 2. Conversion Prerequisites

The conversion of a California partnership or LLC can occur only if each of the partners or members of the converting entity receives a percentage interest in the profits and capital of the converted entity equal to that partner's or member's percentage interest in profits and capital of the converting entity. Corp C §§15911.02, 17540.2, 16902.

If the converting partnership or LLC is converting into a foreign entity, the conversion proceedings will be in accordance with the laws of the place of organization of the foreign entity and the conversion will become effective in accordance with that law. Corp C §§15911.05(b), 17540.5(b), 16905(b).

The conversion of a California corporation into a California partnership or LLC can occur only if (Corp C §1151(a)):

- Each share of the same class or series of the converting corporation will be treated equally with respect to any cash, rights, securities, or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share, unless all the shareholders of the class or series consent to be treated differently; and
- The nonredeemable common shares of the converting corporation will only be converted into nonredeemable equity securities of the converted entity, unless all of the shareholders of the class consent to a different arrangement.

The California General Corporation Law (Corp C §§100-2319) does not provide for the conversion of a California corporation into a foreign other-business entity.

A conversion into a California entity is allowed only if the law under which the converting entity is organized authorizes the entity to effect the conversion. Corp C §§1157(a), 15911.08(a), 17540.8(a), 16908(a).

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§11.27 B. Rights and Obligations on Conversion

Each of the conversion statutes provides that "[a]n entity that converts into another entity under this [article/chapter] is for all purposes the same entity that existed before the conversion." Corp C §§1158(a), 15911.09(a), 17540.9(a), 16909(a). When a conversion takes effect, all of the following apply (Corp C §§1158(b), 15911.09(b), 17540.9(b), 16909(b)):

- All rights and property, whether real, personal, or mixed, of the converting entity are vested in the converted entity.
- All debts, liabilities, and obligations of the converting entity continue as debts, liabilities, and obligations of the converted entity.
- All rights of creditors and liens on the property of the converting entity are preserved unimpaired and remain enforceable against the converted entity to the same extent as against the converting entity as if the conversion had not occurred.
- Any action or proceeding pending by or against the converting entity may be continued against the converted entity as if the conversion had not occurred.

A shareholder, partner, or member of a converting entity is liable for all obligations of the converting entity for which the partner or member was personally liable before the conversion. Corp C §§1158(c)(1), 15911.09(c)(1), 17540.9(c)(1), 16909(c)(1). Similarly, a shareholder, partner, or member of a converted entity remains liable for any obligations of the converting entity for which the shareholder, partner, or member was personally liable before the conversion. Corp C §§1158(d), 15911.09(d), 17540.9(d), 16909(d).

If a person enters into a transaction with a converted entity and reasonably believes at the time of the transaction that a shareholder, limited partner, or member is a general partner, the shareholder, limited partner, or member is liable for the obligation of the converted entity if the obligation arises within 90 days after the conversion takes effect. Corp C §§1158(e), 15911.09(e), 17540.9(e).

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§11.28 C. Plan of Conversion

A California converting entity must approve a plan of conversion, which includes (Corp C §§1152(a), 15911.03(a), 17540.3(a), 16903(a)):

- The terms and conditions of the conversion;
- The jurisdiction of organization of the converting and the converted entities;
- The name of the converted entity after conversion;
- The manner in which the interests of the converting entity will be converted into interests of the converted entity;
- The provisions of the governing documents of the converted entity, including the formation documents and any partnership agreement or operating agreement, to which the holders of the converted entity will be bound; and
- Any other details or provisions required by the law of the converted entity or desired by the parties.

An entity converting to a California entity must approve a plan of conversion or similar instrument as required under the law under which the converting entity is organized. Corp C §§1157(b), 15911.08(b), 17540.8(b), 16908(b).

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§11.29 1. Approval of Plan

The plan of conversion for a California converting limited partnership or limited liability company must be approved by all general partners and a majority in interest of each class of limited partners or by a majority in interest of the members, unless a greater or lesser approval is required by the partnership agreement or the operating agreement. However, if the limited partners or the members would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all limited partners or members, unless the plan provides that all limited partners or members will have dissenters' rights. Corp C §§15911.03(b), 17540.3(b).

If an LLC is converted into a general partnership or a general partnership is converted into a limited partnership, then, in addition, the plan of conversion must be approved by those members or partners who will become general partners. Corp C §§17540(c), 16903(c).

For a general partnership, the plan must be approved by the percentage of partners stated in the partnership agreement necessary to approve a conversion or, if the agreement is silent, by the percentage of partners required to amend the partnership agreement. If the conversion effects a change in the partnership agreement for which the partnership agreement requires a greater vote than is required to amend the agreement, the greater vote is required or, if the agreement is silent on the vote needed to amend the agreement, all partners must approve the plan of conversion. Corp C §16903(b). A partner of a converting general partnership who does not vote to approve a conversion and who does not agree to be a shareholder, partner, or member of the converted entity has the right to dissociate from the partnership. Corp C §16909(e).

The approval required for a conversion of a foreign entity into a California partnership or LLC is governed by the law under which the converting entity is organized. Corp C §§15911.08(c), 17540.8(c), 16908(c).

The plan of conversion for a California converting corporation must be approved by the board of the converting corporation and by the outstanding shares of each class of the converting corporation, unless the converting corporation is a close corporation, in which event the conversion must be approved by at least two-thirds of each class of outstanding shares of the converting corporation (except that the articles may provide for a lesser vote, but not less than a majority of the outstanding shares of each class). Corp C §1152(b).

If a corporation is converted into a partnership or LLC, then in addition the plan of conversion must be approved by each shareholder who would become a general partner or manager, unless the shareholders have dissenters' rights. Corp C §1152(c).

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§11.30 2. Dissenters' Rights

A statutory conversion is a "reorganization," which causes the dissenters' rights provisions of the LLC, limited partnership, and corporate conversion statutes to become applicable. Corp C §§1159, 15911.20-15911.33, 17600-17613. A partner in a general partnership may be entitled to dissociate from the partnership in the event of a conversion. Corp C §16909(e). The dissenters' rights for a statutory conversion are the same as for a statutory merger. See §11.61.

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§11.31 3. Form: Plan of Conversion for Converting Entity to LLC

▶ To download **Word** version, right click and choose *Save Target As*

▶ To download **WordPerfect** version, right click and choose *Save Target As*

11.31-1 Plan of conversion for converting entity to LLC

PLAN OF CONVERSION
FOR CONVERTING _ _[*NAME OF CONVERTING ENTITY*]_ _
TO _ _[*NAME OF LLC*]_ _

This Plan of Conversion is adopted on _ _[*date*]_ _**, to convert** _ _[*name of converting entity*]_ _ **("Converting Entity") to** _ _[*name of LLC*]_ _ **("Converted Entity").**

1. Converted Entity is a limited liability company organized under the laws of the state of California.

2. Converting Entity is a _ _[*corporation/limited partnership/general partnership*]_ _ **organized under the laws of the state of California.**

3. Converting Entity will be converted to Converted Entity.

[*Add if changing name of Converted Entity*]

[4.] On and after the effective date of this conversion, the name of Converted Entity will be _ _[*new name*]_ _**.**

[*Continue*]

[5.] Each outstanding _ _[*1-percent* _ _[*general/limited*]_ _ _ _[*partnership interest/unit/share*]_ _/1*-percent share of* _ _[*name of class of stock*]_ _]_ _ **in Converting Entity will be converted to a** _ _[*number*]_ _ **-percent membership interest in Converted Entity.**

[6.] The articles of organization of Converted Entity are attached as Exhibit _ _[*letter or number*]_ _**.**

[*Attach articles of organization*]

[7.] The operating agreement of Converted Entity is attached as Exhibit _ _[*letter or number*]_ _**.**

[*Attach operating agreement*]

[8.] The _ _[*shareholders/partners*]_ _ **of Converting Entity will, from time to time, when requested by the managers of Converted Entity, execute and deliver all further documents and instruments and take other further action necessary or desirable to carry out the intent and purposes of this Plan of Conversion.**

[*If effective date is delayed, add*]

[9.] This Plan of Conversion will become effective as of the later of _ _[*date*]_ _**, or the effective date of filing of the Certificate of Conversion in the Office of the Secretary of State of California.**

[*Continue*]

[10.] This Plan of Conversion has been duly approved by the _ _[*board and shareholders/partners*]_ _ **of Converting Entity as follows:** _ _[*specify*]_ _**.**

In witness whereof, the undersigned have caused this Plan of Conversion to be executed as of the date first set forth above.

Date: _ _ _ _ _ _ _ _[*NAME OF CONVERTING ENTITY*]_ _**,**
a California _ _[*corporation/limited partnership/general partnership*]_ _

By: __[*Signature*]__
Name: _ _[*Typed name*]_ _
Its: _ _[*President/General Partner*]_ _

Comment: The requirements for a plan of conversion are set forth in Corp C §§1152, 15911.03, 17540.3, 16903.

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§11.32 D. Statement or Certificate of Conversion

Once a plan of conversion has been approved, a California converting entity must file a statement of conversion or a certificate of conversion with the Secretary of State.

If a California entity is the converting entity, a statement of conversion is added to the articles of organization of a California converted LLC, the certificate of partnership of a California converted limited partnership, or the articles of incorporation of a California converted corporation. If the conversion is to a California general partnership, a statement of conversion is added to the entity's statement of partnership authority if one has been filed or, if no such filing has been made, a certificate of conversion is separately filed. However, if the converting entity is a general partnership that has not filed a statement of partnership authority, the converted entity is not required to file a statement of conversion. If the converted entity is a foreign entity, a certificate of conversion must be filed with the Secretary of State. Corp C §§1157(d), 15911.06(a), 16906(a), 17540.6(a).

The Secretary of State has adopted Forms LP-1A, LLC-1A, and GP-1A, which are organizational documents containing a statement of conversion to be used when the converted entity is a domestic limited partnership, a domestic LLC, or a domestic general partnership. Form CONV-1A is to be used when the converted entity is a foreign other business entity or a foreign general partnership. The Secretary of State's website (see this book's Directory) also makes available samples of articles of incorporation containing a statement of conversion when entities convert to a domestic corporation.

A statement or certificate of conversion contains the name and Secretary of State file number of the converting entity, a statement that the plan of conversion has been properly approved, and the form of organization of the converted entity. Corp C §§1155(b), 15911.06(b), 16906(a), 17540.6(b). A statement or certificate of a limited partnership or limited liability company must be signed by all general partners or managers unless a lesser number is provided in the certificate of limited partnership or the articles of organization or operating agreement of an LLC. Corp C §§15911.06(b), 17540.6(b). For a general partnership, the document must be signed by at least two partners. Corp C §16105(a). A statement or certificate of a corporation must be signed and verified by the chairman of the board, the president or any vice president, and by the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer. Corp C §§173, 1155(b). The statement or certificate of conversion of a foreign entity into a California corporation must contain a statement that the converting entity is authorized to effect the conversion by the laws under which it is organized. Corp C §1157(e)(3)(A). The statement or certificate, together with the appropriate filing fee, must be filed with the Secretary of State.

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§11.33 1. Effect of Filing Statement or Certificate of Conversion

Filing a certificate of conversion or an organizational document containing a statement of conversion with the Secretary of State has the effect of filing a certificate of dissolution or a certificate of cancellation of the converting entity; no other filing to dissolve the converting entity is required. Corp C §§1155(d), 15911.06(c), 17540.6(c), 16906(c). The filing of a certificate of conversion by a foreign entity is equivalent to a certificate of cancellation and automatic surrender of the right to transact intrastate business. Corp C §§1157(f), 15911.08(e), 17540.8(e), 16908(e). A copy of the certificate of conversion or organizational document containing a statement of conversion, certified by the Secretary of State, is conclusive evidence of the conversion of the converting entity. Corp C §§1153(b), 15911.04(b), 17540.4(b), 16904(b). On the effectiveness of a conversion, all shareholders, partners, or members of a converting entity, except those who exercise dissenters' rights or who dissociate, are deemed parties to any governing documents of the converted entity. Corp C §§1152(d), 15911.03(c), 17540.3(d), 16903(d).

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§11.34 2. Converted Entity Retains Tax Liabilities of Converting Entity

In general, when a business entity converts to an LLC, the surviving LLC is for all purposes the same entity that existed before the conversion. Corp C §§15911.09(a), 16909(a), 17540.9(a). See §11.27. Thus, all the debts, liabilities, and obligations of the converting entity continue as debts, liabilities, and obligations of the converted entity, including tax liabilities. Corp C §§15911.09(b)(2), 16909(b)(2), 17540.9(b)(2).

When a California corporation converts to a California LLC, the converted entity is deemed to have assumed the liability of each disappearing domestic or foreign entity for the obligation to do the following (Corp C §1155(e)):

- To prepare and file, or cause to be prepared and filed, tax and information returns otherwise required of the disappearing entities; and
- To pay any tax liability determined to be due.

NOTE: The former requirement of filing a tax clearance certificate has been eliminated. See former Rev & T C §23334; see also former Corp C §1155(e) before amendment in 2006; Corp C §§1905(b), 1905.1.

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§11.35 3. Recording Certified Evidence of Conversion When Converted Entity Owns California Real Estate

If an entity that owns California real estate converts to another entity and the law of the state of organization of that entity provides substantially that the conversion vests in the converted entity all of the real property of the converting entity, certified evidence of the conversion can be recorded in the county in which the real estate is located. The filing will evidence record ownership in the converted entity of all interest of the converting entity in the real property located in the county of filing. Corp C §§1156(a), 15911.07(a), 16907(a), 17540.7(a). In addition, this filing creates, in favor of a bona fide purchaser or encumbrancer for value, a conclusive presumption that the conversion was validly completed. Corp C §§1156(c), 15911.07(c), 16907(c), 17540.7(c).

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§11.36 4. Notifying Creditors of Conversion

A member of a converted limited liability company or a partner of a limited partnership is liable for obligations incurred by the converted entity within 90 days of the effective date of the conversion, if the other party to the transaction reasonably believed that the member or partner is a general partner. Corp C §§15911.09(e), 17540.9(e).

In the case of a converted corporation, a shareholder who was a general partner of the converting partnership is liable for obligations incurred within 90 days of the conversion if the other party reasonably believes the shareholder continues to be a general partner. Corp C §1158(e). In addition, a converted corporation is required to give written notice of the conversion within 90 days of the conversion to all known creditors and claimants of the converting entity. Corp C §1158(f). Failure to comply with the notice requirement for converted corporations carries no penalties, and there is no similar notice requirement for converted limited liability companies or limited partnerships.

NOTE: The effect of these provisions is to encourage but not require notice of the conversion to persons who have done business with converted entities. The wise approach is to give notice to avoid any liability for transactions entered into during the 90-day period following the conversion.

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Source: Business Law/Forming and Operating California Limited Liability Companies/11 Conversions and Mergers/ §11.37 5. Form: Limited Liability Company Articles of Organization--Conversion (Secretary of State Form LLC-1A)

§11.37 5. Form: Limited Liability Company Articles of Organization—Conversion (Secretary of State Form LLC-1A)



LLC-1A File # _____

State of California
Secretary of State

Limited Liability Company
Articles of Organization - Conversion

IMPORTANT — Read all instructions before completing this form.

This Space For Filing Use Only

Converted Entity Information

1. NAME OF LIMITED LIABILITY COMPANY (End the name with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively.)

2. THE PURPOSE OF THE LIMITED LIABILTY COMPANY IS TO ENGAGE IN ANY LAWFUL ACT OR ACTIVITY FOR WHICH A LIMITED LIABILITY COMPANY MAY BE ORGANIZED UNDER THE BEVERLY-KILLEA LIMITED LIABILITY COMPANY ACT.

3. THE LIMITED LIABILITY COMPANY WILL BE MANAGED BY (Check only one)

☐ ONE MANAGER ☐ MORE THAN ONE MANAGER ☐ ALL LIMITED LIABILITY COMPANY MEMBER(S)

4. MAILING ADDRESS OF THE CHIEF EXECUTIVE OFFICE | CITY | STATE | ZIP CODE

5. NAME OF AGENT FOR SERVICE OF PROCESS (Item 5: Enter the name of the agent for service of process. The agent may be an individual residing in California or a corporation that has filed a certificate pursuant to California Corporations Code section 1505. Item 6: If the agent is an individual, enter the agent's business or residential address in California. Item 7: If the converting entity is a California limited partnership, enter the mailing address of the individual or corporate agent. Check the box and omit the mailing address if the agent's mailing address is the same as the address in Item 6.)

6. **IF AN INDIVIDUAL**, ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CA | CITY | STATE **CA** | ZIP CODE

7. MAILING ADDRESS OF AGENT FOR SERVICE OF PROCESS | CITY | STATE | ZIP CODE

☐ THE MAILING ADDRESS OF THE AGENT FOR SERVICE OF PROCESS IS THE SAME AS THE AGENT'S BUSINESS OR RESIDENTIAL ADDRESS IN ITEM 6.

Converting Entity Information

8. NAME OF CONVERTING ENTITY

9. FORM OF ENTITY	10. JURISDICTION	11. CA SECRETARY OF STATE FILE NUMBER, IF ANY

12. THE PRINCIPAL TERMS OF THE PLAN OF CONVERSION WERE APPROVED BY A VOTE OF THE NUMBER OF INTERESTS OR SHARES OF EACH CLASS THAT EQUALED OR EXCEEDED THE VOTE REQUIRED. IF A VOTE WAS REQUIRED, PROVIDE THE FOLLOWING FOR EACH CLASS:

STATE THE CLASS AND NUMBER OF OUTSTANDING INTERESTS ENTITLED TO VOTE **AND** THE PERCENTAGE VOTE REQUIRED OF EACH CLASS

Additional Information

13. ADDITIONAL INFORMATION SET FORTH ON THE ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE A PART OF THIS CERTIFICATE.

14. I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT THE FOREGOING IS TRUE AND CORRECT OF MY OWN KNOWLEDGE. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

_____
DATE

_____ _____
SIGNATURE OF AUTHORIZED PERSON TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

_____ _____
SIGNATURE OF AUTHORIZED PERSON TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

Print

Instructions for Completing the Articles of Organization - Conversion (Form LLC-1A)

Where to File: For easier completion, this form is available on the Secretary of State's website at www.sos.ca.gov/business/be/forms.htm and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814 or delivered in person (drop off) to the Sacramento office. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Legal Authority: Statutory provisions for conversion purposes are found in the California Corporations Code commencing with sections 1150, 15911.01, 16901 and 17540.1. All statutory references are to the California Corporations Code, unless otherwise stated. **Note:** If the converting entity is a domestic (California) limited partnership, signing Form LLC-1A constitutes an affirmation under penalty of perjury that the facts stated in the document are true. (Section 15902.08(b).)

- Form LLC-1A may be used for the following conversions: Any California or foreign corporation, foreign limited liability company, California or foreign limited partnership, California or foreign general partnership, or foreign other business entity converting into a California limited liability company.
- The conversion may be effected ONLY if: (1) the state laws of the converting entity and converted entity expressly permit the formation of that converted entity pursuant to a conversion; and (2) the conversion complies with all other applicable California and foreign laws.

Professional Services: Pursuant to Section 17375, a California limited liability company may not render professional services, as defined in Sections 13401(a) and 13401.3. Professional services are defined as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act. If your business is required to be licensed, certified or registered, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional. For licensing requirements in the state of California, please refer to the CalGold website at www.calgold.ca.gov or the California Department of Consumer Affairs website at www.dca.ca.gov.)

Fees: If a California corporation is the converting entity, the filing fee is $150.00. For all other conversions, the filing fee is $70.00. A $15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at www.sos.ca.gov/business/be/service-options.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

Copies: The Secretary of State will certify up to two copies of the filed document(s) without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified with payment of $8.00 per copy.

Minimum Tax Requirement: Filing this document shall obligate most limited liability companies to pay an annual minimum tax of $800.00 to the Franchise Tax Board pursuant to California Revenue and Taxation Code section 17941.

Complete the Limited Liability Company Articles of Organization – Conversion (Form LLC-1A) as follows:

Item 1. Enter the name of the limited liability company. The name must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks. (Sections 17051 and 17052.)

Item 2. This statement is required by statute and should not be altered. Provisions limiting or restricting the business of the limited liability company may be included as an attachment. (Section 17051.)

Item 3. Check the appropriate provision indicating whether the limited liability company is to be managed by one manager, more than one manager, or all the limited liability company member(s). (Section 17051.)

Item 4. If the converting entity is a California limited partnership, enter the mailing address, including the zip code, of the chief executive office of the limited liability company. (Section 15911.06.) Please do not abbreviate the name of the city.

Item 5. Enter the name of the agent for service of process in California. (Section 17061.) An agent is an individual, whether or not affiliated with the limited liability company, who resides in California or a corporation designated to accept service of process if the limited liability company is sued. The agent should agree to accept service of process on behalf of the limited liability company prior to designation. If a corporation is designated as agent, that corporation must have previously filed with the California Secretary of State, a certificate pursuant to California Corporations Code section 1505. Note: **A limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the California Secretary of State.

Item 6. If the designated agent for service of process is an individual, enter the agent's business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. (Section 17061.) Do not complete Item 6 if the agent is a corporation.

Item 7. If the converting entity is a California limited partnership, enter the mailing address, including the zip code, of the designated agent for service of process. **Note:** The mailing address is required whether the designated agent is an individual or a corporation. (Section 15911.06.) **If the designated agent is an individual**, check the box and omit the mailing address if the agent's mailing address is the same as the business or residential address in Item 6.

Item 8. Enter the exact name of the converting entity.

Item 9. Enter the form of the converting entity (i.e., limited partnership, corporation, etc.)

Item 10. Enter the jurisdiction (state or country) in which the converting entity was formed or organized.

Item 11. Enter the file number issued to the converting entity by the California Secretary of State, if any.

Item 12. This statement is required by statute and should not be altered. If a vote was required pursuant to the applicable law, specify the class and the number of outstanding interests of each class entitled to vote on the conversion and the percentage vote required for each class. Attach additional pages, if necessary.

Item 13. Attach any other information to be included in the Articles of Organization of the converted entity, provided that the information is not inconsistent with law. Also, attach additional conversion information required by the laws of the state of the converting entity, if any.

Item 14. Form LLC-1A must be signed as required by the applicable statutes, as follows:

- **If the converting entity is a California corporation**: Form LLC-1A must be signed and acknowledged by the chairman of the board, the president or any vice president AND the secretary, the chief financial officer, the treasurer or any assistant secretary or assistant treasurer. (Section 1155(b).)
- **If the converting entity is a California limited partnership:** Form LLC-1A must be signed and acknowledged by all general partners, unless a lesser number is provided in the Certificate of Limited Partnership. (Section 15911.06(b).)
- **If the converting entity is a California general partnership:** Form LLC-1A must be signed under penalty of perjury by at least two partners. (Section 16105(c).)
- **If the converting entity is a foreign other business entity,** Form LLC-1A must be signed according to the laws of the foreign jurisdiction.

If additional signature space is necessary, the signatures may be made on an attachment to Form LLC-1A.

Any attachments to Form LLC-1A are incorporated by reference and made part of Form LLC-1A. All attachments should be 8 ½" x 11", one-sided and legible.

Note: A Statement of Information (Form LLC-12) is required to be filed with the Secretary of State **within 90 days of filing Form LLC-1A and biennially thereafter** during the applicable filing period. The applicable filing period is the calendar month during which Form LLC-1A was filed and the immediately preceding five calendar months. (California Corporations Code section 17060.) Form LLC-12 is available on the Secretary of State's website at www.sos.ca.gov/business/be/statements.htm and can be viewed, filled in and printed from your computer.

Print

Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 95814

Business Entities
(916) 657-5448

LIMITED LIABILITY COMPANIES

California Tax Information

Registration of a limited liability company (LLC) with the California Secretary of State (SOS) will obligate an LLC that is not taxed as a corporation to pay to the Franchise Tax Board (FTB) an annual minimum tax of $800.00 and a fee based on the annual total income of the entity. The tax and fee are required to be paid for the taxable year of registration and each taxable year, or part thereof, until a Certificate of Cancellation is filed with the SOS. (California Revenue and Taxation Code sections 17941 and 17942.) An LLC is not subject to the taxes and fees imposed by Revenue and Taxation Code sections 17941 and 17942 if the LLC did no business in California during the taxable year and the taxable year was 15 days or less. (California Revenue and Taxation Code section 17946.)

An LLC that is taxed as a corporation generally determines its California income under the Corporation Tax Law commencing with California Revenue and Taxation Code section 23001.

PLEASE NOTE: A domestic nonprofit LLC is a taxable entity and subject to the tax requirements stated above unless the LLC has applied for tax-exempt status and the FTB determines the LLC qualifies for tax-exempt status. Therefore, until such a determination is made, a nonprofit LLC must file a return and pay the associated tax (and, if applicable, the fee) every year until the LLC is formally cancelled. If the LLC intends to seek tax exempt status:

- At the time of filing its Articles of Organization with the SOS, the LLC must include, in an attachment to that document, additional statements as required by the law under which the LLC is seeking exemption. Please refer to the FTB's Exemption Application Booklet (FTB 3500 Booklet) for information regarding the required statements and for suggested language.
- After filing its Articles of Organization with the SOS, the LLC may apply for tax-exempt status by mailing an Exemption Application (Form FTB 3500), along with an endorsed copy of the Articles of Organization and all other required supporting documentation, to the FTB, P.O. Box 942857, Sacramento, California 94257-4041.
- The FTB 3500 Booklet and Form FTB 3500 can be accessed from the FTB's website at www.ftb.ca.gov or can be requested by calling the FTB at 1-800-338-0505. For further information regarding franchise tax exemption, refer to the FTB's website or call the FTB at (916) 845-4171.

For further information regarding franchise tax requirements, please contact the FTB at:

From within the United States (toll free) .....(800) 852-5711
From outside the United States (not toll free) .....(916) 845-6500
Automated Service - From within the United States (toll free) .....(800) 338-0505
Automated Service - From outside the United States (not toll free).....(916) 845-6600

Professional Services Information

A domestic or foreign LLC may not render professional services. (Corp. Code § 17375.) "Professional services" are defined in California Corporations Code sections 13401(a) and 13401.3 as:

> Any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act.

If your business is required to be licensed, registered or certified, it is recommended that you contact the appropriate licensing authority before filing with the SOS's office in order to determine whether your services are considered professional.

Comment: Effective October 2, 2006, the Secretary of State expanded its preclearance and expedited filing services

to include all business entity documents filed under the Corporations Code, Financial Code, or Insurance Code. These services were previously offered only for specified corporate documents. They are now available for all corporate, LLC, and limited partnership documents, including interspecies mergers and conversions, and for all other documents filed by other entity types. See §§7.25-7.27 for further details.

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§11.38 E. Effective Date of Conversion

The conversion of a California entity becomes effective on the required approval of the shareholders, partners, or members of the converting entity, the filing of all documents required to create the converted entity (including a statement of conversion, if required), and the occurrence of the effective date if set forth in the plan of conversion. Corp C §§1157(d), 15911.04(a), 17540.4(a), 16904(a). The conversion of a foreign entity into a California partnership or LLC becomes effective at the time the conversion is effective under the laws under which the converting entity is organized as long as a certificate of limited partnership containing a statement of conversion has been filed with the Secretary of State. Corp C §§15911.08(d), 17540.8(d), 16908(d). The conversion of a foreign entity into a California corporation becomes effective on the filing with the Secretary of State of the articles of incorporation of the converted corporation containing a statement of conversion. Corp C §1157(d). See §11.32.

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§11.39 F. Securities Law Compliance

If the LLC membership interests to be received in the statutory conversion are securities, the conversion is an "entity conversion transaction" and, if not exempted, the conversion must be qualified under California law. See Corp C §§25005.1, 25120. However, most statutory conversions will be exempted under Corp C §25103(h). See §§11.15-11.18.

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§11.40 G. Abandonment of Conversion

After a conversion has been approved, the parties may abandon the conversion before it is effective, subject to the contractual rights of third parties, if the converting entity obtains approval by the partners in the same manner as required for approval of the original plan of conversion. Corp C §§1152(f), 15911.03(e), 17540.3(f), 16903(f).

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IV. STATUTORY MERGERS

§11.41 A. Acts Permit Merger

The Beverly-Killea Limited Liability Company Act (Corp C §§17000-17655) permits the following entities to be merged (Corp C §17550(a)):

- Two or more LLCs into one LLC;
- One or more LLCs and one or more other business entities into one of those other business entities; and
- One or more LLCs and one or more other business entities into one LLC.

However, the merger of any number of LLCs with any number of other business entities may be made only if the other business entities that are organized in California are authorized by the laws under which they are organized to effect the merger. Corp C §17550(b).

When an LLC is the survivor of the merger, any constituent foreign other business entities must not be barred by the laws under which they are organized from effecting the merger. Corp C §17550(b)(1).

When a foreign LLC or foreign other business entity is the survivor, the laws of the jurisdiction under which the survivor is organized must authorize that merger. Further, if one or more domestic corporations are also a party to the merger, the merger may be made only if, with respect to any foreign other business entity that is a corporation, the foreign corporation is authorized by the laws under which it is organized to effect that merger. Corp C §17550(b)(2).

California law authorizes general partnerships, limited partnerships, corporations, and LLCs to take part in such a merger. Corp C §§1113(a), 15911.10, 15911.11, 16910, 17550(a). Accordingly, a partnership or corporation can be converted to an LLC by first forming a new LLC and then merging the partnership or corporation into the LLC by following the Beverly-Killea Limited Liability Company Act's merger procedures. Corp C §§17550-17556. The outstanding equity of the converting entity is automatically converted to membership interests of the LLC or such other property as is provided in the agreement of merger.

NOTE: The Act's streamlined merger procedures are generally superior to other, nonstatutory conversion methods because the Act permits a limited partnership, general partnership, or corporation to merge into a domestic LLC without filing dissolution documents, distributing its assets to its partners or shareholders, and having the partners or shareholders contribute those assets to the LLC. Corp C §§1113(i)(1), 15911.04(c), 16915(c), 17552(c).

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§11.42 B. Documenting the Merger

A merger of a domestic partnership or corporation into an LLC under the Beverly-Killea Limited Liability Company Act's merger provisions must be documented and approved in the following manner:

- The parties must execute an agreement of merger containing the terms and conditions of the proposed merger and the manner and basis of converting the interests in the partnership to membership interests in the LLC. See §§11.45-11.50.
- The merger must be approved by each constituent entity. See §§11.51-11.54.
- The parties must file a certificate of merger executed by each constituent entity. See §§11.55-11.57.
- The parties may be required to provide persons who object to the merger with dissenters' rights. See §11.61.

A foreign LLC or foreign other business entity may be converted into a domestic LLC only if the converting entity is authorized by the laws under which it is organized to effect the conversion. Corp C §17540.8(a). If the surviving entity is a foreign LLC or foreign other business entity, the merger proceedings may be conducted in accordance with the laws of the state or place of organization of the survivor, subject to California's reorganization approval and dissenters' rights requirements. Corp C §17555(b).

NOTE: Before proceeding with the merger, the practitioner should review the parties' loan documents, licenses, and other contracts to verify that the merger will not cause a breach or violation of those instruments. If the merger would pose a problem, the agreements must be amended or consents obtained before the merger occurs.

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§11.43 C. Rights and Obligations on Merger

On a statutory merger of LLCs or LLCs and other business entities, the separate existence of the disappearing LLCs and disappearing other business entities ceases. The surviving LLC (or surviving other business entity) succeeds, without other transfer, act, or deed, to all the rights and property, whether real, personal, or mixed, of each of the disappearing entities. Corp C §§16916, 17554(a), 17556. In addition, the survivor is subject to all the debts and liabilities of each disappearing entity in the same manner as if the surviving LLC (or surviving other business entity) had itself incurred them. Corp C §§1113(i)(1), 15911.16(a), 16914(a)(1), 17554(a). In addition, following a merger all of the following apply:

- All rights of creditors and liens on the property of the merging entity are preserved unimpaired, provided that the liens are limited to the property affected immediately before the effective date of the merger. Corp C §§1113(i)(2), 15911.16(b), 16914(a)(2), 17554(b).
- Any pending litigation involving a disappearing business entity may be prosecuted to judgment, and the LLC may be proceeded against or substituted in the place of the disappearing business entity. Corp C §§1113(i)(3), 15911.16(c), 16914(a)(3), 17554(c).

NOTE: Although the debts and liabilities of the LLC and other constituent business entities to the merger become the debts and liabilities of the surviving LLC, the liability of a general partner for debts and liabilities of a disappearing partnership or limited partnership existing before the merger is not affected. Corp C §§15911.16(d), 17554(d).

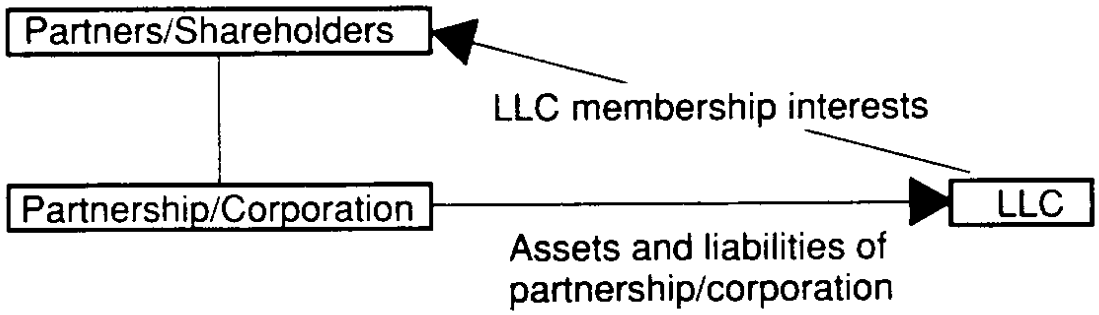
- The surviving LLC is deemed to have assumed the liability of each disappearing constituent entity to prepare and file information returns and pay any tax liability determined to be due. Corp C §17554.5(a). See §11.34.

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Source: Business Law/Forming and Operating California Limited Liability Companies/11 Conversions and Mergers/ §11.44 D. Diagram: Structure of Statutory Merger

§11.44 D. Diagram: Structure of Statutory Merger

Print



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E. Agreement of Merger

§11.45 1. Required Contents of Agreement

The agreement of merger must include the following information (Corp C §17551(a)):

- The terms and conditions of the merger;
- The name and place of incorporation or organization of each disappearing party to the merger;
- The name and place of incorporation or organization of the surviving LLC and any change of its name (see §§7.2-7.3 for restrictions on names of LLCs);
- The manner of converting interests, shares, or securities of the merging constituent entities into interests of the surviving LLC, or cash, property, rights, interests, or securities in addition to or in lieu of interests in the LLC (or a statement that the interests, shares, or securities are canceled without consideration);

NOTE: Shares of the same class of a disappearing corporation or interests of the same class in a disappearing partnership must be treated equally, unless all shareholders or partners of the class of interests not treated equally consent. Corp C §§1113(c), 15911.12(b), 17551(b).

- Any desired amendments to the surviving LLC's articles of organization or operating agreement (if the filed certificate of merger states the amendments to the articles of organization, the LLC need not file a certificate of amendment (Corp C §17552(a)(3));

NOTE: An agreement of merger may amend the operating agreement of a constituent LLC, or adopt a new operating agreement for a constituent LLC, if it is the surviving LLC in the merger. The amendment or adoption is effective at the effective time or date of the merger. If the articles of organization or the operating agreement require a greater majority to approve amendments to these documents than is required to approve the merger, that greater majority must consent for the amendments to be effective. See Corp C §17551(e).

- Any other provisions required by the laws under which any constituent other business entity is organized (see, *e.g.,* Corp C §§1113(b), 15911.02, 16911); and
- Any other desired provisions, including, without limitation, a provision for the treatment of fractional interests.

The agreement should also recite the vote required by the merging entity to approve the merger.

Generally, interests converted will equal interests received if the LLC is formed to convert an existing entity to an LLC. If economic and voting interests in the existing entity are bifurcated (*e.g.,* if an assignee of a partnership interest is not admitted as a substituted partner), the practitioner should consider whether the manner of converting interests may differ (*e.g.,* granting that assignee only an economic, but not membership, interest in the LLC).

A merger agreement entered into for the purpose of converting an existing entity to an LLC can be relatively simple. In an arm's-length transaction, however, counsel should consider including representations, warranties, and covenants concerning continued operations, indemnities, legal opinions, and tax opinions. Those provisions may also be stated in a related second agreement between the parties.

After execution, the agreement of merger must be kept at the California office at which the surviving LLC's records are maintained, and each holder of an interest in or shares of a party to the merger has the right to receive a copy of the agreement of merger on request. Corp C §17551(f).

See §§11.46-11.49 for forms of agreement of merger.

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§11.46 2. Form: Short-Form Agreement of Merger

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11.46-1 Short-form agreement of merger

AGREEMENT OF MERGER
BETWEEN _ _[*NAME OF LLC*]_ _
AND _ _[*NAME OF MERGING ENTITY*]_ _

This Agreement of Merger is entered into as of _ _[*date*]_ _**, between** _ _[*name of LLC*]_ _ **("Surviving LLC") and** _ _[*name of other entity*]_ _ **("Merging Entity").**

1. Surviving LLC is a limited liability company organized under the laws of the state of California.

2. Merging Entity is a _ _[*corporation/limited partnership/general partnership*]_ _ **organized under the laws of the state of California.**

3. Merging Entity will be merged into Surviving LLC.

[*Add if changing name of Surviving LLC*]

[4.] On and after the effective date of this merger, the name of Surviving Entity will be _ _[*new name*]_ _**.**

[*Continue*]

[5.] Each outstanding _ _[*1-percent partnership interest/unit/share*]_ _ **in Merging Entity will be converted to a** _ _[*number*]_ _ **-percent interest in Surviving LLC.**

[*Add if amending articles of organization*]

[6.] The articles of organization of Surviving LLC are amended as follows:

[*List amendments*]

[*Add if amending operating agreement*]

[7.] The operating agreement of Surviving LLC is _ _[*amended/amended and restated*]_ _ **as follows:**

[*List amendments*]

[*Continue*]

[8.] The _ _[*partners/officers and directors*]_ _ **of Merging Entity will, from time to time, as and when requested by Surviving LLC, execute and deliver all further documents and instruments and take other further action necessary or desirable to carry out the intent and purposes of this Agreement of Merger.**

[*If effective date delayed, add*]

[9.] This merger will become effective as of the later of _ _[*date*]_ _ **or the effective date of filing of the Certificate of Merger in the Office of the Secretary of State of California.**

[*Continue*]

[10.] This merger has been approved on behalf of Surviving LLC by _ _[*names*]_ _ **and on behalf of Merging Entity by** _ _[*names*]_ _**.**

In witness whereof, the undersigned have caused this Agreement of Merger to be executed as of the date

first set forth above.

_ _[*Name of LLC*]_ _,
a California limited liability company

By: _____
_ _[*Typed name*]_ _,
Its: Manager

_ _[*Name of corporation/ partnership*]_ _,
a _ _[*state*]_ _ _ _[*corporation/limited partnership/general partnership*]_ _

By: _____
_ _[*Typed name*]_ _,
Its: _ _[*Title*]_ _

By: _____
_ _[*Typed name*]_ _,
Its: _ _[*Title*]_ _

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§11.47 3. Form: Long-Form Agreement of Merger Between Limited Liability Company and General Partnership

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11.47-1 Long-form agreement of merger between LLC and general partnership

AGREEMENT OF MERGER
BETWEEN _ _[*NAME OF LLC*]_ _
AND _ _[*NAME OF GENERAL PARTNERSHIP*]_ _

This Agreement of Merger ("Agreement") is entered into as of _ _[*date*]_ _**, between** _ _[*name of LLC*]_ _**, a California limited liability company ("LLC"), and** _ _[*name of general partnership*]_ _**, a California general partnership ("Partnership").**

RECITALS

A. LLC is a limited liability company organized under the laws of the state of California that filed its articles of organization with the California Secretary of State on _ _[*date*]_ _**.**

B. Partnership is a general partnership formed under the laws of the state of California under an agreement of partnership entered into as of _ _[*date*]_ _**.**

C. The parties intend that Partnership merge with and into LLC (the "Merger") under the terms and conditions set forth in this Agreement and the applicable provisions of California law.

D. The parties desire to enter into this Agreement to set forth certain provisions relating to consummation of the Merger.

NOW, THEREFORE, in consideration of these premises and of the mutual provisions contained in this Agreement, the parties agree as follows:

ARTICLE I: DEFINITIONS

For purposes of this Agreement, the following terms will have the meanings specified:

1.1. "Certificate of Merger" will mean the certificate of merger in the form attached to this Agreement as Exhibit A.

1.2. "Closing" will mean the closing of the transactions contemplated by this Agreement.

1.3. "Corporations Code" will mean the California Corporations Code, as amended from time to time.

1.4. "Effective Date" will mean _ _[*the later of* _ _[*date*]_ _ *or*]_ _ **the date when the Certificate of Merger is properly filed with the California Secretary of State.**

[*Add if LLC will issue certificates of interest*]

[1.5.] "Exchange Agent" will mean _ _[*name*]_ _**.**

[*Continue*]

[1.6.] "LLC Percentage Interest" will mean the percentage share of a Membership Interest of LLC, as defined in the Operating Agreement.

[1.7.] "Operating Agreement" will mean that agreement dated _ _[*date*]_ _ among the Members (as defined in Corporations Code §17001(x)) of LLC.

[1.8.] "Partnership Percentage Interest" will mean _ _[*e.g., the percentage share of the profits, losses, distributions and rights, including voting and participation in management, of a partner of Partnership*]_ _.

[1.9.] "Surviving Entity" will mean LLC.

ARTICLE II: THE MERGER

2.1. *Closing.* The Closing will be held on a date agreed on by LLC and Partnership, but in no event more than five business days following satisfaction of all conditions precedent to the Merger specified in this Agreement. The Closing will be held at the offices of _ _[*company*]_ _, located at _ _[*address*]_ _, California at _ _[*time*]_ _ on that date, or at such other time and place as the parties may agree to in writing.

2.2. *Certificate of Merger*. Subject to the terms and conditions of this Agreement, at or before the Closing, Partnership and LLC will execute and deliver the Certificate of Merger. Within _ _[*number*]_ _ days after the Closing, _ _[*specify*]_ _ will deliver the Certificate of Merger, together with the filing fee, to the California Secretary of State for filing.

2.3. *Consequences of the Merger*. On the Effective Date:

(a) The Merger will become effective;

(b) The separate existence of Partnership will cease and Partnership will be merged with and into LLC as the Surviving Entity;

(c) The partners of Partnership will become Members of LLC;

[*Add one of the following alternatives*]

[*Alternative: Not member managed*]

(d) _ _[*The partners/name(s) of other persons or person*]_ _ will be the _ _[*managers/manager*]_ _ of LLC;

[*Alternative: Member managed*]

(d) The LLC will be managed by all the Members; and

[*Continue*]

(e) The Merger will have all the effects provided by applicable law, including without limitation Corporations Code §17554, which provides that:

(i) LLC will succeed to all the rights and property of Partnership, without any other transfer, act, or deed, and will be subject to all the debts and liabilities of Partnership in the same manner as if LLC incurred them; and

(ii) All rights of creditors and all liens on the property of Partnership will be preserved unimpaired, provided that those liens will be limited to the property affected immediately before the Effective Date.

2.4. *Further Acts After Effective Date*. If at any time after the Effective Date, LLC considers or is advised that any other actions or things are necessary or desirable (a) to vest, perfect, or confirm of record or otherwise in LLC its right, title, or interest in, to, or under any of the rights, properties, or assets of Partnership or (b) to otherwise carry out this Agreement, the Members of LLC are authorized, in the name and on behalf of Partnership, to execute and deliver all those things and to take and do all actions that may be necessary or desirable to vest, perfect, or confirm in LLC all rights, title, and interests in, to, and under those rights, properties, or assets or to otherwise carry out this Agreement.

ARTICLE III: ARTICLES OF ORGANIZATION AND OPERATING AGREEMENT

[*Add one of the following alternatives*]

[*Alternative: Not amending articles of organization*]

3.1. *Articles of Organization*. LLC's articles of organization in effect immediately before the Effective Date will be the articles of organization of Surviving Entity.

[*Alternative: Amending articles of organization*]

3.1. *Articles of Organization*. On the Effective Date, LLC's articles of organization will be amended as follows:

[*List amendments*]

[*Continue*]

[*Add one of the following alternatives*]

[*Alternative: Not amending operating agreement*]

3.2. *Operating Agreement*. The Operating Agreement will be the operating agreement of Surviving Entity.

[*Alternative: Amending operating agreement*]

3.2. *Operating Agreement*. On the Effective Date, the Operating Agreement will be amended as follows:

[*List amendments*]

[*Continue*]

ARTICLE IV: MANNER AND BASIS OF CONVERTING PARTNERSHIP INTERESTS

4.1. *Conversion of Equity Interests of Partnership*. As of the Effective Date, by virtue of the Merger and without any action on the part of any partner of Partnership:

(a) *Partnership Percentage Interests*. Each Partnership Percentage Interest outstanding immediately before the Effective Date will be converted to _ _[*number*]_ _ LLC Percentage Interests (the "Exchange Ratio"). If any Partnership Percentage Interests are varied between the date of this Agreement and the Effective Date, the Exchange Ratio will be appropriately adjusted.

(b) *Adjustment of Exchange Ratio*. If the outstanding Partnership Percentage Interests or LLC Percentage Interests are changed into a different number of interests or a different class by reason of any reclassification, recapitalization, split, combination, exchange, or readjustment between the date of this Agreement and the Effective Date, the Exchange Ratio will be correspondingly adjusted.

[*Add the following paragraph if LLC to issue certificates of interest*]

[4.2.] *Exchange of Certificates*.

(a) *Certificates of Interest*. Promptly after the Effective Date, LLC will make available to the Exchange Agent certificates of interest representing the LLC Percentage Interests issuable in exchange for outstanding Partnership Percentage Interests.

(b) *Exchange Procedures*. Each partner of Partnership who delivers an assignment of Partnership Percentage Interests to the Exchange Agent, _ _[*in the form reasonably prescribed by LLC/in substantially the form attached to this Agreement as Exhibit B*]_ _, may receive the LLC Percentage Interests to which he, she, or it is entitled under Section 4.1. After the Effective Date and until that delivery, each Partnership Percentage Interest will be deemed to represent the right to receive, on that delivery, the amount of LLC Percentage Interests as provided by this Agreement and the provisions.

[*Continue*]

ARTICLE V: CONDITIONS TO LLC'S OBLIGATIONS

All obligations of LLC under this Agreement are subject to the satisfaction, at or before the Closing, of each of the following conditions:

5.1. *Agreement*. The requisite partners of Partnership will have delivered to LLC duly executed copies of this Agreement and the Certificate of Merger.

5.2. *Consents and Approvals*. Partnership and LLC will have obtained all consents and approvals of third parties (including governmental authorities) required for Partnership and LLC to consummate the transactions contemplated by this Agreement, and no third party will have withdrawn from or suspended any material license, permit, or contractual right of Partnership.

5.3. *Partner Approval*. This Agreement and the transactions contemplated by this Agreement will have been approved by at least _ _[*number*]_ _ percent of the Partnership Percentage Interests entitled to vote on or consent in writing to the Merger.

5.4. *No Outstanding Options*. Immediately before the Closing, there will be no options, warrants, or other securities or agreements outstanding for the purchase of any interest in Partnership.

5.5. *Other Legal Requirements*. All statutory and other legal requirements for the valid consummation of the Merger will have been fulfilled, including without limitation all requirements regarding notice to creditors of the bulk transfers contemplated by this Agreement. No law or regulation will have passed or been enacted that would prevent the consummation of the transactions contemplated by this Agreement.

[*If LLC Percentage Interests are securities under California securities laws, add the following paragraph*]

[5.6.] *Securities Laws Compliance*. Unless otherwise exempt under Corporations Code §25103(h), the Commissioner of Corporations will have issued a permit qualifying the offer and exchange of LLC Percentage Interests.

[*Continue*]

ARTICLE VI: CONDITIONS TO PARTNERSHIP'S OBLIGATIONS

The obligations of Partnership under this Agreement are subject to the satisfaction, at or before the Closing, of the following conditions:

6.1. *Agreement*. The requisite Members of LLC will have delivered to Partnership duly executed copies of this Agreement and the Certificate of Merger.

6.2. *Member Approval*. This Agreement and the transactions contemplated by this Agreement will have been approved by at least __ _[*number*]_ _ percent of LLC Percentage Interests entitled to vote on or consent in writing to the Merger.

ARTICLE VII: TERMINATION AND ABANDONMENT OF REORGANIZATION

7.1. *Termination by Mutual Consent*. This Agreement may be terminated at any time before the Closing by the mutual written consent of Partnership and LLC.

7.2. *Termination by LLC*. LLC may terminate this Agreement at any time before the Closing by delivery of written notice to Partnership if Partnership has violated this Agreement in any material respect or the Closing has not occurred by _ _[*date*]_ _.

7.3. *Termination by Partnership*. Partnership may terminate this Agreement at any time before the Closing by delivery of written notice to LLC if LLC has violated this Agreement in any material respect or the Closing has not occurred by _ _[*date*]_ _.

7.4. *Effect of Termination*. If this Agreement is terminated under this Article VII:

(a) This Agreement will become void and of no further force or effect, with no liability or obligation on the

part of LLC or Partnership, except that nothing in this provision will relieve any party of any liability for willful breach of this Agreement;

(b) The Merger may be abandoned; and

(c) LLC and Partnership will each bear its own costs associated with this Agreement and all transactions contemplated by this Agreement.

[*If LLC Percentage Interests are securities under federal or California securities laws, add the following article*]

ARTICLE VIII: SECURITIES LAWS COMPLIANCE

[*Continue*]

[*If LLC Percentage Interests are securities under federal securities laws, add the following paragraphs*]

[8.1.] *Federal Securities Act Exemption*. The LLC Percentage Interests to be issued under this Agreement will not be registered under the Securities Act of 1933, in reliance on Securities Act of 1933 §4(2) or such other exemption as LLC and its counsel elect.

[8.2.] *Stock Restrictions*. In addition to any legend imposed by applicable state securities laws, the LLC Percentage Interests issued under this Agreement, whether represented by certificates or merely reflected in the Operating Agreement, will bear a restrictive legend stating:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THESE SECURITIES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE OFFERED, SOLD, TRANSFERRED, PLEDGED, OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT FOR THE SECURITIES UNDER THE SECURITIES ACT OF 1933 OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY, THAT REGISTRATION IS NOT REQUIRED UNDER SAID ACT.

[*Continue*]

[*If LLC Percentage Interests are securities under California securities laws, add the following paragraph*]

[8.3.] *State Securities Law Qualifications*. Unless otherwise exempt under Corporations Code §25103(h), the offer and exchange of LLC Percentage Interests under this Agreement will be qualified by the Commissioner of Corporations. LLC will be responsible, with the reasonable cooperation of Partnership, for preparing and filing with the Commissioner of Corporations an application for qualification of the offer and exchange of LLC Percentage Interests by permit under Corporations Code §25121 and §260.121 of the Rules of the California Commissioner of Corporations, codified at 10 Cal Code Regs §260.121.

[*Continue*]

ARTICLE [IX]: MISCELLANEOUS

[9.1.] *Headings*. The headings in this Agreement are included for convenience only and will affect neither the construction or interpretation of any provision in this Agreement nor any of the rights or obligations of the parties to this Agreement.

[9.2.] *Binding Nature*. This Agreement will be binding on and inure to the benefit of the parties to this Agreement.

[9.3.] *Applicable Law*. This Agreement will be governed by _ _[*e.g., California*]_ _ law, _ _[*excluding/including*]_ _ any laws that direct the application of another jurisdiction's laws. The parties will submit any dispute to the jurisdiction of the federal and state courts of _ _[*e.g., the state of California*]_ _. Venue will lie exclusively in _ _[*name*]_ _ County.

[9.4.] *Exhibits*. The exhibits attached to this Agreement by this reference are incorporated into and constitute a part of this Agreement.

In witness whereof, the undersigned have caused this Agreement of Merger to be executed as of the date first set forth above.

_ _[*Name of LLC*]_ _,
a California limited liability company

By: _____
_ _[*Typed name*]_ _,
Its: Manager

_ _[*Name of general partnership*]_ _,
a California general partnership

By: _____
_ _[*Typed name*]_ _,
Its: General Partner

By: _____
_ _[*Typed name*]_ _,
Its: General Partner

Comment: See §11.57 for Secretary of State Form OBE MERGER-1, Certificate of Merger, to be attached to this agreement as Exhibit A.

The Beverly-Killea Limited Liability Company Act does not specify who should sign the merger agreement. Presumably, it should be signed as any other contract. However, there should be some document, which need not be the agreement, in which each approving member and manager demonstrates approval of the merger.

If profit and loss allocations for the LLC are expressed as a percentage, there should not be any questions about fractional shares. If LLC units are issued instead of LLC percentage interests, the merger agreement can avoid the problem of fractional units by including in Article IV a provision similar to section 4.1(e) in the merger agreement between a limited partnership and a limited liability company set forth in §11.48.

Members of the LLC are entitled to dissenters' rights. Corp C §17601(a). See §11.61.

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§11.48 4. Form: Long-Form Agreement of Merger Between Limited Partnership and Limited Liability Company

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11.48-1 Long-form agreement of merger between limited partnership and LLC

AGREEMENT OF MERGER
BETWEEN _ _[*NAME OF LLC*]_ _
AND _ _[*NAME OF LIMITED PARTNERSHIP*]_ _

This Agreement of Merger ("Agreement") is entered into as of _ _[*date*]_ _**, between** _ _[*name of LLC*]_ _**, a California limited liability company ("LLC"), and** _ _[*name of limited partnership*]_ _**, a California limited partnership ("Partnership").**

RECITALS

A. LLC is a limited liability company organized under the laws of the state of California that filed its articles of organization with the California Secretary of State on _ _[*date*]_ _**.**

B. Partnership is a limited partnership organized under the laws of the state of California under the filing of a certificate of limited partnership with the California Secretary of State on _ _[*date*]_ _**.**

C. The parties intend that Partnership merge with and into LLC (the "Merger") under the terms and conditions set forth in this Agreement and the applicable provisions of the California law.

D. The parties desire to enter into this Agreement to set forth certain covenants relating to the consummation of the Merger.

NOW, THEREFORE, in consideration of these premises and of the mutual provisions contained in this Agreement, the parties agree as follows:

ARTICLE I: DEFINITIONS

For purposes of this Agreement, the following terms will have the meanings specified:

1.1. "Act" will mean the California Revised Limited Partnership Act, as amended from time to time.

1.2. "Certificate of Merger" will mean the certificate of merger in the form attached to this Agreement as Exhibit A.

1.3. "Closing" will mean the closing of the transactions contemplated by this Agreement.

1.4. "Corporations Code" will mean the California Corporations Code, as amended from time to time.

1.5. "Dissenting Limited Partnership Units" will mean Limited Partnership Units held by limited partners of Partnership who perfect their dissenters' rights under California law.

1.6. "Effective Date" will mean _ _[*the later of* _ _[*date*]_ _ *or*]_ _ **the date when the Certificate of Merger is properly filed with the California Secretary of State.**

[*If LLC will issue certificates of interest, add*]

1.7. "Exchange Agent" will mean _ _[*name*]_ _**.**

[*Continue*]

[1.8.] "General Partner Percentage Interest" will mean _ _[*e.g., the percentage share of the profits, losses, distributions and partners rights, including voting and participation in management, of a general partner of partnership*]**_ _.**

[1.9.] "Limited Partnership Unit" will mean a unit of limited partnership interest in Partnership under Partnership's limited partnership agreement.

[1.10.] "LLC Units" will mean units of membership interests in LLC issued under the Operating Agreement.

[1.11.] "Operating Agreement" will mean that agreement dated _ _[*date*]**_ _ among the Members (as defined in Corporations Code §17001(x)) of LLC.**

[1.12.] "Surviving Entity" will mean LLC.

ARTICLE II: THE MERGER

2.1. *Closing*. The Closing will be held on such date as LLC and Partnership agree, but in no event more than five business days following satisfaction of all conditions precedent to the Merger specified in this Agreement. The Closing will be held at the offices of _ _[*name of company*]**_ _, located at _ _**[*address*]**_ _, California at _ _**[*time*]**_ _ on that date, or at such other time and place as the parties may agree to in writing.**

2.2. *Certificate of Merger*. Subject to the terms and conditions of this Agreement, at or before the Closing, Partnership and LLC will execute and deliver the Certificate of Merger. Within _ _[*number*]**_ _ days after the Closing, _ _**[*specify*]**_ _ will deliver the Certificate of Merger, together with the filing fee, to the California Secretary of State for filing.**

2.3. *Consequences of the Merger*. On the Effective Date:

(a) The Merger will become effective;

(b) The separate existence of Partnership will cease and Partnership will be merged with and into LLC as the surviving entity;

(c) The limited and general partners of Partnership will become Members of LLC;

[*Add one of the following alternatives*]

[*Alternative: Not member managed*]

(d) _ _[*The general partners/names(s) of other persons or person*]**_ _ will be the _ _**[*managers/manager*]**_ _ of LLC; and**

[*Alternative: Member managed*]

(d) The LLC will be managed by all the Members; and

[*Continue*]

(e) The Merger will have all the effects provided by applicable law, including without limitation Corporations Code §17554, which provides that:

(i) LLC will succeed to all the rights and property of Partnership, without other transfer, act, or deed, and will be subject to all the debts and liabilities of Partnership in the same manner as if LLC incurred them; and

(ii) All rights of creditors and all liens on the property of Partnership will be preserved unimpaired, provided that those liens will be limited to the property affected immediately before the Effective Date.

2.4. *Further Acts After Effective Date*. If at any time after the Effective Date, LLC considers or is advised that any other actions or things are necessary or desirable (a) to vest, perfect, or confirm of record or otherwise in

LLC its right, title, or interest in, to, or under any of the rights, properties, or assets of Partnership or (b) to otherwise carry out this Agreement, the Members of LLC are authorized, in the name and on behalf of Partnership, to execute and deliver all those things and to take and do all actions that may be necessary or desirable to vest, perfect, or confirm in LLC all rights, title, and interests in, to, and under those rights, properties, or assets or to otherwise carry out this Agreement.

ARTICLE III: ARTICLES OF ORGANIZATION AND OPERATING AGREEMENT

[*Add one of the following alternatives*]

[*Alternative: Not amending articles of organization*]

3.1. *Articles of Organization*. LLC's articles of organization in effect immediately before the Effective Date will be the articles of organization of Surviving Entity.

[*Alternative: Amending articles of organization*]

3.1. *Articles of Organization*. On the Effective Date, LLC's articles of organization will be amended as follows:

[*List amendments*]

[*Continue*]

[*Add one of the following alternatives*]

[*Alternative: Not amending operating agreement*]

3.2. *Operating Agreement*. The Operating Agreement will be the operating agreement of Surviving Entity.

[*Alternative: Amending operating agreement*]

3.2. *Operating Agreement*. On the Effective Date, the Operating Agreement will be amended as follows:

[*List amendments*]

[*Continue*]

ARTICLE IV: MANNER AND BASIS OF CONVERTING PARTNERSHIP INTERESTS

4.1. *Conversion of Equity Interests of Partnership*. As of the Effective Date, by virtue of the Merger and without any action on the part of any partner of Partnership:

(a) *Limited Partnership Units*. Each Limited Partnership Unit outstanding immediately before the Effective Date, other than Dissenting Limited Partnership Units, will be converted into _ _[*number*]_ _ LLC Units (the "Limited Partner Exchange Ratio"). If the number of Limited Partnership Units is changed between the date of this Agreement and the Effective Date, the Limited Partner Exchange Ratio will be appropriately adjusted.

(b) *General Partner Percentage Interests*. Each General Partner Percentage Interest outstanding immediately before the Effective Date will be converted into _ _[*number*]_ _ LLC Units (the "General Partner Exchange Ratio"). If the amount of General Partner Percentage Interests is changed between the date of this Agreement and the Effective Date, the General Partner Exchange Ratio will be appropriately adjusted.

(c) *Adjustment of Exchange Ratio*. If the outstanding Limited Partnership Units, General Partner Percentage Interests, or LLC Units are changed into a different number of units or interests or a different class by reason of any reclassification, recapitalization, split, combination, exchange, or readjustment between the date of this Agreement and the Effective Date, the Limited Partner Exchange Ratio or General Partner Exchange Ratio, as the case may be, will be correspondingly adjusted.

(d) *Dissenters' Rights*. Dissenting Limited Partner Units will not be converted into LLC Units but will be converted into the right to receive such consideration as may be determined to be due under Article 7.6 of the Act. Partnership will give LLC prompt notice of any demand received by Partnership for appraisal of Dissenting Limited Partner Units, and LLC will have the right to participate in all negotiations and proceedings connected

with that demand. Except with the prior written consent of LLC or as required under Article 7.6 of the Act, Partnership will not voluntarily make any payment for, or settle or offer to settle, any such demand for appraisal. Each limited partner who becomes entitled to payment of the value of Dissenting Limited Partner Units will receive payment for those Dissenting Limited Partner Units, but only after that value is agreed to or finally determined under Article 7.6 of the Act. After the Effective Date, if LLC has the legal obligation to deliver LLC Units to any limited partner who has failed to make an effective demand for appraisal of Dissenting Limited Partner Units or has lost his, her, or its right to make that demand, LLC will issue and deliver the LLC Units to which that limited partner is then entitled on surrender by that limited partner of his, her, or its Limited Partner Units in the form of assignment prescribed by LLC.

[*If parties wish to avoid fractional units, add the following subparagraph*]

(e) *Fractional Units*. No fractional LLC Units will be issued. In lieu of fractional LLC Units, cash will be paid for any such fraction in an amount proportionate to _ _[*dollar amount*]_ _ per LLC Unit.

[*Continue*]

[*If LLC will issue certificates of interest, add the following paragraph*]

4.2. *Exchange of Certificates*.

(a) *Certificate of Interests*. Promptly after the Effective Date, LLC will make available to the Exchange Agent the certificates of interest representing the LLC Units issuable in exchange for outstanding Limited Partnership Units.

(b) *Exchange Procedures*. Each limited partner of Partnership who delivers an assignment of _ _[*limited partnership units/a certificate of interest issued by partnership*]_ _ to the Exchange Agent, and each general partner of Partnership who delivers an assignment of _ _[*general partner percentage interests/a certificate of interest issued by Partnership*]_ _ to the Exchange Agent, _ _[*all in the form reasonably prescribed by LLC/all in the form attached to this Agreement as Exhibit B*]_ _, may receive the LLC Units to which he, she, or it is entitled under Section 4.1. After the Effective Date and until that delivery, each Limited Partnership Unit and each General Partner Percentage Interest will be deemed to represent the right to receive on that delivery the number of LLC Units provided by this Agreement and the provisions of the Code.

[*Continue*]

ARTICLE V: CONDITIONS TO LLC'S OBLIGATIONS

All obligations of LLC under this Agreement are subject to the satisfaction, at or before the Closing, of each of the following conditions:

5.1. *Agreement*. The general partners of Partnership will have delivered to LLC duly executed copies of this Agreement and the Certificate of Merger.

5.2. *Consents and Approvals*. Partnership and LLC will have obtained all consents and approvals of third parties (including governmental authorities) required for Partnership and LLC to consummate the transactions contemplated by this Agreement, and no third party will have withdrawn from or suspended any material license, permit, or contractual right of Partnership.

5.3. *Partner Approval*. This Agreement and the transactions contemplated by this Agreement will have been approved by all the general partners of Partnership and at least _ _[*number*]_ _ percent of the Limited Partnership Units entitled to vote on or consent in writing to the Merger, and no more than _ _[*number*]_ _ percent of the Limited Partnership Units will qualify as Dissenting Limited Partner Units under Article 7.6 of the Act.

5.4. *No Outstanding Options*. Immediately before the Closing, there will be no options, warrants, or other securities or agreements outstanding for the purchase of any interest in Partnership.

5.5. *Other Legal Requirements*. All statutory and other legal requirements for the valid consummation of the Merger will have been fulfilled, including without limitation all requirements regarding notice to creditors of the bulk transfers contemplated by this Agreement. No law or regulation will have passed or been enacted that would prevent the consummation of the transactions contemplated by this Agreement.

[*If LLC units are securities under California securities laws, add the following paragraph*]

5.6. *Securities Laws Compliance*. Unless otherwise exempt under Corporations Code §25103(h), the Commissioner of Corporations will have issued a permit qualifying the offer and exchange of LLC Units.

[*Continue*]

ARTICLE VI: CONDITIONS TO PARTNERSHIP'S OBLIGATIONS

The obligations of Partnership under this Agreement are subject to the satisfaction, at or before the Closing, of the following conditions:

6.1. *Agreement*. The requisite Members of LLC will have delivered to Partnership duly executed copies of this Agreement and the Certificate of Merger.

6.2. *Member Approval*. This Agreement and the transactions contemplated by this Agreement will have been approved by at least _ _[*number*]_ _ percent of LLC Units entitled to vote on or consent in writing to the Merger.

ARTICLE VII: TERMINATION AND ABANDONMENT OF REORGANIZATION

7.1. *Termination by Mutual Consent*. This Agreement may be terminated at any time before the Closing by the mutual written consent of Partnership and LLC.

7.2. *Termination by LLC*. LLC may terminate this Agreement at any time before the Closing by delivery of written notice to Partnership if Partnership has violated this Agreement in any material respect or the Closing has not occurred by _ _[*date*]_ _.

7.3. *Termination by Partnership*. Partnership may terminate this Agreement at any time before the Closing by delivery of written notice to LLC if LLC has violated this Agreement in any material respect or the Closing has not occurred by _ _[*date*]_ _.

7.4. *Effect of Termination*. If this Agreement is terminated under this Article VII:

(a) This Agreement will become void and of no further force or effect, with no liability or obligation on the part of LLC or Partnership, except that nothing in this provision will relieve any party of any liability for willful breach of this Agreement;

(b) The Merger may be abandoned; and

(c) LLC and Partnership will each bear its own costs associated with this Agreement and all transactions contemplated by this Agreement.

[*If LLC Units are securities under federal or California securities laws, add the following article*]

ARTICLE VIII: SECURITIES LAWS COMPLIANCE

[*Continue*]

[*If LLC Units are securities under federal securities laws, add the following paragraphs*]

[8.1.] *Federal Securities Act Exemption*. The LLC Units to be issued under this Agreement will not be registered under the Securities Act of 1933, in reliance on Securities Act of 1933 §4(2) or such other exemption as LLC and its counsel will elect.

[8.2.] *Stock Restrictions*. In addition to any legend imposed by applicable state securities laws, the LLC Units issued under this Agreement, whether represented by certificates or merely reflected in the Operating Agreement, will bear a restrictive legend stating:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE

SECURITIES ACT OF 1933. THESE SECURITIES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE OFFERED, SOLD, TRANSFERRED, PLEDGED, OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT FOR THE SECURITIES UNDER THE SECURITIES ACT OF 1933 OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY, THAT REGISTRATION IS NOT REQUIRED UNDER SAID ACT.

[*Continue*]

[*If LLC Units are securities under California securities laws, add the following paragraph*]

[8.3.] *State Securities Law Qualifications*. Unless otherwise exempt under Corporations Code §25103(h), the offer and exchange of LLC Units under this Agreement will be qualified by the Commissioner of Corporations. LLC will be responsible, with the reasonable cooperation of Partnership, for preparing and filing with the Commissioner of Corporations an application for qualification of the offer and exchange of LLC Units by permit under Corporations Code §25121 and §260.121 of the Rules of the California Commissioner of Corporations.

[*Continue*]

ARTICLE [IX]: MISCELLANEOUS

[9.1.] *Headings*. The headings in this Agreement are included for convenience only and will affect neither the construction or interpretation of any provision in the Agreement nor any of the rights or obligations of the parties to this Agreement.

[9.2.] *Binding Nature*. This Agreement will be binding on and inure to the benefit of the parties to it.

[9.3.] *Applicable Law*. This Agreement will be governed by _ _[*e.g., California*]_ _ law, _ _[*excluding/including*]_ _ any laws that direct the application of another jurisdiction's laws. The parties will submit any dispute to the jurisdiction of the federal and state courts of _ _[*e.g., the state of California*]_ _. Venue will lie exclusively in _ _[*name*]_ _ County.

[9.4.] *Exhibits*. The exhibits attached to this Agreement by this reference are incorporated into and constitute a part of this Agreement.

In witness whereof, the undersigned have caused this Agreement of Merger to be executed as of the date first set forth above.

_ _[*Name of LLC*]_ _,
a California limited liability company

By: _____
_ _[*Typed name*]_ _,
Its: Manager

_ _[*Name of limited partnership*]_ _,
a California limited partnership

By: _____
_ _[*Typed name*]_ _,
Its: General Partner

By: _____
_ _[*Typed name*]_ _,
Its: General Partner

Comment: See §11.57 for Secretary of State Form OBE MERGER-1, Certificate of Merger, to be attached to this agreement as Exhibit A.

If the limited partner equity interests are not described as "Units" in the limited partnership agreement, this form should be changed to conform with the term used in that agreement to designate those equity interests.

The general partners typically are made the member-managers of the LLC.

Generally, all limited partners and members of the LLC will be entitled to dissenters' rights. If the partnership is publicly owned or formed before 1991, the dissenters' rights for partners are more limited. See Corp C §§15911.21(b), 15911.32, 17601. See §11.61.

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§11.49 5. Form: Long-Form Agreement of Merger Between Corporation and Limited Liability Company

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11.49-1 Long-form agreement of merger between corporation and LLC

AGREEMENT OF MERGER
BETWEEN _ _[*NAME OF LLC*]_ _
AND _ _[*NAME OF CORPORATION*]_ _

This Agreement of Merger ("Agreement") is entered into as of _ _[*date*]_ _**, between** _ _[*name of LLC*]_ _**, a California limited liability company ("LLC"), and** _ _[*name of corporation*]_ _**, a California corporation ("Company").**

RECITALS

A. LLC is a limited liability company organized under the laws of the state of California that filed its articles of organization with the California Secretary of State on _ _[*date*]_ _**.**

B. Company is a California corporation that filed its articles of incorporation with the California Secretary of State on _ _[*date*]_ _**.**

C. The parties intend that Company merge with and into LLC (the "Merger") under the terms and conditions set forth in this Agreement and the applicable provisions of California law.

D. The parties desire to enter into this Agreement to set forth certain provisions relating to consummation of the Merger.

Now therefore, in consideration of these premises and of the mutual provisions contained in this Agreement, the parties agree:

ARTICLE I: DEFINITIONS

For purposes of this Agreement, the following terms will have the meanings specified:

1.1 "Capital Stock" will mean the outstanding shares of common stock of Company.

1.2 "Certificate of Merger" will mean a certificate of merger in substantially the form attached to this Agreement as Exhibit A.

1.3 "Closing" will mean the closing of the transactions contemplated by this Agreement.

1.4 "Code" will mean the California Corporations Code, as amended from time to time.

1.5 "Dissenting Shares" will mean Capital Stock held by shareholders of Company who perfect their dissenters' rights under California law.

1.6 "Effective Date" will mean the later of _ _[*date*]_ _ **or the date when the Certificate of Merger is properly filed with the California Secretary of State.**

[*If LLC will issue certificates of interest, add*]

1.7. "Exchange Agent" will mean _ _[*name*]_ _**.**

[*Continue*]

[1.8.] "LLC Units" will mean units of membership interests in LLC issued under the Operating Agreement.

[1.9.] "Operating Agreement" will mean that agreement dated _ _[*date*]_ _, among the Members (as defined in Corporations Code §17001(x)) of LLC.

[1.10.] "Surviving Entity" will mean LLC.

ARTICLE II: THE MERGER

2.1. *Closing*. The Closing will be held on such date as LLC and Company will agree, but in no event more than five business days following satisfaction of all conditions precedent to the Merger specified in this Agreement. The Closing will be held at the offices of _ _[*name of company*]_ _, located at _ _[*address*]_ _, California at _ _[*time*]_ _ on that date, or at such other time and place as the parties may agree to in writing.

2.2. *Certificate of Merger*. Subject to the terms and conditions of this Agreement, at or before the Closing, Company and LLC will execute and deliver the Certificate of Merger. Within _ _[*number*]_ _ days after the Closing, _ _[*name*]_ _ will deliver the Certificate of Merger, together with the filing fee, to the California Secretary of State for filing.

2.3. *Consequences of the Merger*. On the Effective Date:

(a) The Merger will become effective;

(b) The separate existence of Company will cease and Company will be merged with and into LLC as the Surviving Entity;

(c) The shareholders of Company will become Members of LLC;

[*Add one of the following alternatives*]

[*Alternative: Not member managed*]

(d) _ _[*The board of directors of Company/name(s) of other persons or person*]_ _ will be the _ _[*managers/manager*]_ _ of LLC; and

[*Alternative: Member managed*]

(d) The LLC will be managed by all the Members; and

[*Continue*]

(e) The Merger will have all the effects provided by applicable law, including without limitation Corporations Code §17554, which provides that:

(i) LLC will succeed to all the rights and property of Company, without other transfer, act, or deed, and will be subject to all the debts and liabilities of Company in the same manner as if LLC incurred them; and

(ii) All rights of creditors and all liens on the property of Company will be preserved unimpaired, provided that those liens will be limited to the property affected immediately before the Effective Date.

2.4. *Further Acts After Effective Date*. If at any time after the Effective Date, LLC considers or is advised that any other actions or things are necessary or desirable (a) to vest, perfect, or confirm of record or otherwise in LLC its right, title, or interest in, to, or under any of the rights, properties, or assets of Company or (b) to otherwise carry out this Agreement, the Members of LLC are authorized, in the name and on behalf of Company, to execute and deliver all those things and to take and do all actions that may be necessary or desirable to vest, perfect, or confirm in LLC all rights, title, and interests in, to, and under those rights, properties, or assets or to otherwise carry out this Agreement.

ARTICLE III: ARTICLES OF ORGANIZATION

AND OPERATING AGREEMENT

[*Add one of the following alternatives*]

[*Alternative: Not amending articles of organization*]

3.1. *Articles of Organization*. LLC's articles of organization in effect immediately before the Effective Date will be the articles of organization of Surviving Entity.

[*Alternative: Amending articles of organization*]

3.1. *Articles of Organization*. On the Effective Date, LLC's articles of organization will be amended as follows:

[*List amendments*]

[*Continue*]

[*Add one of the following alternatives*]

[*Alternative: Not amending operating agreement*]

3.2. *Operating Agreement*. The Operating Agreement will be the operating agreement of Surviving Entity.

[*Alternative: Amending operating agreement*]

3.2. *Operating Agreement*. On the Effective Date, the Operating Agreement will be amended as follows:

[*List amendments*]

[*Continue*]

ARTICLE IV: MANNER AND BASIS OF CONVERTING CAPITAL STOCK

4.1. *Conversion of Equity Interests in Company*. As of the Effective Date, by virtue of the Merger and without any action on the part of any shareholder of Company:

(a) *Capital Stock*. Each share of Capital Stock outstanding immediately before the Effective Date, other than Dissenting Shares, will be converted into _ _[*number*]_ _ LLC Units (the "Exchange Ratio"). If the number of outstanding shares of Capital Stock is varied between the date of this Agreement and the Effective Date, the Exchange Ratio will be appropriately adjusted.

(b) *Adjustment of Exchange Ratio*. If the outstanding shares of Capital Stock or LLC Units are changed into a different number of units or a different class by reason of any reclassification, recapitalization, split, combination, exchange, or readjustment between the date of this Agreement and the Effective Date, the Exchange Ratio will be correspondingly adjusted.

(c) *Dissenters' Rights*. Dissenting Shares will not be converted into LLC Units but will be converted into the right to receive any consideration that may be determined to be due under Corporations Code §§1300-1312. Company will give LLC prompt notice of any demand received by Company for appraisal of Dissenting Shares, and LLC will have the right to participate in all negotiations and proceedings connected with that demand. Except with the prior written consent of LLC or as required under Corporations Code §§1300-1312, Company will not voluntarily make any payment for, or settle or offer to settle, any such demand for appraisal. Each shareholder who becomes entitled to payment of the value of Dissenting Shares will receive payment for those Dissenting Shares, but only after that value is agreed to or finally determined under Corporations Code §§1300-1312. After the Effective Date, if LLC has the legal obligation to deliver LLC Units to any shareholder who has failed to make an effective demand for appraisal of Dissenting Shares or has lost his, her, or its right to make that demand, LLC will issue and deliver the LLC Units to which that shareholder is then entitled on surrender by that shareholder of his, her, or its Capital Stock in the form of assignment prescribed by LLC.

[*If parties want to avoid fractional units, add the following subparagraph*]

(c) *Fractional Units*. No fractional LLC Units will be issued. In lieu of fractional LLC Units, cash will be paid for any fraction in an amount proportionate to _ _[*dollar amount*]_ _ per LLC Unit.

[*Continue*]

[*If LLC will issue certificates of interest, add the following paragraph*]

4.2. *Exchange of Certificates*.

(a) *Certificate of Interests*. Promptly after the Effective Date, LLC will make available to the Exchange Agent certificates of interest representing the LLC Units issuable in exchange for outstanding Capital Stock.

(b) *Exchange Procedures*. Each shareholder of Capital Stock who surrenders a stock certificate for cancellation to the Exchange Agent may receive the LLC Units to which he, she, or it is entitled under Section 4.1. After the Effective Date and until that surrender, each share of Capital Stock will be deemed to represent the right to receive, on that delivery, the number of LLC Units as provided by this Agreement and the provisions of the Code.

[*Continue*]

ARTICLE V: CONDITIONS TO LLC'S OBLIGATIONS

All obligations of LLC under this Agreement are subject to the satisfaction, at or before the Closing, of each of the following conditions:

5.1. *Agreement*. Company will have delivered to LLC duly executed copies of this Agreement and the Certificate of Merger.

5.2. *Consents and Approvals*. Company and LLC will have obtained all consents and approvals of third parties (including governmental authorities) required for Company and LLC to consummate the transactions contemplated by this Agreement, and no third party will have withdrawn from or suspended any material license, permit, or contractual right of Company.

5.3. *Shareholder Approval*. This Agreement and the transactions contemplated by this Agreement will have been approved by at least _ _[*number*]_ _ percent of _ _[*each class of*]_ _ Capital Stock entitled to vote on or consent in writing to the Merger, and no more than _ _[*number*]_ _ percent of the Capital Stock will qualify as Dissenting Shares under Corporations Code chapter 13.

5.4. *No Outstanding Options*. Immediately before the Closing, there will be no options, warrants, or other securities or agreements outstanding for the purchase of any interest in Company.

5.5. *Other Legal Requirements*. All statutory and other legal requirements for the valid consummation of the Merger will have been fulfilled, including without limitation all requirements regarding notice to creditors of the bulk transfers contemplated by this Agreement. No law or regulation will have passed or been enacted that would prevent the consummation of the transactions contemplated by this Agreement.

[*If LLC Units are securities under California securities laws, add the following paragraph*]

5.6. *Securities Laws Compliance*. The Commissioner of Corporations will have issued a permit qualifying the offer and exchange of LLC Units.

[*Continue*]

ARTICLE VI: CONDITIONS TO COMPANY'S OBLIGATIONS

The obligations of Company under this Agreement are subject to the satisfaction, at or before the Closing, of the following conditions:

6.1. *Agreement*. The requisite Members of LLC will have delivered to Company duly executed copies of this Agreement and the Certificate of Merger.

6.2. *Member Approval*. This Agreement and the transactions contemplated by this Agreement will have been approved by at least _ _[*number*]_ _ percent of LLC Units entitled to vote on or consent in writing to the Merger.

ARTICLE VII: TERMINATION AND

ABANDONMENT OF REORGANIZATION

7.1. *Termination by Mutual Consent*. This Agreement may be terminated at any time before the Closing by the mutual written consent of Company and LLC.

7.2. *Termination by LLC*. LLC may terminate this Agreement at any time before the Closing by delivery of written notice to Company if Company has violated this Agreement in any material respect or the Closing has not occurred by _ _[*date*]_ _.

7.3. *Termination by Company*. Company may terminate this Agreement at any time before the Closing by delivery of written notice to LLC if LLC has violated this Agreement in any material respect or the Closing has not occurred by _ _[*date*]_ _.

7.4. *Effect of Termination*. If this Agreement is terminated under this Article VII:

(a) This Agreement will become void and of no further force or effect, with no liability or obligation on the part of LLC or Company, except that nothing in this provision will relieve any party of any liability for willful breach of this Agreement;

(b) The Merger may be abandoned; and

(c) LLC and Company will each bear its own costs associated with this Agreement and all transactions contemplated by this Agreement.

[*If LLC Units are securities under federal or California securities laws, add the following article*]

ARTICLE VIII: SECURITIES LAWS COMPLIANCE

[*Continue*]

[*If LLC Units are securities under federal securities laws, add the following paragraphs*]

[8.1.] *Federal Securities Act Exemption*. The LLC Units to be issued under this Agreement will not be registered under the Securities Act of 1933, in reliance on Securities Act of 1933 §4(2) or any other exemption LLC and its counsel elect.

[8.2.] *Stock Restrictions*. In addition to any legend imposed by applicable state securities laws, the LLC Units issued under this Agreement, whether represented by certificates or merely reflected in the Operating Agreement, will bear a restrictive legend stating:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THESE SECURITIES HAVE BEEN ACQUIRED FOR INVESTMENT AND MAY NOT BE OFFERED, SOLD, TRANSFERRED, PLEDGED, OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT FOR THE SECURITIES UNDER THE SECURITIES ACT OF 1933 OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY, THAT REGISTRATION IS NOT REQUIRED UNDER SAID ACT.

[*Continue*]

[*If LLC Units are securities under California securities laws, add the following paragraph*]

[8.3.] *State Securities Law Qualifications*. Unless otherwise exempt under the Corporations Code, the offer and exchange of LLC Units under this Agreement will be qualified by the Commissioner of Corporations. LLC will be responsible, with the reasonable cooperation of Company, for preparing and filing with the Commissioner of Corporations an application for qualification of the offer and exchange of LLC Units by permit under Corporations Code §25121 and §260.121 of the Rules of the California Commissioner of Corporations.

[*Continue*]

ARTICLE [IX]: MISCELLANEOUS

[9.1.] *Headings*. The headings in this Agreement are included for convenience only and will affect neither the construction or interpretation of any provision in this Agreement nor any of the rights or obligations of the

parties to this Agreement.

[9.2.] *Binding Nature*. This Agreement will be binding on and inure to the benefit of the parties to it.

[9.3.] *Applicable Law*. This Agreement will be governed by _ _[*e.g., California*]_ _ law, _ _[*excluding/including*]_ _ **any laws that direct the application of another jurisdiction's laws. The parties will submit any dispute to the jurisdiction of the federal and state courts of _ _[*e.g., the state of California*]_ _. Venue will lie exclusively in _ _[*name*]_ _ County.**

[9.4.] *Exhibits*. The exhibits attached to this Agreement by this reference are incorporated into and constitute a part of this Agreement.

In witness whereof, the undersigned have caused this Agreement of Merger to be executed as of the date first set forth above.

_ _[*Name of LLC*]_ _,
a California limited liability company

By: _____
_ _[*Typed name*]_ _,
Its: Manager

_ _[*Name of corporation*]_ _,
a California corporation

By: _____
_ _[*Typed name*]_ _,
Its: President

By: _____
_ _[*Typed name*]_ _,
Its: Secretary

Comment: See §11.57 for form Certificate of Merger to be attached to this Agreement as Exhibit A.

This form assumes that the only outstanding stock is common stock. If other classes of stock or options and warrants are outstanding, conversion of those interests must be addressed in Article IV.

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§11.50 6. Amendment of Agreement of Merger

An agreement of merger may be amended before the filing of the certificate of merger or the agreement of merger if the amendment is approved by the members of each constituent LLC in the same manner as required for approval of the original agreement of merger. If the amendment changes any of the principal terms of the agreement of merger, the amendment must be approved by each of the constituent other business entities in the same manner as required for approval of the original agreement of merger. Corp C §17551(c).

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F. Approval of Merger

§11.51 1. By Limited Liability Company

At least a majority in interest of the members of an LLC, or any greater percentage indicated in the LLC's articles of organization or written operating agreement, must approve the agreement of merger. However, if the members of a constituent LLC become personally liable for the obligations of a constituent business entity as a result of the merger, then either all members of the LLC must approve the agreement of merger, or the agreement must grant all members dissenters' rights. Corp C §17551(a). (This might occur, *e.g.,* in a merger between an LLC and a general partnership in which the partnership survived.) On dissenters' rights, see §11.61.

Amendments to the articles of organization or operating agreement or adoption of a new operating agreement contained in the agreement of merger are effective when the merger is effective. However, if any amendment or adoption requires greater approval than that required for approval of the agreement, the amendment or adoption will be effective only if the merger agreement is approved by that greater number of members. Corp C §17551(e).

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§11.52 2. By Limited Partnership

All general partners of a merging limited partnership must approve the agreement of merger, and a majority in interest of each class of limited partners (or any greater number that may be required by the partnership agreement) must approve the principal terms of the merger. Corp C §15911.12. If as a result of the merger members of the limited partnership become personally liable for the obligations of a constituent business entity, then either all limited partners must approve the agreement of merger or the agreement must grant all limited partners dissenters' rights. Corp C §15911.12. On dissenters' rights, see §11.61.

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§11.53 3. By General Partnership

The agreement of merger must be approved by the number or percentage of partners specified for merger in the partnership agreement or, if not stated, then by that number or percentage of partners specified by the partnership agreement to approve an amendment to the partnership agreement (or that greater number if the merger effects a change for which the partnership agreement requires a greater number or percentage of partners than that required to amend the partnership agreement). Corp C §16911(a).

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§11.54 4. By Corporation

The board of directors of each constituent corporation to the merger must approve the merger. Corp C §1200(a). In addition, the principal terms of the merger must be approved by the majority of the outstanding shares of each class of the constituent corporation (or any greater number that may be required by the articles of incorporation). Corp C §1201(a), (f).

If the constituent corporation is a close corporation, and its shareholders will get shares of a corporation that is not a close corporation, holders of two-thirds of the outstanding shares must approve the merger unless the articles of incorporation allow a lesser vote. Corp C §1201(e). The merger must be approved by holders of all outstanding shares if the merger results in the cancellation, without consideration, of all outstanding shares of the corporation. Corp C §1202(a). If a class or series of preferred shares will receive less than would be required by the corporation's articles of incorporation, the merger must be approved by the same percentage of the outstanding shares of the class or series as would be required to amend the article provisions to allow for that lesser distribution. Corp C §1202(b).

Shareholders of a disappearing corporation that is not publicly traded who did not approve the merger may demand that the corporation purchase their shares for cash. Corp C §1300(a). On dissenters' rights, see §11.61.

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G. Certificate of Merger

§11.55 1. Contents of Certificate

The parties to the merger must file Form OBE MERGER-1, Certificate of Merger, with the Secretary of State. Corp C §17552(a). See §11.57 for Form OBE MERGER-1. The following information must be provided on the certificate (see, *e.g.,* Corp C §§1113(g)(2), 15911.14(a), 16915(b), 17552(a)):

- Identification of the surviving LLC and the disappearing entities;
- The name, type of entity, jurisdiction under which the entity was organized, and Secretary of State file number, if any, of all entities involved in the merger;
- The number of shares or interests entitled to vote on the merger, if appropriate;

NOTE: If a vote of the members was required under Corp Code §17551, the certificate must include a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class that equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class. Corp C §17552(a)(2).

- A statement that the principal terms of the agreement of merger were approved, as required by law, if appropriate;
- Any required changes to the articles of organization of the surviving LLC;

NOTE: If the surviving entity is an LLC, Form OBE MERGER-1 may make any change required in the information set forth in the articles of the surviving LLC resulting from the merger, including any change in its name. The filing of a certificate of merger setting forth any changes to the articles of the surviving LLC has the same effect as filing an amendment to its articles of organization; the LLC is not required to file Form LLC-2 (amendment of articles of organization) under Corp C §17054 to reflect those changes. Corp C §17552(a)(3).

- Unless the merger is to be effective on filing, the effective date of the merger (which cannot be more than 90 days after the date the certificate of merger is filed);
- If the surviving entity is an other business entity or foreign LLC, the full name, type of entity, legal jurisdiction in which it was organized and by whose laws its internal affairs are governed, and the address of its principal place of business; and

NOTE: If the surviving entity is a foreign LLC, in a merger in which a domestic corporation is a disappearing other business entity, a copy of the agreement of merger and required attachments (see Corp C §1113(g)(1)) must be filed at the same time as the certificate of merger. Corp C §17552(a).

- Any other information required by the laws under which each constituent other business entity is organized. See, *e.g.,* Corp C §1113(g)(1).

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§11.56 2. Execution of Certificate

Form OBE MERGER-1 must be executed and acknowledged by all parties to the merger as follows:

Domestic LLCs. If the LLC is manager managed, all the managers must execute and acknowledge Form OBE MERGER-1 (unless a lesser number is specified in the LLC's articles of organization or operating agreement). If the LLC is member managed, all the members must execute and acknowledge Form OBE MERGER-1 (unless a lesser number is specified in the LLC's articles of organization or operating agreement). Corporations Code §17552(a) specifies that managers sign Form OBE MERGER-1 and Corp C §17001(w) defines a "manager" as a manager in a manager-managed LLC and as each member in a member-managed LLC.

Domestic general partnerships. Two partners must execute and acknowledge Form OBE MERGER-1, unless the partnership agreement provides for a lower number. Corp C §16915(b).

Domestic limited partnerships. Unless the certificate of limited partnership provides otherwise, all general partners of a limited partnership must execute and acknowledge Form OBE MERGER-1. Corp C §15911.14(a).

Domestic corporations. The chairperson, president or vice president, and secretary or assistant secretary must execute and acknowledge Form OBE MERGER-1. Corp C §1113(g)(2).

Foreign business entities. Those persons required to execute a certificate or agreement of merger under the laws of their state of organization must execute and acknowledge Form OBE MERGER-1. Corp C §17552(a).

NOTE: "Acknowledged" is defined in Corp C §17001(a), and Form OBE MERGER-1 contains the wording needed to satisfy the definition. The instructions to Form OBE MERGER-1 contain signatory requirements providing that the certificate must be executed and acknowledged by one or more managers of a foreign LLC; by one or more general partners of a foreign limited partnership; or by one or more general partners of a foreign general or limited liability partnership.

The certificate must be accompanied by the applicable filing fee. See Govt C §12190(i)-(j). The certificate must be mailed to the Secretary of State's office, or hand delivered for over-the-counter processing to the Sacramento office. The certificate cannot be filed in the regional offices. The address for filing may be found in this book's Directory.

NOTE: Effective October 2, 2006, the Secretary of State expanded its preclearance and expedited filing services to include all business entity documents filed under the Corporations Code, Financial Code or Insurance Code. These services were previously offered only for specified corporate documents. They are now available for all corporate, LLC, and limited partnership documents, including interspecies mergers and conversions, and for all other documents filed by other entity types. See §§7.25-7.27.

A certificate of merger certified by the Secretary of State is conclusive evidence of the merger. Corp C §17553.

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Source: Business Law/Forming and Operating California Limited Liability Companies/11 Conversions and Mergers/ §11.57 3. Form: Limited Liability Company Certificate of Merger (Secretary of State Form OBE MERGER-1)

§11.57 3. Form: Limited Liability Company Certificate of Merger (Secretary of State Form OBE MERGER-1)



OBE MERG

State of California
Secretary of State

Certificate of Merger

(California Corporations Code sections
1113(g), 6019.1, 8019.1, 9640, 12540.1, 15911.14, 16915(b) and 17552)

IMPORTANT — Read all instructions before completing this form.

This Space For Filing Use Only

1. NAME OF SURVIVING ENTITY	2. TYPE OF ENTITY	3. CA SECRETARY OF STATE FILE NUMBER	4. JURISDICTION
5. NAME OF DISAPPEARING ENTITY	**6. TYPE OF ENTITY**	**7. CA SECRETARY OF STATE FILE NUMBER**	**8. JURISDICTION**

9. THE PRINCIPAL TERMS OF THE AGREEMENT OF MERGER WERE APPROVED BY A VOTE OF THE NUMBER OF INTERESTS OR SHARES OF EACH CLASS THAT EQUALED OR EXCEEDED THE VOTE REQUIRED. IF A VOTE WAS REQUIRED, SPECIFY THE CLASS AND THE NUMBER OF OUTSTANDING INTERESTS OF EACH CLASS ENTITLED TO VOTE ON THE MERGER AND THE PERCENTAGE VOTE REQUIRED OF EACH CLASS. ATTACH ADDITIONAL PAGES, IF NECESSARY.

SURVIVING ENTITY		DISAPPEARING ENTITY	
CLASS AND NUMBER	AND PERCENTAGE VOTE REQUIRED	CLASS AND NUMBER	AND PERCENTAGE VOTE REQUIRED

10. IF EQUITY SECURITIES OF A PARENT PARTY ARE TO BE ISSUED IN THE MERGER, CHECK THE APPLICABLE STATEMENT.

☐ No vote of the shareholders of the parent party was required. ☐ The required vote of the shareholders of the parent party was obtained.

11. IF THE SURVIVING ENTITY IS A DOMESTIC LIMITED LIABLITY COMPANY, LIMITED PARTNERSHIP, OR PARTNERSHIP, PROVIDE THE REQUISITE CHANGES (IF ANY) TO THE INFORMATION SET FORTH IN THE SURVIVING ENTITY'S ARTICLES OF ORGANIZATION, CERTIFICATE OF LIMITED PARTNERSHIP OR STATEMENT OF PARTNERSHIP AUTHORITY RESULTING FROM THE MERGER. ATTACH ADDITIONAL PAGES, IF NECESSARY.

12. IF A DISAPPEARING ENTITY IS A DOMESTIC LIMITED LIABLITY COMPANY, LIMITED PARTNERSHIP, OR PARTNERSHIP, AND THE SURVIVING ENTITY IS NOT A DOMESTIC ENTITY OF THE SAME TYPE, ENTER THE PRINCIPAL ADDRESS OF THE SURVIVING ENTITY.

PRINCIPAL ADDRESS OF SURVIVING ENTITY | CITY AND STATE | ZIP CODE

13. OTHER INFORMATION REQUIRED TO BE STATED IN THE CERTIFICATE OF MERGER BY THE LAWS UNDER WHICH EACH CONSTITUENT OTHER BUSINESS ENTITY IS ORGANIZED. ATTACH ADDITIONAL PAGES, IF NECESSARY.

14. STATUTORY OR OTHER BASIS UNDER WHICH A FOREIGN OTHER BUSINESS ENTITY IS AUTHORIZED TO EFFECT THE MERGER.

15. FUTURE EFFECTIVE DATE, IF ANY

_____ - _____ - _____
(Month) (Day) (Year)

16. ADDITIONAL INFORMATION SET FORTH ON ATTACHED PAGES, IF ANY, IS INCORPORATED HEREIN BY THIS REFERENCE AND MADE PART OF THIS CERTIFICATE.

17. I CERTIFY UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF CALIFORNIA THAT THE FOREGOING IS TRUE AND CORRECT OF MY OWN KNOWLEDGE. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

SIGNATURE OF AUTHORIZED PERSON FOR THE SURVIVING ENTITY DATE — TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

SIGNATURE OF AUTHORIZED PERSON FOR THE SURVIVING ENTITY DATE — TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

SIGNATURE OF AUTHORIZED PERSON FOR THE DISAPPEARING ENTITY DATE — TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

SIGNATURE OF AUTHORIZED PERSON FOR THE DISAPPEARING ENTITY DATE — TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

For an entity that is a business trust, real estate investment trust or an unincorporated association, set forth the provision of law or other basis for the authority of the person signing: _____

Print

Instructions for Completing the Certificate of Merger (Form OBE MERGER-1)

Where to File: For easier completion, this form is available on the Secretary of State's website at www.sos.ca.gov/business/be/forms.htm and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814 or delivered in person (drop off) to the Sacramento office. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Legal Authority: Statutory filing provisions are found in California Corporations Code sections 1113(g), 6019.1, 8019.1, 9640, 12540.1, 15911.14, 16915(b) and 17552. All statutory references are to the California Corporations Code, unless otherwise indicated. **Note:** If a limited partnership is a party to the merger, signing the Certificate of Merger (Form OBE MERGER-1) constitutes an affirmation under penalty of perjury that the facts stated in the document are true. (Section 15902.08(b).)

- The Certificate of Merger (Form OBE MERGER-1) may be used for mergers between: (1) limited liability companies only, in which a one or more California limited liability companies are a party to the merger; (2) limited partnerships only, in which one or more California limited partnerships are a party to the merger; or (3) other business entities (i.e., interspecies mergers), in which one or more California corporations, limited liability companies, limited partnerships or partnerships are a party to the merger. [The term "other business entity" is defined in Sections 174.5, 5063.5, 12242.5, 15911.01(k), 16901(12) and 17001(ac).]

- It is recommended that legal counsel be consulted prior to submitting the Certificate of Merger (Form OBE MERGER-1) to ensure that all issues are appropriately addressed.

Fees: The fee for filing the Certificate of Merger (Form OBE MERGER-1) is: (1) $150.00 for interspecies mergers; (2) $70.00 for mergers involving only limited liability companies; and (3) $70.00 for mergers involving only limited partnerships. A $15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at www.sos.ca.gov/business/be/service-options.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

Copies: The Secretary of State will certify up to two copies of the filed document(s) without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified with payment of $8.00 per copy.

Additional Information & Filing Requirements: Please refer to the attached "Certificate of Merger - General Information" document for additional information and requirements for filing a Certificate of Merger.

Complete the Certificate of Merger (Form OBE MERGER-1) as follows:

Items 1-8. Enter the following information for the surviving entity (Items 1-4) and the disappearing entity (Items 5-8): The exact name of the entity, the type of entity (e.g., corporation, limited liability company, limited partnership, etc.), the file number issued to the entity by the California Secretary of State, if any, and the jurisdiction (state or country) under which the entity was organized. If more than one entity is disappearing, attach additional pages with the required information.

Item 9. This statement is required by statute and must not be altered. If a vote was required pursuant to the applicable law, specify the class and the number of outstanding interests of each class entitled to vote on the merger **and** the percentage vote required for each class. Attach additional pages, if necessary.

Item 10. If equity securities of a parent party are to be issued in the merger, check the applicable statement regarding the vote of the shareholders of the parent party. Only one box may be checked.

Item 11. If the surviving entity in the merger is a domestic limited liability company, limited partnership or registered general partnership, enter any requisite changes to the information set forth in the surviving entity's Articles of Organization, Certificate of Limited Partnership or Statement of Partnership Authority resulting from the merger, if any, and include the text of each amendment adopted. Attach additional pages, if necessary. (Sections 15911.14, 16915 and 17552.)

Item 12. If a disappearing entity in the merger is a domestic limited liability company, limited partnership or partnership, enter the address of the principal place of business of the surviving entity. Item 12 should not be completed when the merger is between entities of the same type where there is a surviving domestic entity (e.g., a disappearing domestic or foreign limited liability company merging into a surviving domestic limited liability company). (Sections 15911.14, 16915 and 17552.)

Item 13. Enter any other information required to be stated in the Certificate of Merger by the laws under which each party to the merger was organized. Attach additional pages, if necessary.

Item 14. Set forth the statutory authority or other basis under which each foreign corporation or other business entity is authorized by law to effect the merger.

Item 15. Enter a valid future effective date of the Certificate of Merger, if any. If none is indicated, the merger shall be effective upon filing with the California Secretary of State, or as otherwise provided by law.

Item 16. This statement confirms that attachments to the Certificate of Merger, if any, are incorporated by reference.

Item 17. The Certificate of Merger must be signed and acknowledged by each constituent other business entity as set forth in Sections 1113(g)(1) or (2), 6019.1(f), 8019.1(g), 12540.1(g), 15911.14(a), 16915(b) or 17552(a). If additional signature space is necessary, the acknowledged signature(s) may be made on an attachment to the Certificate of Merger. Note: If a constituent other business entity is a business trust, real estate investment trust or an unincorporated association, set forth the provision of law or other basis for the authority of the person signing.

Any attachments to the Certificate of Merger are incorporated by reference and made part of the Certificate of Merger. All attachments should be 8 ½" x 11", one-sided and legible.

Print

Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 95814

Business Entities
(916) 657-5448

Certificate of Merger
General Information

The attached Certificate of Merger (Form OBE MERGER-1) may be used for the following mergers:

- **Limited Liability Company Mergers:** Mergers involving only limited liability companies in which one or more California limited liability companies is a party to the merger;
- **Limited Partnership Mergers:** Mergers involving only limited partnerships in which one or more California limited partnerships is a party to the merger; and
- **Interspecies Mergers:** Mergers involving "other business entities" in which one or more California corporations, limited liability companies, limited partnerships, or partnerships is a party to the merger. [The term "other business entity" is defined in California Corporations Code sections 174.5, 5063.5, 12242.5, 15911.01(k), 16901(12) and 17001(ac).]

Upon the filing of the Certificate of Merger by the Secretary of State, the separate existence of the disappearing domestic or qualified/registered business entity shall cease in California.

Statutory filing provisions are found in California Corporations Code sections 1113(g) (stock corporations); 6019.1 (nonprofit public benefit corporations); 8019.1 (nonprofit mutual benefit corporations); 9640 (nonprofit religious corporations); 12540.1 (consumer cooperative corporations); 15911.14 (limited partnerships); 16915(b) (general partnerships and limited liability partnerships); and 17552 (limited liability companies). One or more business entities can merge only if each entity is authorized by the laws under which it is organized to effect the merger and at least one California domestic entity is involved.

There are a variety of filing requirements based not only on the types of entities involved in the merger, but also the domicile of the entities merging and whether or not any foreign (out-of-state) entities are qualified to transact business in the State of California. It is not feasible to provide information and sample documents for each set of circumstances. Documents must be drafted in accordance with applicable law, dependent upon the particular circumstances of the entities involved. Due to the complexity of merger transactions, it is recommended that the advice of private legal counsel, specializing in business entity matters, be consulted regarding the specific needs of the merging entities.

When preparing merger documents, regardless of the type of merger, be sure the entity name included in the documents is exactly as it appears on the records of the Secretary of State, including entity endings, punctuation and abbreviations. For mergers in which a California or qualified foreign corporation or limited liability company is a party to the merger, prior to filing please verify the status of the entity being merged, as merger documents **cannot** be filed on behalf of suspended/forfeited corporations or limited liability companies. (California Revenue and Taxation Code sections 23301, 23301.5 and 23775.) The status of the entity can be checked online on the Secretary of State's California Business Search at kepler.sos.ca.gov.

Additional Information

If the surviving entity is a foreign limited liability company or foreign other business entity and a California (domestic) limited liability company is one of the disappearing entities: The surviving entity shall file with the Secretary of State (1) an agreement that the entity may be served in this state in a proceeding for the enforcement of an obligation of any merging entity and in a proceeding to enforce the rights of any holder of a dissenting interest or dissenting shares in a merging domestic limited

liability company or domestic other business entity; (2) an irrevocable appointment of the Secretary of State as the entity's agent for service of process, and an address to which process may be forwarded; and (3) an agreement that the entity will promptly pay the holder of any dissenting interest or dissenting share in a merging domestic limited liability company or domestic other business entity the amount to which that person is entitled under California law. (California Corporations Code section 17555(g)(1), (2) and (3).)

If a disappearing entity is a registered (domestic or foreign) limited liability partnership: The filing of a Certificate of Merger shall have no effect on the registered status of the entity on the records of the Secretary of State's office. To withdraw the registration, a Notice of Status Change (Form LLP-4) must be filed with the Secretary of State. (California Corporations Code sections 16954 and 16960.) Form LLP-4, along with filing information and instructions, is available on the Secretary of State's website at www.sos.ca.gov/business/be/forms.htm.

If no California entity is a party to the merger (all parties are foreign entities whether qualified or not): The Certificate of Merger may not be filed in California. If a disappearing entity in the merger is qualified or registered in California, to surrender or cancel the entity, it will be necessary to file a:

1) Certificate of Surrender – for foreign corporations;
2) Certificate of Cancellation (Form LLC-4/7) – for foreign limited liability companies;
3) Certificate of Cancellation (Form LP-4/7) – for foreign limited partnerships; or
4) Notice of Status Change (Form LLP-4) – for foreign limited liability partnerships.

The forms, along with pertinent filing information and instructions, are available on the Secretary of State's website at www.sos.ca.gov/business/be/forms.htm.

Where to File

The merger document(s) can be mailed to Secretary of State, Document Filing Support Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814 or delivered in person (drop off) to the Sacramento office. Merger documents are filed only in the Secretary of State's Sacramento office. Please refer to the Secretary of State file number(s) when submitting document(s) for filing to ensure proper application. For easier completion, the Certificate of Merger (Form OBE MERGER-1) is available on the Secretary of State's website at www.sos.ca.gov/business/be/forms.htm and can be viewed, filled in and printed from your computer. If you are not completing the form online, please type or legibly print in black or blue ink.

Fees

The fee for filing a Certificate of Merger (Form OBE MERGER-1) is $150.00 for interspecies mergers, $70.00 for mergers involving only limited liability companies and $70.00 for mergers involving only limited partnerships. A $15.00 special handling fee is applicable for processing documents delivered in person (drop off) to the Sacramento office. The special handling fee is in addition to the filing fee, should be included in a separate check, and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee in lieu of the special handling fee. Please refer to the Secretary of State's website at www.sos.ca.gov/business/be/service-options.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filings services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

Copies

The Secretary of State will certify up to two copies of the filed merger document(s) without charge, provided that the complete copies with any required attachments are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified with payment of $8.00 per copy.

Print

Signatory Requirements

A Certificate of Merger (Form OBE MERGER-1) must be executed and acknowledged by the surviving entity and by each merging other business entity as set forth in California Corporations Code section 1113(g)(1) or (2), 6019.1(f), 8019.1(g), 12540.1(g), 15911.14(a), 16915(b) or 17552(a). The following table clarifies these signatory requirements:

Entity Type	Domestic or Foreign	Signatories
Corporations	Domestic and Foreign	Executed and acknowledged by the chairperson of the board, president or a vice president **and** also by its secretary or an assistant secretary.
Limited Liability Companies	Domestic	Executed and acknowledged by all managers of the limited liability company (unless a lesser number is specified in the articles of organization or operating agreement).
	Foreign	Executed and acknowledged by one or more managers.
Limited Partnerships	Domestic	Executed and acknowledged by all general partners (unless a lesser number is provided in the certificate of limited partnership or limited partnership agreement).
	Foreign	Executed and acknowledged by one or more general partners.
General Partnerships and Limited Liability Partnerships	Domestic	Executed and acknowledged by two partners (unless a lesser number is provided in the partnership agreement).
	Foreign	Executed and acknowledged by one or more general partners.
Business Trusts; Real Estate Investment Trusts; Unincorporated Associations	Domestic and Foreign	Executed by those persons required or authorized to execute the certificate of merger by the laws under which that party is organized, specifying for that party the provision of law or other basis for the authority of the signing persons.

If the certificate is signed by an attorney-in-fact, the signature should be followed by the words "attorney-in-fact for (name of the person)."

If the certificate is signed by an entity, the person who signs on behalf of the entity should note their name and position/title, the exact entity name and the entity's relation to the merging entity. Example: If a limited liability company ("Smith LLC") is the manager of a merging limited liability company, the signature of the person signing on behalf of Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Manager.

If the certificate is signed by a trust, the trustee should sign as follows: _____ , trustee for _____ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5/1/94).

If the surviving entity or the merging other business entity is a limited partnership, and the certificate is filed by any person other than the general partner(s), the signature must be followed by the words "signature pursuant to Section _____" identifying the appropriate statutory authority. (California Corporations Code section 15902.05(d).)

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§11.58 H. Effective Date of Merger

In general, a merger becomes effective on the filing of the certificate of merger or the agreement of merger, as applicable, in the office of the Secretary of State. However, a certificate of merger or an agreement of merger (see Corp C §17522) may specify a future effective date or time certain, not to exceed 90 days after the date of filing. In this event, the merger becomes effective at that specified future effective date or time. Corp C §17553(a). See Corp C §§15911.15, 16912(a).

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§11.59 I. Surviving Entity Assumes Tax Liabilities of Merging Entities

When two or more business entities merge into an LLC, the surviving LLC will be deemed to have assumed the liability of each disappearing domestic or foreign entity for the obligation to do the following (Corp C §§1155(e), 16915.5(a), 17554.5(a)):

- To prepare and file, or cause to be prepared and filed, tax and information returns otherwise required of the disappearing entities; and
- To pay any tax liability determined to be due.

When a merger involves a California corporation, the surviving LLC succeeds to all the rights and property of each disappearing entity and is subject to all the debts, liabilities, and obligations of each disappearing entity in the same manner as if the surviving entity had itself incurred them, including tax liabilities. Corp C §1113(i)-(j).

NOTE: The former prerequisite of filing a tax clearance certificate is no longer applicable. See former Rev & T C §23334; see also former Corp C §1155(e) before amendment in 2006; Corp C §§1905(b), 1905.1.

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§11.60 J. Recording Evidence of Merger

If an entity that owns California real estate merges with another entity and the law of the state of organization (including California) of any disappearing entity provides that the making and filing of the agreement or certificate of merger vests in the surviving entity all the real property belonging to the disappearing entity, a certified agreement or certificate of merger may be filed in the office of the county recorder of any county in which that real estate is located. The filing will show ownership in the surviving entity of all interest of the disappearing entities in the real property located in the county of filing. Corp C §§1109, 15911.18(a), 16916(a), 17556.

In addition, this filing creates, in favor of a bona fide purchaser or encumbrancer for value, a conclusive presumption that the merger was validly completed. Corp C §§15911.09, 16916(c).

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§11.61 K. Dissenters' Rights

A statutory merger is a "reorganization," which gives dissenters' rights to each LLC member entitled to vote on the merger. Corp C §§17600(a), 17601(a). An LLC member may be entitled to require the LLC to purchase that member's interest at fair market value if that member voted against, or did not vote in favor of, the merger; made demand that the LLC purchase the interest; and submitted to the LLC the certificate representing the interest or a written statement of the number or amount of the interest for which payment is demanded. See Corp C §§17600-17613.

A general partner of a disappearing partnership is entitled to dissociate and require the partnership to purchase the partner's interest in a buyout if that partner did not vote in favor of the merger and did not agree to become a partner or member of the surviving entity. Corp C §§16701, 16914(e).

A limited partner also may be entitled to require the limited partnership to purchase that partner's interest at fair market value if:

- The partner voted against, or did not vote in favor of, the merger;
- The partner demanded that the limited partnership purchase the interest;
- The partner submitted to the limited partnership the certificate representing the interests or a written statement of the number or amount of the interest for which payment is demanded; and
- Corporations Code art 7.6 applies to the limited partnership.

See Corp C §§15911.20-15911.33, 15711.

Similarly, a shareholder entitled to vote on the merger may be entitled to require the corporation to purchase that shareholder's shares at fair market value if that shareholder voted against, or did not vote in favor of, the merger; made demand that the corporation purchase the shares; and submitted to the corporation the certificate representing the shares or a written statement of the number of shares for which payment is demanded. See Corp C §§1300-1312.

The entities participating in a merger are required to send to persons with dissenters' rights a notice that the merger has been approved, copies of the dissenters' rights code sections, the price determined to be the fair market value of the dissenting shares, and a brief description of the dissenters' rights procedures. Corp C §§1301(a), 15911.22(a), 16914(e), 17602(a).

NOTE: Typically, an agreement of merger provides that the merger can be abandoned if too great a percentage of members, partners, limited partners, or shareholders dissent.

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§11.62 L. Abandonment of Merger

Subject to the contractual rights of third parties, including other constituent LLCs and other constituent business entities, a party to a merger may abandon it before it is effective, even after approval, as follows:

- The members of the constituent LLC may abandon the merger by the vote of a majority in interest of the members of the LLC or such greater percentage as may be required by the articles of organization or operating agreement. Corp C §17551(d).
- The general partners of a limited partnership may abandon the merger without further limited partner approval. Corp C §15911.12(d).
- The partners of a general partnership may abandon the merger if the abandonment is approved by the same percentage of partner interests required for approval of the original agreement of merger. Corp C §16911(d).
- The board of directors of the constituent corporation may abandon the merger without further shareholder approval. Corp C §§1113(e), 1201(h).

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§11.63 V. CONVERTING PARTNERSHIPS TO LIMITED LIABILITY COMPANIES OUTSIDE CONVERSION AND MERGER STATUTES

In addition to statutory conversion and merger, a partnership may be converted to an LLC generally by one of at least three alternative methods:

- Alternative 1: The partners contribute their partnership interests to the LLC in exchange for LLC membership interests, and the partnership subsequently liquidates and distributes its assets to its sole partner, the LLC. See §§11.64-11.66.
- Alternative 2: The partnership liquidates and distributes its assets to its partners, who then contribute their undivided interests in the assets to the LLC in exchange for LLC membership interests. See §§11.67-11.69.
- Alternative 3: The partnership contributes its assets to the LLC in exchange for the LLC membership interests, which are then distributed to the partnership members in liquidation of the partnership. See §§11.70-11.72.

NOTE: Before converting a partnership to an LLC, the practitioner should verify that the conversion will not cause a breach or violation of the partnership's or LLC's loan agreements, licenses, or other contracts.

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§11.64 A. Alternative 1: Partners Contribute Partnership Interests to Limited Liability Company

If all the partners agree to convert to an LLC, Alternative 1 is the easiest to implement because the assets of the partnership need be conveyed only once. This alternative avoids the possibility that two levels of transfer tax will be imposed. If there are many partners, however, this approach can be cumbersome because each partner must take the necessary steps to assign partnership interests to the LLC, unless all partners assign their interests in one document.

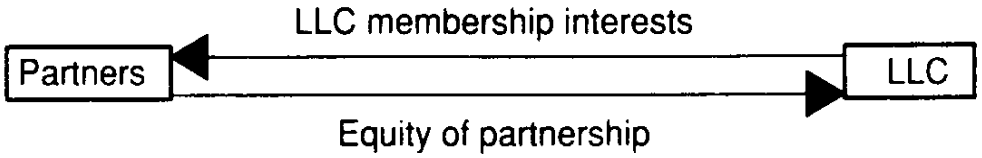
If fewer than all partners cooperate, Alternative 1 is not appropriate because the LLC would have less than all of the partnership interests. Alternative 3 may then provide the best approach. See §§11.70-11.72.

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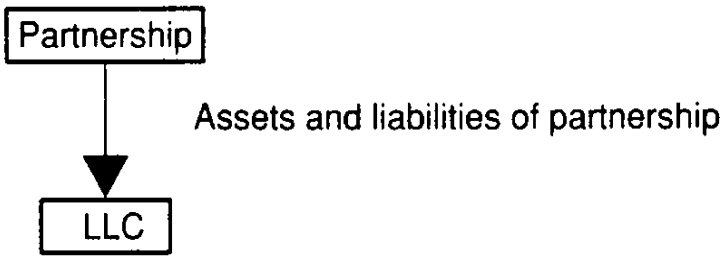
§11.65 1. Diagram: Exchanging Partnership Interests for Limited Liability Company Membership Interests, Steps 1 and 2

Print

STEP 1: Partners contribute partnership interests to the LLC in exchange for membership interests



STEP 2: Partnership dissolves and distributes its assets to its sole partner, the LLC



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§11.66 2. Documentation for Alternative 1 Conversion

To effect a conversion of a partnership to an LLC under Alternative 1, counsel should prepare the following documents:

(a) Exchange and formation agreement. The partners may, but need not, enter into an agreement to contribute their partnership interests to the LLC in exchange for all of the LLC membership interests, subject to terms and conditions such as a list of managers, a requirement that all partners must transfer their interests, and identification of a liquidating partner or committee who will wind up the affairs of the partnership. The proposed articles of organization and operating agreement can be appended to this agreement. The agreement should also detail the mechanics for dissolving the partnership and liquidating its assets to the LLC. On winding up the partnership affairs, see Advising California Partnerships §§16.21-16.28 (3d ed Cal CEB 1999).

(b) Articles of organization. Articles of organization must be filed for the LLC. Corp C §17050. See §§7.14-7.30.

(c) Operating agreement. The operating agreement should contain, in addition to standard provisions, the following information:

- A recitation that the LLC is the successor in interest to a partnership and that the partners elected to convert the partnership to an LLC;
- A recitation of the method of converting the partnership to an LLC;
- A recitation of the percentage or units of LLC membership interests that will be distributed to the members and the percentage interest in or units of the converting partnership that will be contributed;
- The identification of each partner's partnership interest as that member's initial capital contribution; and
- The profit and loss allocation and distribution provisions, which should be similar to the allocations in the original partnership agreement, unless potentially adverse income tax consequences would result because of debt relief (if allocations differ, the transaction may not qualify for the "mere change in form" exception to property tax reassessment; see §§11.21-11.22).

(d) Assignments of partnership interests. All of the partners should execute an assignment of their partnership interests to the LLC in exchange for LLC membership interests. The practitioner must review the partnership agreement to determine if there are any restrictions on assignment. If there are, the partnership must first take any actions necessary to approve the assignment or amend the partnership agreement to permit the transaction. Alternatively, the assignment could be included in the exchange and formation agreement.

(e) Bill of sale. The liquidating partner or committee should execute a bill of sale and any other necessary documents transferring title to all of the partnership's interest in personal property to the LLC.

(f) Grant deeds. The liquidating partner or committee should execute a grant or quitclaim deed transferring title to all of the partnership's interest in real property to the LLC.

(g) Assumption of liabilities and consents. The LLC should assume the obligations of the partnership's liabilities by executing an assumption agreement. The LLC may need to obtain prior written consent to properly assume some liabilities, such as mortgages and leases, without triggering a default.

(h) Documents formally terminating partnership. The partnership must execute, publish, and record notices and certificates of dissolution and of cancellation of the certificate of limited partnership, as appropriate. Corp C §§16805(a), 15902.03. On documents requisite to formal termination of a partnership, see generally Advising Partners, chap 16.

(i) Any documents necessary for securities compliance. The LLC should make all federal and state securities law filings and disclosures required by law.

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§11.67 B. Alternative 2: Partners Contribute Partnership Assets to Limited Liability Company

Alternative 2 may be appropriate if the parties want to specially allocate and distribute assets to partners and not all assets are to be used by the successor LLC.

Under Alternative 2, the partnership assets are conveyed by the partnership to the partners and then by the partners to the LLC in exchange for LLC interests. Because this double transfer could result in two levels of transfer tax, the assets should be deeded directly to the LLC unless the transfer falls within a transfer tax exception.

If there are many partners, this approach can be cumbersome because each partner must take the necessary steps to contribute assets to the LLC.

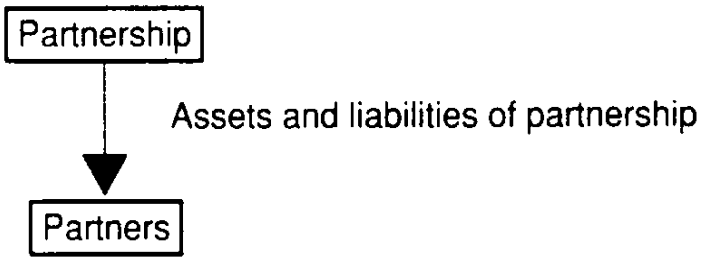
If fewer than all partners cooperate, Alternative 2 is not appropriate because the LLC would have less than all of the partnership assets. Alternative 3 may then provide the best approach. See §§11.70-11.72.

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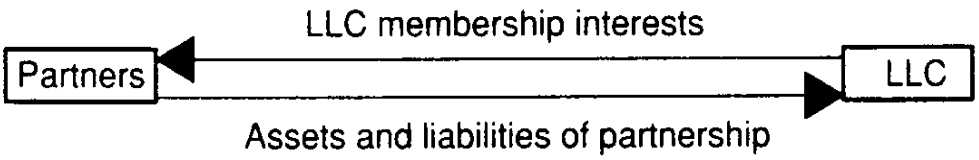
§11.68 1. Diagram: Liquidating Partnership and Contributing Partnership Assets, Steps 1 and 2

Print

STEP 1: Partnership dissolves and distributes its assets to its partners



STEP 2: Partners contribute undivided interests in partnership assets to the LLC in exchange for membership interests



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§11.69 2. Documentation for Alternative 2 Conversion

To effect a conversion of a partnership to an LLC under Alternative 2, counsel should prepare the following documents:

(a) Agreement of liquidation and dissolution. This agreement should detail the terms and conditions of the dissolution, including the following (see Advising California Partnerships, chap 16 (3d ed Cal CEB 1999)):

- As a condition to the liquidation, transfer by all of the partners of their undivided interests in the assets to the newly formed LLC;
- Identify liquidating partner or committee to wind up the affairs of the partnership;
- Provide that partnership assets will be directly deeded and transferred to the LLC to avoid duplication of documentation and potential transfer taxes; and
- Specify the mechanics for dissolving the partnership and liquidating its assets to the LLC, which can serve as a checklist to accomplish this process.

(b) Articles of organization. Articles of organization must be filed for the LLC. Corp C §17050. See §§7.14-7.30.

(c) Operating agreement. The operating agreement should contain, in addition to standard provisions, the following information:

- A recitation that the LLC is the successor in interest to a partnership and that the partners elected to convert the partnership to an LLC;
- A recitation of the method of converting the partnership to an LLC;
- A recitation of the percentage or units of LLC membership interests that will be distributed to the members and the percentage interest in the partnership's assets that will be contributed;
- The identification of each partner's interest in the partnership's assets as that member's initial capital contribution; and
- The profit and loss allocation and distribution provisions, which should be similar to the allocations in the original partnership agreement, unless potentially adverse income tax consequences would result because of debt relief (if allocations differ, the transaction may not qualify for the "mere change in form" exception to property tax reassessment; see §§11.21-11.22).

(d) Assignment of interests. The partners should execute an assignment transferring all of their right, title, and interest in the partnership's assets to the LLC in exchange for LLC membership interests.

(e) Bill of sale. The liquidating partner or committee should execute a bill of sale and any other necessary documents transferring title to all of the partnership's interest in personal property to the LLC.

(f) Grant deeds. The liquidating partner or committee should execute a grant or quitclaim deed transferring title to all of the partnership's interest in real property to the LLC.

(g) Exchange and formation agreement. The partners may, but need not, enter into an agreement to contribute their partnership interests to the LLC in exchange for all of the LLC membership interests, subject to certain terms and conditions, such as a list of managers. The proposed articles of organization and operating agreement can be appended to this agreement so that their terms are binding on the parties to the transaction. In lieu of a separate agreement, these terms can be made a part of the agreement of liquidation and dissolution.

(h) Assumption of liabilities and consents. The LLC should assume the obligations of the partnership's liabilities by executing an assumption agreement. The LLC may need to obtain prior written consent to properly assume some liabilities, such as mortgages and leases, without triggering a default.

(i) Documents formally terminating partnership. The partnership must execute, publish, and record notices and certificates of dissolution and of cancellation of certificate of limited partnership, as appropriate. Corp C §§16805(a), 15902.03. On documents requisite to formal termination of a partnership, see generally Advising California Partnerships, chap 16 (3d ed Cal CEB 1999).

(j) Any documents necessary for securities compliance. The LLC should make all federal and state securities law filings and disclosures required by law.

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§11.70 C. Alternative 3: Partnership Contributes Assets to Limited Liability Company

If there are any uncooperative partners who oppose converting the partnership to an LLC, the partnership must convert under Alternative 3 (unless dissenters are bought out by the partnership or partners before conversion). This alternative may be unavailable, however, unless the partnership agreement permits a transfer of all the partnership's assets with the consent of less than all the partners. Alternative 3 is also the most appropriate approach for conversion of a partnership with a large number of partners because it avoids (1) creation of numerous undivided interests in the assets, (2) transfers of multiple partnership interests to the LLC, and (3) the need for multiple signatories.

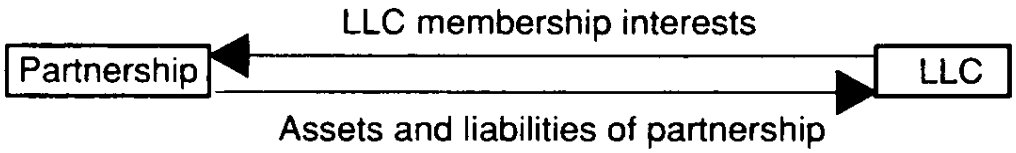
The practitioner should verify that the partnership agreement allows the partnership to transfer all its assets to an LLC. The partnership agreement may be silent about the authority of the partnership, through its general partners, to transfer partnership assets to an LLC in exchange for LLC interests. In such situations, transfer of assets without the consent of all partners is risky. However, the agreement may permit the partnership to transfer substantially all the partnership's assets if more than 50 percent of the interests in the partnership approve the transfer, and may provide for amendment of the agreement by a vote of a majority or supermajority of its partners. If a lesser percentage of interests in the partnership is required to approve an amendment than to approve a transfer, the partnership agreement should be amended. If amendment of the partnership agreement requires a unanimous vote, then all parties must consent to the conversion, and the advantage of converting by Alternative 3 may be lost.

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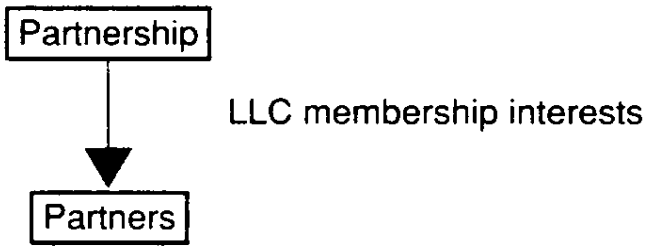
§11.71 1. Diagram: Exchanging Partnership Assets for Limited Liability, Steps 1 and 2

Print

STEP 1: Partnership contributes its assets to the LLC in exchange for membership interests



STEP 2: Partnership dissolves and distributes its remaining assets, the LLC membership interests, to its partners



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§11.72 2. Documentation for Alternative 3 Conversion

To effect a conversion of a partnership to an LLC under Alternative 3, counsel should prepare the following documents:

(a) Amendment of partnership agreement. Counsel should review the partnership agreement to ascertain whether it must be amended before converting to an LLC to allow the partnership to transfer its assets to form an LLC. Any amendment should provide for the following:

- The conversion of the partnership to an LLC on the vote of a majority of the partners;
- The creation of an LLC and the transfer of partnership assets to the newly formed LLC in exchange for membership interests;
- The subsequent liquidation of the partnership and distribution of LLC interests;
- That the conversion is conditioned on no, or only a small number of, dissenters; and
- Any other terms that might be part of an agreement to wind up the affairs of the partnership and dissolve.

(b) Articles of organization. Articles of organization must be filed for the LLC. Corp C §17050. See §§7.14-7.30.

(c) Operating agreement. The operating agreement should contain, in addition to standard provisions, the following information:

- A recitation that the LLC is the successor in interest to a partnership and that the partners elected to convert the partnership to an LLC;
- A recitation of the method of converting the partnership to an LLC;
- A recitation of the percentage or units of LLC membership interests that will be distributed to the members and the percentage interest in or units of the converting partnership that will be contributed;
- The identification of the partnership's assets as that member's (*i.e.,* the partnership's) initial capital contribution; and
- The profit and loss allocation and distribution provisions, which should be similar to the allocations in the original partnership agreement, unless there are potentially adverse income tax consequences because of debt relief (if allocations differ, the transaction may not qualify for the "mere change in form" exception to property tax reassessment; see §§11.21-11.22).

(d) Bill of sale. The partnership should execute a bill of sale and any other necessary documents transferring title to all of the partnership's interest in personal property to the LLC.

(e) Grant deeds. The partnership or committee should execute a grant or quitclaim deed transferring title to all of the partnership's interest in real property to the LLC.

(f) Assignments of LLC membership interests. The partnership should execute an assignment transferring all of its rights, title, and interest in the LLC to the partners.

(g) Documents formally terminating partnership. The partnership must execute, publish, and record notices and certificates of dissolution and of cancellation of certificate of limited partnership, as appropriate. Corp C §§16805(a), 15902.03. On documents requisite to formal termination of a partnership, see generally Advising California Partnerships, chap 16 (3d ed Cal CEB 1999).

(h) Assumption of liabilities and consents. The LLC should assume the obligations of the partnership's liabilities by executing an assumption agreement. The LLC may need to obtain prior written consent to properly assume some liabilities, such as mortgages and leases, without triggering a default.

(i) Any documents necessary for securities compliance. The LLC should make all federal and state securities law filings and disclosures required by law.

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§11.73 VI. CONVERTING CORPORATIONS TO LIMITED LIABILITY COMPANIES OUTSIDE CONVERSION AND MERGER STATUTES

In addition to statutory conversion and merger, a corporation may be converted to an LLC generally by one of at least three alternative methods:

- Alternative 1. The shareholders contribute their stock to the LLC in exchange for LLC membership interests, and the corporation subsequently liquidates and transfers its assets to its sole shareholder, the LLC. See §§11.74-11.76.
- Alternative 2. The corporation liquidates and distributes its assets to its shareholders, who then contribute their undivided interests in the assets to the LLC in exchange for LLC membership interests. See §§11.77-11.79.
- Alternative 3. The corporation contributes its assets to the LLC in exchange for membership interests, which are then distributed to its shareholders on liquidation of the corporation. See §§11.80-11.82.

NOTE: Before converting the corporation to an LLC, counsel should verify that the conversion will not cause a breach or violation of the corporation's or LLC's loan agreements, licenses, or other contracts.

Generally, at least 50 percent of the holders of each class of shares of a corporation must approve the decision to wind up and dissolve the corporation. The board of directors may elect to wind up and dissolve the corporation in limited circumstances. Corp C §1900. On corporate dissolution, see Counseling California Corporations, chap 8 (3d ed Cal CEB 2008).

NOTE: Counsel should examine the corporation's articles of incorporation and bylaws to verify that they do not require a greater percentage of shareholders to approve the dissolution. Additionally, if any preferred shares are outstanding, counsel must ascertain whether the preferred shares must be redeemed, or whether other related requirements must be satisfied, before the corporation may undertake the acts necessary for conversion to an LLC.

The income tax consequences of converting a corporation to an LLC may vary with the alternative chosen. The corporation is liquidated in each of these three alternatives, possibly resulting in a double tax consequence (particularly if assets have appreciated). On income tax consequences of corporate dissolution, see §§11.11-11.14; Counseling Cal Corps §§8.5-8.19.

Just as a merger may be abandoned (see §11.62), the election to dissolve the corporation may be revoked by majority shareholder or board approval, as appropriate, and filing of a certificate of revocation. Corp C §1902.

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§11.74 A. Alternative 1: Shareholders Contribute Stock to Limited Liability Company

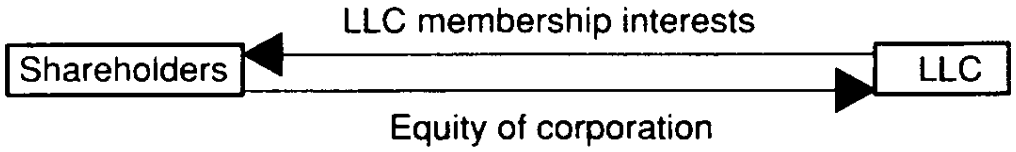
Alternative 1 is appropriate for converting a corporation to an LLC if the parties want to quickly convert and there is no time to get a permit from the DOC. The parties can use the Corp C §25102(f) exemption, if available, and proceed with the conversion, assuming all shareholders contribute their stock.

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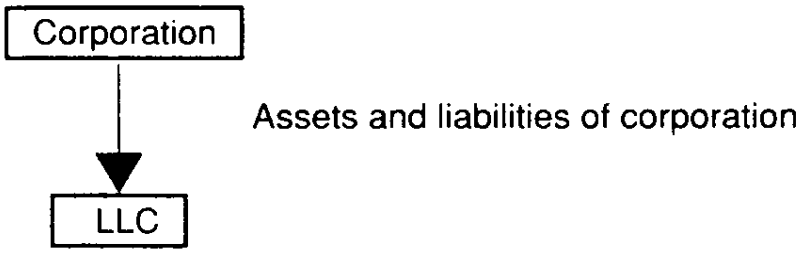
§11.75 1. Diagram: Exchanging Stock for LLC Membership Interests, Steps 1 and 2

Print

STEP 1: Shareholders contribute stock to the LLC in exchange for membership interests



STEP 2: Corporation dissolves and distributes its assets to its sole shareholder, the LLC



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§11.76 2. Documentation for Alternative 1 Conversion

To effect a conversion of a corporation to an LLC under Alternative 1, counsel should prepare the following documents:

(a) Exchange and formation agreement. The shareholders may, but need not, enter into an agreement to contribute their stock to the LLC in exchange for all of the LLC membership interests, subject to certain terms and conditions such as a list of managers and a requirement that all shareholders must transfer their interests. The proposed articles of organization and operating agreement can be appended to this agreement. The agreement should also detail the mechanics for dissolving the corporation and liquidating its assets to the LLC.

(b) Articles of organization. Articles of organization must be filed for the LLC. Corp C §17050. See §§7.14-7.30.

(c) Operating agreement. The operating agreement should contain, in addition to standard provisions, the following information:

- A recitation that the LLC is the successor in interest to a corporation and that the shareholders elected to convert the corporation to an LLC;
- A recitation of the method of converting the corporation to an LLC;
- A recitation of the percentage or units of LLC membership interests that will be distributed to the members and the number of shares of the converting corporation that will be contributed;
- The identification of each shareholder's shares as that member's initial capital contribution; and
- The profit and loss allocation and distribution provisions, which should be similar to the relative interests of the shareholders in the corporation, unless there are potentially adverse income tax consequences because of debt relief (if allocations differ, the transaction may not qualify for the "mere change in form" exception to property tax reassessment; see §§11.21-11.22).

(d) Assignments of stock. All of the shareholders should execute an assignment transferring their stock to the LLC in exchange for LLC membership interests. The assignment could instead be included in the exchange and formation agreement.

(e) Bill of sale. The corporation should execute a bill of sale and any other necessary documents transferring title to all of the corporation's interest in personal property to the LLC.

(f) Grant deeds. The corporation should execute a grant or quitclaim deed transferring title to all of the corporation's interest in real property to the LLC.

(g) Assumption of liabilities and consents. The LLC should assume the obligations of the corporation's liabilities by executing an assumption agreement. The LLC may need to obtain prior written consent to properly assume some liabilities, such as mortgages and leases, without triggering a default.

(h) Documents formally terminating corporation. The corporation must:

- Adopt a resolution or written consent of the shareholders or board, as appropriate, approving the dissolution (Corp C §1900);
- Execute and file a certificate of election to wind up and dissolve, unless all shareholders approve the dissolution (Corp C §1901);
- Send written notice of dissolution to shareholders, creditors, and claimants (Corp C §1903(c));
- File a certificate of dissolution with the Secretary of State (Corp C §1905(b));
- File IRS Form 966 (IRC §6043); and
- Take all other steps necessary to settle the corporation's affairs (Corp C §2001).

On documents formally terminating a corporation, see generally Counseling California Corporations §§8.20-8.58 (3d ed Cal CEB 2008).

(i) Any documents necessary for securities compliance. The LLC should make all federal and state securities law filings and disclosures required by law.

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§11.77 B. Alternative 2: Shareholders Contribute Corporation Assets to Limited Liability Company

The practitioner should consider adopting Alternative 2 if all shareholders agree to the conversion. It generally will be the best approach to follow if not all of the corporate assets will be transferred to the successor LLC. The documentation may be cumbersome, however, if many shareholders are involved.

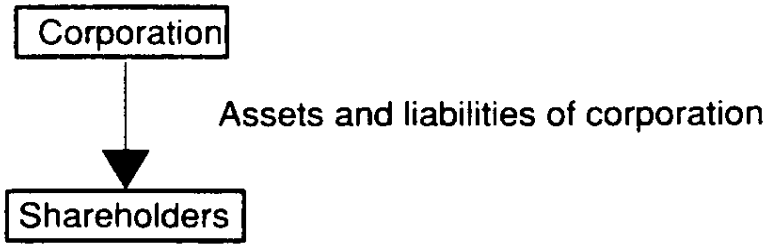
To avoid imposition of transfer tax at two levels, assets to be used by the LLC should be deeded by the corporation directly to the LLC rather than first to the shareholders and then from the shareholders to the LLC.

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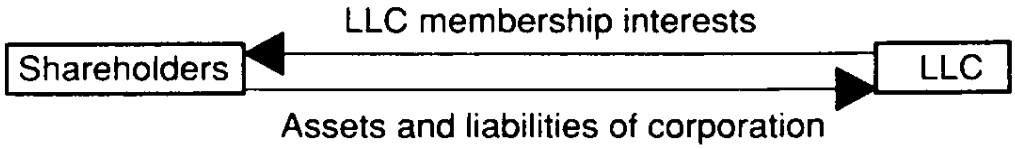
§11.78 1. Diagram: Liquidating Corporation and Contributing Corporation Assets, Steps 1 and 2

Print

STEP 1: Corporation dissolves and distributes its assets to its shareholders



STEP 2: Shareholders contribute undivided interests in corporate assets to the LLC in exchange for membership interests



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§11.79 2. Documentation for Alternative 2 Conversion

To effect a conversion of a corporation to an LLC under Alternative 2, counsel should prepare the following documents:

(a) Plan of distribution. The board of directors or shareholders should consider adopting a plan of distribution containing the terms and conditions of the liquidation, such as the following:

- Transfer by all of the shareholders of their proportionate shares of the assets to the newly formed LLC;
- Authorization and direction for the officers and directors to take the actions necessary to wind up and dissolve the corporation;
- Provision for direct deeding and transfer of the corporation's assets to the LLC to avoid duplication; and
- Identification of the mechanics for dissolving the corporation and liquidating its assets to the LLC, which can serve as a checklist to accomplish this process.

On adopting a plan of distribution generally, see Counseling California Corporations §§8.35-8.38 (3d ed Cal CEB 2008).

(b) Articles of organization. Articles of organization must be filed for the LLC. Corp C §17050. See §§7.14-7.30.

(c) Operating agreement. The operating agreement should contain, in addition to standard provisions, the following statements and information:

- A recitation that the LLC is the successor in interest to a corporation and that the shareholders elected to convert the corporation to an LLC;
- A recitation of the method of converting the corporation to an LLC;
- A recitation of the percentage or units of LLC membership interests that will be distributed to the members and the percentage interest in the corporation's assets that will be contributed;
- The identification of each shareholder's interest in corporate assets as that member's initial capital contribution; and
- The profit and loss allocation and distribution provisions, which should be similar to the relative interests of the shareholders in the corporation, unless there are potentially adverse income tax consequences because of debt relief (if allocations differ, the transaction may not qualify for the "mere change in form" exception to property tax reassessment; see §§11.21-11.2).

(d) Exchange and formation agreement. The shareholders may, but need not, enter into an agreement to contribute their interests in the corporation's assets to the LLC in exchange for all of the LLC membership interests, subject to certain terms and conditions such as a list of managers and a requirement that all shareholders must transfer their interests. The proposed articles of organization and operating agreement can be appended to this agreement.

(e) Bill of sale. The corporation should execute a bill of sale and any other necessary documents transferring title to all of the corporation's interests in personal property to the LLC.

(f) Grant deeds. The corporation should execute a grant or quitclaim deed transferring title to all of the corporation's interests in real property to the LLC.

(g) Assumption of liabilities and consents. The LLC should assume the obligations of the corporation's liabilities by executing an assumption agreement. The LLC may need to obtain prior written consent to properly assume some liabilities, such as mortgages and leases, without triggering a default.

(h) Documents formally terminating corporation. The corporation must:

- Adopt a resolution or written consent of the shareholders or board, as appropriate, approving the dissolution (Corp C §1900);
- Execute and file a certificate of election to wind up and dissolve, unless all shareholders approve the dissolution (Corp C §1901);
- Send written notice of dissolution to shareholders, creditors, and claimants (Corp C §1903(c));
- File a certificate of dissolution with the Secretary of State (Corp C §1905(b));

- File IRS Form 966 (IRC §6043); and
- Take all other steps necessary to settle the corporation's affairs (Corp C §2001).

On documents formally terminating a corporation, see generally Counseling California Corporations §§8.53-8.58 (3d ed Cal CEB 2008).

(i) Any documents necessary for securities compliance. The LLC should make all federal and state securities law filings and disclosures required by law.

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Source: Business Law/Forming and Operating California Limited Liability Companies/11 Conversions and Mergers/ §11.80 C. Alternative 3: Corporation Contributes Assets to Limited Liability Company

§11.80 C. Alternative 3: Corporation Contributes Assets to Limited Liability Company

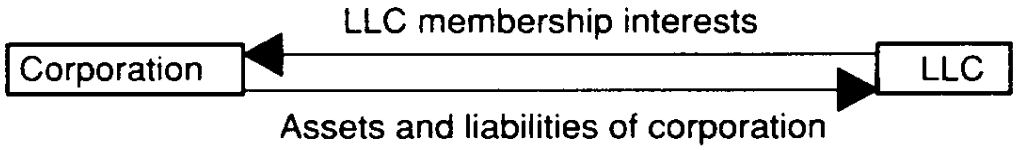
The practitioner should consider adopting Alternative 3 if many shareholders are involved or not all shareholders agree to the conversion.

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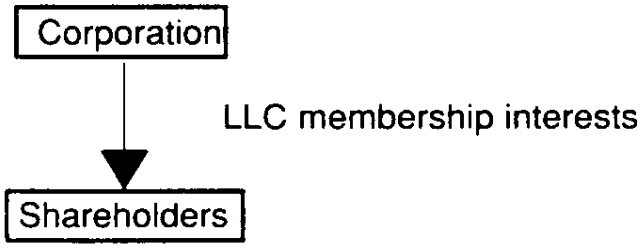
§11.81 1. Diagram: Exchanging Corporation Assets for LLC Membership Interests, Steps 1 and 2

Print

STEP 1: Corporation contributes its assets to the LLC in exchange for membership interests



STEP 2: Corporation dissolves and distributes its remaining assets, the LLC membership interests, to its shareholders



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§11.82 2. Documentation for Alternative 3 Conversion

To effect a conversion of a corporation to an LLC under Alternative 3, counsel should prepare the following documents:

(a) Approval of asset transfer. The board of directors and the shareholders should approve the transfer of the corporation's assets to form an LLC. Corp C §1001(a). The board may abandon the transfer, subject to the contractual rights of third parties. Corp C §1001(b). See §11.62.

(b) Articles of organization. Articles of organization must be filed for the LLC. Corp C §17050. See §§7.14-7.30.

(c) Operating agreement. The operating agreement should contain, in addition to standard provisions, the following information:

- A recitation that the LLC is the successor in interest to a corporation and that the shareholders elected to convert the corporation to an LLC;
- A recitation of the method of converting the corporation to an LLC;
- A recitation of the percentage or units of LLC membership interests that will be distributed to the members and the number of shares of the converting corporation that will be contributed;
- The identification of the corporation's assets as that member's (*i.e.,* the corporation's) initial capital contribution; and
- The profit and loss allocation and distribution provisions, which should be similar to the relative interests of the shareholders in the corporation, unless there are potentially adverse income tax consequences because of debt relief (if allocations differ, the transaction may not qualify for the "mere change in form" exception to property tax reassessment; see §§11.21-11.22).

(d) Bill of sale. The corporation should execute a bill of sale and any other necessary documents transferring title to all of the partnership's interest in personal property to the LLC.

(e) Grant deeds. The corporation should execute a grant or quitclaim deed transferring title to all of the corporation's interest in real property to the LLC.

(f) Assignment of LLC membership interests. The corporation should execute an assignment transferring all of its right, title, and interest in the LLC to the shareholders.

(g) Assumption of liabilities and consents. The LLC should assume the obligations of the corporation's liabilities by executing an assumption agreement. The LLC may need to obtain prior written consent to properly assume some liabilities, such as mortgages and leases, without triggering a default.

(h) Documents formally terminating corporation. The corporation must:

- Adopt a resolution or written consent of the shareholders or board, as appropriate, approving the dissolution (Corp C §1900);
- Execute and file a certificate of election to wind up and dissolve, unless all shareholders approve the dissolution (Corp C §1901);
- Send written notice of dissolution to shareholders, creditors, and claimants (Corp C §1903(c));
- File a certificate of dissolution with the Secretary of State (Corp C §1905(b));
- File IRS Form 966 (IRC §6043); and
- Take all other steps necessary to settle the corporation's affairs (Corp C §2001).

On the formalities of terminating a corporation, see generally, Counseling California Corporations chap 8 (3d ed Cal CEB 2008).

(i) Any documents necessary for securities compliance. The LLC should make all federal and state securities law filings and disclosures required by law.

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12

Issuing and Transferring Membership Interests

Christopher Chediak
William F. Webster

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§12.1 I. SCOPE OF CHAPTER

This chapter addresses the various provisions of the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17656) (the Act), governing the offer, sale, issuance, transfer, and assignment of LLC interests. The applicability of federal and California securities laws to those transactions is discussed in detail, focusing on the exemptions from securities registration or qualification that may be available. The chapter also covers the conditions of a member's withdrawal from the LLC.

An extensive examination of federal and California securities laws is beyond the scope of this chapter. For further discussion of California securities laws, see Organizing Corporations in California, chap 4 (3d ed Cal CEB 2001); Marsh & Volk, Practice Under the California Securities Laws (rev ed 1973). For federal securities law practice, see Loss, Seligman & Paredes, Fundamentals of Securities Regulation (5th ed 2004); Shields & Strouse, Securities Practice Handbook (5th ed 1987).

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II. CHARACTER OF LLC MEMBERSHIP INTERESTS

A. Under the Beverly-Killea Limited Liability Company Act

§12.2 1. LLC's Issuance of Membership Interests

Under the Beverly-Killea Limited Liability Company Act, an LLC may be established with one or more members. Corp C §17050(b).

Following its formation, the LLC may issue additional membership interests at the times provided in the articles of organization or operating agreement and in accordance with the requirements set forth in those documents. Except as provided in the articles of organization or operating agreement, a membership interest may be issued only if a majority in interest of the members, excluding the person acquiring the membership interest, vote in favor of the issuance of the new membership interest and then only when the person acquiring the membership interest becomes a party to the operating agreement. Corp C §17100(a)(1).

The operating agreement or articles of organization may modify or even eliminate the approval requirements for the admission of a member; for example, the operating agreement may provide that a member may be admitted at the discretion of the managers or specify other terms under which a new member may be admitted.

The LLC's operating agreement may provide that a membership interest may be represented by a certificate of interest signed by a manager or officer of the LLC. Corp C §17105. It is unusual for LLCs to issue certificates unless the entity has many members. If certificates are issued, they should bear a legend setting forth any restrictions on transferability. See §§12.31, 12.64.

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§12.3 2. "Membership Interest" Defined; "Economic Interest" Distinguished

The Beverly-Killea Limited Liability Company Act defines "membership interest" as "a member's rights in the limited liability company, collectively, including the member's economic interest, any right to vote or to participate in management, and any right to information concerning the business and affairs of the limited liability company." Corp C §17001(z).

An interest in an LLC may comprise either a "membership interest" or an "economic interest." Both types of interests are personal property of the member or assignee, and neither comprises an interest in the property of the LLC. Corp C §17300. This distinction between a member's interest and ownership of LLC property recognizes the entity status of an LLC. Similarly, Corp C §16203 provides that property acquired by a general partnership is property of the partnership and not of the partners individually.

In general, an economic interest comprises the economic rights normally represented by a membership interest; *i.e.,* it is the "right to share in the income, gains, losses, deductions, credit, or similar items of, and to receive distributions from, the limited liability company." Corp C §17001(n), (z). However, an economic interest expressly does not include the right to vote or to participate in management (Corp C §17001(n)), and the right to information concerning the business and affairs of the LLC is limited to obtaining the following types of information specified in Corp C §17106(a) for purposes reasonably related to the holding of an economic interest:

- A current list of the full name and last known address (either business or residence) of each member and holder of an economic interest, including their respective contributions and share of profits and losses;
- A current list of the full name and address (either business or residence) of each manager of the LLC if the articles provide for managers of the LLC;
- Copies of the federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years; and
- Any written operating agreement of the LLC.

See Corp C §17058(a)(1)-(2), (4).

Each economic interest holder also has the right, on reasonable request, to inspect and copy during normal business hours any record required to be maintained at the principal office of the LLC (Corp C §17058; see §§13.16-13.17) and to obtain from the manager a copy of the LLC's federal, state, and local tax or information returns for each year. Corp C §17106(b)(1)-(2). These requests must be for purposes reasonably related to the interest of that person as an economic interest holder. Corp C §17106(b).

Corporations Code §17005(b)(4) provides that the rights of a "member" to information regarding the LLC as specified in Corp C §17106 may not be varied by either the articles of organization or the operating agreement of the LLC.

Despite the potential ambiguity between the scope of the waiver prohibitions of Corp C §17005(b)(4), which applies to rights of members only, and Corp C §17106(h), which forbids any waiver of the information rights provided in §17106, as a matter of policy the waiver prohibition should protect both members and economic interest holders.

Both membership and economic interests in an LLC may be transferred in whole or in part. Corp C §17301(a)(1). The Act allows significant flexibility with regard to the sale, issuance, and assignment of membership and economic interests in an LLC. However, the securities laws may inhibit or greatly restrict that flexibility.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.4 3. Creating Separate Series or Classes of Membership Interests

§12.4 3. Creating Separate Series or Classes of Membership Interests

The articles of organization or operating agreement may provide for the creation of different classes or series of membership interests. Corp C §17102. Either document may also provide for specific classes to be senior to other classes and designate specific classes of members for voting purposes. Corp C §17103(a). Accordingly, an LLC may be structured to accommodate differing types of membership interests and interests issued at different times during the term of the LLC.

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4. Transfers of Membership Interests

§12.5 a. By Members

Economic or membership interests may be assigned in whole or in part. Corp C §17301. Unless the articles of organization or operating agreement specifies different requirements for the transfer of membership interests, a majority in interest of the members not transferring their interests must vote in favor of the admission of a new member or for the admission of an assignee as a member. Corp C §§17301(a)(1), 17303(a).

To become a member, the transferee or assignee must become a party to the operating agreement. Corp C §17100(a)(1). If a member assigns a membership interest without obtaining the required approval from the other members, the assignment will transfer only an economic interest and the assignee will not become a member. See §12.3.

Whenever a new member is added, the member must be added to the list of members required by Corp C §17058(a)(1).

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.6 (1) Rights and Obligations of Assignor

§12.6 (1) Rights and Obligations of Assignor

Unless otherwise provided in the operating agreement or articles of organization, following assignment of an interest, the assignor will continue to be a member until the assignee of that interest becomes a member and will have all rights of membership, except the assigned rights. Corp C §17301(a)(4). The assignor of a membership interest or economic interest is not released from liability as a member solely by reason of the assignment. Corp C §17301(b). The assignor is obligated to

- Contribute cash or property or to contribute services under Corp C §§17200-17201; and
- Return prohibited distributions under Corp C §17254(e).

In addition, the assignor is liable for

- Improper distributions for which the assignor voted that are in violation of any of the operating agreement provisions (Corp C §17255(a)); and
- Prohibited distributions made in violation of Corp C §17254 or §17303(c) (liquidating payments to creditors).

The continuing liability of an assignor may be modified by the operating agreement. Modifications will be effective against the LLC and other members, but not necessarily against creditors. Corp C §17201(b)(2), (d). A member's continuing obligation to make contributions is an example of a liability that a creditor may seek to enforce. If the operating agreement does not modify that obligation, an assignor may wish to obtain relief through an amendment of the operating agreement or a release from the LLC and all its members. However, that amendment or release will not be effective against a creditor who relied on the contribution obligation of the assignor in extending the credit. Corp C §17201(b)(2).

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§12.7 (2) Rights and Obligations of Assignee

An assignee who holds only an economic interest will have no right to vote, participate in management, or exercise any other rights of a member unless the articles of organization or operating agreement grants any such rights to holders of economic interests. Corp C §17301(a)(2). An assignee of an economic interest is entitled only to distributions of property or cash and allocations of taxable income, gain, loss, deduction, and credit. Corp C §17301(a)(3). In addition, an economic interest holder is entitled to obtain the types of information required under Corp C §17106. See §12.3.

An assignee who becomes a member has the rights and powers and is subject to the restrictions and liabilities of a member (to the extent assigned). On becoming a member, the assignee is also liable for the obligations of the assignor to make contributions and return any prohibited distributions. Corp C §§17303(b), 17254. However, the assignee is not obligated for liabilities unknown to the assignee at the time the assignee became a member and that could not be ascertained from the articles of organization or operating agreement. Corp C §17303(b).

The assignee's obligation to make contributions and return prohibited distributions may be modified by the operating agreement or articles of organization. Corp C §17005. Any modification may excuse or reduce the assignee-member's obligation to the LLC and other members, but may not be effective against creditors. Corp C §17005(b), (d). Certain creditors may have superior rights, *e.g.,* creditors with knowledge of the obligation who extended credit before the assignee's obligation was compromised, or creditors who may assert rights under the fraudulent conveyance laws, bankruptcy laws, or general principles of equity. See Corp C §§17201(b)(2), 17201(d); §§6.23-6.33. A prudent assignee will evaluate his or her obligations under the operating agreement and articles of organization before accepting an assignment. If the operating agreement is oral, the assignee may wish to enter into a written agreement with the assignor and the LLC specifying his or her obligations before accepting the assignment.

An assignee of the economic interest may incur a potential tax liability for future gain unless an IRC §754 election to step up basis is in effect when the sale occurs. See §5.79.

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b. Other Transfers

§12.8 (1) Rights of Secured and Judgment Creditors

A security interest in or other encumbrance against a member's interest does not provide the secured creditor with the power to exercise any rights or powers of a member. Corp C §17301(c). The secured creditor obtains rights to the economic interest of the member.

A lien by a judgment creditor against a member's interest is created by service of a notice of motion for a charging order on the member and all other members of the LLC and continues unless the order is denied. CCP §708.320. A judgment creditor of a member may charge the "assignable" membership interest of a member without becoming a member. Corp C §17302(b).

A court may appoint a receiver of the share of a member's distributions from the LLC that are "due or to become due" to a member who is a judgment debtor and may "make all other orders, directions, accounts, and inquires that the member might have made or that the circumstances of the case may require." Corp C §17302(a).

To obtain the balance of the benefits of the economic interest, the creditor must establish a right to foreclose on the membership interest. The court may order a foreclosure on the membership interest at any time and the purchaser at the foreclosure sale obtains the rights of an "assignee." Corp C §17302(b). The judgment debtor and the other members of the LLC retain the right to redeem the membership interest at any time before foreclosure. Corp C §17302(c). If the membership interest is redeemed by one or more of the other members with property of the LLC, all members whose membership interests are not changed must consent to the redemption. Corp C §17302(c).

The charging order rules of Corp C §17302 provide the exclusive remedy for a judgment creditor to satisfy a judgment out of a membership or economic interest in an LLC. Corp C §17302(e).

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§12.9 (2) Effect of Member's Death or Incompetence

If a member dies, or is judged legally incompetent, the member's executor, administrator, guardian, or other legal representative may exercise all of the member's rights for the purpose of settling the estate or administering the member's property. Corp C §17304(c). These rights include any power the member has under the articles of organization or operating agreement to give an assignee the right to become a member. See §§6.19-6.20. When the estate's assets include an interest in an LLC, the representative must determine the nature of the LLC interest and whether the interest may be transferred. Ownership of an LLC interest should be distinguished from membership in the LLC. A nonmember ownership interest is like the interest of a nonpartner assignee in a partnership or limited partnership. It is entirely economic and excludes member rights such as the right to participate in management, to vote on certain matters, and to inspect the LLC's books and records. The articles of organization or the operating agreement of most LLCs place restrictions on the transfer of membership interests for business and tax reasons. The most obvious business reason for such restrictions is the desire of LLC members to maintain control over who may become a member.

If the member is a corporation, trust, or other entity, and is dissolved or terminated, the member's powers may be exercised by its legal representatives or successor. Corp C §17304(b). The death, incompetency, or dissolution of a member may also be a basis for dissolution of the LLC. See §§1.23, 6.19.

The operating agreement or articles of organization may modify the rights attributable to a deceased or dissolved member to the extent that the modifications are reasonable. Corp C §17100(c). The legal representative of a dead or dissolved member should review the operating agreement and the articles of organization to determine that member's rights.

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§12.10 c. Through Conversion or Merger Procedures

The Beverly-Killea Limited Liability Company Act provides procedures for converting an LLC into another business entity or foreign LLC or merging an LLC into one or more domestic or foreign business entities, and, conversely, for converting or merging other business entities into an LLC. Corp C §§17540.2, 17550(a). Conversions and mergers are discussed in detail in chap 11. No conversion or merger of an LLC may occur unless the other business entities participating are authorized to effect a conversion or merger under the laws applicable to those entities. Corp C §§17540.2, 17550(b). On completion of a conversion, the interests in the LLC are converted into interests in another business entity or foreign LLC. On completion of a merger, the interests in the LLC may be converted into interests in another form or entity or the other entities' owners may obtain interests in the LLC.

The transfer of interests incident to a merger has both securities and tax consequences; see §§12.34, 12.74-12.75 and chap 11.

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§12.11 B. Membership Interests Under State and Federal Securities Laws

An LLC interest may be a security for purposes of federal securities laws and generally should be treated by counsel as a security under California securities laws (see §§12.47-12.48; Corp C §25019). As a result, any offer, sale, issuance, or transfer of an LLC interest may be subject to the registration requirements of federal securities laws and qualification requirements of California securities laws.

The federal securities laws governing offers and sales of securities are the Securities Act of 1933 (the Securities Act), as amended (15 USC §§77a-77aa), the Securities Exchange Act of 1934 (the Exchange Act), as amended (15 USC §§78a-78oo), and the rules, regulations, and administrative rulings of the Securities and Exchange Commission (the SEC). California's securities laws are contained in the California Corporate Securities Law of 1968 (the California Securities Law) (Corp C §§25000-25707) and the Rules of the California Corporations Commissioner (10 Cal Code Regs §§250.9-260.617). Offers and sales of securities to residents of other states are also governed by the securities laws of the state in which the transaction occurs.

Even if an exemption from registration and qualification is available, state and federal antifraud laws will apply if the interest is a security. Under Corp C §25120, qualification may also be necessary with respect to an exchange incident to a conversion, merger, or other change in the "rights, preferences or privileges" of the interests involved. See Corp C §25005.1. If an LLC interest is offered, sold, or transferred to a resident of another state, counsel also must comply with the securities laws of that state.

In addition, if the interest is a security under federal securities law, the parties selling the securities may have to be licensed to sell the securities under the "broker-dealer" requirements of 15 USC §78*o*, and the parallel California licensing requirements of Corp C §25210 (but see the exemption for issuers in Corp C §25004). Thus, counsel must evaluate the application of both state and federal securities laws with respect to any offer, issuance, sale, or transfer of an LLC interest, or any change in the rights, preferences, or privileges of any membership interest.

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III. APPLICATION OF FEDERAL SECURITIES LAWS TO ISSUANCE AND TRANSFER OF MEMBERSHIP INTERESTS

§12.12 A. "Security" Includes Investment Contract

Whether an LLC interest is a "security" under federal law depends on the facts and circumstances of each situation. *SEC v W. J. Howey Co.* (1946) 328 US 293, 298, 90 L Ed 1244, 1249, 66 S Ct 1100; see §12.14 on the *Howey* test for determining whether an investment contract is a security. Section 2(a)(1) (15 USC §77b(a)(1)) of the Securities Act (15 USC §§77a-77aa) lists instruments defined as "securities," including "stock," "bond," "note," and "debenture." Also listed is "investment contract," which is a broadly defined term encompassing other instruments that are considered to be securities. Limited partnership interests are not specified in the Securities Act, but are usually deemed to be securities because they are "investment contracts." Nor are general partnership interests listed specifically, but they may comprise investment contracts, and thus securities, in certain circumstances. *Williamson v Tucker* (5th Cir 1981) 645 F2d 404. See §12.15 for discussion of the *Williamson* test. Likewise, LLC interests are not specified in the Securities Act, but may be "investment contracts" and thus securities.

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B. When an LLC Interest Is an Investment Contract

§12.13 1. By Analogy to General Partnership Interest

General partnership interests are generally not deemed to be securities, because general partners will usually have the power (whether they exercise it or not) to exercise meaningful control over, and participate in, the management of the entity. *Matek v Murat* (9th Cir 1988) 862 F2d 720. See §12.15 on the element of investor control as an indicator used in the analysis of whether an investment is a security. Because an LLC is generally a closely held company whose members may, by statute, participate in the management and control of the company, and because any member potentially may exercise that right, an LLC should be considered more closely analogous to a general partnership than to a limited partnership in determining whether the equity interests are investment contracts and thus securities. Limited partnership interests are presumed to be securities because state law governing limited partnerships precludes limited partners from exercising meaningful control in managing the entity.

The analogy to general partnerships may apply even in the case of manager-managed LLCs because the members may exercise participatory and management powers without jeopardizing their limited liability protection. However, the fact that those members may have no *actual* power to participate and manage may indicate that the membership interests are more closely akin to investment contracts and, accordingly, to securities. Also, a significant distinction between an LLC and a general partnership is the liability protection afforded members. Nevertheless, the most appropriate test should be that applicable to a general partnership interest.

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§12.14 a. Profits Derived From the Efforts of Others: The *Howey* Test

In determining whether general and limited partnership interests, which are the equity interests most similar to LLC interests, are "investment contracts" and thus securities, a crucial element has been whether profits are derived "solely from the efforts of a promoter or third party." This element is the one on which courts have focused. In *SEC v W. J. Howey Co.* (1946) 328 US 293, 298, 90 L Ed 1244, 1249, 66 S Ct 1100, the U.S. Supreme Court defined an "investment contract" as "a contract, transaction or scheme whereby a person invests his or her money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."

Significant case law has developed interpreting each of the elements of the *Howey* test for an investment contract. In refining the *Howey* elements, the Supreme Court and commentators have concluded that "money" need not be cash. *International Bhd. of Teamsters v Daniel* (1979) 439 US 551, 560 n12, 58 L Ed 2d 808, 817 n12, 99 S Ct 790. The circuit courts disagree over whether a "common enterprise" requires a horizontal pooling of investments or merely a single investor and single promoter and have not agreed on precisely the types of returns that may comprise "profits." With respect to the requirement that the profits arise "solely" from the efforts of others, the Ninth Circuit has required the "efforts" to be merely "undeniably significant ones, [that is,] those essential managerial efforts which affect the failure or success of the enterprise." *SEC v Glenn W. Turner Enters., Inc.* (9th Cir 1973) 474 F2d 476, 482. Courts have found investment contracts where significant efforts included the prepurchase exercise of expertise by promoters in selecting or negotiating the price of an asset in which investors would acquire an interest. *SEC v Mutual Benefits Corp.* (11th Cir 2005) 408 F3d 737, 743; see also *Consolidated Mgmt. Group, LLC v Department of Corps.* (2008) 162 CA4th 598, 75 CR3d 795 (LLC acting as joint venture partner had already selected oil and gas exploration and drilling equipment and set its purchase price before soliciting investors; these facts alone might have supported finding of investor dependence). In deciding whether the *Howey* test is met, "form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v Knight* (1967) 389 US 332, 336, 19 L Ed 2d 564, 88 S Ct 548. The United States Supreme Court has held that an investment scheme is not excludable from the investment contract characterization merely because it promises a fixed rather than variable return. *SEC v Edwards* (2004) 540 US 389, 157 L Ed 2d 813, 124 S Ct 892.

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§12.15 b. Investor Lacks Ability to Control Management: The *Williamson* Test

For determining when a general partnership interest is a security because it is an "investment contract," the Ninth Circuit, in *Hocking v Dubois* (9th Cir 1989) 885 F2d 1449 and *Holden v Hagopian* (9th Cir 1992) 978 F2d 1115, adopted the test set forth in *Williamson v Tucker* (5th Cir 1981) 645 F2d 404. The essential inquiry under *Williamson* is whether, although on the face of the partnership agreement the investor *theoretically* retains some powers in managing the affairs of the partnership, he or she nonetheless can demonstrate that *in fact* he or she is unable to exercise any meaningful partnership control or power. The court offered these three examples of such a demonstration (645 F2d at 424):

(1) There is an agreement among the parties that leaves so little power in the hands of the partner that he is the equivalent of a limited partner;

(2) A partner is so inexperienced and unknowledgeable about business affairs that he is incapable of exercising his partnership powers; and

(3) A partner is so dependent on some unique entrepreneurial or management ability of the promoter or manager that he cannot replace the promoter or manager or otherwise exercise meaningful partnership powers.

NOTE: The second factor, involving the experience and knowledge of the investors, has been applied differently in different federal circuits. In the Ninth Circuit, "[t]he proper inquiry is whether the partners are inexperienced or unknowledgeable 'in business affairs' generally, not whether they are experienced and sophisticated in the particular industry or area in which the partnership engages and they have invested." *Holden,* 978 F2d at 1121. The Fifth Circuit, on the other hand, interprets its decision in *Williamson* to require that "the investors' expertise… be considered in relation to the nature of the underlying venture." *Long v Shultz Cattle Co.* (5th Cir 1989) 881 F2d 129, 135. In *Consolidated Mgmt. Group, LLC v Department of Corps.* (2008) 162 CA4th 598, 75 CR3d 795, the state court of appeal chose to follow the Fifth Circuit's approach, rather than the Ninth Circuit's, finding it to be more consonant with *Howey* and the remedial purpose of the securities laws, and one that takes into account the reality that general business sophistication does not necessarily equip an investor to manage a specialized enterprise. 162 CA4th at 612.

Subsequent cases interpreting *Williamson* have limited the situations in which general partnership interests may be considered securities and effectively have created a presumption that general partnership interests are not securities. See, *e.g., Rivanna Trawlers, Inc. v Thompson* (4th Cir 1988) 840 F2d 236.

For LLCs applying the *Williamson* test, the inquiry is this: To what extent does the LLC member hold actual power over the management and affairs of the entity? Given the flexibility of LLCs and the wide variety of characteristics for membership interests, this inquiry requires analysis sharply focused on the *specific* powers that a *particular* member *actually exercises* in managing the affairs of the LLC.

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§12.16 2. Other Tests of Interest as Security: "Similar Circumstances" and "Family Resemblance"

Although the *Williamson* and *Howey* analyses would appear to be the appropriate tests for whether LLC interests are securities, other tests also may be applicable. In *Landreth Timber Co. v Landreth* (1985) 471 US 681, 85 L Ed 2d 692, 105 S Ct 2297, the Supreme Court set forth what has become known as the "similar circumstances test." Under this test, the Supreme Court noted that an instrument's label should have little bearing on its status as a "security." The Court examined whether an instrument has attributes of common stock, emphasizing:

- The right to receive profits based on one's equity interest in the entity;
- The ability to vote based on the equity interest;
- The negotiability of the instrument;
- The ability to pledge the instrument; and
- The possibility of appreciation in value of the instrument.

The Supreme Court provided another test in *Reves v Ernst & Young* (1990) 494 US 56, 64, 108 L Ed 2d 47, 59, 110 S Ct 945. This test, known as the "family resemblance test," was used to determine whether a "note" was a security, and examined such factors as the motivations of the purchaser and seller, the plan of distribution, the reasonable expectations of the investing public, and the existence of a different regulatory framework to protect the investor. Some commentators have applied the "similar circumstances test" and the "family resemblance test" to conclude that a presumption should arise that LLC interests are securities. See Steinberg & Conway, *The Limited Liability Company as a Security*, 19 Pepperdine L Rev 1105 (1992).

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§12.17 3. Investment-as-Security Analysis Applied to a Specific LLC Interest

Counsel's analysis should start with the *Williamson* test and a determination of whether the operating agreement and articles of organization allow the members any significant power in excess of that typically afforded a limited partner. It is probable that most LLCs will grant members powers greater than those of a limited partner. Accordingly, counsel must next consider whether the members exercise those powers. Members' lack of experience or knowledge could make them entirely dependent on managers, and similar to limited partners. However, members' interest in profits and preservation of invested capital should encourage their participation and exercise of the powers, and make them, by analogy, closer to general partners.

If the LLC is a joint venture between very few sophisticated members (two or three), in which all members are actively participating, the federal securities laws probably do not apply. Nonetheless, if the status of the LLC interest as a security under federal law is uncertain, issuers and sellers of LLC interests should treat the interests as securities until more guidance is provided by the courts.

For further information regarding analysis of whether LLC interests should be presumed securities, see Sargent, *Are Limited Liability Company Interests Securities?*, 19 Pepperdine L Rev 1069, 1098-1100 (1992); Steinberg & Conway, *The Limited Liability Company as a Security*, 19 Pepperdine L Rev 1105, 1116 (1992).

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§12.18 C. Registering Transactions Under the Securities Act

A practitioner who has determined that the LLC interest being issued or transferred may be defined as a security under federal securities laws must next determine whether it must be registered or is exempt from registration.

Under Securities Act §5 (15 USC §77e), any offer to buy or sell a security by use of the mails or the facilities of interstate commerce must be registered with the SEC unless the *security* or *transaction* is exempt. For definitions of the key terms, *e.g.*, offer and sale, interstate commerce, refer to the sources cited in §12.1.

If an offer or sale is not registered, and no exemption is available, the issuer or seller is liable to the purchaser for the amount of the investment or for damages if the security has been subsequently resold. The issuer or seller may also be subject to fines and imprisonment if the violation was willful. Securities Act §§12 and 24 (15 USC §§77*l*, 77x).

Registration under the Securities Act is an expensive and time-consuming process that requires several months to complete. Fortunately, the Securities Act provides a number of exemptions from registration that are available to the majority of transactions in LLC membership or economic interests.

NOTE: The exemptions apply only to the registration requirements of the Securities Act; there is no exemption from the antifraud or civil liability provisions of the securities laws. See Securities Act §§12, 17 (15 USC §§77*l*, 77q) and Exchange Act §10(b) (15 USC §78j(b)); §§12.38-12.41.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.19 D. Securities and Transactions Exempt From Registration Requirement

§12.19 D. Securities and Transactions Exempt From Registration Requirement

Exemptions from the registration requirement, found in Securities Act §§3 and 4 (15 USC §§77c(a)-(b), 77d), fall into two basic categories: one for *securities* and one for *transactions*.

Exempt securities include securities issued and guaranteed by the United States or any state, by certain nonprofit organizations, by a regulated bank or savings and loan, or by a bankruptcy debtor-in-possession.

Exemptions based on the type of transaction more often apply to newly formed business organizations. Examples are:

- Nonpublic offerings by an issuer (Securities Act §4(2));
- Intrastate transactions (Securities Act §3(a)(11));
- Sales (essentially resales) by any person other than an issuer, underwriter, or dealer (Securities Act §4(1)); and
- Sales to accredited investors (Securities Act §4(6)).

An issuer of LLC interests is most likely to use one of the exemptions described in §§12.20-12.27 for nonpublic offerings or for limited offerings under Regulation D.

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§12.20 1. Nonpublic Offerings

Most LLC issuances are likely to be made to a small number of investors. Accordingly, most LLC offerings will be small offerings that should not involve a public offering.

Securities Act §4(2) (15 USC §77d(2)) provides an exemption from registration for "transactions by an issuer not involving any public offering." Significant litigation has arisen concerning whether a particular transaction involves a public offering. The parameters of the exemption are still not entirely clear. Section 4(2) is a nonexclusive exemption and a practitioner may use §4(2) and another exemption. For example, a private offering to investors may be structured to fit within one of the "safe harbors" available under Rule 504, 505, or 506 of Regulation D (17 CFR §§230.504-230.506) (see §§12.24-12.27), or as an intrastate offering exempt under Rule 147 (17 CFR §230.147) (see §12.29). In either of these cases, if the issuer fails to qualify the transaction under the safe harbor, the issuer may be able to rely on the §4(2) exemption as a "fallback position."

It is generally not advisable for a practitioner to rely solely on §4(2), except in an offering to a few insiders when only one financing of the enterprise is contemplated. For example, the initial issuance of stock to the founder of a closely held corporation would clearly be exempt under §4(2). For other small offerings, counsel should use the exemption provided by Regulation D or Rule 147.

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a. Requirements for a Nonpublic Offering

§12.21 (1) Information Available to Investors

In *SEC v Ralston Purina Co.* (1953) 346 US 119, 125, 97 L Ed 1494, 1498, 73 S Ct 981, involving the issuance of stock to employees, the Supreme Court held that

> the applicability of §4(2) should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering."

In determining whether the offerees in *Ralston Purina* were in need of the protection of the Beverly-Killea Limited Liability Company Act, a critical factor was whether the offerees had "access to the kind of information which registration would disclose."

The SEC provided further guidance in Release No. 33-4552 (Nov. 6, 1962) 27 Fed Reg 11316, stating that

> [w]hether a transaction is one not involving any public offering is essentially a question of fact and necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, the nature, scope, size, type and manner of the offering.

The release then lists a number of factors to consider, such as number and identity of offerees, size and manner of offering, and the actions and intent of the investors.

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§12.22 (2) Securities Have "Come to Rest"

An important factor in assessing the availability of a transaction exemption under Securities Act §4(2), set forth in SEC Release No. 33-4552 (Nov. 6, 1962) 27 Fed Reg 11316, is "whether the securities offered have come to rest in the hands of the initial informed group or whether the purchasers are merely a conduit for a wider distribution." Persons acting as "conduits" are deemed to be "underwriters," as defined in Securities Act §2(a)(11) (15 USC §77b(a)(11)). If an issuee of securities promptly resells the securities, the availability of the §4(2) exemption by the issuer will be jeopardized. Even an issuance of interests to only a small number of members may not be completed under §4(2) if some members intend to resell membership or economic interests in the LLC.

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§12.23 b. Investor Representations and Legend Requirements

An issuer relying on the Securities Act §4(2) exemption may use several means to protect the exemption against investors who are purchasing with the intent to distribute. One method is to require each investor to sign an agreement containing representations of his or her investment intent, such as a subscription agreement (see form in §12.59) or an investor questionnaire (see form in §12.60). Another is to place a legend on the face of any certificate as evidence of the LLC interests' status as "restricted securities." See form in §12.31. The SEC has stated that these legends on stock certificates "are not to be regarded as a basis for exemption, but they have proved in many cases to be an effective means of preventing illegal distributions." Release No. 33-5121 (Dec. 30, 1970) 36 Fed Reg 1525. A legend on an LLC certificate may be less effective than on a share certificate; however, the operating agreement or articles of amendment may also include the requirement that any resales comply with Rule 144 (17 CFR §230.144; see §12.36). Preventing the transfer of mere economic interests will be more difficult. A resale of economic interests may also jeopardize the availability of an exemption under §4(2).

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.24 2. Limited Offerings--Regulation D

§12.24 2. Limited Offerings—Regulation D

Because of the uncertainty of the availability of the nonpublic offering exemption, in 1982 the SEC promulgated Regulation D (17 CFR §§230.501-230.508), which provides safe harbors from the registration requirement of the Securities Act for three different types of transactions, set forth in Rules 504-506 (17 CFR §§230.504-230.506). Rules 501-503 (17 CFR §§230.501-230.503) and 507-508 (17 CFR §§230.507-230.508) set forth conditions applicable to all three exemptions. The safe harbors provided by Regulation D are nonexclusive, both with respect to each other and to other statutory exemptions. An issuer may therefore tailor a transaction to comply with several exemptions to ensure that at least one will apply.

One of the safe harbors discussed in §§12.25-12.27 will usually be available for an offering of LLC interests since LLCs are likely to be closely held.

NOTE: Effective March 16, 2009, all Form D filings must be made electronically. See 17 CFR §230.503T.

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§12.25 a. Rule 504: Offerings Up to $1,000,000

Rule 504 (17 CFR §230.504) establishes a safe harbor from the registration requirements of the Securities Act for transactions with an aggregate offering price not exceeding $1,000,000, less the aggregate offering price of all other securities sold under either Rule 504 or 505, or in violation of the Securities Act §5 registration requirement (17 CFR §230.505), within the preceding 12 months. See requirements of integrating and combining different offerings in Rule 502 (17 CFR §230.502).

Under Rule 504, an issuer may offer and sell its securities to an unlimited number of persons without regard to their sophistication or experience. The exemption is available only for companies that

- Do not report under the Exchange Act;
- Are not investment companies; and
- Are not development stage or "blind pool" companies.

Unlike offerings under Rules 505 and 506 (17 CFR §230.506), offerings under Rule 504 are not subject to the prohibition on advertising contained in Rule 502 and are not deemed to be "restricted securities" under Rule 144 (17 CFR §230.144). Nor are offerings under Rule 504 subject to the information delivery requirement contained in Rule 502. Like Rules 505 and 506, Rule 504 requires the issuer to file a Form D Notice of Sale with the SEC within 15 days of the first sale of a security as provided in Rule 503.

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§12.26 b. Rule 505: Offerings Up to $5,000,000

Rule 505 (17 CFR §230.505) establishes a safe harbor from the registration requirements of the Securities Act for transactions with an aggregate offering price not exceeding $5,000,000 less the offering price of any other securities sold under either Rule 504 (17 CFR §230.504) or 505, or in violation of the Securities Act §5 registration requirement, within the preceding 12 months. (See requirements of integrating and combining different offerings in Rule 502 (17 CFR §230.502).) Under Rule 505, an issuer may offer and sell to an unlimited number of accredited investors and to 35 nonaccredited investors. 17 CFR §230.501(e). Accredited investor is defined in Rule 501 (17 CFR §230.501), and includes individuals and entities who, because of their wealth, size, or status are presumed to be able to look out for their own interests and bear the economic risk of investment.

The exemption is not available for investment companies, and violations of certain provisions that would preclude an issuer from using Regulation A (the so-called "bad boy" provisions of Rule 262 (17 CFR §230.262)) will also preclude the use of Rule 505. All of the conditions contained in Rule 502 are applicable to offerings relying on the Rule 505 safe harbor:

(1) A disclosure document conforming to the appropriate level of information must be provided to all unaccredited investors;

(2) No advertising is allowed; and

(3) The securities issued are restricted securities.

Rule 503 (17 CFR §230.503) is also applicable: Form D must be filed within 15 days of the first sale of a security.

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§12.27 c. Rule 506: Offerings With No Monetary Limit

Rule 506 (17 CFR §230.506) establishes a safe harbor under which transactions that meet its requirements will be deemed not to be public offerings under §4(2). Under Rule 506, an issuer may sell to an unlimited number of accredited investors and to 35 nonaccredited investors. Accredited investor is defined in Rule 501 (17 CFR §230.501). See §12.26.

Nonaccredited investors must also meet a certain standard (or the issuer must reasonably believe they meet that standard): that they have sufficient knowledge and experience in business and financial matters to be capable of evaluating the risks of the investment. The issuer will generally determine whether the investor is accredited, and whether nonaccredited investors meet the qualification standard just mentioned, based on the information and representations provided by the investor in the Subscription Agreement and Investor Questionnaire. See §§12.59-12.60.

As under the Rule 505 (17 CFR §230.505) safe harbor, the issuer must meet all of the conditions of Rule 502 (17 CFR §230.502) for Rule 506 to apply, and Form D must be filed within 15 days of the first sale of a security.

NOTE: Effective March 16, 2009, all Form D filings must be made electronically. See 17 CFR §230.503T.

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3. Intrastate Offerings

§12.28 a. Section 3(a)(11) Exemption

Securities Act §3(a)(11) (15 USC §77c(a)(11)) exempts from the registration and prospectus delivery requirements securities offered and sold only to persons within a single state or territory, when the issuer is resident or incorporated in, and doing business in, that state or territory. If securities are purchased with a view to redistribute them to nonresidents, the exemption is unavailable. Whether the offering has "come to rest" in the state of the issuer is a question of fact; the resale to a nonresident shortly after purchase, especially to a securities dealer, would tend to indicate an intent to redistribute the securities to nonresidents. As a result, many practitioners are reluctant to rely on this exemption if another exemption is available.

The SEC has provided guidance on the availability of the intrastate exemption under §3(a)(11) in Release No. 33-4434 (Dec. 6, 1961) 26 Fed Reg 11896.

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§12.29 b. Rule 147

Rule 147 (17 CFR §230.147) provides a nonexclusive safe harbor for intrastate transactions. If its requirements are met, the transaction is deemed exempt under Securities Act §3(a)(11). Rule 147 contains objective standards for ascertaining the residence of the issuer and offerees and provides the following criteria as determinative that the issuer is doing business within a state:

- At least 80 percent of its consolidated gross revenues are derived from business, real property, and services within the state;
- At least 80 percent of its total assets are within the state;
- At least 80 percent of the net proceeds from the sale of securities is used for business operation within the state; and
- The issuer's principal business office is within the state.

Similar criteria are provided for determining that purchasers are within the state. Securities may be resold only to residents of the state for a period of nine months after the date of the last sale by the issuer (Rule 147(e)). To ensure compliance with these rules, the issuer must take the following steps (Rule 147(f)):

- Place a legend on any certificate issued for the LLC interests or in the operating agreement stating that the interests have not been registered and setting forth Rule 147's limitation on resale (see form language in §12.31);
- Make an appropriate notation in its records, or, if a transfer agent is used, issue appropriate stop-transfer instructions; and
- Obtain a written representation of residence from each purchaser.

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§12.30 c. Using Intrastate Exemption With Other Exemptions

Section 3(a)(11) is similar to Securities Act §4(2) in that counsel should use it as a "fallback" qualification for obtaining a safe harbor exemption. If the issuer is relying solely on the intrastate exemption, the issuer should ensure its availability by complying with the safe harbor requirements of Rule 147 (17 CFR §230.147). However, given that the safe harbor of Rule 147 is nonexclusive and not always reliable for issuers of LLC interests, ideally issuers should use Rule 147 only in conjunction with other exemptions; an issuer cannot be certain that Rule 147 will exempt an offering because a member may sell an interest to an out-of-state resident within 9 months and eliminate the nonregistration safe harbor. The operating agreement or articles of organization may prohibit sales of membership interests to nonresidents but may not prevent sales of economic interests to nonresidents, and these may jeopardize the exemption.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.31 d. Form: Legend for Certificate and Operating Agreement

§12.31 d. Form: Legend for Certificate and Operating Agreement

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THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE ON THE INTRASTATE OFFERING EXEMPTION CONTAINED IN SECTION 3(a)(11) OF THE ACT AND RULE 147 PROMULGATED UNDER THAT RULE. IT IS UNLAWFUL TO SELL OR OTHERWISE TRANSFER THESE SECURITIES OR AN INTEREST IN THEM TO ANY PERSON WHO IS NOT A BONA FIDE RESIDENT OF THE STATE OF CALIFORNIA FOR A PERIOD OF NINE MONTHS FROM THE LAST SALE BY THE ISSUER OF THESE SECURITIES.

Comment: When Rule 147 (17 CFR §230.147) is being relied on to exempt the issuance of LLC membership interests, the above legend should appear on any certificates that are used to represent membership interests. It should also be provided for in the operating agreement.

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§12.32 4. Coordination with California Exemption for Sales to Qualified Purchasers—Regulation CE

Rule 1001 of Regulation CE (for "coordinated exemptions") (17 CFR §230.1001) provides an exemption from the registration requirements of the Securities Act for offers and sales of securities that are exempt from registration under the California securities laws under Corp C §25102(n). See §12.67. Corporations Code §25102(n) allows the issuer to publish a general announcement concerning the proposed offering and limits sales under the exemption to certain qualified purchasers. See §12.68. Before the adoption of Regulation CE, an issuer relying on the exemption of Corp C §25102(n) was often unable to utilize a federal exemption other than Rule 504 (17 CFR §230.504), which is limited to a maximum offering amount of $1,000,000, or the intrastate exemption available under Securities Act §3(a)(11) (15 USC §77c(a)(11)). See §§12.25, 12.28.

Regulation CE provides that offers and sales of securities in amounts of up to $5,000,000 that are exempt from qualification under California law under Corp C §25102(n) are also exempt from the registration requirements of the Securities Act. Rule 1001(a) (17 CFR §230.1001(a)). Issuers are not required to notify the SEC of their reliance on this exemption. However, notices are required to be filed with the California Commissioner of Corporations under Corp C §25102(n)(7). See §12.81.

The $5,000,000 offering maximum is determined without regard to the aggregation rules applicable under Regulation D. See, *e.g.*, Rules 504(b)(2) and 505(b)(2)(i) (17 CFR §§230.504(b)(2), 230.505(b)(2)(i)). Purchasers of securities issued under this exemption receive restricted securities and must either register the securities or subsequent sales or sell them under an exemption, such as Rule 144. Rule 1001(c). See §12.36.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.33 5. Offerings Under Compensatory Benefit Plans

§12.33 5. Offerings Under Compensatory Benefit Plans

Rule 701 (17 CFR §230.701) provides an exemption from the registration requirements of the Securities Act for offers and sales of securities under certain compensatory benefit plans and contracts for compensation. The rule is incorporated by reference in Corp C §25102(o). Section 25102(o) exempts from registration an offer or sale of securities to employees, directors, or consultants by a limited liability company under an option or purchase plan that complies with the requirements of 10 Cal Code Regs §§260.140.41, 260.140.42, 260.140.45, and 260.140.46, for which a notice of transaction is filed under 10 Cal Code Regs §260.102.19, accompanied by the appropriate fee under Corp C §25608(y).

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E. Other Transactions

§12.34 1. Conversions, Mergers, and Exchanges

In a typical conversion or merger of another entity into an LLC that is the surviving entity, the LLC will issue membership interests in exchange for the equity interests in the converting or disappearing entity. If the LLC interests issued in the conversion, merger, or exchange are securities (as discussed in §§12.12-12.17), the transaction must comply with the registration requirements under federal securities laws unless an exemption is available.

The exemptions discussed in §§12.19-12.31, such as those offered under Securities Act §§4(2) and 3(a)(11), as well as the safe harbors offered under Regulation D and Rule 147 (17 CFR §230.147), are applicable to mergers.

Additionally, Securities Act §3(a)(10) (15 USC §77c(a)(10)) provides an exemption for securities that an issuer exchanges with its existing security holders for other securities, cash, or a combination of securities and cash in which the transaction has been approved following a fairness hearing by any governmental entity authorized to grant such approval.

Mergers involving California companies with equity owners who are California residents frequently undergo a "fairness hearing" under Corp C §25142 to qualify for the §3(a)(10) exemption and avoid registration.

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§12.35 2. Nonissuer Transactions

If the LLC issues membership interests (that are securities) in an original issue based on an exemption, *e.g.,* for nonpublic offerings, subsequent sales of the securities are not necessarily exempt because the exemption applies to the particular transaction meeting the requirements of the exemption. A member's resale of securities is a new transaction for which an exemption must be found or the securities registered. In many instances the exemption provided by Securities Act §4(1) will apply. That section exempts transactions by any person other than an issuer, underwriter, or dealer.

Securities issued under the Securities Act §4(2) exemption and Rules 504 (17 CFR §230.504) and 505 (17 CFR §230.505) of Regulation D are restricted securities. See Securities Act §5; see also 17 CFR §230.144 for the definition of restricted securities. Purchasers receiving securities issued in reliance on §4(2) must comply with Rule 144 (see §12.36) or the Securities Act §4(1½) exemption (see §12.37) before transferring the securities. Moreover, whether purchasers comply with Rule 144 or the §4(1½) exemption in subsequent transactions is a factor in determining whether the issuer's initial offering was exempt under §4(2).

Purchasers receiving securities issued under Rule 147 (17 CFR §230.147) must comply with the restrictions set forth in that Rule before transferring the securities. See §12.29.

Securities issued under Regulation CE, the coordinated exemption with Corp C §25102(n), are also restricted securities. See §12.32.

In addition to complying with the securities laws, a member must also observe any limitations on transfer set forth in the operating agreement before transferring a security.

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§12.36 (a) Rule 144

Rule 144 (17 CFR §230.144) is not applicable to the vast majority of limited liability companies because it exists solely to facilitate the resale of restricted securities into a market in which the securities are widely held. Rule 144 provides a safe harbor in which resales of restricted securities will not be deemed "distributions" on satisfaction of certain conditions. Any affiliate or other person who sells restricted securities of an issuer will not be distributing them if the seller complies with the conditions of Rule 144, including the 6-month holding period requirement. See Release No. 33-8813 (June 22, 2007). (Other conditions relate to current public information, volume limitations, the manner of sale, and submission of a Form 144.) Rule 144 also provides that any affiliate or other person that sells securities acquired from the issuer under the exemption of Regulation CE and subject to the resale limitations of Regulation CE is not engaged in a distribution. See §12.32.

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§12.37 (b) Securities Act §4(1½) Exemption

A means by which an issuee may resell restricted securities outside of Rule 144 (17 CFR §230.144) has been developed through commentary and release comments by the SEC: the so-called Securities Act §4(1½) exemption for resales. This exemption involves a resale in reliance on the exemption at §4(1) based on the "private offering" (*i.e.*, §4(2)) nature of the sale. For further information regarding the §4(1½) exemption, see Hicks, Resales of Restricted Securities, chap 6 (rev ed 2010).

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§12.38 F. Application of Federal Antifraud Provisions to Issuance and Transfer of Membership Interests

Exemption from the securities registration requirement does not exempt an issuer or seller of LLC interests from the antifraud provisions of §§12 and 17 of the Securities Act (15 USC §§77*l*, 77q) or §10(b) of the Exchange Act (15 USC §78j(b)). These provisions create both civil and criminal liability for the issuer for devices and schemes to defraud investors and for misstated or omitted material facts in transactions involving securities.

The antifraud provisions mandate that the issuer of securities in a private offering provide complete and accurate information to potential investors, either in the form of a disclosure document or by giving the investors access to all information needed for an informed investment decision. The method of delivery of the information will depend on the nature of the investor and the circumstances of the transaction.

Sections 12.38-12.41 summarize the major sources of antifraud liability, and §§12.42-12.44 discuss the disclosures required of an issuer by those provisions.

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§12.39 1. Exchange Act §10(b) and Rule 10b-5

Exchange Act §10(b) (15 USC §78j(b)) and Rule 10b-5 (17 CFR §240.10b-5) create a broad prohibition against the use of devices or schemes to defraud and the use of misstatements or omissions of material facts in the offer or sale of securities. See also 17 CFR §§240.10b5-1, 240.10b5-2. Rule 10b-5 has served as the basis for a broad spectrum of legal actions. An implied private right of action has been recognized since the emergence of Rule 10b-5 and was confirmed by the Supreme Court in *Superintendent of Ins. v Bankers Life & Cas. Co.* (1971) 404 US 6, 13 n9, 30 L Ed 2d 128, 134 n9, 92 S Ct 165. In *Ernst & Ernst v Hochfelder* (1976) 425 US 185, 47 L Ed 2d 668, 96 S Ct 1375, the Supreme Court held that a plaintiff must show "scienter," which has been interpreted as an intent to defraud (or "recklessness" by some courts) to establish a cause of action under Rule 10b-5.

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§12.40 2. Securities Act §17

The language for Rule 10b-5 was taken from Securities Act §17 (15 USC §77q), which also serves as a broad prohibition against the use of devices or schemes to defraud and the use of untrue statements or omissions of material facts in the offer or sale of securities. The circuits have split on the existence of a private right of action under §17, and the Supreme Court has not addressed the issue. The Supreme Court has held that a cause of action under Securities Act §17(a)(2)-(3) (15 USC §77q(a)(2)-(a)(3)), unlike under Securities Act §17(a)(1) and Rule 10b-5, may be established without a showing of scienter. *Aaron v SEC* (1980) 446 US 680, 64 L Ed 2d 611, 100 S Ct 1945. There is also authority that a cause of action may be established under the antitouting provisions of Securities Act §17(b) (15 USC §77q(b)) without a showing of scienter. *SEC v Liberty Capital Group* (WD Wash 1999) 75 F Supp 2d 1160.

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§12.41 3. Securities Act §12

For the issuer of securities, the primary source of liability would appear to be the remedies prescribed in Securities Act (15 USC §77*l*). However, claims also may be asserted against an issuer under Securities Act §11 (15 USC §77m) and Exchange Act §10(b) (15 USC §78j(b)). See *In re National Golf Props. Inc. Sec. Litig.* (CD Cal, Mar. 18, 2003, No. CV 02-1383-GHk (RZx)) 2003 US Dist Lexis 4321. Securities Act §12(a) establishes a private right of action for investors to recover either the price paid for the securities or damages if the securities have been subsequently resold, if the securities are offered or sold (1) in violation of the Securities Act §5 registration requirement, or (2) by the use of written or oral communications containing misstatements or omissions of material facts. A plaintiff need not establish reliance on the misstatement or omission and, instead of requiring that scienter be shown, Securities Act §12(a) employs a negligence standard. Securities Act §12(a)(2) liability does not extend to a private sales contract, and §12(a)(2) claims can arise only out of sales of securities to the public for the first time by prospectus. *Gustafson v Alloyd Holdings, Inc.* (1995) 513 US 561, 131 L Ed 2d 1, 115 S Ct 1061. Section 12(a)(2) liability is not limited to claims arising out of an initial public offering and may include secondary offerings. *In re National Golf Props. Inc. Sec. Litig., supra*.

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§12.42 4. Disclosure Documents

To comply with the disclosures required by the antifraud provisions in private sales of LLC interests that are securities, issuers will often prepare a disclosure document for distribution to investors, usually taking the form of a private placement memorandum. The disclosures concern the issuer and its business and finances, as well as the limitations on resale of securities.

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§12.43 a. All Material Information

One model for a disclosure document to follow is a prospectus prepared to register an offering under the Securities Act. The information the prospectus must disclose is set forth in Form S-1 and SEC Regulations S-K and S-B. However, a disclosure document for a private placement is not held to the exacting standards of such a prospectus and need not disclose the level of information required by Regulations S-K and S-B nor follow the format of Form S-1. Nonetheless, prospectus disclosure items provide handy guidelines indicating the type of information to be supplied. The applicable standard is to provide to prospective investors all material information relevant to the business of the issuer. For a guide to drafting private placement memorandums, see 1 Harroch, Start-Up and Emerging Companies—Planning, Financing and Operating the Successful Business, chap 10 (rev ed 1998).

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§12.44 b. Type of Investor Determines Level of Disclosure

With respect to the prohibition against omission of material facts, each of the antifraud provisions contains the qualification "in light of the circumstances under which they were made."

To determine the level of requisite information for the disclosure document to be prepared, and whether a disclosure document need be prepared at all, counsel must know who is purchasing the LLC interests and their relationship to the issuing LLC. Many LLCs are small closely held companies with membership interests issued only to a few insiders. In these cases, their prior access to information about the company will be adequate to meet the disclosure obligation. Other LLCs are formed by individuals or core management groups that will then seek to raise capital by selling membership interests to outside investors in private transactions. In those cases, a disclosure document containing all material information relevant to the issuer will probably be necessary to meet the disclosure obligations. In determining the level of disclosure, the ultimate inquiry for the issuer LLC is whether the purchaser of a membership interest will be able to claim, at some future date, that the investment decision was based in part on the issuer's misstatement or omission of a material fact.

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§12.45 5. Regulation D Information Delivery Requirement

In addition to the disclosure required by the antifraud provisions of the securities laws (see §§12.42-12.44), Rule 502 (17 CFR §230.502) of Regulation D (see §§12.24-12.27) has an information delivery requirement. The information delivery requirement under Regulation D applies only to nonaccredited investors for offerings under Rules 505 and 506 (17 CFR §230.505-230.506). The level of information required varies with the amount of the offering, and the method of delivering that information is specifically set forth in Rule 502. In many cases the disclosure document prepared to comply with the antifraud disclosure requirement may also be used to comply with the Regulation D information delivery requirement, and vice versa, because antifraud disclosure applies to all investors, whether accredited or nonaccredited, with no particular requirement for the method of delivery.

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§12.46 6. California Notice Requirement

Under Corp C §17656, an LLC that is an "issuer" as defined in Sarbanes-Oxley Act of 2002 §2 (15 USC §7201) is liable for civil penalties of up to $1,000,000 if the LLC has knowledge of certain acts done by a member, manager, officer, or agent of the LLC and the LLC fails to notify the Attorney General or appropriate government agency and its members and investors in writing of these acts within 30 days after acquiring that knowledge. These acts generally include:

- Making a statement that contains untrue or omitted material facts with the intent to give membership shares in the LLC materially greater or materially less apparent market value than they really possess (Corp C §17656(a)(1)(A));
- Intentionally deciding not to record an accounting transaction that the independent auditors required the LLC to record during the course of an audit for the primary purpose of rendering the financial statements materially false or misleading (Corp C §17656(a)(1)(B), (e)(7));
- Refusing to post a notice required by law with the intent to give membership shares in the LLC materially greater or less apparent market value than they really possess (Corp C §17656(a)(1)(B), (e)(8)); and
- Misstating or concealing material facts from a regulatory body to avoid a statutory or regulatory duty or prohibition, with the intent to give the membership shares in the LLC greater or less apparent market value than they really possess (Corp C §17656(a)(1)(C), (e)(9)).

Because Corp C §17656 applies only to LLCs that (1) have securities registered under Exchange Act §12 (15 USC §78*l*), (2) are required to file reports under Exchange Act §15(d) (15 USC §78o(d)), or (3) have filed and not withdrawn a registration statement that has not yet become effective under the Securities Act of 1933 (15 USC §§77a-77aa), an extensive discussion of Corp C §17656 is beyond the scope of this chapter.

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IV. APPLICATION OF CALIFORNIA SECURITIES LAWS TO ISSUANCE AND TRANSFER OF MEMBERSHIP INTERESTS

A. LLC Membership Interests Defined as Securities

§12.47 1. Exemption Based on Members' Active Participation in Management

Although the definition of "security" under California law specifically includes "interest in a limited liability company" (Corp C §25019), in recognition of members' ability to participate in an LLC's management (unlike limited partners), the statute exempts interests of members who can "prove" that all of the LLC's members are actively engaged in its management. Evidence that members vote or have the right to vote, or have the right to receive information concerning the business and affairs of the LLC, or to participate in the management of the company will not establish, without more, that all members are actively engaged "in the management" of the LLC. Corp C §25019.

The term "in the management" is not otherwise defined. The word "manager" is defined at Corp C §17001(w) to mean a person

> elected by the members… to manage the limited liability company if the articles of organization contain the statement referred to in subdivision (b) of Section 17151, or, if the articles of organization do not contain that statement, "manager" means each of the members of the limited liability company.

Thus, the exemption is available only when, for example, all members of the LLC perform functions analogous to those performed by officers of a corporation or general partners in a partnership and it can be shown that they are actively engaged in the management of the LLC. If the members merely have the *right* to vote or participate in the management of the LLC, but not all of them exercise that right, then membership interests will be securities requiring compliance with the securities laws.

It is conceivable that many LLC interests may be deemed "securities" under California law and not under federal law. For example, if not all of the members are actively involved in management, under federal law and the *Williamson* test (see §12.15), a managing member's interest would be analogous to that of a typical general partner and therefore would not be considered a security. Under California law, if all members are not actively involved in the management of the LLC, the managing member's interest will be a security by definition under Corp C §25019.

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§12.48 2. Risk That Nonsecurity Interest Will Convert to Security Interest After Acquisition

Until further contrary authority is promulgated regarding Corp C §25019, issuers must assume that a membership interest that is not a security as of the date of issuance may subsequently convert into a security. To determine whether an LLC interest is a security in California, counsel must consider not only the member's dependence on the other members or managers in making a profit from the business, but also the actual conduct of the member following completion of the acquisition of an LLC interest. Any member may take action that will convert an interest that is otherwise not a security into a security, and that also will convert all other interests of the LLC into securities.

For example, if three parties form an LLC to engage in a member-managed business, and all intend to be actively involved in the business, they may reasonably determine that the interests will not be securities. However, if one party later decides not to actively participate and terminates that party's active participation, that interest will be a security, as will the interests of the other two members. If the LLC did not comply with requirements to secure an exemption from registration or qualification, the LLC will be in violation of the securities law. Alternatively, the conversion of the interests to securities by the change of a member to a nonparticipating member may constitute a new issuance requiring compliance with the securities laws.

The unusual nature of the definition of "security" under Corp C §25019 with regard to membership interests results in a number of uncertainties. Because of these uncertainties in the status of membership interests as securities under California law, each holder of a nonsecurity membership interest arguably may have an implied duty to provide notice to the other members of the intention of the holder to withdraw from active involvement or to continue to be actively involved, since withdrawal from active involvement may result in the conversion of the membership interests into securities.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.49 B. Qualification Required for Nonexempt Security Transactions

§12.49 B. Qualification Required for Nonexempt Security Transactions

An LLC interest that is a security offered or sold in California must be "qualified" (equivalent to "registration" under federal laws) with the California Department of Corporations (DOC), unless an exemption from the qualification requirement is available (see §§12.52-12.73 for exemptions). Both issuer offers and sales, and issuer recapitalizations, reorganizations, conversions, or mergers must be qualified (Corp C §§25005.1, 25110, 25120). Similarly, nonissuer offers and sales (secondary sales) must be qualified, unless exempt (Corp C §25130).

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§12.50 1. Merit Regulation: "Fair, Equitable, and Just" Standard

Qualification consists of obtaining the permission of the Commissioner of Corporations to offer and sell the securities. In contrast to federal securities laws that rely on disclosure for regulation, California engages in merit regulation of securities, requiring that offerings made in the state meet the "fair, just and equitable" standards set forth in the securities statutes and implemented by the Commissioner of Corporations.

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§12.51 2. Transaction Definitions Essential for Determining Whether Qualification Is Required

Determining whether a transaction must be qualified requires consideration of the statutory definitions and interpretations of key terms, *e.g.*, security, offer, and sale, "in this state," and issuer and nonissuer transactions.

As discussed in §12.47, an LLC interest is defined in the statute as a security, with an exemption, of uncertain application, for LLC interests when all members participate in management of the LLC.

An offer, or offer to sell, includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value. Corp C §25017(b). An offer also includes preliminary negotiations concerning a fixed plan. 6 Ops Cal Comm'r Corps 76/13C (1976); *B. C. Turf & Country Club, Ltd. v Daugherty* (1949) 94 CA2d 320, 210 P2d 760.

A sale includes every sale contract, contract to sell, or disposition of, a security or interest in a security for value (including a sale of LLC membership interests in exchange for services). A sale also includes any exchange of securities and any change in the rights, preferences, privileges, or restrictions of or on an outstanding security. Corp C §25017(a).

An offer or sale is "in this state" when an offer to sell is made in California, an offer to buy is accepted in California, or (if both the seller and purchaser are domiciled in California) the security is delivered to the purchaser in California. Corp C §25008.

Issuer transaction is not defined, but the definition of "nonissuer transaction" (Corp C §25011) implies that an issuer transaction is any transaction that is directly or indirectly for the benefit of the issuer. Qualification requirements differ depending on whether the offer or sale is an issuer or nonissuer transaction. In an issuer transaction, the member receives his or her interest from the LLC, and the LLC must qualify the transaction (Corp C §§25110, 25120) or find an exemption. A member's subsequent transfer of an LLC interest is a nonissuer transaction that the member must qualify (Corp C §25130) or find an exemption for.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.52 C. Exemptions From Qualification for Issuance of Membership Interests

§12.52 C. Exemptions From Qualification for Issuance of Membership Interests

Qualification is an expensive and time-consuming process. The majority of issuances of securities can avoid the process by qualifying for one of the exemptions from qualification described in §§12.52-12.73.

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§12.53 1. Exempt Securities

Certain securities are deemed to be such inherently safe investments that purchasers do not require the protection of the DOC. The issuance and transfer of these securities is exempt from the qualification requirement. Corp C §§25100-25101. The most common exempt securities are securities listed or approved for listing on a national exchange (Corp C §25100(o)) and certain publicly traded securities of quality corporations (see 10 Cal Code Regs §260.105.17). Rarely, if ever, will LLC interests be among the securities listed in Corp C §25100.

Under the National Securities Markets Improvement Act of 1996 (NSMIA) (Pub L 104-290, 110 Stat 3416), which was enacted to ease the burden on issuers of complying with both federal and state securities laws, federal law preempts state registration and qualification of "covered securities." As a result, any security that meets the definition of a "covered security" is excluded from California's qualification requirements, as well as the registration or qualification requirements of all other states. "Covered securities" include securities that are:

- Listed, or authorized for listing, on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market;
- Listed, or authorized for listing, on a national securities exchange that the SEC determines has listing standards substantially similar to those of the New York Stock Exchange, the NYSE Amex, or the National Market System;
- Equal in seniority or senior to an issuer's listed security;
- Offered or sold to "qualified purchasers" as defined by the SEC; or
- Sold in transactions exempt from registration under SEC rules under Securities Act §4(2). (This would apply to Rule 506 under Regulation D, but not Rules 504 or 505.)

Conforming changes have been adopted in California so that covered securities are not subject to qualification. Corp C §§25100.1, 25101.1, 25102.1. See, in this regard, *Consolidated Mgmt. Group, LLC v Department of Corps.* (2008) 162 CA4th 598, 75 CR3d 795 (Department of Corporations' desist and refrain order was not preempted by NSMIA; offer and sale of joint venture interests failed to meet Rule 506 requirements, so interests were not "covered securities," and state qualification was necessary).

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2. Exempt Transactions

§12.54 a. Issuer and Nonissuer Transactions and Reorganizations Can Be Exempt

Offers and sales of otherwise nonexempt securities in California may be exempted from the qualification requirements by Corp C §25102 (exempting certain issuer transactions), Corp C §25104 (exempting nonissuer transactions, *i.e.*, secondary sales of securities), and Corp C §25103 (exempting reorganization, recapitalization, and entity conversion transactions).

These exemptions apply only to the particular transaction meeting the exemption requirements, not to the LLC interest itself. Future transactions involving the LLC interest, or that class of interest, may not be exempt.

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§12.55 b. Limited Offering Exemption

Practitioners representing LLCs issuing membership interests will find the limited offering exemption most broadly applicable (Corp C §25102(f)). The exemption for small offerings under Corp C §25102(h) applies only to issuances of shares and is therefore not available to LLCs. The limited offering exemption of Corp C §25102(f) is similar to the federal Regulation D exemption and often used by issuers qualifying for the nonpublic offering exemption under Regulation D. See §§12.24-12.27.

Any offer or sale, other than an offer or sale to a pension or profit-sharing trust of the issuer, that meets the following four criteria can qualify for the limited offering exemption:

(1) Sales may be to no more than 35 purchasers;

(2) Purchasers have a preexisting relationship with the issuer or financial experience or the advice of a professional advisor;

(3) The issuer does not advertise the offer and sale; and

(4) Purchasers represent that they are purchasing for their own accounts.

The issuer must meet one additional requirement—filing a notice with the Commissioner of Corporations. See §12.66.

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§12.56 (1) No More Than 35 Purchasers

Certain investors are excluded from the count, primarily (Corp C §25102(f)(4)):

- Institutional investors;
- Officers and directors of the issuer;
- Affiliates of the issuer;
- Promoters; and
- Individuals meeting certain financial standards.

LLC managers will be excluded from the count by the regulation excluding any person who occupies a position with the issuer having duties and authority substantially the same as a corporate officer. 10 Cal Code Regs §260.102.13.

The regulations define a promoter as a person who takes the initiative in founding the business or enterprise of the issuer. 10 Cal Code Regs §260.102.12(f). An individual who invests $150,000 or more in the transaction is excluded, provided he or she meets certain sophistication standards or is able to bear the economic risk. Also excluded is an individual who falls within one of the categories of an "accredited investor" under Rule 501(a) (17 CFR §230.501) of Regulation D. 10 Cal Code Regs §260.102.13(e), (g). See §12.24.

A husband and wife (and any custodian or trustee for the account of their minor children) count as one purchaser; a partnership, corporation or other entity not specifically formed for the purpose of purchasing the securities counts as one purchaser. Corp C §25102(f)(4). Presumably, if the entity was formed for the purpose of purchasing the securities, then each equity owner counts as a purchaser.

Transactions under Corp C §25102(f) generally will be integrated together for purposes of counting the number of purchasers if they involve the same or similar securities and occur six months or less apart. 10 Cal Code Regs §260.102.12.

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§12.57 (2) Qualified Purchasers

For the limited offering exemption to apply, all purchasers must have:

- A preexisting personal or business relationship with the offeror or any of its officers, directors, or controlling persons (presumably LLC managers would be included), or
- By reason of the purchaser's business or financial experience *or* the business or financial experience of the purchaser's professional adviser who is not affiliated with or compensated by the issuer, can reasonably be assumed to have the capacity to protect his or her own interests in connection with the transaction.

A "preexisting business relationship" is defined as "any relationship consisting of personal or business contacts of a nature and duration such as would enable a reasonably prudent purchaser to be aware of the character, business acumen and general business and financial circumstances of the person with whom such relationship exists." 10 Cal Code Regs §260.102.12(d)(1). Relationships such as employer-employee or that of a security holder of the issuer do not necessarily create such a "preexisting business relationship" (although they may) and each inquiry will be based on the facts of the particular situation. Purchasers excluded from the count of 35 purchasers (see §12.56), are excluded from the requirement of a preexisting relationship.

A "professional advisor" is defined as "a person who, as a regular part of such person's business, is customarily relied upon by others for investment recommendations and decisions" and is customarily compensated for those services either specifically or for related professional services. 10 Cal Code Regs §260.102.12(g). Attorneys and certified public accountants are specifically included in the definition of "professional advisor." The purchaser's professional advisor must be designated as such by the purchaser.

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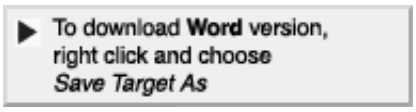
§12.58 (3) Purchaser's Investment Representation

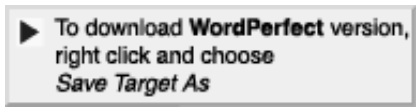
Each purchaser must represent that he or she is purchasing for his or her own account (or trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security. Corp C §25102(f)(3). An investor will typically make these representations in a subscription agreement or investor questionnaire. See §§12.59-12.60.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.59 (4) Form: Subscription Agreement

§12.59 (4) Form: Subscription Agreement





12.59-1 Subscription agreement

_ _[*NAME*]_ _ Limited Liability Company
Subscription Agreement

1. Subscription

(a) The undersigned ("Undersigned" or "Purchaser") applies to become a Member in _ _[*name*]_ _ Limited Liability Company (the "LLC"), a California limited liability company, and to purchase the number of Units of limited liability company interests (the "Units") indicated below in accordance with the terms and conditions of this Subscription Agreement and the LLC Operating Agreement (the "Operating Agreement") attached as _ _[*e.g., Exhibit A*]_ _ to the Limited Offering Memorandum of the LLC (the "Memorandum").

(b) Before this subscription for Units is considered, the Undersigned must complete, execute, and deliver to _ _[*name*]_ _ (the "Manager"):

(i) The purchaser's personal check in the amount of _ _[*dollar amount*]_ _ per Unit.

(ii) An Investor Questionnaire in the form attached as _ _[*e.g., Appendix 1*]_ _.

(iii) The Assumption Agreement attached as _ _[*e.g., Appendix 2*]_ _, in which the Undersigned, as a Member, personally assumes primary liability for _ _[*his/her*]_ _ prorata share of _ _[*certain indebtedness incurred by the LLC*]_ _.

(iv) The full recourse Promissory Note, attached as _ _[*e.g., Appendix 3*]_ _, in favor of the LLC in an amount equal to _ _[*dollar amount*]_ _ per Unit, due and payable on _ _[*date*]_ _.

(c) The Undersigned understands that each Unit shall be subject to _ _[*voluntary assessments/mandatory assessments*]_ _ but only to the extent necessary to _ _[*e.g., cover the LLC's obligation to pay interest on its Notes and to pay the principal to the extent the Members have assumed liability*]_ _. Assessment may be made at the sole direction of the Manager but in no event will payment be required before _ _[*date*]_ _.

(d) The Manager in its discretion may elect to take whatever action it deems in the best interest of the LLC to collect the amounts owing to the LLC, all as more fully described in the Memorandum and the Operating Agreement.

(e) The Undersigned understands that the cash received by the LLC from each subscriber before the closing of the sale of LLC interests will be deposited in interest-bearing accounts to the extent deemed reasonable and prudent by the Manager, and all interest earned will accrue to the benefit of the LLC.

(f) This Subscription is irrevocable. It may be rejected in whole or in part by the Manager in its sole discretion. In the event that this Subscription is rejected by the Manager, all funds and documents tendered by the Undersigned will be returned, together with any interest earned by the LLC as allocated by the LLC as described above.

(g) The Manager has the discretion, under Section _ _ _ _ of the Operating Agreement, to accelerate the Closing Date and close the offering at any time after _ _[*number*]_ _ of the Units have been subscribed. In the event _ _[*number*]_ _ of the Units have not been subscribed by the Closing Date, the Manager has the Discretion to (1) purchase unsold Units so as to achieve _ _[*number*]_ _ Units sold, or (2) terminate the offering and return all funds to subscribers with interest earned by the LLC, as described above. The Manager also has

the discretion to extend the Closing Date until _ _[*date*]_ _. On the oral or written consent of the subscribers, the minimum number of Units may be reduced.

(h) This Subscription is not transferable or assignable by the Undersigned.

(i) Without in any manner limiting the restrictions on transferability set forth in this document, this Subscription, on acceptance by the LLC, shall be binding on the heirs, executors, administrators, successors, and assigns of the Undersigned.

(j) Without in any manner limiting the restrictions on transferability set forth in this document, if the Undersigned is more than one person, the obligations of the Undersigned shall be joint and several and the representations and warranties shall be deemed to be made by and binding on each such person and his or her heirs, executors, administrators, successors, and assigns.

2. Acknowledgments

The Undersigned understands and acknowledges that:

(a) Neither the LLC nor the Manager has financial or operating history; _ _[*e.g., the experience of the principals of the Manager is limited to an aggregate of prior programs currently in operation*]_ _.

(b) There are substantial risks incident to the ownership of Units in the LLC; the investment is speculative and involves a high degree of risk of loss by the Undersigned of the Undersigned's entire investment in the LLC.

(c) The Undersigned has been advised to consult the Undersigned's own attorney concerning the LLC and to consult with independent tax counsel regarding the tax considerations of participating in the LLC.

(d) The books and records of the LLC will be reasonably available for inspection by the Undersigned or the Undersigned's representatives, if any, at the LLC's place of business.

(e) The discussion of the federal income tax considerations arising from investment in the LLC as set forth in the Memorandum, and the Tax Opinion of _ _[*name*]_ _ attached as Exhibit _ _ _ _, is general and the federal income tax considerations to the Undersigned of investment in the LLC will depend on the Undersigned's particular circumstances.

(f) The discussion of the federal income tax considerations relates to an investment by an individual and does not address the federal income tax considerations of a corporation, partnership, trust, or other form of business entity.

(g) There can be no assurance that the Internal Revenue Code or Treasury Regulations under the Internal Revenue Code will not be amended in a manner that would deprive the LLC or Members of some or all of the tax benefits described in the Memorandum.

(h) The financial projections included in the Memorandum are estimates only, based on assumptions that may be incorrect, and there can be no assurance of their accuracy. Further, the LLC may be audited by the Internal Revenue Service and certain deductions shown in the financial projections may be challenged by the Internal Revenue Service (see discussion under "Risk and Other Important Factors" and "Federal Income Tax Considerations" in the Memorandum).

(i) The offering has not been registered under the Securities Act of 1933, as amended (the "Act").

(j) The Undersigned understands that the Units that are the subject of this Agreement have not been qualified as securities with the Commissioner of Corporations of the state of California, and that the issuance of those Units or the payment or receipt of any part of the consideration before qualification is unlawful, unless the transfer of the Units, or any part of them, is exempt from qualification by California Corporations Code §25100, 25102, or 25105. Purchaser understands that, under the requirements of California Corporations Code §25102(a), the rights of all parties to this Agreement are expressly conditioned on qualification being obtained, unless the transfer of the Units is exempt from qualification, and that none of the Units can or will be issued to Purchaser until the transfer of the Units is so qualified, unless the transfer of the Units is exempt from

qualification by §25102, §25100, or §25105.

(k) Neither the Securities and Exchange Commission nor the California Commissioner of Corporations, nor any other federal or state agency, has passed on the Units or made any finding or determination concerning the fairness of this investment and no such agency has recommended or endorsed the Units.

(l) Since the Units have not been registered under the Act or registered or qualified under any state law, a purchaser of Units must bear the economic risk of investment for an indefinite period of time, because the Units will bear a restrictive legend and may not be sold, pledged, or otherwise transferred in the absence of an effective registration or qualification under federal and applicable state law or an opinion by counsel to the LLC that registration or qualification is not required.

(m) The Undersigned understands and acknowledges that the LLC is under no obligation and has not undertaken to register or qualify the sale, transfer, or other disposition of Units by it or on its behalf, to take any other action necessary to make compliance with an exemption from registration or qualification available or to register or qualify the Units at any time in the future.

(n) The Undersigned will not make any sale, transfer, or other disposition of Units except in compliance with the Act and its rules and regulations and applicable California and other state law.

(o) The transferability of Units is further restricted by the Operating Agreement. No public market exists for the Units or is anticipated to exist for the Units.

(p) To qualify for an exemption from the qualification described in (j) above, California Corporations Code §25102(f) requires, among other things, that Purchaser must have either (1) a preexisting personal or business relationship with the LLC, or any of its Managers or controlling persons, or (2) by reason of Purchaser's business or financial experience (or the business or financial experience of its professional advisors, who are unaffiliated with and who are not compensated by the LLC or any affiliate or selling agent of the LLC, directly or indirectly) may reasonably be assumed to have the capacity to protect Purchaser's own interests in connection with the transaction contemplated by this Agreement.

3. Representations

The Undersigned represents and warrants as follows:

[*Please cross out and/or write in any information necessary to make the following statements complete and correct:*]

(a) The Undersigned has read and is familiar with the Memorandum and exhibits, including the Operating Agreement.

(b) The Undersigned has carefully reviewed and understands the risks of, and other considerations relating to, a purchase of Units, including those set forth under the "Risk Factors," "Conflicts of Interest," and "Federal Tax Considerations" sections of the Memorandum.

(c) The Undersigned and the Undersigned's representatives, if any, have been furnished all materials relating to the LLC and its proposed activities, the offering of Units or anything set forth in the Memorandum that they have requested, and have been afforded the opportunity to obtain any additional information and ask all questions concerning the LLC and the Units necessary to verify the accuracy of any representations or information set forth in the Memorandum and to understand any additional matters the Undersigned believes are necessary to evaluate the investment and associated risks.

(d) The Manager has answered all inquiries that the Undersigned and the Undersigned's representatives, if any, have put to it concerning the LLC and its proposed activities, the Manager, and all other matters relating to the LLC and the offering and sale of the Units.

(e) Neither the Undersigned nor the Undersigned's representatives, if any, have been furnished any offering literature other than the Memorandum and the documents attached as exhibits, and have relied only on the information contained in the Memorandum and such exhibits and information, as described in subparagraphs (c) and (d) above, furnished or made available to them by the LLC, its counsel, or the Manager.

(f) The Undersigned has not distributed the Memorandum to anyone other than the Undersigned's lawyer, accountant, or other financial advisors, and has not made any copies of it.

(g) The Undersigned is at least 21 years of age.

(h) The Undersigned has an individual net worth in excess of $1,000,000 or has individual income in excess of $200,000 in each of the two most recent years and reasonably expects an income in excess of $200,000 in the current year or joint income together with his or her spouse or domestic partner of $300,000 in each of those two years and an expected joint income of $300,000 in the current year. If a partnership, each partner is within the above standard.

(i) The Undersigned has adequate means of providing for the Undersigned's current needs and personal contingencies, has no need for liquidity in this investment, could afford to lose the entire amount of this investment and understands that the Undersigned may lose this entire investment.

(j) The Undersigned's commitment to all tax-sheltered investments is reasonable in relation to the Undersigned's net worth.

(k) The Undersigned is obtaining the Units for the Undersigned's own account (or for a trust account if the Undersigned is a trustee) for investment purposes and not with a view or intention to resell or distribute the same, and has no present intention, agreement, or arrangement to divide the Undersigned's participation with others or to resell, assign, transfer, or otherwise dispose of all or any part of the Units for which the Undersigned has subscribed.

(l) The Undersigned has been advised that Units must be held indefinitely unless (1) distribution of Units is subsequently registered for resale under the Act or (2) in the opinion of counsel acceptable to the Company, some other exemption from registration under the Act is available.

(m) If the Undersigned is a corporation, partnership, trust, or other entity, it is authorized and otherwise duly qualified to purchase and hold Units in the LLC. If the Undersigned is one of the aforementioned entities, it agrees to supply any additional written information that may be required.

(n) Except as set forth below, all of the information concerning the Undersigned's financial position and business experience that the Undersigned has provided to the Manager, in the Acknowledgment of Receipt attached to the Memorandum and in any suitability questionnaire completed by the Undersigned, is correct and complete as of _ _[*date*]_ _, and, if there should be any material change in that information before the acceptance of this subscription by the Manager, the Undersigned will immediately furnish the revised or corrected information to the Manager.

Exceptions: _____

_____

(o) [*Please circle (i), (ii), or (iii), below*]

(i) The Undersigned has such knowledge and experience in business and financial matters that the Undersigned is capable of evaluating the LLC and its proposed activities, the risks and merits of investment in the Units and of protecting the Undersigned's interests and making an informed investment decision, and has not consulted with others in connection with evaluating such risks and merits.

(ii) The Undersigned has been advised by others, listed below (who are unaffiliated with and who are not compensated by the Manager or the LLC or any of its affiliates or selling agents, directly or indirectly), and now is capable of evaluating the LLC and its proposed activities, the risks and merits of investment in the Units and of making an informed investment decision, and the persons listed below are not purchaser representatives utilized in connection with evaluating such risks and merits:

(1) _____
Name

_____

Relationship

(2) _____
Name

_____
Relationship

(iii) The Undersigned and the Purchaser Representatives listed below (who are unaffiliated with and who are not compensated by the Manager or the LLC or any of its affiliates or selling agents, directly or indirectly) together have such knowledge and experience in business and financial matters that the Undersigned and the purchaser representatives together are capable of evaluating the LLC and its proposed activities, and the risks and merits of investment in the Units and of making an informed investment decision.

Purchaser Representatives (Each person listed must complete a Purchaser Representative Questionnaire in the form required by the Manager, which must be acknowledged by the Purchaser):

(1) _____
Name

_____
Relationship

(2) _____
Name

_____
Relationship

(p) The Undersigned is not relying on the Manager nor any of its officers or shareholders for independent legal, accounting, financial, or tax advice in connection with the Undersigned's evaluation of the risks and merits of investment in the LLC and the consequences to the Undersigned of such an investment.

4. Adoption of Operating Agreement

The Undersigned adopts, accepts, and agrees to be bound by all of the terms and provisions of the Operating Agreement and to perform all obligations imposed on a Member with respect to the Units purchased. On acceptance of this Subscription Agreement by the Manager on behalf of the LLC, and on filing by the Manager of Articles of Organization establishing the LLC, the Undersigned shall become a member of the LLC for all purposes.

5. Indemnification

(a) The Undersigned agrees to indemnify the Manager and the LLC and hold the Manager and the LLC harmless from and against any and all liability, damage, cost, or expense incurred on account of or arising out of:

(i) Any inaccuracy in the Undersigned's declarations, representations, and warranties set forth in this document or in any other declarations, representations, and warranties in other communications to the LLC;

(ii) The disposition of any of the Units that the Undersigned will receive, contrary to the Undersigned's foregoing declarations, representations, and warranties; and

(iii) Any action, suit, or proceeding based on (1) the claim that declarations, representations, or warranties were inaccurate or misleading or otherwise cause for obtaining damages or redress from the Manager or the LLC, or (2) the disposition of any of the Units or any part of them.

(b) The Undersigned consents to the indemnification of the Manager by the LLC, to the extent that indemnification is lawful, in accordance with the terms and conditions of the Operating Agreement.

6. Choice of Laws

This Subscription Agreement shall be construed in accordance with and governed by the laws of the state of California, except for the manner in which the Undersigned elects to take title to the Units, which shall be construed in accordance with the laws of the state of his or her principal residence.

7. Power of Attorney

(a) The Undersigned irrevocably constitutes and appoints the Manager with full power of substitution as the Undersigned's true and lawful attorney-in-fact and agent, to execute, acknowledge, verify, swear to, deliver, record, and file, in the Undersigned's name, all instruments, documents, and certificates that may from time to time be required by the laws of the United States of America, the state of California, and any other state in which the LLC conducts or plans to conduct business, or any political subdivision or agent of the government to effectuate, implement, and continue the valid existence of the LLC, including, without limitation, the power and authority to execute, verify, swear to, acknowledge, deliver, record, and file the following:

(i) The Operating Agreement, the Articles of Organization, and all other instruments (including amendments) that the Manager deems appropriate to form, qualify, or continue the LLC as a limited liability company in the state of California and all other jurisdictions in which the LLC conducts or plans to conduct business;

(ii) All instruments that the Manager deems appropriate to reflect any amendment to the Operating Agreement, or modification of the LLC, made in accordance with the terms of the Operating Agreement;

(iii) A fictitious business name certificate and such other certificates and instruments as may be necessary under the fictitious or assumed name statute from time to time in effect in the state of California and all other jurisdictions in which the LLC conducts or plans to conduct business;

(iv) All instruments relating to the admission of any additional or substituted Member; and

(v) All conveyances and other instruments that the Manager deems appropriate to reflect the dissolution and termination of the LLC under the terms of the Operating Agreement.

That agent and attorney-in-fact shall not, however, have the right, power, or authority to amend or modify the Operating Agreement when acting in those capacities, except to the extent authorized in the Operating Agreement.

(b) The power of attorney granted is a special power of attorney and shall be deemed to be coupled with an interest, shall be irrevocable, shall survive the death, dissolution, bankruptcy, incompetency, or legal disability of the Undersigned, and shall extend to the Undersigned's heirs, successors, and assigns. The Undersigned agrees to be bound by any representations made by the Manager acting in good faith under that power of attorney, and each Member waives any and all defenses that may be available to contest, negate, or disaffirm any action of the Manager taken in good faith under that power of attorney.

8. Subscription for Units

Number of Units (including fractions of them) subscribed for:

_____

Member Information (The information below should be consistent with the form of ownership selected below.)

Name (please print):

_____

If entity named above,

By_____

Social Security or taxpayer ID number:

_____

Taxable year end

_____

Name of company

_____

Business address (including zip code)

_____

_____

Business phone

_____

Residence address (including zip code)

_____

_____

Residence phone

_____

All communications to be sent to:

[ ] Business address or

[ ] Residence address

[*Please indicate by checking the appropriate box below the form in which you will hold title to your interest. Please consider carefully. Once your subscription is accepted, a change in the form of title constitutes a transfer of the membership interest and will therefore be restricted by the terms of the operating agreement and result in additional costs to you. Subscribers should seek the advice of their attorneys in deciding in which of the forms they should take ownership of the units, because different forms of ownership can have varying gift tax, estate tax, income tax, and other consequences, depending on the state of the investor's domicile and the investor's particular personal circumstances. For example, in community property states, if community property assets are used to purchase units held as separate property, adverse gift tax consequences may result.*]

[ ] Individual ownership (one signature required)

[ ] Joint tenants with right of survivorship and not as tenants in common (both or all parties must sign)

[ ] Community property (one signature required if interest held in one name, *i.e.,* managing spouse or domestic partner; two signatures required if interest held in both names)

[ ] Tenants in common (both or all parties must sign)

[ ] General partnership (fill out all documents in the name of the partnership, by a partner authorized to sign, and include a copy of the Partnership Agreement)

[ ] Limited partnership (fill out all documents in the name of the limited partnership, by a general partner authorized to sign, and include a copy of the Limited Partnership Agreement and any other document showing that the investment is authorized)

[ ] Corporation (fill out all documents in the name of the corporation, by the President or other officer authorized to sign, and include a copy of the Corporation's Articles and certified Corporate Resolution authorizing the signature)

[ ] Trust (fill out all documents in the name of the trust, by the trustee, and include a copy of the instrument creating the trust and any other documents necessary to show that the investment by the trustee is authorized; the date of the trust must appear on the Notarial where indicated)

Subject to acceptance by the Manager, the Undersigned has completed this Subscription Agreement and executed the two Appendixes to evidence _ _[*his/her/its*]_ _ subscription to _ _[*name*]_ _, LLC, on _ _[*date*]_ _.

_____
Subscriber

_____
Subscriber

_____
Subscriber

Subscribers must also execute the appendixes attached.

The Manager has accepted this Subscription this _ _ _ _ _ _ day of _ _ _ _ _ _, _ _[*year*]_ _.

_____, LLC

By: _____
Manager

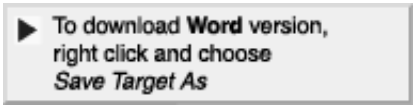
By: _____
Individual

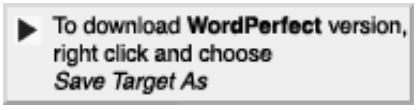
Comment: The subscription agreement can be used with offerings relying on the exemption of Securities Act §4(2), any of the Regulation D safe harbor provisions (see §§12.20-12.27), and the exemption in Corp C §25102(f) (see §§12.55-12.66). It is most suitable for limited liability companies that are manager-managed and have members that are passive investors.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.60 (5) Form: Investor Questionnaire

§12.60 (5) Form: Investor Questionnaire





12.60-1 Investor questionnaire

CONFIDENTIAL QUESTIONNAIRE FOR THE ACQUISITION OF A LIMITED LIABILITY COMPANY INTEREST IN _ _[*NAME*]_ _, A CALIFORNIA LIMITED LIABILITY COMPANY

This information on this questionnaire is given by _ _[*name of purchaser*]_ _ ("Purchaser") in connection with the proposed purchase of a limited liability membership interest ("Unit" or "Units") in _ _[*name of company*]_ _, a California Limited Liability Company ("LLC"). The following information is needed to ensure that (1) an investment in LLC by Purchaser is suitable in light of Purchaser's personal, financial, and tax position, and (2) Purchaser has such knowledge and experience in financial and business matters that Purchaser is capable of evaluating the merits and risks of the investment.

If the answer to any question is not applicable, please so state.

All information contained in this Investor Questionnaire will be treated confidentially. However, Purchaser agrees that the Manager of the LLC may present this questionnaire to parties deemed appropriate if called on to establish that the proposed offer and sale of the Units is exempt from registration under the Securities Act of 1933, as amended (the "Act"), or meets the requirements of applicable state securities laws. Notwithstanding the foregoing, I, as Purchaser, understand and agree that the Manager of the LLC may furnish copies of this questionnaire to any bank or institutional lender that may be making loans to the LLC, which loans are anticipated to be secured by an assignment of the promissory notes of subscribers for Units in the LLC.

Purchaser expressly understands that a Unit in the LLC constitutes a security for purposes of federal and state laws, and that the following information is being given for the purpose of enabling the offer and transfer of the Unit(s) to Purchaser to qualify for an exemption from registration under federal securities laws and for an exemption from qualification under California securities laws.

1. Name and Address of Purchaser:

Name:_____

Residence address:_____

_____

_____

Country of residence:_____

Residence telephone number:_____

Employer:_____

Business address:_____

_____

_____

Business telephone number:_____

Year of birth (or date of organization or incorporation):

_____

TIN or Social Security number:_____

Business currently operated by purchaser:_____

_____

2. Financial Information:

(a) _ _[*year*]_ _ expected income (check appropriate box)

[ ] Less than $100,000

[ ] $100,000-$200,000

[ ] $200,000-$300,000

[ ] More than $300,000

(b) _ _[*year*]_ _ income (check appropriate box)

[ ] Less than $100,000

[ ] $100,000-$200,000

[ ] $200,000-$300,000

[ ] More than $300,000

(c) _ _[*year*]_ _ income (check appropriate box)

[ ] Less than $100,000

[ ] $100,000-$200,000

[ ] $200,000-$300,000

[ ] More than $300,000

(d) Over the next five years, current level of income is expected to:

[ ] Increase

[ ] Decrease

[ ] Remain the same

(e) The net worth of Purchaser (including spouse or domestic partner) is approximately: $_ _ _ _ _ _ _ _ _

(f) Liquid net worth (items easily converted to cash):

[ ] over $100,000

[ ] over $200,000

[ ] over $300,000

(g) Please provide the appropriate percentage of your current income by source:

Salary _ _ _ _ _ _percent

Bonus and commissions _ _ _ _ _ _ percent

Dividends and interest _ _ _ _ _ _ percent

Real estate income _ _ _ _ _ _ percent

Other income _ _ _ _ _ _ percent

3. Information about Officers and Directors:

If Purchaser is a corporation, name each officer and director and controlling person of Purchaser and provide the following information for each:

(a) Educational background (name of college attended, major, degree obtained, if any, and year obtained);

(b) Investing courses attended (list the name of each course, sponsor, and date of attendance); and

(c) Any professional licenses or registrations, including bar admissions, accounting certifications, real estate brokerage licenses, and SEC or state broker/dealer registrations held.

(i)_____

_____

(ii)_____

_____

(iii)_____

_____

4. Investment Experience of Purchaser:

Nature of investment	Amount	Date
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _
_ _ _ _ _ _ _ _ _ _ _ _	_ _ _ _ _ _	_ _ _ _ _ _

5. Additional Information:

In addition to the information provided above, please describe below any information relevant to Purchaser's

ability to evaluate the merits and risks of purchasing a Unit as an investment.

_____

_____

6. Method of Investment Evaluation:

Purchaser agrees and understands that Purchaser, in answering this question and this questionnaire, (a) must have sufficient knowledge and experience in financial and business matters and (b) must be capable of evaluating the merits and risks of a purchase of Units, or (c) must retain the services of a Professional Adviser (who may be an attorney, accountant, or other financial adviser unaffiliated with, and who is not compensated by, the LLC or any affiliate or selling agent of the LLC, directly or indirectly) for the purpose of aiding in the evaluation of this particular transaction. Purchaser represents, by signature of an authorized agent of Purchaser, on the Method A or Method B line below, that:

Method A: __[*Signature*]__

Purchaser has sufficient knowledge and experience in financial and business matters that Purchaser is capable of (a) evaluating the merits and risks of an investment decision and (b) protecting Purchaser's own interests and will not require a Professional Adviser.

Method B: __[*Signature*]__

Purchaser has relied on the advice of the following Professional Adviser(s), who _ _[*is/are*]_ _ not affiliated with, or paid by, the LLC, in (a) evaluating the merits and risks of accepting the Units described in the Limited Offering Memorandum and (b) in protecting Purchaser's own interests:

_____	_____
Name	**Name**
_____	_____
Relationship	**Relationship**

The above-named Professional Adviser(s) has/have furnished a completed Professional Adviser Questionnaire. The above-named Professional Adviser(s) and Purchaser together have sufficient knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of an acceptance of, and investment in, the Units described in the Limited Offering Memorandum, and of making an informed investment decision in accepting those Units.

7. Purchaser understands that the LLC will be relying on the accuracy and completeness of the responses to the foregoing questions and Purchaser represents and warrants to the Manager and the LLC as follows:

(a) The answers to the above questions are complete and correct and may be relied on by the Manager and the LLC in determining whether the offer of, and transfer of, the Units in connection with which Purchaser has executed this questionnaire are exempt from registration under the Securities Act of 1933 and the California Corporate Securities Law of 1968, as amended; and

(b) Purchaser will notify the Manager and the LLC immediately if any material change in any statement made in this document occurs before acceptance of the Subscription Agreement.

Date: _ _ _ _ _ _ **Purchaser**

By: __[*Signature*]__
_ _[*Printed name*]_ _
_ _[*Title*]_ _

Comment: This is a form of a questionnaire to use to ensure that a purchaser of a limited liability company interest meets business-investment sophistication and relationship-to-issuer standards under Corp C §25102(f)(2), for purposes

of an exemption from qualification of the limited liability company interests, and under Regulation D of the Securities Act of 1933 for an exemption from registration under federal securities laws.

The questionnaire also provides additional representations establishing investment intent of the purchaser for purposes of Corp C §25102(f)(3). In light of the particular transaction, counsel must analyze the provisions of the questionnaire, and whether any particular answer is crucial to reliance on the questionnaire as a whole to show that the investor meets relevant securities law criteria for an investment in the limited liability company.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.61 (6) Form: Professional Adviser Questionnaire

§12.61 (6) Form: Professional Adviser Questionnaire

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12.61-1 Professional adviser questionnaire

PROFESSIONAL ADVISER QUESTIONNAIRE

This information on this questionnaire is given by _ _[*name*]_ _ in connection with the proposed sale of limited liability company membership interests ("Units") by _ _[*name of company*]_ _, a California limited liability company (the "LLC"), to _ _[*name*]_ _ ("Purchaser"), a _ _[*state*]_ _ resident, under the Limited Offering Memorandum and Subscription Agreement to be entered into by and between Purchaser and the LLC.

_ _[*Name*]_ _ is acting as the professional adviser and investment representative for Purchaser in connection with the above-described transaction.

1. Identification:

Name:_____

Age:_____

Business address:_____

Business telephone number:_____

2. Present occupation or position, indicating period of practice or employment and field of professional specialization, if any:

_____

_____

3. List business or professional education background (including college attended, major, degrees received), if any:

_____

_____

4. List professional licenses or registrations, including bar admissions, accounting certifications, real estate brokerage licenses, and SEC, NASD, or state broker/dealer registrations:

_____

_____

5. Describe the nature of investments that you have previously evaluated:

_____

_____

6. Describe previous evaluations of investments made by you in connection with your own investments, those of your clients, or those of other persons:

_____

_____

7. State the length of time you have known the investor and in what capacity:

_____

8. (a) Do you or any of your affiliates have any material economic or business relationship with the LLC?

_ _ _ _ Yes _ _ _ _ No

(b) Has any such material relationship existed at any time during the previous two years?

_ _ _ _ Yes _ _ _ _ No

(c) Is any such material relationship now being mutually contemplated?

_ _ _ _ Yes _ _ _ _ No

If the answer is yes to any of the above three questions, please explain in detail on an attached sheet the nature of the relationship and the amount of compensation received or to be received as a result of that relationship.

9. In advising Purchaser in connection with the proposed investment of Purchaser in the Units, will you be relying in part on Purchaser's own expertise, or on the expertise of any officer, director, or controlling person of Purchaser, in certain areas?

_ _ _ _ Yes _ _ _ _ No

If the answer is yes, please explain on an attached sheet.

10. In advising Purchaser in connection with the prospective investment, will you be relying in part on the expertise of an additional representative or representatives?

_ _ _ _ Yes _ _ _ _ No

If the answer is yes, please provide the name and address of the additional representative or representatives:

_____

11. Representations and Warranties of Undersigned:

I understand that the Manager and the LLC will be relying on the accuracy and completeness of my responses to the foregoing questions and I represent and warrant to the Manager and the LLC as follows:

(a) I am acting as a professional adviser and investment representative for Purchaser in connection with the proposed purchase of Units in the LLC, and in Purchaser's prospective interest in the LLC as a result of that purchase.

(b) The answers to the above questions are complete and correct and may be relied on by the Manager and the LLC in determining whether the offer, sale, and transfer of the Units to Purchaser are exempt from registration under the Securities Act of 1933 and the California Corporate Securities Law of 1968, as amended.

(c) I have disclosed to Purchaser in writing, before Purchaser's acknowledgment of me as its professional adviser and investment representative, any material relationship with the LLC disclosed in answer to question 8

above.

(d) I personally (or, if I have checked yes in question 9, together with Purchaser) have such knowledge and experience in financial and business matters that I am capable of evaluating the merits and risks of Purchaser's investment in the LLC.

(e) _ _[*I/We*]_ _ have received and reviewed a copy of the proposed Limited Offering Memorandum and Subscription Agreement and have reviewed, or not reviewed at my/our option, publicly available information, including financial information, regarding the LLC.

(f) The Manager and the LLC have made available to me all documents relating to the transfer of, and resultant investment in, the Units that I may have requested and have provided answers to all my questions concerning the business of the LLC, necessary to verify the accuracy of the information described in (e) above.

(g) In evaluating the suitability of an investment in the LLC Units by Purchaser, I have relied solely on the representations and other information set forth in the information or contained in any documents or answers to questions furnished to me by the LLC.

(h) _ _[*I/We*]_ _ will notify the Manager and the LLC immediately if any material change in any statement made in this document occurs before the execution of the proposed Subscription Agreement.

Date: _ _ _ _ _ _

By: __[*Signature*]__
Purchaser Representative

_ _[*Printed name*]_ _

_ _[*Title*]_ _

Comment: This form of questionnaire is to be used to ensure that the professional adviser of a purchaser who purchases a limited liability company interest meets sophistication and relationship-to-issuer standards under Corp C §25102(f)(2), for purposes of an exemption from qualification of the limited liability company interests, and under Regulation D of the Securities Act of 1933 for an exemption from registration under federal securities laws. See also the Comment to the form in §12.60.

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.62 (7) Form: Assumption Agreement

§12.62 (7) Form: Assumption Agreement

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12.62-1 Assumption Agreement

ASSUMPTION AGREEMENT

This Assumption Agreement (Agreement) is made and entered into as of _ _[*date*]_ _, by and among _ _[*name of company*]_ _, a California limited liability company (Company), having an address of _ _[*address*]_ _, and _ _[*name*]_ _ (Undersigned), on the following terms and conditions.

1. Assumption of Assumed Obligations. Undersigned assumes primary and personal liability for _ _[*all of/the portions specified below*]_ _ of the _ _[*debts, obligations, and*]_ _ liabilities of the Company listed below (Assumed Obligations), including without limitation (a) the prompt and complete payment when due of all principal, interest, and other sums payable from time to time, and (b) the prompt and complete performance when due of all other obligations, liabilities, covenants, agreements, and duties of the Company. The Assumed Obligations comprise the following: _ _[*specify obligations to be assumed or, if partial assumption, specify the prorata share*]_ _.

2. Consent to Assumption. Undersigned agrees to enter into and duly execute such additional documentation as may be required by _ _[*the third parties to the Assumed Obligations*]_ _, as necessary or useful to obtain any required consent.

3. Agreement Under §17101(e). This Agreement is intended by the parties to be an agreement of Undersigned to be personally liable for the Company's obligations under the Assumed Obligations in accordance with California Corporations Code §17101(e). The Company's Operating Agreement or Articles of Organization shall be amended to set forth this assumption of liability and shall specifically reference §17101(e).

4. No Amendments. Undersigned and the Company agree that the Assumed Obligations (other than by giving effect to this Agreement) have not been amended, modified, or supplemented from the date of the execution and delivery. _ _[*Specify if any amendments have occurred.*]_ _ The Company represents and warrants to Undersigned that the Company is not in default of any of the Assumed Obligations, and, to the knowledge of the Company, there is no condition that would give rise to a default under those Assumed Obligations.

5. Miscellaneous. The execution or acceptance of this Agreement shall not be deemed or construed as a novation or an accord and satisfaction of any of the duties, obligations, liens, security interests, or liabilities of the Assumed Obligations. It is mutually agreed by and among the parties that nothing in this Agreement shall impair, waive, annul, vary, or affect any provision, condition, covenant, or agreement of the Assumed Obligations, except as specifically amended in this Agreement. This Agreement and all of its provisions shall be governed by and construed in accordance with the laws of the state of California. In the event any provision of this Agreement is prohibited, unenforceable or invalid under the laws of any jurisdiction, that shall not in any manner affect the enforceability or validity of its remaining provisions. This Agreement shall be binding on the parties and their respective successors and assigns, and shall inure to the benefit of the successors and assigns of each party. This Agreement may be executed in multiple counterparts, each of which shall be deemed original, but those counterparts together shall constitute one and the same instrument. Time is of the essence for each time and date set forth in this Agreement. Should any provision of this Agreement require judicial interpretation, it is agreed that the court interpreting or construing the same shall not apply a presumption that its terms shall be more strictly construed against one party by reason of the rule of construction that a document is to be construed more strictly against the party who itself or through its agent prepared the same, it being agreed that the agents and lawyers of all parties have participated in its preparation. In the event of a dispute between the parties that results in litigation or arbitration, the prevailing party shall be entitled to recover from the other reasonable costs and attorney fees incurred in enforcing this Agreement.

Date: _ _ _ _ _ _

_ _[*Name of limited liability company*]_ _,
a _ _[*state of organization*]_ _ **limited liability company**

By: __[*Signature*]__
Name: _ _[*Typed name*]_ _
Its: Manager

Date: _ _ _ _ _ _

__[*Signature*]__
_ _[*Typed name*]_ _

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.63 (8) Form: Full Recourse Promissory Note

§12.63 (8) Form: Full Recourse Promissory Note

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12.63-1 Full recourse promissory note

FULL RECOURSE PROMISSORY NOTE

_ _[*Dollar amount*]_ _ _ _[*date*]_ _

_ _ _ _ _ _, California

For value received, _ _[*name*]_ _, an individual (Maker), promises to pay to _ _[*name of company*]_ _, LLC, a California limited liability company, or order (Payee), the principal sum of _ _[*dollar amount*]_ _, with interest on unpaid principal accruing at the rate of _ _[*number*]_ _ percent (insert reasonable rate; in no event less than the imputed interest rate under IRS guidelines) per year. Maker shall pay Payee the principal and interest _ _[*specify terms as applicable: on or before the, e.g., 5th anniversary date of this Note*]_ _. Interest shall accrue and compound annually on the unpaid balance, computed on the basis of a 360-day year.

This Note may be prepaid before the occurrence of either event set forth above, in whole or in part, without penalty, at the option of Maker and without the consent of Payee.

Maker shall make payment(s) in lawful money of the United States of America and in immediately available funds.

This Note shall be governed by the laws of the state of California excluding its conflict of law rules. The exclusive jurisdiction and venue of any legal action instituted by any party to this Note shall be in the County of _ _[*name*]_ _, California.

Maker waives presentment, protest and demand, notice of protest, notice of demand and dishonor, notice of nonpayment of this Note. Maker expressly agrees that this Note or any payment under it may be extended by Payee from time to time without in any way affecting the liability of Maker.

The prevailing party in any action (1) to collect payment on this Note, (2) in connection with any dispute that arises over its enforcement, validity, or interpretation, whether or not legal action is instituted or prosecuted to judgment, or (3) to enforce any judgment obtained in any related legal proceeding shall be entitled to all costs and expenses incurred, including attorney fees.

If any provision or any term, clause, or part of any provision of this Note is found to be invalid for any reason, the same shall be ineffective, but the remainder of this Note and of the provision shall not be affected and shall remain in full force and effect.

Any of the terms or conditions of this Note may be waived by Payee, but no such waiver shall affect or impair the rights of Payee to require observance, performance, or satisfaction, either of that term or condition as it applies on a subsequent occasion or of any other term or condition of this Note.

[*Add, if applicable*]

This Note is secured by a pledge of Maker's membership interest in _ _[*name of company*]_ _, LLC, a California limited liability company, comprising _ _[*specify number*]_ _ Units in that company in accordance with _ _[*e.g., a Subscription Agreement dated* _ _[*date*]_ _]_ _. Payee has full recourse against Maker with respect to the obligation evidenced by this Note.

Maker: __[*Signature*]__

_ _[*Typed name*]_ _
_ _[*Address*]_ _

Payee: _ _[*Name of limited liability company*]_ _,
a _ _[*state of organization*]_ _ **limited liability company**

By: __[*Signature*]__
Name: _ _[*Typed name*]_ _
Its: Manager
_ _[*Address*]_ _

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§12.64 (9) Form: Legend Limiting Transfer for Certificate or Operating Agreement

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12.64-1 Legend limiting transfer

THIS SECURITY HAS NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES ACT OF 1933 OR THE SECURITIES LAWS OF ANY STATE AND MAY BE OFFERED AND SOLD ONLY IF SO REGISTERED AND QUALIFIED OR IF AN EXEMPTION FROM SUCH REGISTRATION AND QUALIFICATION EXISTS.

Comment: If the LLC's operating agreement provides that membership interests are evidenced by certificates (Corp C §17105), the certificate will typically contain a legend, such as the one above, setting forth the limitations on transfer of the membership interest applicable under the securities laws in addition to any legend required under the operating agreement. The operating agreement may also include a notice or legend setting forth these limitations.

This legend should be clear, and if a certificate is used, the legend should be put in a prominent place either on the face or back of the certificate. If no certificate is used, the legend should be included in the operating agreement.

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§12.65 (10) No Advertising

The offer or sale must not be accomplished by the publication of any advertisement. Corp C §25102(f)(4). This prohibition is interpreted so as to facilitate the circulation of disclosure materials to offerees and purchasers, but not to the general public. Disclosure documents are not "disseminated to the public" if the issuer limits the circulation to persons reasonably believed to be interested in purchasing the securities or prospective purchasers that may meet the qualifications of Corp C §25102(f)(2). 10 Cal Code Regs §260.102.12(j). Prohibited forms of advertising include any advertisement, notice, article, or other communication published in any newspaper, magazine, or broadcast over radio or television, and any seminar whose attendees were invited by a general solicitation or general advertisement.

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§12.66 (11) Filing Notice

Issuers must file a notice with the Commissioner of Corporations for each transaction. Corp C §25102(f)(4); 10 Cal Code Regs §260.102.14(a). If the issuer is filing a notice with the SEC required by either the Securities Act §4(6) or Regulation D, it may file a copy of that notice. In all other cases, it files the Commissioner's form, found at 10 Cal Code Regs §260.102.14(c). This form is now required to be filed electronically. When filing electronically, the issuer must provide (1) a federal employer identification number for the issuer and, if applicable, for a representative filing on behalf of the issuer, and (2) an irrevocable consent appointing the Commissioner of Corporations to be the issuer's attorney to receive service of process under Corp C §25165. 10 Cal Code Regs §260.102.14(e). In addition, an issuer filing electronically must print a copy of the notice, manually sign and date the notice at or before the time of its filing, and retain the manually signed notice for 5 years from the date of filing. The issuer must provide a copy of the manually signed notice to the Commissioner of Corporations on demand. 10 Cal Code Regs §260.102.14(e).

The issuer must file the notice within 15 days following the first sale of a security. If the issuer fails to file the notice, it may still use the exemption, but if the DOC demands that a delinquent notice be filed, the issuer must file the notice within 15 business days after demand, along with the fee that would have been incurred had the issuance been qualified by permit. 10 Cal Code Regs §260.102.14(b).

See this book's Directory for addresses and telephone numbers of the Department of Corporations (DOC).

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§12.67 c. Exemption for Sales to Qualified Purchasers That Are Accompanied by a General Announcement

Corporations Code §25102(n) contains an exemption for offers and sales to qualified purchasers. Of particular importance is the fact that the issuer may publish a general announcement about the proposed offering. Contrast this with the limited offering exemption of Corp C §25102(f), in which advertising of any kind is precluded. See §12.65.

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§12.68 (1) Purchaser Must Be Qualified

An LLC can use the exemption of Corp C §25102(n) if sales are made only to qualified purchasers or other persons that the LLC believes, after reasonable inquiry, to be qualified purchasers. Qualified purchasers includes "excluded purchasers" as defined under 10 Cal Code Regs §260.102.13 (defines excluded purchasers for purposes of 25102(f)) and certain other purchasers designated as qualified by rule of the Commissioner. No telephone solicitation is permitted until the issuer has determined that the prospective purchaser is a qualified purchaser.

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§12.69 (2) Disclosure Document

Significantly, under Corp C §25102(n)(4) the issuer must deliver a written offering disclosure statement that meets the disclosure requirements of federal Regulation D (see §12.24) and that discloses any other information prescribed by the Commissioner to any natural person purchaser who is not an excluded purchaser.

The issuer must provide the disclosure statement at least 5 business days before the sale or acceptance of the subscription. However, if the disclosure statement contains a misrepresentation of fact in violation of Corp C §25401 or fails to meet the requirements of Regulation D, the Corp C §25102(n) exemption is still available. Corp C §25102(n)(4).

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§12.70 (3) Information in General Announcement

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The general announcement permitted under Corp C §25102(n) must be written and must contain the following information:

- The name of the issuer;
- The full title of the security;
- The anticipated suitability standards;
- A statement that no money or other consideration is being solicited or will be accepted and that an indication of interest by a prospective purchaser involves no commitment (if a disclosure statement is required, the publication must also state that no sales will be made or subscriptions accepted until 5 business days after delivery of the disclosure statement);
- Any other information which the Commissioner requires by rule; and
- A legend that states (Corp C §25102(n)(5)):

FOR MORE COMPLETE INFORMATION ABOUT _ _[*name of Issuer*]_ _ **AND** _ _[*full title of Security*]_ _**, SEND FOR ADDITIONAL INFORMATION FROM** _ _[*name and address*]_ _ **BY SENDING THIS COUPON OR CALLING** _ _[*telephone number*]_ _**.**

The general announcement may also include a brief description and the geographic location of the issuer and its business, and the price of the security to be issued, method of determination of the probable price, or probable price range, and aggregate offering price. The announcement may contain no additional information. Corp C §25102(n)(5).

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§12.71 (4) Filing Notice of Transaction

The issuer is also required to file a notice of transaction concurrently with the publication of a general announcement or at the time of the initial offer, whichever occurs first. A second notice is required within 10 business days following the close or abandonment of the offering, but not more than 210 days after the first notice is filed. The exemption is unavailable if the issuer fails to file the first notice or pay the required filing fee. The first notice also must include an undertaking to deliver the disclosure statement, if required, and to deliver a copy to the Commissioner within 10 days following demand by the Commissioner. The Commissioner may assess a $1000 fine for failure to deliver the disclosure statement to the Commissioner. Corp C §25102(n)(7).

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§12.72 d. Nonissuer Exemptions

A member's sale of a membership interest must be qualified under Corp C §25130 unless exempt. The exemption most likely to apply to the transfer of an LLC interest in a private transaction is that found in Corp C §25104(a) for offers and sales by the owner of a security that is not sold through the publication of any advertisement or through a broker-dealer in a public offering. In the rare case of a publicly traded LLC, the exemption of Corp C §25104(b) (an offer or sale through a licensed broker-dealer under an unsolicited order or offer to buy) may be applicable. Any of the other exemptions set forth under Corp C §25104 may be available in isolated instances, *e.g.*, sales to institutional investors (Corp C §25104(c)); sales within 18 months after qualification (Corp C §25104(h)); any transaction by, *e.g.,* executors, administrators, trustees in bankruptcy, or receivers, on behalf of the nonissuer (Corp C §25104(f)); or offers (but not sales) for which a registration has been filed under the Securities Act (Corp C §25104(g)).

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Source: Business Law/Forming and Operating California Limited Liability Companies/12 Issuing and Transferring Membership Interests/§12.73 e. Other Transactions Exempt From Qualification

§12.73 e. Other Transactions Exempt From Qualification

Other transactions that are deemed not to require regulation by the DOC and are thus exempt from the qualification requirement are:

- Nonpublic offers (not sales) and offers (not sales) of registered securities (Corp C §25102(a)-(b));
- Transactions between issuers and underwriters (Corp C §25102(d));
- Nonpublic offerings of debt securities (Corp C §25102(e));
- Sales to institutional investors (Corp C §25102(i));
- Sales of certain oil and gas title leases and stock sales to employee benefit plans (Corp C §25102(j), (m));
- Sales under a bankruptcy plan of reorganization (Corp C §25102(k)); and
- Sales under option or purchase plans (Corp C §25102(o)).

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D. Exemption From Qualification for Mergers and Conversions

§12.74 1. Conversion to LLC From Corporate, Partnership, or Limited Partnership Form

Many entities that were formed as corporations, limited partnerships, or general partnerships may wish to convert into LLCs. Corporations, general partnerships, and limited partnerships may convert into LLCs by statutory conversion. Corp C §17540.8. Another conversion method is to form an LLC and to merge a corporation or limited partnership into the LLC using the merger provisions of the Beverly-Killea Limited Liability Company Act. Corp C §17550(a). The equity owners of the corporation or limited partnership exchange their equity interests in the disappearing entity for proportionate equity interests in the LLC. See chap 11 for a discussion of statutory conversions, mergers, and other conversion methods.

Corporations Code §25120 requires qualification for any offer or sale of securities in any exchange "in connection with any merger or consolidation" or in "an entity conversion transaction." "Entity conversion transaction" means a statutory conversion under Corp C §§1151, 1157, 15911.02, 15911.08, 16902, 16908, 17540.2, 17540.8, or a conversion that occurs entirely out of state, unless the interests in the converted entity that are to be held by the interest holders of the converting entity are not securities under California law. Corp C §25005.1. An LLC interest generally will be considered a security under California law unless the LLC is a single-member LLC. See §12.11. If the LLC interests and the interests of the disappearing entity in a merger are securities or another entity is converted into an LLC and the LLC interests are securities, Corp C §25120 will apply.

If the disappearing entity's interests in a merger are not securities, the transaction may more appropriately constitute a Corp C §25110 issuer transaction, not a reorganization, and may be exempt under Corp C §25102(f).

If both interests in a merger are securities or the converted entity's interests are securities, as is probable if an LLC is the resulting entity, the exemption of Corp C §25103(h) may be available. Corporations Code §25103(h) provides that a merger or conversion will be exempt from qualification if the merger or conversion, had it involved the issuance of a security in a transaction subject to Corp C §25110, would have been exempt from qualification under Corp C §25102(f) and if:

(1) Not less than 75 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the transaction voted in its favor;

(2) Not more than 10 percent of the outstanding securities of each constituent or converting entity entitled to vote on the transaction voted against the transaction; and

(3) All such security holders who are entitled to vote on the proposed transaction are subject to a state statute, such as California's current statutes for all forms of entities, that provides for dissenters' rights in favor of holders that do not vote in favor of or voted against the statutory conversion or merger; or

(4) The transaction is solely for the purposes of changing the state or form of organization;

(5) All securities of the same class are treated equally or all the security holders consent to unequal treatment; and

(6) The holders of nonredeemable voting equity securities receive nonredeemable voting equity securities.

Certain entities may not have statutory dissenters' rights and will not be eligible to take advantage of the Corp C §25103(h) exemption unless the transaction is properly characterized as merely a change in the issuer's form of organization. Corporations Code §16909(a) provides that, for statutory conversions and, arguably, statutory mergers, an "entity that converts into another entity pursuant to this article is for all purposes the same entity that existed before the conversion." See §§11.12-11.13.

As an alternative to Corp C §25103(h), in certain limited circumstances an issuer may rely on the exemption for exchanges incident to a merger provided by Corp C §25103(c). This exemption is only available if less than 25 percent of the outstanding securities of each class, any of whose holders are entitled to receive securities in the merger, have California addresses according to the records of the company in which they hold the securities. This exemption is not available with regard to certain "roll-up" transactions. See Corp C §§25014.6, 25103(c).

The exemption from qualification provided by 10 Cal Code Regs §260.103 is not available for a typical conversion into an LLC through a merger unless the conversion may be characterized as a change in the rights, preferences, privileges, and restrictions of or on existing securities or an exchange of securities exclusively with its existing security holders within the provisions of 10 Cal Code Regs §260.103(a)(1). A transaction is exempt under this regulation if it would have been exempt under any of the issuer exemptions of Corp C §25102 if it had involved issuing a new security of the type involved in the transaction. An entity conversion transaction is not considered a change in the rights, preferences, privileges, or restrictions of or on outstanding securities or an exchange of securities by an issuer exclusively with its existing security holders for purposes of Corp C §§25103 and 25120. Corp C §25005.1.

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§12.75 2. Alternative to Merger or Conversion

As an alternative to a merger or conversion, the parties may structure the transaction so that it has the same result as a merger. For example, the owners of the currently existing entity could contribute their shares or interests to the newly formed LLC in exchange for membership interests. The existing entity would then dissolve. The membership interests in the LLC could be issued under an exemption for issuer transactions such as a limited offering exemption provided by Corp C §25102(f). See §§12.55-12.66.

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§12.76 E. Qualifying an Issuer Transaction

California securities law provides three methods of qualification: coordination (Corp C §25111), notification (Corp C §25112), and permit (Corp C §25113). If an exemption is not found for the transaction, one of these methods must be used before the issuance of LLC interests that are securities.

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§12.77 1. Qualification by Coordination

If an issuer's offering of securities is registered under the Securities Act (including an offering statement qualified under Regulation A, 17 CFR 230.252(a)), the transaction may be qualified by coordination under Corp C §25111.

It is unlikely that an LLC will become a registered company under the Securities Act. For further information on qualification by coordination, see Organizing Corporations in California, chap 4 (3d ed Cal CEB 2001).

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§12.78 2. Qualification by Notification

An issuer qualifies by notification if the offer and sale will not be registered with the SEC but the issuer has another security registered under the Exchange Act or is an investment company registered under the Investment Company Act of 1940 (Corp C §25112). Although it is unlikely that an LLC will register its securities, it is possible that an LLC may be registered as an investment company. The filing fee is $200 plus one-fifth of one percent of the offering price of the securities up to a maximum of $2500. Corp C §25608(e).

The issuer must complete and file the form for application set forth in 10 Cal Code Regs §260.110, accompanied by information concerning the company and the securities as itemized in 10 Cal Code Regs §260.112. The categories of information include the following:

- "Description of Business";
- "Use of Proceeds to Issuer";
- "Plan of Distribution"; and
- "Remuneration of Directors and Officers, and Principal Security Holders."

The exhibits required include charter documents of the applicant, contracts that affect the securities offered, financial statements, a copy of any advertising to be used, and a description of consideration other than cash to be received for the security. Qualification becomes effective automatically 10 days after the application is filed unless a stop order from the Commissioner of Corporations is in effect. Corp C §25143.

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§12.79 3. Qualification by Permit

If the offer and sale of securities cannot be qualified by coordination or notification, the issuer may obtain a qualification by permit. Qualification by permit is available even if qualification by coordination or notification is also available. Corp C §25113(a). Qualification by permit involves preparing an application and filing it with the DOC. Before issuing a permit, the Commissioner must affirmatively find that the plan of business and issue of securities is fair, just, and equitable. 10 Cal Code Regs §§260.140-260.141; Commissioner of Corporations Release No. 25-C (Jan. 27, 1972).

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§12.80 a. Preparing the Application

The application form for qualification by permit prescribed by 10 Cal Code Regs §§260.110 and 260.112-260.113 must be used. The issuer must complete the same facing page as for other applications and complete items calling for additional information and exhibits. See Organizing Corporations in California, chap 4 (3d ed Cal CEB 2001).

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§12.81 b. Filing the Application

The application may be filed at any office of the DOC. Only the original application must be filed unless the DOC specifically asks for additional copies. The filing fee of $200 plus one-fifth of one percent of the offering price of the securities, up to a maximum of $2500, must accompany the application. Corp C §25608(e).

The information required in the application must be true and complete as of the effective date. If facts occur that render the information materially misleading, the applicant must file a pre-effective amendment containing the necessary supplemental or correcting information. Posteffective amendments may also be necessary for changes in the terms and conditions of the offering. An amendment includes the same facing page used for an original application, any recalculation of the filing fee if the amendment has that effect, and only the items that are being amended, with changes indicated by underlines and strikeouts. 10 Cal Code Regs §260.110.4.

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§12.82 c. Department of Corporations' Review of the Application

After receiving the application, the DOC will typically complete its review within a few weeks. If there are deficiencies in the application, the DOC will contact the applicant or counsel for the applicant and request an amendment to the application. The amendment is processed in the same way as the original application. If the applicant does not respond to the DOC's request within a reasonable amount of time, the DOC may, by notice to the applicant, order the application abandoned. 10 Cal Code Regs §250.16. If the applicant disagrees with the conclusions reached in the deficiency letter, the applicant may request an informal conference. If the DOC does not promptly issue a permit or a deficiency letter, the applicant may request a formal hearing.

The DOC applies a "merit" standard in reviewing applications that requires it to determine the fairness of the transaction, as opposed to a determination of full disclosure, which is the standard applied by the SEC. The test is whether the (Corp C §25140(b))

> proposed plan of business of the applicant and the proposed issuance of securities are fair, just and equitable… [whether] the applicant intends to transact its business fairly and honestly, and… [whether] the securities which it proposes to issue and the methods to be used by it in issuing them are not such as, in… [the Commissioner's] opinion, will work a fraud upon the purchaser.

The Rules of the Commissioner set forth numerous and specific standards for what constitutes a "fair, just and equitable" transaction depending on the nature of the transaction. 10 Cal Code Regs §§260.140-260.140.139. These standards act as guidelines, the ultimate determination being within the sole discretion of the Commissioner of Corporations. The burden is placed on the Commissioner, when denying a permit, to make a specific finding that a particular offer or sale of securities does not meet the fair, just, and equitable standard. Corp C §25140(a).

The securities are qualified for sale when the Commissioner issues the permit. Corp C §25113(c). The permit remains effective until the earlier of 12 months or until all securities are sold unless the Commissioner specifies a different period.

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V. WITHDRAWAL OF A MEMBER FROM THE LLC

§12.83 A. When Members May Withdraw

The articles of organization or the operating agreement may provide that a member may withdraw at the time or on the occurrence of specified events, or that a member has no right to withdraw from the LLC. As used in the Beverly-Killea Limited Liability Company Act, "withdrawal" includes resignation and retirement. Corp C §17001(as). Despite any prohibition against withdrawal contained in the articles of organization or the operating agreement, a member may withdraw from the LLC at any time by giving written notice to the other members. Corp C §17252(a).

Unless required under the articles of organization or the operating agreement, the withdrawing member will not be entitled to any payment for the membership interest on withdrawal. Beginning on the date of withdrawal, the former member becomes solely an economic interest holder. If the withdrawal is in violation of the operating agreement, the LLC may offset any damages for the breach against the amounts, if any, otherwise subsequently distributable to the withdrawing member with respect to the withdrawing member's economic interest in the LLC. Corp C §17252(a).

Whenever a member withdraws, the list of members required by Corp C §17058(a)(1) must be modified to reflect the change in members. Corp C §17252(b).

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§12.84 B. Rights of Member on Withdrawal

On a member's withdrawal, the member becomes an economic interest holder only and has no further rights as a member. Corp C §17252(a).

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§12.85 C. Member's Withdrawal Not Subject to Securities Laws

The withdrawal of a member is not typically a transfer subject to federal or state securities laws, because a withdrawal involves the surrender for cancellation, or rescission, of a security. Unless a new security is issued in the withdrawal, the transaction is not subject to the application of the securities laws.

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13

Operating a Limited Liability Company

Christopher Chediak
Allan B. Duboff

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§13.1 I. SCOPE OF CHAPTER

After a limited liability company has been formed, its members must comply with various operational requirements and procedures. Some of these are unique to LLCs, but many apply to any entity starting a new business in California. This chapter contains a basic summary of operational requirements and procedures applicable to a newly formed California LLC, such as inspection and voting rights, filings, and licensing. Because many of the requirements of the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17655) (the Act) may be modified by the LLC's operating agreement, it is essential to consider the LLC's articles of organization and its operating agreement when reviewing this chapter.

Counsel and client should agree on each party's responsibility for fulfilling each operational requirement following the LLC's formation. Some matters must be handled by the client or the client's accountants. It may be useful to establish a written record of the delegation of duties between client, accountant, and attorney. A sample memorandum from the attorney to the client is set forth in §13.43, which may be modified to include the attorney's responsibilities.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.2 II. MAINTAINING LIMITED LIABILITY PROTECTION

§13.2 II. MAINTAINING LIMITED LIABILITY PROTECTION

The formation of an LLC generally shields its members from personal liability for the acts of the entity, whether that liability arises in contract, tort, or otherwise. Corp C §17101(a). However, the Beverly-Killea Limited Liability Company Act also provides that the members remain subject to liability under the common law governing alter ego liability and also subject to personal liability "under the same or similar circumstances and to the same extent as a shareholder of a corporation." Corp C §17101(b). This language is essentially the same as the corporate standard for disregarding the entity. There is one exception: The failure of LLC members or managers to hold meetings or observe similar formalities will *not* be a factor establishing a member's alter ego or personal liability *if* the LLC's articles of organization or operating agreement do not expressly require that meetings of members or managers be held. Corp C §17101(b).

The Act expressly permits the articles of organization or written operating agreement to provide that a member will be personally liable for any or all of the debts, obligations, or liabilities of the LLC and requires that any such provision imposing personal liability specifically reference Corp C §17101(e). Corp C §17101(e).

For discussion of the alter ego doctrine and of disregarding the corporate entity, see generally Organizing Corporations in California, chap 1A (3d ed Cal CEB 2001).

Members of an LLC may also be personally liable for the LLC's acts as a result of

- Improper distributions that can be challenged by the LLC's creditors (see §§6.31-6.32);
- Breach of fiduciary duty (see §§6.35-6.39);
- Participation in tortious conduct (Corp C §17101(c)) (see §6.23);
- A written guaranty or other contractual obligation entered into by the member, other than an operating agreement (Corp C §17101(c)); or
- Failure to pay withholding taxes (see §13.11).

To minimize the possibility of personal liability being imposed on the member or members for acts of the LLC, counsel should observe the following precautions:

(a) All operating formalities specified in the operating agreement or articles of organization should be respected. Although LLCs are not required to hold meetings (see §13.20), if the operating agreement provides for them, a minute book should be maintained, with properly executed minutes or written consents for all meetings of members or managers. The minutes should reflect compliance with all necessary approval requirements by the members or managers.

(b) The LLC should be adequately capitalized to pursue the business activities in which it is engaged or proposes to engage, including anticipated liabilities. Proper records should be maintained as evidence of the adequacy of capitalization. The LLC should also obtain adequate insurance as protection against unanticipated liabilities.

(c) All transactions between the LLC and its owners should be fully disclosed to all members and should be fair to the LLC.

(d) The status of the LLC as a separate legal entity should be respected in all its operations. The LLC's funds should not be commingled with the funds of its members, managers, or any third party. The LLC should have its own separate bank account. In addition, separate financial books and records for the LLC should be maintained that are distinct from those of members, managers, or any other entity.

(e) The LLC should conduct all business in its own name, not in the individual name of any manager or member. To ensure that third parties are not confused in their dealings with the LLC:

- All letterhead, bills, invoices, and other business forms used by the LLC should show its full legal name (or fictitious business name), address, and telephone number(s).
- The LLC's telephone number(s) should be listed under its full legal or fictitious business name in all phone and business directories.
- The LLC's full legal or fictitious business name should appear on all LLC signs or advertisements, including signs at its principal place of business. Employee business cards should also show the LLC name.

- All contracts should be entered into in the LLC's name and executed with signature blocks that clearly identify the signing party as an agent of the LLC.

(f) The LLC should be properly qualified to do business in each state in which registration is required.

(g) If the operating agreement is to include a provision personally obligating any member for any debts, obligations, or liabilities of the LLC, the provision should be carefully drafted to specify and limit, if appropriate, these liabilities and to specify which member or members personally will be liable.

The formation of an LLC also protects its manager and officers from personal liability under any judgment or for any liability of the LLC, whether arising in contract, tort, or otherwise, solely by reason of being a manager or officer or both. Corp C §17158(a). A manager may agree to be personally liable for any or all of the LLC's liabilities if that agreement is set forth in the articles of organization or a written operating agreement that specifically references Corp C §17158(b), or under the terms of any written guaranty or other contractual obligation entered into by the manager other than the operating agreement. Corp C §17158(b).

To minimize the possibility of a manager or officer being held personally liable for the obligations of the LLC, a provision contained in the articles of organization or operating agreement imposing liability on the manager or officer should be narrowly drafted, and all separate agreements signed by the manager or officer should be reviewed to make certain that a manager or officer signing in a representative capacity does not unintentionally create personal liability.

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III. COMPLYING WITH FILING REQUIREMENTS

§13.3 A. Biennial Information Filing

Newly formed LLCs must file an informational statement with the Secretary of State within 90 days after filing the original articles of organization. Corp C §17060(a). Form LLC-12, "Statement of Information" (see §13.3A), will be sent to the LLC by the Secretary of State's office with the filed articles of organization. This statement must contain (Corp C §17060(a)(1)-(5)):

- The name of the LLC, the Secretary of State's file number, and, if the LLC is a foreign LLC, the name of the state where it was organized;
- The name and street address of its agent for service of process;
- The street address of its principal executive office and, if it is a domestic LLC, the office at which its records are kept;
- The names and addresses of any managers and the chief executive officer, if any (if no manager has been elected or appointed, the name and address of each member); and
- The general type of business comprising the LLC's principal business activities (for example, manufacturer of aircraft; wholesale liquor distributor; or retail department store).

In every second year, Form LLC-12R, the statement of information renewal form, must be filed during the calendar month in which the original articles of organization were filed or during any of the immediately preceding five calendar months. See §13.3B for a sample of the form. Foreign LLCs must submit this filing biennially in the month during which the application for registration was filed, or during any of the preceding five months. Corp C §17060(c).

If the LLC changes its agent or address for service of process, it must file a statement designating the new agent or address. A $250 penalty may be imposed for late filing of the annual information statement, and the LLC may have its powers, rights, and privileges suspended for failing to file the statement. Corp C §§17651(a), 17654. The Secretary of State will first send a notice of delinquency to the LLC, noting the LLC's right to request relief for reasonable cause or unusual circumstances that justify its failure to file. Corp C §17653(a). If no statement is filed within 60 days after the delinquency notice was sent, the Secretary of State will certify the LLC as delinquent and notify the Franchise Tax Board, which will assess a penalty under Rev & T C §19141. Corp C §17653(b). However, if the Secretary of State determines that the LLC's failure to file the statement is excusable because of reasonable cause or unusual circumstances that justify the failure, the Secretary of State may waive the penalty. Corp C §17653(f).

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.3A 1. Form: Statement of Information (Secretary of State Form LLC-12)

§13.3A 1. Form: Statement of Information (Secretary of State Form LLC-12)



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State of California
Secretary of State

STATEMENT OF INFORMATION
(Limited Liability Company)

Filing Fee $20.00. If amendment, see instructions.

IMPORTANT — READ INSTRUCTIONS BEFORE COMPLETING THIS FORM

1. **LIMITED LIABILITY COMPANY NAME** (Please do not alter if name is preprinted.)

This Space For Filing Use Only

DUE DATE:

FILE NUMBER AND STATE OR PLACE OF ORGANIZATION

2. SECRETARY OF STATE FILE NUMBER	3. STATE OR PLACE OF ORGANIZATION

COMPLETE ADDRESSES FOR THE FOLLOWING (Do not abbreviate the name of the city. Items 4 and 5 cannot be P.O. Boxes.)

4. STREET ADDRESS OF PRINCIPAL EXECUTIVE OFFICE	CITY AND STATE	ZIP CODE

5. CALIFORNIA OFFICE WHERE RECORDS ARE MAINTAINED **(DOMESTIC ONLY)**	CITY	STATE	ZIP CODE
		CA	

NAME AND COMPLETE ADDRESS OF THE CHIEF EXECUTIVE OFFICER, IF ANY

6. NAME	ADDRESS	CITY AND STATE	ZIP CODE

NAME AND COMPLETE ADDRESS OF ANY MANAGER OR MANAGERS, OR IF NONE HAVE BEEN APPOINTED OR ELECTED, PROVIDE THE NAME AND ADDRESS OF EACH MEMBER (Attach additional pages, if necessary.)

7. NAME	ADDRESS	CITY AND STATE	ZIP CODE
8. NAME	ADDRESS	CITY AND STATE	ZIP CODE
9. NAME	ADDRESS	CITY AND STATE	ZIP CODE

AGENT FOR SERVICE OF PROCESS (If the agent is an individual, the agent must reside in California and Item 11 must be completed with a California address. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code **section 1505** and Item 11 must be left blank.)

10. NAME OF AGENT FOR SERVICE OF PROCESS

11. ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA, **IF AN INDIVIDUAL**	CITY	STATE	ZIP CODE
		CA	

TYPE OF BUSINESS

12. DESCRIBE THE TYPE OF BUSINESS OF THE LIMITED LIABILITY COMPANY

13. THE INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.

TYPE OR PRINT NAME OF PERSON COMPLETING THE FORM	SIGNATURE	TITLE	DATE

Print

INSTRUCTIONS FOR COMPLETING FORM LLC-12

For easier completion, this form is available on the Secretary of State's website at http://www.sos.ca.gov/business/ and can be viewed, filled in and printed from your computer. Completed forms along with the applicable fees can be mailed to Secretary of State, Statement of Information Unit, P.O. Box 944230, Sacramento, CA 94244-2300 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered.

Every **domestic and registered foreign limited liability company** shall file a Statement of Information with the Secretary of State, within 90 days after filing of its original Articles of Organization or Application for Registration, and biennially thereafter during the applicable filing period. The applicable filing period for a limited liability company is the calendar month during which its original Articles of Organization or Application for Registration were filed and the immediately preceding five calendar months. A limited liability company is required to file this statement even though it may not be actively engaged in business at the time this statement is due. Changes to information contained in a previously filed statement can be made by filing a new form, completed in its entirety.

Statutory filing provisions are found in California Corporations Code section 17060, unless otherwise indicated. Failure to file this Statement of Information by the due date will result in the assessment of a $250.00 penalty. (Corporations Code sections 17651(b) and 17653; Revenue and Taxation Code section 19141)

FILING FEES: The fee for filing the initial or biennial Statement of Information is **$20.00**. Checks should be made payable to the Secretary of State. If this statement is being filed to amend any information on a previously filed statement and is being filed outside the applicable filing period, as defined above, **no fee** is required.

COPIES: The Secretary of State will endorse file one copy of the statement if an exact copy is submitted along with the statement to be filed. Copies submitted with the statement to be filed can be certified upon request and payment of the $8.00 per copy certification fee.

Complete the Statement of Information (Form LLC-12) as follows:

Item 1. Please do not alter the preprinted name. If the name is not correct, please attach a statement indicating the correct name and the date the name change amendment was filed with the Secretary of State. If blank, enter the name of the limited liability company **exactly** as it is of record with the California Secretary of State.

Item 2. Please do not alter the preprinted file number. If blank, enter the file number issued by the California Secretary of State.

Item 3. Please do not alter the preprinted jurisdiction. If blank, and the limited liability company is a registered foreign limited liability company (organized outside the state of California), enter the state or place under the laws of which the limited liability company is organized.

Item 4. Enter the complete street address, city and zip code of the limited liability company's principal executive office. Please do not enter a P.O. Box or abbreviate the name of the city. This address will be used for mailing purposes.

Item 5. If the limited liability company is formed under the laws of the state of California, enter the complete street address, city and zip code of the office required to be maintained pursuant to Corporations Code section 17057(a). Please do not enter a P.O. Box or abbreviate the name of the city.

Item 6. Enter the name and complete business or residential address of the chief executive officer, if any. Please do not abbreviate the name of the city.

Items 7-9. Enter the name and complete business or residential address of any manager or managers, appointed or elected in accordance with the Articles of Organization or Operating Agreement, or if no manager has been so elected or appointed, the name and business or residential address of each member. Attach additional pages, if necessary. Please do not abbreviate the name of the city.

Item 10. Enter the name of the agent for service of process in California. An agent is an individual (manager, member or any other person, whether or not affiliated with the company) who resides in California or a corporation designated to accept service of process if the company is sued. The agent **must** agree to accept service of process on behalf of the company prior to designation.

If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, **a limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.

If an individual is designated as agent, complete Items 10 and 11. If a corporation is designated as agent, complete Item 10 and proceed to Item 12 (do not complete Item 11).

Item 11. If an individual is designated as agent for service of process, enter a business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. Please do not enter an address if a corporation is designated as agent.

Item 12. Briefly describe the general type of business that constitutes the principal business activity of the limited liability company.

Item 13. Type or print the name and title of the person completing this form and enter the date this form was completed.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.3B 2. Form: Statement of Information (Secretary of State Form LLC-12R)

§13.3B 2. Form: Statement of Information (Secretary of State Form LLC-12R)



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State of California
Secretary of State

STATEMENT OF INFORMATION
(Limited Liability Company)

Filing Fee $20.00. If amendment, see instructions.

IMPORTANT — READ INSTRUCTIONS BEFORE COMPLETING THIS FORM

1. **LIMITED LIABILITY COMPANY NAME** (Please do not alter if name is preprinted.)

This Space For Filing Use Only

DUE DATE:

FILE NUMBER AND STATE OR PLACE OF ORGANIZATION

2. SECRETARY OF STATE FILE NUMBER	3. STATE OR PLACE OF ORGANIZATION

NO CHANGE STATEMENT

☐ If there has been no change in any of the information contained in the last Statement of Information filed with the Secretary of State, check the box and proceed to Item 13.

If there have been any changes to the information contained in the last Statement of Information filed, or no Statement of Information has been previously filed, this form must be completed in its entirety.

COMPLETE ADDRESSES FOR THE FOLLOWING (Do not abbreviate the name of the city. Items 4 and 5 cannot be P.O. Boxes.)

4. STREET ADDRESS OF PRINCIPAL EXECUTIVE OFFICE	CITY AND STATE	ZIP CODE

5. CALIFORNIA OFFICE WHERE RECORDS ARE MAINTAINED **(DOMESTIC ONLY)**	CITY	STATE	ZIP CODE
		CA	

NAME AND COMPLETE ADDRESS OF THE CHIEF EXECUTIVE OFFICER, IF ANY

6. NAME	ADDRESS	CITY AND STATE	ZIP CODE

NAME AND COMPLETE ADDRESS OF ANY MANAGER OR MANAGERS, OR IF NONE HAVE BEEN APPOINTED OR ELECTED, PROVIDE THE NAME AND ADDRESS OF EACH MEMBER (Attach additional pages, if necessary.)

7. NAME	ADDRESS	CITY AND STATE	ZIP CODE
8. NAME	ADDRESS	CITY AND STATE	ZIP CODE
9. NAME	ADDRESS	CITY AND STATE	ZIP CODE

AGENT FOR SERVICE OF PROCESS (If the agent is an individual, the agent must reside in California and Item 11 must be completed with a California address. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 11 must be left blank.)

10. NAME OF AGENT FOR SERVICE OF PROCESS

11. ADDRESS OF AGENT FOR SERVICE OF PROCESS IN CALIFORNIA, **IF AN INDIVIDUAL**	CITY	STATE	ZIP CODE
		CA	

TYPE OF BUSINESS

12. DESCRIBE THE TYPE OF BUSINESS OF THE LIMITED LIABILITY COMPANY

13. THE INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.

TYPE OR PRINT NAME OF PERSON COMPLETING THE FORM	SIGNATURE	TITLE	DATE

Print

INSTRUCTIONS FOR COMPLETING FORM LLC-12R

For easier completion, this form is available on the Secretary of State's website at http://www.sos.ca.gov/business/ and can be viewed, filled in and printed from your computer. Completed forms along with the applicable fees can be mailed to Secretary of State, Statement of Information Unit, P.O. Box 944230, Sacramento, CA 94244-2300 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered.

Every **domestic and registered foreign limited liability company** shall file a Statement of Information with the Secretary of State, within 90 days after filing of its original Articles of Organization or Application for Registration, and biennially thereafter during the applicable filing period. The applicable filing period for a limited liability company is the calendar month during which its original Articles of Organization or Application for Registration were filed and the immediately preceding five calendar months. A limited liability company is required to file this statement even though it may not be actively engaged in business at the time this statement is due. Changes to information contained in a previously filed statement can be made by filing a new form, completed in its entirety.

Statutory filing provisions are found in California Corporations Code section 17060, unless otherwise indicated. Failure to file this Statement of Information by the due date will result in the assessment of a $250.00 penalty. (Corporations Code sections 17651(b) and 17653; Revenue and Taxation Code section 19141)

FILING FEES: The fee for filing the initial or biennial Statement of Information is **$20.00**. Checks should be made payable to the Secretary of State. If this statement is being filed to amend any information on a previously filed statement and is being filed outside the applicable filing period, as defined above, **no fee** is required.

COPIES: The Secretary of State will endorse file one copy of the statement if an exact copy is submitted along with the statement to be filed. Copies submitted with the statement to be filed can be certified upon request and payment of the $8.00 per copy certification fee.

Complete the Statement of Information (Form LLC-12R) as follows:

Item 1. Please do not alter the preprinted name. If the name is not correct, please attach a statement indicating the correct name and the date the name change amendment was filed with the Secretary of State. If blank, enter the name of the limited liability company **exactly** as it is of record with the California Secretary of State.

Item 2. Please do not alter the preprinted file number. If blank, enter the file number issued by the California Secretary of State.

Item 3. Please do not alter the preprinted jurisdiction. If blank, and the limited liability company is a registered foreign limited liability company (organized outside the state of California), enter the state or place under the laws of which the limited liability company is organized.

No Change If there has been any change to the last Statement of Information filed with the Secretary of State, including a change to any address, or no Statement of Information has ever been filed, complete this form in its entirety.

If there has been no change in the information contained in the last Statement of Information filed with the Secretary of State, check the box and proceed to Item 13.

Item 4. Enter the complete street address, city and zip code of the limited liability company's principal executive office. Please do not enter a P.O. Box or abbreviate the name of the city. This address will be used for mailing purposes.

Item 5. If the limited liability company is formed under the laws of the state of California, enter the complete street address, city and zip code of the office required to be maintained pursuant to Corporations Code section 17057(a). Please do not enter a P.O. Box or abbreviate the name of the city.

Item 6. Enter the name and complete business or residential address of the chief executive officer, if any. Please do not abbreviate the name of the city.

Items 7-9. Enter the name and complete business or residential address of any manager or managers, appointed or elected in accordance with the Articles of Organization or Operating Agreement, or if no manager has been so elected or appointed, the name and business or residential address of each member. Attach additional pages, if necessary. Please do not abbreviate the name of the city.

tem 10. Enter the name of the agent for service of process in California. An agent is an individual (manager, member or any other person, whether or not affiliated with the company) who resides in California or a corporation designated to accept service of process if the company is sued. The agent **must** agree to accept service of process on behalf of the company prior to designation.

If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, **a limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.

If an individual is designated as agent, complete Items 10 and 11. If a corporation is designated as agent, complete Item 10 and proceed to Item 12 (do not complete Item 11).

Item 11. If an individual is designated as agent for service of process, enter a business or residential address in California. Please do not enter "in care of" (c/o) or abbreviate the name of the city. Please do not enter an address if a corporation is designated as agent.

Item 12. Briefly describe the general type of business that constitutes the principal business activity of the limited liability company.

Item 13. Type or print the name and title of the person completing this form and enter the date this form was completed.

Comment: The above form is filed every 2 years during the LLC's applicable filing period. If there have been no

changes since the filing of the last Statement of Information, only a box need be checked and the form signed and filed. If changes have occurred in the information last reported, this form is filled out completely. The filing fee is $20. For easier completion, the above form and Form LLC-12 are available on the Secretary of State's website (see the Directory) and can be viewed, filled in, and printed from one's computer. Completed forms and applicable fees can be mailed or delivered in person to the Secretary of State's Sacramento office. See Directory. The form should be typed or legibly printed in black or blue ink. The form should not be altered.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.4 B. Fictitious Business Names

§13.4 B. Fictitious Business Names

An LLC that plans to transact business under a name other than that listed in its articles of organization must file a Fictitious Business Name Statement with the clerk of the county in which the LLC has its principal place of business. See generally Bus & P C §§17900-17930. If the registrant does not have a place of business in California, the Fictitious Business Name Statement should be filed with the clerk of Sacramento County. Bus & P C §17915. Typically, filings are also made in any other counties where the LLC will be transacting business. Once filed with the county clerk, the Fictitious Business Name Statement must be published in a newspaper of general circulation in that county, once a week for 4 consecutive weeks. An affidavit of publication must then be filed with the county clerk within 30 days after completion of publication. Information on publication fees are available from the newspapers that publish such notices.

NOTE: A foreign LLC that has filed an application for registration with the California Secretary of State under Corp C §17451 and does business under any name other than the name on file with the Secretary of State is subject to the same requirements described above. Bus & P C §17900(b)(5); see also Bus & P C §17910.5(b).

An entity that has no place of business in California should file its fictitious business name statement with the Clerk of Sacramento County, but may file in other counties as well. Bus & P C §17915.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.5 C. Updating Recorded Articles of Organization

§13.5 C. Updating Recorded Articles of Organization

An LLC may record a certified copy of its articles of organization and any exhibits or attachments, amendments, or corrections with the office of the county recorder of any county in California. Foreign LLCs may record a certified copy of the LLC's application for registration, certificate of registration, or any amendment. Once recorded, these documents will create a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the statements in the document with respect to the LLC's real property in that county. Corp C §17052(f). All recorded documents must first have been filed with the office of Secretary of State. If an LLC elects to record its articles of organization and related documents, the LLC should record amended documents when appropriate to avoid any purchaser or encumbrancer of the LLC's real property being entitled to rely on outdated information. If, for example, the management of the LLC as reflected in a recorded document changes, after filing the revised document with the office of Secretary of State, the LLC should record the amendments in any county in which the filed documents were recorded. Failure to properly update the recording could allow a bona fide purchaser or encumbrancer for value to rely on conduct or actions that might not otherwise bind the LLC. Corp C §17052(f).

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IV. LICENSING AND QUALIFICATION REQUIREMENTS

§13.6 A. State and Local Licenses

As with other forms of business entities, state and local licensing is required for a wide variety of businesses that may be conducted as an LLC. It is important to note that many types of businesses requiring specific licenses may not be conducted by an LLC. For example, LLCs are prohibited from rendering professional services that require a license, certification, or registration under the Business and Professions Code or the Chiropractic Act. Corp C §17375. See §3.92.

The licensing requirements of cities, counties, or other local governments vary widely. Some cities require certain businesses to obtain a license to conduct business in the city and to pay business taxes. Typically, a new business must register, and a minimum tax must be paid, on or before the last day of the month after the date the business commences.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.7 B. Qualifying to Do Business in Other States

§13.7 B. Qualifying to Do Business in Other States

Before conducting business in any state other than California, an LLC should qualify or register to do business in that state unless registration is not required. Each state's requirements vary and are usually based on the nature of the LLC's activities in that state. Various penalties may apply for failure to qualify to do business in a state. These penalties may include limitations on the enforceability of the LLC's contracts in the state's courts; the voiding of contracts entered into while not qualified to do business; and fines, penalties, and potential personal liability for members.

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V. ACCOUNTING AND TAX MATTERS

§13.8 A. Selection and Change of Method of Accounting

Selection of the LLC's accounting method is made in its first income tax return. Reg §1.446-1(e)(1). For general discussion of choosing an accounting method, see §§5.12-5.14.

If a change is to be made in the accounting method, an application for permission to change must be made on IRS Form 3115 (Application for Change in Accounting Method) or, if applicable, IRS Form 1128 (Application to Adopt, Change, or Retain a Tax Year) during the taxable year in which the change will be made. Reg §1.446-1(e)(3)(i). Consent to a change of the accounting method must be obtained in advance from the Internal Revenue Service. IRC §446; Reg §1.446-1(e)(3). Similar consent from the Franchise Tax Board must also be obtained, after federal consent has been given. Rev & T C §24651(e). To obtain FTB consent, send a copy of IRS Form 3115, a copy of the IRS letter giving consent to the change, and a cover letter explaining why the LLC is changing its accounting period to the FTB at the address listed in this book's Directory. The cover letter should clearly indicate that a "Change in Accounting Method" is being requested. The name of the taxpayer requesting the change and the taxpayer's California Corporate Number must be included in the cover letter. The FTB will acknowledge receipt of the request within 30 days. After the request has been reviewed, the FTB's Change in Accounting Periods and Methods Coordinator will notify the requestor in writing whether the request for an accounting method change has been approved or denied.

Further information about the procedure for changing the accounting method is set forth in FTB Notice 2000-8 (Nov. 7, 2000), as corrected by FTB Notice 2001-2 (Feb. 1, 2001).

In most cases, a change of the accounting period will necessitate the filing of a short-period tax return.

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§13.9 B. Choice of Fiscal Year

The taxable year of the LLC is determined as though the LLC were a separate taxpayer. IRC §706(b)(1). However, an LLC is severely limited in its ability to use a taxable year that differs from that of its members. In general, an LLC must adopt the same taxable year as those of its members who own, in the aggregate, more than 50 percent of LLC profits *and* capital. IRC §706(b)(1)(B)(i), (b)(4)(A)(i). If those members do not have the same taxable year, the LLC must adopt the same taxable year as all of its principal members. IRC §706(b)(1)(B)(ii). A principal member for these purposes is one who owns 5 percent or more of LLC profits *or* capital. IRC §706(b)(3). If the principal members do not have the same taxable year or if there are no principal members, the LLC must adopt the calendar year. IRC §706(b)(1)(B)(iii). See §5.11 for further discussion.

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C. Federal and State Tax Filing Requirements

§13.10 1. Employer Identification Number

An LLC may obtain an employer identification number (EIN) by filing Form SS-4 with the IRS. This filing should be completed promptly after the LLC's articles of organization are filed because an EIN must be shown on all federal tax returns and other documents. There is no filing fee. Form SS-4 must be signed by the client, but it can be filed by the client or its attorney or accountant. Until an EIN is received, forms can be filed with an indication that an application is pending. An EIN may be obtained by telephone from the IRS regional office for the county in which the LLC has its principal place of business. The IRS will issue an EIN over the telephone only to the client, not to its attorney or accountant. The IRS officer will ask the client for the same information requested on Form SS-4, so the client should have a copy of the form for reference. A completed, signed copy of the form (with the EIN indicated on it) must still be filed when the EIN has been obtained by telephone. Copies of Form SS-4, with instructions, are available at any local IRS office.

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§13.11 2. Employers' Payroll Withholding Taxes

If it is an employer, the LLC must withhold federal and state income taxes from its employees' wages, as well as pay social security taxes, federal unemployment taxes, California unemployment insurance taxes, California disability insurance taxes, and Medicare taxes.

The employer's willful failure to collect, account for, and pay withholding taxes subjects the employer to a significant penalty. The individuals responsible for failing to collect or pay withholding taxes also may be held personally liable for a 100-percent penalty, equal to the amount not paid to the IRS. California's withholding procedures are similar to the federal requirements.

Generally, employers subject to either income tax withholding or social security taxes must file a quarterly return on IRS Form 841 and deposit the income tax withholdings and FICA taxes with an authorized commercial bank depository or a federal reserve bank or branch. An LLC that is subject to personal income tax withholding requirements under the Unemployment Insurance Code must register with the California Employment Development Department.

For a detailed discussion of employer tax obligations, see Advising California Employers and Employees, chap 7 (Cal CEB 2005). See also Internal Revenue Service Circular E, Employer's Tax Guide and California Employer's Tax Guide (Form DE-44).

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.12 3. California and Federal Tax Returns

§13.12 3. California and Federal Tax Returns

With respect to LLCs with more than one member, federal and California tax returns are due on the 15th day of the fourth month following the close of the taxable year. California imposes an annual franchise tax and a statutory fee on the total income of an LLC. For further information, see chap 5.

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§13.13 D. California Sales and Use Taxes

Anyone engaged in the business of selling tangible personal property at retail in California must obtain a seller's permit from the California State Board of Equalization. Rev & T C §§6014, 6066, 6226. A separate permit must be obtained for each retail business location, and it must be conspicuously displayed. Rev & T C §6067. The Board of Equalization may require the LLC to post security (in the form of cash, government bonds, or insured deposits in banks or savings and loan institutions) to ensure compliance with sales and use tax laws. The amount of security is fixed by the Board under a statutory formula, but it cannot exceed $50,000. Rev & T C §6701. Businesses having a seller's permit may purchase tangible personal property for resale without paying sales tax to the seller as long as they deliver a signed resale certificate to the seller on a form prescribed by the Board. Rev & T C §§6091-6092, 6241-6242.

California also imposes a use tax on most retail purchases made outside California that are intended for use in California. Rev & T C §6201. Any retailer engaged in business is required to collect the sales and use tax and remit them to the state. Rev & T C §6203. Leases of personal property can also be subject to the state sales and use taxes. Rev & T C §6203.

The holder of a seller's permit must file sales and use tax returns and prepay taxes collected. Generally, these payments must be made on a quarterly basis. Rev & T C §6452.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.14 E. Personal and Real Property Taxes

§13.14 E. Personal and Real Property Taxes

The LLC must pay annual property taxes based on the value of the taxable real and personal property it owns or possesses on the immediately preceding January 1. Rev & T C §§401, 2192. This tax is usually paid to the county assessor for the county in which the property is located. All real and personal property to which these taxes apply is subject to lien to secure payment. Rev & T C §§2187, 2189, 2189.3.

If an LLC owns taxable personal property having an aggregate cost of $100,000 or more, it must file annually a written property statement on or before the date set by the county assessor. If the LLC owns taxable personal property that cost less than $100,000, no written property statement need be filed unless one is requested by the assessor. Rev & T C §441. Real property taxes are payable in two installments, the first due before December 10 and the second before April 10 of each fiscal year. Rev & T C §§2704-2705. Personal property taxes must be paid by the date specified in the assessor's notice.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.15 F. Other Taxes

§13.15 F. Other Taxes

California imposes a statutory fee on gross receipts, as described in §§5.4-5.5. Other special taxes may be imposed by federal, state, or local governments. These include alcohol, tobacco, documentary transfer taxes, and real estate transaction taxes. The appropriate county or city assessor should be contacted to ascertain the applicable taxes.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.16 VI. MAINTAINING BOOKS AND RECORDS

§13.16 VI. MAINTAINING BOOKS AND RECORDS

Each LLC is required to maintain an office in California at which the records described below are kept. Corp C §17057(a). This requirement may not be varied by the operating agreement or articles of organization. Corp C §17005(c). The following information must be maintained at the LLC's office (Corp C §17058(a)-(b)):

- A current alphabetical list of each member, holder of an economic interest, and manager if the LLC is manager managed, indicating the name and address of each, with their capital contributions and share of profits and losses;
- A copy of the articles of organization and operating agreement (if any) and all amendments to either, plus any powers of attorney under which the articles, operating agreement, or amendments were executed;
- Copies of the LLC's federal, state, and local income tax or information returns and financial statements, if any, for the six most recent taxable years;
- All books and records relating to the LLC's internal affairs for no less than the current and preceding four fiscal years; and
- All records on the cost and value of all property the LLC owns, possesses, or controls in each California county.

An LLC that does not maintain the records required by Corp C §17058 is subject to a $25 penalty for each day that the failure or refusal continues, beginning 30 days after it receives a written request by any member of the LLC to comply with that requirement. Corp C §17651(a). A maximum penalty of $1500 may be assessed. This penalty is paid to the member or members requesting performance who were damaged by the failure or refusal to maintain the required records and filed a suit within 90 days after having made the written request. Corp C §17651(a). The maximum daily penalty for failing to comply with any number of separate requests made on any one day is $250.

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VII. MEMBERS' INFORMATION AND INSPECTION RIGHTS

§13.17 A. Generally

Every member or holder of an economic interest has a right to require a manager to promptly deliver a copy of any written operating agreement of the LLC and copies of the information required to be maintained by it under Corp C §17058(a)(1)-(2), (4). Corp C §17106(a). See §12.3. This right is limited to purposes reasonably related to the member's or interest holder's ownership interest. The LLC must pay for the copying expenses. Corp C §17106(a). Managers must also deliver amendments to the articles or operating agreement signed by them under a power of attorney. Corp C §17106(d).

Each member, manager, and holder of an economic interest also has the right, on reasonable request, to inspect and copy during normal business hours any record required to be maintained at the principal office of the LLC and to obtain from the manager a copy of the LLC's federal, state, and local income tax or information returns for each year. Corp C §17106(b)(1), (2). These requests also must be for a purpose reasonably related to the interest of that person as a member, manager, or holder of an economic interest. Corp C §17106(b).

If the LLC has more than 35 members, additional reporting requirements apply. The manager(s) must send annual reports to each member no later than 120 days after the close of each fiscal year, containing a balance sheet, an income statement, and a statement of cash flows for the fiscal year. Corp C §17106(c)(1).

NOTE: The annual report may be delivered electronically (by fax, e-mail, or other means) to any member who has provided an unrevoked consent to such delivery. The LLC should maintain a current list of member fax numbers or e-mail addresses for this purpose if it chooses to distribute information electronically. The electronic record must be capable of retention, retrieval, and review, and renderable into clearly legible tangible form. The consent itself must comply with the Electronic Signatures in Global and National Commerce Act (15 USC §7001(c)(1)). Corp C §17001(o)(1). See §13.18 for a sample consent.

In addition, three or more members, or members representing at least 5 percent of the voting interests, may make a written request to a manager for an income statement for the initial 3-, 6-, or 9-month period of the current fiscal year (as long as that period ended more than 30 days before the date of the request) and a balance sheet as of the end of that period. The statement must be delivered or mailed to the members within 30 days. Corp C §17106(c)(2).

An LLC must also send to each member or holder of an economic interest, within 90 days after the end of each taxable year, the information necessary to complete the member's or holder's federal or state income tax or information returns, and, in the case of an LLC with 35 or fewer members, a copy of the LLC's federal, state, and local income tax or information returns for the year. Corp C §17106(b), (e).

All financial statements delivered to members must be accompanied by the reports of any independent accountants engaged by the LLC or, if none, the manager's certificate that the statements were prepared without audit. Corp C §17106(c).

If the LLC does not provide its members with the information and financial statements required by the Beverly-Killea Limited Liability Company Act, the members may sue to compel the company to do so. Corp C §17106(f). If the court finds that the LLC's failure to comply with the Act is not justified, the court may award the complaining parties their reasonable expenses incurred in bringing the action, including attorney fees. Corp C §17106(g).

An action by the California State Attorney General against any LLC failing to comply with the disclosure requirements described above also may be instituted. Corp C §17107; see §13.38.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.18 B. Form: Consent to Electronic Delivery of Notices, Reports, and Information

§13.18 B. Form: Consent to Electronic Delivery of Notices, Reports, and Information

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13.18-1 Consent to electronic delivery of notices, reports, and information

Consent to Electronic Delivery of Documents

The undersigned, being a member or interest holder of _ _[*name of LLC*]_ _, consents to electronic delivery of any document relating to the business, operation, or management of _ _[*name of LLC*]_ _. This includes, but is not limited to, meeting notices and meeting minutes (if the members elect to hold meetings), annual reports, tax information, financial information, voting information, and all other notices, reports and information.

This consent is intended to apply to all electronic transmissions by and to the LLC, as those terms are defined in Corporations Code §17001(o)(1)-(2).

The undersigned acknowledges that he or she has received this Consent to Electronic Delivery of Documents from _ _[*name of LLC*]_ _ by electronic transmission, and that he or she is able to access information or documents transmitted by _ _[*name of LLC*]_ _in that manner. The undersigned will promptly advise _ _[*name of LLC*]_ _, either in writing or electronically, of any change in his or her address for the receipt of electronic transmissions.

The undersigned acknowledges that this consent may be withdrawn or revoked at any time, by a writing mailed to:

_ _[*name and address of LLC*]_ _

by certified mail, return receipt requested, or by electronic transmission to _ _[*name of LLC*]_ _, receipt of which is confirmed by a reply transmission. On receipt of that withdrawal or revocation by _ _[*name of LLC*]_ _, the undersigned will have the right to receive all subsequent documents, notices, reports, and information in nonelectronic (paper) form.

Any electronic transmission by _ _[*name of LLC*]_ _must be capable of retention, retrieval, and review, and renderable into clearly legible tangible form. The undersigned has the right to inspect and copy a tangible form of any document or other communication transmitted electronically to him or her, in accordance with the record inspection rights set forth in _ _[*section number*]_ _ of the operating agreement for _ _[*name of LLC*]_ _.

_ _[*Name of LLC*]_ _**will promptly advise the undersigned if the software or hardware requirements for receiving any electronic transmission change.**

Comment: For ease of communication and management, having the ability to distribute notices, reports and information electronically is essential. Corporations Code §17001(o)(1) requires a member's consent be obtained to distribute the annual report electronically. Such a consent must meet the requirements of the Electronic Signatures in Global and National Commerce Act (15 USC §7001(c)(1)). Among those requirements is that the consent itself be given electronically, to demonstrate that the recipient is able to receive and send such transmissions. 15 USC §§7001(c)(1)(A), 7001(c)(1)(C)(ii). That Act also requires that the consent:

- Inform the recipient of (a) any right to have an electronic record made available in nonelectronic (paper) form, (b) the right of the recipient to withdraw his or her consent to have the record provided in an electronic form, and (c) any conditions, consequences (such as termination of the parties' relationship), or fees if the recipient's consent is withdrawn (15 USC §7001(c)(1)(B)(i));
- Inform the recipient whether his or her consent applies (a) only to the specific transaction that gave rise to the

obligation to provide the record, or (b) to identified categories of records that may be provided over the course of the parties' relationship (15 USC §7001(c)(1)(B)(ii));

- Describe the procedures the recipient must use to withdraw the consent and to update information needed to contact the recipient electronically (15 USC §7001(c)(1)(B)(iii));
- Inform the recipient of (a) how, after consenting to the electronic record, the recipient may obtain a paper copy of the electronic record on request, and (b) the fee, if any, to be charged for the copy (15 USC §7001(c)(1)(B)(iv));
- Provide the recipient (before consent) with a description of the hardware and software requirements for access to and retention of the electronic records (15 USC §7001(c)(1)(C)(i)); and
- If the software or hardware requirements necessary to access the electronic record change, advise the recipient of (a) the new hardware and software requirements, and (b) the recipient's right to withdraw consent without the imposition of any fees or any condition or consequence not previously disclosed (15 USC §7001(c)(1)(D)(i)).

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§13.19 VIII. MEMBERS' VOTING RIGHTS

Members have voting or approval rights to the extent set forth in the articles of organization or the operating agreement. Corp C §17103(a). Members also have certain voting or approval rights under the Beverly-Killea Limited Liability Company Act that cannot be varied and may have certain rights that will exist if the agreement has no contrary provision. For a list of these rights, see §§6.17-6.20.

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IX. MEMBERS' MEETINGS

§13.20 A. Frequency

Although members have voting or approval rights under the Beverly-Killea Limited Liability Company Act, the Act does not require members to hold meetings. If the articles and the operating agreement do not require that meetings be held, failure to hold them will not be a factor if a third party challenges a member's limited liability. See Corp C §17101(b). For clarity, the operating agreement may specifically exclude the obligation to hold meetings.

If the articles or operating agreement establish requirements for when meetings of members are to occur, those requirements should be followed. If no such provision exists, a members' meeting may be called, for any matter on which members may vote, by any manager or by members representing more than 10 percent of the membership interests. Corp C §17104(b).

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§13.21 B. Form: Call for Meeting

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13.21-1 Call for meeting

CALL OF MEMBERS'
MEETING OF _ _[*NAME OF COMPANY*]_ _

I call a _ _[*regular/special*]_ _ **meeting of the members of this company, to be held at** _ _[*address and city*]_ _ **on** _ _[*date*]_ _.

[*Add if appropriate*]

The purpose of this meeting will be to consider and act on _ _[*list of topics*]_ _**.**

[*Continue*]

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name and title*]_ _

Comment: Although the Beverly-Killea Limited Liability Company Act does not require a written call for meeting, it is sometimes useful to provide a record. A written call should be filed with the notice of the meeting. Notices may be by electronic communication, subject to the operating agreement and articles of organization.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.22 C. Record Date

§13.22 C. Record Date

The identity and interests of the members who are entitled to vote at a meeting and must be given notice of the meeting are determined from the records as of a date certain, called the "record date." Subject to a contrary provision in the operating agreement, the record date is a date fixed by statute or by the manager or the members calling the meeting. A record date set by the manager or the members may not be more than 60 nor less than 10 days before the meeting date. Corp C §17104(k).

Unless otherwise fixed, the statutory record date for determining members entitled to receive notice of and vote at a meeting is the close of business on the business day preceding the day notice is given (see Corp C §17001(ao)), or, if notice is waived (see §13.25), at the close of business on the business day preceding the day the meeting is held. Corp C §17104(k)(1).

For purposes of obtaining the members' written consent to an action without a meeting, the record date, unless otherwise fixed, is the day on which the first written consent is given. Corp C §17104(k)(2). The record date for determining members for any other purpose (*e.g.,* receiving a distribution), unless otherwise fixed, is at the close of business on the day on which the managers adopt the resolution relating to the particular matter, or the 60th day before the date of the action, whichever is later. Corp C §17104(k)(3).

If a member meeting is adjourned, the record date for that meeting applies for purposes of notice and voting unless a manager or the members calling the meeting set a new record date for the adjourned meeting. If the meeting is adjourned for more than 45 days, a new record date must be set. Corp C §17104(k)(4).

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§13.23 D. Notice of Meeting

Unless the articles of organization or the operating agreement provide otherwise, written notice of a meeting of members is to be given to each member not less than 10 nor more than 60 days before the meeting date. The notice should specify the place, date, and hour of the meeting and the general nature of the business to be transacted. If any means of electronic transmission or video screen communication is to be used for the meeting, the notice must include a statement to that effect. Corp C §17104(c)(1). See §13.26 regarding electronic forms of communication. Only business set forth in the notice may be transacted at the meeting. Corp C §17104(c)(1).

On written request to a manager by anyone entitled to call a meeting of members, the manager must give notice to the members entitled to vote that a meeting will be held at the time requested by the person calling the meeting. If notice is not given within 20 days after the receipt of the request, the person entitled to call the meeting may give the notice. Corp C §17104(c)(3).

Unless the articles or operating agreement provide otherwise, notice of any meeting of members may be given personally, by mail, by electronic transmission, or by other written communication, addressed to the member at the address of that member appearing on the books of the company or given by the member to the company for the purpose of notice. If no such address appears in the company's books, notice is deemed to have been given if sent to the member in care of the company's principal executive office, or if published at least once in a newspaper of general circulation in the county where that office is located. Notice is deemed given at the time it is delivered personally, delivered by electronic transmission, deposited in the mail, or sent by other means of written communication. Corp C §17104(c)(2). An affidavit of mailing or delivery by electronic transmission of any notice or report in accordance with these requirements that is executed by the manager is prima facie evidence of the notice or report. Corp C §1704(c)(2). See also §13.26.

A notice may not be given to a member by electronic transmission if the LLC is unable to deliver two consecutive notices to the member by that means or if the secretary, assistant secretary, transfer agent, or other person responsible for giving the notice on behalf of the LLC becomes aware of the inability to deliver notice to the member by that means.

In practice, meetings of small or medium-sized companies are often called by informal notice to the members, with a waiver of notice and consent to the holding of the meeting, or by a written approval of the minutes of the meeting signed by any members who were not present, which is then filed with the company records or made part of the minutes of the meeting after conversion into the form in which those records or minutes are kept. Corp C §17104(e). Member action also may be taken without a meeting by written consent of the members required to approve such action under Corp C §17104(i). See §13.25.

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§13.24 E. Form: Notice of Members' Meeting

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13.24-1 Notice of members' meeting

NOTICE OF _ _[*ANNUAL/SPECIAL*]_ _ MEETING OF MEMBERS OF _ _[*NAME OF COMPANY*]_ _

Notice is given that _ _[*the annual/a special*]_ _ meeting of the members of _ _[*name of company*]_ _ will be held at _ _[*address and city*]_ _, at _ _[*time*]_ _, to consider and act on:

[*If the meeting is to be held by electronic transmission or by video screen communication*]

Notice is given that _ _[*the annual/a special*]_ _ meeting of the members of _ _[*name of company*]_ _ will be held by _ _[*specify means of attending, e.g., electronic transmission/designated electronic message board/video screen communication*]_ _, at _ _[*time*]_ _. _ _[*If the meeting may also be attended in person, specify location.*]_ _ The purpose of the meeting is to consider and act on:

[*If managers are to be elected at the meeting*]

1. Election of Managers. The managers intend at this time to present the following nominees for election:

[*List names*]

[2.]_ _[*E.g., the annual report to members.*]_ _

[3.]_ _[*Other business (state its general nature).*]_ _

[*For either annual or special meeting, add if desired and if proxy voting is not prohibited in the operating agreement or articles of organization (and enclose proxy form)*]

If you do not expect to be present in person at the meeting _ _[*or by electronic transmission/video screen communication*]_ _ and wish your membership interests to be voted, you may complete the attached proxy form and mail it in the enclosed addressed envelope.

[*Continue*]

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name and title*]_ _

Comment: The place of the meeting may be fixed in the articles of organization or the operating agreement; if they do not specify a location, the meeting must be held at the company's principal executive office. Corp C §17104(a). On notice by electronic transmission, see §13.23.

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§13.25 F. Form: Waiver of Notice and Consent

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13.25-1 Waiver of notice and consent

WAIVER OF NOTICE AND CONSENT
TO HOLDING _ _[*THE ANNUAL/A SPECIAL*]_ _ MEETING
OF MEMBERS OF _ _[*NAME OF COMPANY*]_ _

The undersigned member(s) of _ _[*name of company*]_ _, a California Limited Liability Company, desiring to hold _ _[*the annual/a special*]_ _ meeting of the members of that company at _ _[*address and city*]_ _, California, at _ _[*time*]_ _, on _ _[*date*]_ _, waive notice and consent to the holding of that meeting, and agree that any business transacted at that meeting shall be as valid and legal and have the same force and effect as though that meeting were held after notice was duly given.

The business conducted or to be conducted at that meeting includes:

[*Describe in general terms subjects of meeting*]

Date: _ _ _ _ _ _ __[*Signature(s)*]__
_ _[*Member(s)*]_ _

Comment: Unless required otherwise by the articles or operating agreement, the waiver need not set forth the nature of the business conducted at the meeting. However, unless an action is approved by unanimous consent of members entitled to vote, the general nature of the proposal must be stated in the waiver. Corp C §17104(g). The waiver and consent must be filed with the company records or made a part of the minutes of the meeting. Corp C §17104(e).

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§13.26 G. Form: Declaration of Mailing or Delivery by Electronic Transmission

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13.26-1 Declaration of mailing or delivery by electronic transmission

DECLARATION OF MAILING OR DELIVERY BY ELECTRONIC TRANSMISSION OF NOTICE OF MEETING OF MEMBERS

I, _ _[*name*]_ _, am, and at all times stated in this declaration was, the manager of _ _[*name of company*]_ _. On _ _[*date*]_ _, I caused a notice of _ _[*the annual/a special*]_ _ meeting of members of the company, a copy of which is attached to this declaration, to be _ _[*deposited in the United States mail at _ _[city and state*]_ _, first class postage prepaid/delivered by _ _[*specify means of electronic transmission*]_ _]_ __, addressed to each member entitled to vote at the meeting at the _ _[*electronic*]_ _ address of that member appearing in the books of the company or given by the member to the company for the purpose of notice.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name and title*]_ _

Comment: An affidavit of mailing or electronic transmission signed by a manager is prima facie evidence that notice was given. Corp C §17104(c)(2). A declaration under penalty of perjury, as in the form above, may be used in place of an affidavit. CCP §2015.5. The method of mailing or electronic delivery of the notice must be specified. See §13.23.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/ H. Proxies/§13.27 1. Use of Proxies

H. Proxies

§13.27 1. Use of Proxies

Subject to any limitations set forth in the operating agreement or articles of organization, anyone entitled to vote membership interests may authorize others, by a proxy, to vote the membership interests on his or her behalf. See Corp C §§17104(j), 705(a), 178-179. The proxy rules for voting a membership interest in an LLC are the same as those for voting the shares of a California corporation. Thus, a proxy purporting to be executed in accordance with the General Corporation Law is presumptively valid. Corp C §705(a).

As a general rule, a proxy is valid for only 11 months after its date, unless the proxy provides for a later expiration date. Corp C §705(b). Proxies may be revoked by a written notice to the company or by execution and presentation at the meeting of a later proxy. Corp C §705(b). If more than one proxy has been executed, the dates on the proxy forms, not the postmark dates, presumptively govern the order of execution. Corp C §705(b). If a person who has executed a proxy attends the meeting and votes in person instead, the proxy is revoked for that meeting only; an otherwise unexpired proxy will continue in effect for all meetings not attended by the person who executed the proxy. Corp C §705(b).

Subject to statutory limitations, a proxy may sometimes be made irrevocable for certain periods if it so states. Making proxies irrevocable may be advisable when (a) the proxy is given to secure performance or to protect a legal or equitable title until the happening of events that, by the proxy's terms, discharge the obligation, or (b) the proxy is held by any of the following or a nominee of any of the following (Corp C §705(e)):

- A pledgee of the membership interest;
- A person who has purchased, has agreed to purchase, or holds an option to purchase a membership interest, or a person who has sold a portion of his or her membership interest to the maker of the proxy;
- A creditor of the company or of the member who is given the proxy in consideration of the extension or continuation of credit to the company or the member;
- An employee of the company, if the proxy is given as required consideration in connection with his or her employment contract;
- A person designated under a voting trust; or
- A beneficiary of a trust with respect to a membership interest held by the trust.

Proxies held under Corp C §705(e) may be revoked by events making them inapplicable. See the last paragraph of §705(e), reproduced below:

> Notwithstanding the period of irrevocability specified, the proxy becomes revocable when the pledge is redeemed, the option or agreement to purchase is terminated or the seller no longer owns any shares of the corporation or dies, the debt of the corporation or the shareholder is paid, the period of employment provided for in the contract of employment has terminated, the agreement under [Corp C §706] has terminated, or the person ceases to be a beneficiary of the trust. In addition to the foregoing clauses (1) through (5), a proxy may be made irrevocable (notwithstanding [Corp C §705(c)]) if it is given to secure the performance of a duty or to protect a title, either legal or equitable, until the happening of events which, by its terms, discharge the obligations secured by it.

The maker's death or incapacity does not revoke a proxy unless the company receives written notice of death or incapacity before the vote is counted. Corp C §705(c).

Unless the existence of an irrevocable proxy and its irrevocability are noted on the certificate of membership interest, a transferee of the membership interest without knowledge can revoke the proxy. Corp C §705(f).

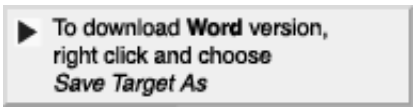
Detailed requirements for and limitations on irrevocable proxies are set forth in Corp C §§705(d)-(f), 706. See also Corp C §604; Counseling California Corporations §§3.41-3.42 (3d ed Cal CEB 2008).

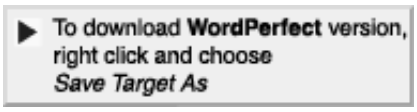
Proxies of companies subject to federal securities reporting requirements are regulated in considerable detail. See Securities Exchange Act of 1934 §14 (15 USC §78n); SEC Regulation 14A (17 CFR §§240.14a-1—240.14a-104).

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.28 2. Form: Proxy

§13.28 2. Form: Proxy





13.28-1 Proxy

PROXY

_ _[*NAME OF COMPANY*]_ _

The undersigned appoints the person named below to act as the undersigned's proxy holder at the meeting specified, and any adjournment of that meeting.

Date of meeting:_____

Place of meeting: _____, California

Name of proxy holder (to be filled in by member):

_____

The proxy holder shall be entitled to cast the number of votes the undersigned would be entitled to cast if personally present, for or against any proposal, including the election of managers and any and all other business that may come before the meeting.

_ _[*This proxy may be revoked by the undersigned at any time by written notice to the Company or by execution and presentation at the meeting of a later proxy.*]_ _

Date: _ _ _ _ _ _ **Signed: _____**

_____
Member

_____
Member

Number and class of membership interests held:

_____

INSTRUCTIONS TO MEMBER: PLEASE SIGN EXACTLY AS YOUR NAME APPEARS ON YOUR CERTIFICATE OF MEMBERSHIP INTEREST. JOINT MEMBERS SHOULD EACH SIGN PERSONALLY. IF SIGNED BY AN ATTORNEY IN FACT, ATTACH THE POWER OF ATTORNEY.

[*Add, if appropriate*]

IF YOU CANNOT ATTEND THE MEETING, THE COMPANY MANAGEMENT RECOMMENDS THAT YOU APPOINT _ _[*NAME*]_ _ AS YOUR PROXY.

Comment: This form may be used by companies that are not subject to federal securities law requirements.

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I. Meeting Procedures

§13.29 1. Conducting the Meeting; Participation by Electronic Transmission or Video Screen

The Beverly-Killea Limited Liability Company Act does not specify who will preside at members' meetings. Thus, the operating agreement may name the person who will preside. The presiding person may wish to rely on an attorney's assistance in conducting the meeting, particularly in small, closely held corporations. It is generally desirable for the attorney to go over the agenda with that person and discuss the manner in which the meeting will be conducted and votes taken, and the vote required for approval. The degree of formality largely depends on the number of, and relationship among, the members. The operating agreement may also establish how the meeting will be conducted.

The first order of business after the meeting is called to order should be to ascertain whether a quorum is present or represented at the meeting (see §13.27) and the number of membership interests that each member is entitled to vote. This issue may be a simple matter in closely held companies, but large companies may require formal member certification procedures. In addition, if any members are attending by conference telephone or video screen communication, the members should verify that each can hear the other members. Further procedures depend on the type of business to be transacted.

Unless the operating agreement or articles of organization provide otherwise, meetings of the members may be conducted, in whole or in part, by electronic transmission or by video screen communication if the LLC implements "reasonable measures" to provide members, in person or by proxy, a "reasonable opportunity" to participate in the meeting and to vote on matters submitted to the members, including an opportunity to read or hear the proceedings of the meeting substantially as they happen. Corp C §17104(*l*). In addition, if any member votes or takes action at the meeting by electronic transmission or video screen communication, a record of that vote or action must be maintained by the LLC. Corp C §17104(*l*). The term "electronic transmission" by and to the LLC is defined in Corp C §17001(o)(1)-(2) to include communication by facsimile, electronic mail, posting on an electronic message board or network, or other means of electronic communication.

If the LLC communicates to a member or manager by message board network, the LLC must have designed the message board for those communications and provided separate notice to the recipient of the posting. Corp C §17001(o)(1). A communication by an LLC must be to a recipient who has provided an unrevoked consent to the use of that means of communication. (See §13.18 for a sample form.) Each form of electronic communication must create a record that is capable of retention, retrieval, and review and that may subsequently be rendered into "clearly legible" tangible form. Corp C §17001(o)(1). Further, the electronic communications must satisfy the requirements of the Electronic Signatures in Global and National Commerce Act (E-Sign) (15 USC §§7001-7031). 15 USC §7001(c)(1).

Electronic communications *to* the LLC must be directed to the facsimile number or electronic mail address that the LLC has provided to the members or managers for this purpose or an electronic message board or network that the LLC has designated for those communications. The message is considered validly delivered on posting. Corp C §17001(o)(2). For any such electronic communications, the LLC must place into effect "reasonable measures" to verify that the sender is the member or manager (in person or by proxy, if permitted) purporting to send the transmission. Corp C §17001(o)(2). The form of communication to the LLC must created a record that is capable of retention, retrieval, and review, and that may be subsequently rendered into clearly legible, tangible form.

See also §13.23 regarding notices by electronic means of communication.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.30 2. Quorum

§13.30 2. Quorum

Unless the articles or the operating agreement provide otherwise, a majority in interest of the members entitled to vote, whether at the meeting in person or represented by proxy, constitutes a quorum. Corp C §17104(h)(1). If a quorum is initially present at a meeting, but enough members withdraw to reduce the remaining number to less than a quorum, business may nevertheless be transacted as long as any action is approved by the requisite percentage of interests of members specified in the Beverly-Killea Limited Liability Company Act, the articles of organization, or the operating agreement. Corp C §17104(h)(2). If a quorum is lost, the meeting may be adjourned by a majority vote of the membership interests present. Corp C §17104(h)(3).

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§13.31 3. Voting at Meetings

In companies with relatively few members, votes may be cast by voice, by a show of hands, or by electronic transmission or video screen, and elections for managers, if any, need not be by ballot. See §13.29 regarding electronic transmissions and video screen communication. However, because the articles or operating agreement may establish specified voting rights for different members or may specify that the membership interests not be held on a per capita basis, the use of ballots is recommended for most situations. If the articles and the agreement are silent on voting, members vote in proportion to their interest in current profits. If a member has assigned his or her entire interest in the LLC and the assignee has not been admitted as a member, the member/assignor votes in proportion to the interest in current profits that he or she would have had if the assignment had not been made. Corp C §17103(a)(1).

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§13.32 4. Recording the Proceedings

Each LLC must keep copies of its books and records relating to the company's internal affairs for at least the current and past 4 fiscal years. Corp C §17058(a)(7). See §13.16. To meet this requirement, the company must maintain minutes of each member meeting, or written consents of members to action taken without a meeting, as well as copies of notices and waivers of notice of members' meetings. For convenience, the company may keep these records in a "corporate-style" minute book.

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.33 5. Form: Outline for Preparation of Minutes

§13.33 5. Form: Outline for Preparation of Minutes

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13.33-1 Outline for preparation of minutes

MINUTES PREPARATION ITEMS FOR MEETING OF MEMBERS

1. Name of company:_____

2. Date and time of meeting:_____

3. Place of meeting:_____

4. Type of meeting: Annual ( ) Special ( )

5. Meeting held under: Waiver ( ) Notice ( ) (attach notice or waiver)

6. Meeting held by: Personal attendance ( ) Electronic bulletin board ( ) Electronic transmission ( ) Video screen communication ( )

(If by conference telephone or video screen communication, all members participating must verify that they can hear one another. If electronic bulletin board, see §13.29 for requirements.)

7. Members present

Member	Percentage of membership interests
_ _ _ _ _ _ _ _ _ _ _ _ _ _ _	_ _ _
_ _ _ _ _ _ _ _ _ _ _ _ _ _ _	_ _ _
_ _ _ _ _ _ _ _ _ _ _ _ _ _ _	_ _ _

8. Proxies presented

Member represented	Name of proxy holder	Percentage of membership interests
_ _ _ _ _ _	_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _ _ _ _	_ _ _

9. Membership interests constituting quorum:_____ percent

10. Other persons present:_____

_____

11. Minutes of previous meeting approved? Yes ( ) No ( )

12. Reports presented

a. Operations

Person making report:_____

b. Financial condition

Person making report:_____

c. Written financial report also presented?

Date of report:_____

13. Managers nominated

Nominee	Percentage of membership interests voted for (if elected, indicate with X)	
_ _ _ _ _ _	_ _ _	_ _
_ _ _ _ _ _	_ _ _	_ _
_ _ _ _ _ _	_ _ _	_ _

14. Other business

a. Amendment to articles

Percentage of membership interests voting for amendment

Article no.: _ _ _ _ _ _ percent

Change:_____

b. Amendment to operating agreement

Percentage of membership interests voting for amendment

Article and paragraph no.: _ _ _ _ _ _ percent

Change:_____

[*Add other business as appropriate*]

Comment: The proceedings of members' meetings may be taken and transcribed by a court reporter or recorded on a tape recorder or similar device as an aid in preparing minutes. Such elaborate recording procedures are usually unnecessary except at meetings of publicly held companies or meetings at which the actions to be taken are likely to be contested. Minutes generally are not detailed and need only describe the general considerations and resolutions that were adopted. Handwritten notes usually provide sufficient detail for preparation of minutes. Using a form such as this helps organize the notes and ensure that all actions are recorded.

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§13.34 6. Form: Minutes of Members' Meeting

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13.34-1 Minutes of members' meeting

MINUTES OF _ _[*ANNUAL/SPECIAL*]_ _ MEETING

1. Introduction

_ _[*The annual/A special*]_ _ meeting of _ _[*name of LLC*]_ _, a California Limited Liability Company, was held on _ _[*date*]_ _, at _ _[*address and city*]_ _, California.

2. Persons Present

The following members were present at the meeting, in person or by proxy, representing membership interests as indicated:

Member	Percentage of membership interests held
_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _

The following persons also were present:

Member	Percentage of membership interests held
_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _

The following members, representing membership interests as indicated, attended by _ _[*conference telephone/video screen communication*]_ _, and all members participating verified that they could hear each other _ _[*If electronic bulletin board or other form of electronic communication, specify.*]_ _:

Member	Percentage of membership interests held
_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _
_ _ _ _ _ _	_ _ _

3. Notice of Meeting

[*either*]

The _ _[*manager/president*]_ _ of the company called the meeting to order and announced that a quorum was present and that the meeting was held according to a written notice of meeting _ _[*electronic transmission*]_ _ given to all members of the company. _ _[*A/An electronic*]_ _ copy of this notice was ordered inserted in the _ _[*company records/minute book*]_ _ immediately preceding the minutes of this meeting.

[*or*]

The _ _[*manager/president*]_ _ of the company called the meeting to order and announced that the meeting was held according to a waiver of notice and written consent to the holding of the meeting. The waiver and consent was presented to the meeting and, on a motion duly made, seconded, and unanimously carried, was made a part of the records and ordered inserted in the _ _[*company records/minute book*]_ _ immediately preceding the records of this meeting.

4. Reading of Previous Minutes

[*either*]

The minutes of the previous meeting of members were then read and approved.

[*or*]

It was then moved, seconded, and unanimously resolved to dispense with the reading of the minutes of the last meeting.

5. Election of Managers

The _ _[*manager/president*]_ _ announced that the next order of business was the election of managers to serve until the next annual meeting of members and until their successors have been duly elected and qualified. The following nominations were made and seconded.

[*If election uncontested, add*]

No further nominations were made, and the following persons were duly elected as managers of the company:

[*List names*]

6. Other Business

The _ _[*manager/president*]_ _ then announced that the next order of business was approval by the members of _ _[*matters to be approved*]_ _. After discussion, the matter was _ _[*approved/disapproved*]_ _ by the members by the following vote:

[*Describe or tabulate vote*]

7. Adjournment

There being no further business to come before the meeting, on motion duly made, seconded, and adopted, the meeting was adjourned.

__[*Signature*]__
_ _[*Manager/Secretary*]_ _

Comment: The minutes should be filed in the company records along with appropriate notices, consents, and waivers. If the records are electronic, the minutes, notices, consents, and waivers may be converted into electronic format. See §13.29. For a form of notice, see §13.24. For a form of waiver and consent, see §13.25.

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X. MEMBERS' ACTION OR CONSENT WITHOUT MEETING

§13.35 A. Governing Principles

Subject to any restrictions in the articles of organization or in the operating agreement, any action that may be taken at a members' meeting may be taken without a meeting, if a consent in writing, setting forth the action so taken, is signed and delivered to the company within 60 days after the record date for that action. The consent must be signed by members having at least the minimum number of votes that would be necessary to authorize the action at a meeting at which all members entitled to vote on it were present and voted. Corp C §17104(i)(1).

Unless the consents of all members entitled to vote have been solicited in writing, notice of member approval of the following actions, without a meeting and by less than unanimous written consent, must be given at least 10 days before the consummation of the action authorized by that approval:

- An amendment to the articles or the operating agreement, or
- The dissolution or a merger of the company.

In addition, prompt notice must be given of the taking of any other action approved by members without a meeting by less than unanimous written consent to those members entitled to vote who did not consent in writing. Corp C §17104(i)(2).

A consent may be revoked if the company receives written revocation, personally or by proxy, before the number of consents necessary to authorize the action have been filed with the manager secretary. Corp C §17104(i)(3).

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§13.36 B. Form: Members' Consent

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13.36-1 Members' consent

_ _[*NAME OF COMPANY*]_ _
ACTION BY MEMBERS WITHOUT A MEETING

The undersigned, members of _ _[*name of company*]_ _, a California Limited Liability Company, consent to the following actions of the company:

1. Adoption of the following resolutions by the members: _ _[*full text of resolutions*]_ _

2. Election of the following persons as managers of the company: _ _[*names of managers*]_ _.

This consent is granted under California Corporations Code §17104(i) with respect to all membership interests held by the undersigned that are entitled to vote on these matters.

Date: _ _ _ _ _ _ __[*Signature of member*]__
_ _[*Typed name(s)*]_ _

[*Repeat signature blocks as necessary*]

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.37 XI. MEETINGS OF MANAGERS

§13.37 XI. MEETINGS OF MANAGERS

Members are free to agree in the operating agreement on all procedures by which managers make decisions, including:

- Whether meetings are required (the Beverly-Killea Limited Liability Company Act establishes no requirements for managers' meetings);
- The holding of meetings;
- The authority of any manager or officer to call a meeting;
- The time required for the notice of the meeting;
- The method of delivery of the notice;
- Whether the notice must specify the purpose of the meeting;
- The managers' ability to waive notice and consent to holding the meeting;
- Quorum requirements;
- The number of managers required to adjourn a meeting;
- Whether notice of adjournment must be given to managers who are absent at the time of adjournment;
- The location of the meeting;
- The managers' and members' ability to participate in a meeting through conference telephone equipment or electronic forms of communication or video screens; and
- The managers' ability to appoint committees and the actions those committees may take.

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XII. MEMBERS' ENFORCEMENT RIGHTS

§13.38 A. Actions by Attorney General

If the LLC is not providing members with the information and financial statements the Beverly-Killea Limited Liability Company Act requires, or is not providing other rights granted by the articles of organization or operating agreement, a member may file a complaint with the Attorney General, who may then send the company notice of the complaint and institute or intervene in proceedings for various types of relief if (1) the company does not answer in a timely and satisfactory manner and (2) enforcement of the member's rights by private civil action, class action, or otherwise would be so burdensome or expensive as to be impracticable. These proceedings may be for injunctive relief, dissolution, appointment of a receiver, or any other temporary, preliminary, provisional, or final remedies as may be appropriate to protect the members' rights. Corp C §17107(b).

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§13.39 B. Class Actions and Derivative Actions

Chapter 11 of the Beverly-Killea Limited Liability Company Act governs class actions and derivative actions by members. See Corp C §§17500-17501. Class actions on behalf of all or some of the members against the company are permitted regardless of the number of members in the class. Corp C §17500.

Derivative actions may generally be brought by members who were record or beneficial members at the time of the transaction at issue or by their successors in interest. Members who do not meet this requirement may bring derivative actions on a showing that a strong prima facie case exists that similar actions are not pending or likely to be instituted, that the plaintiff acquired an interest before learning of the wrongdoing and before it was disclosed to the public, that the action is necessary to prevent the defendant from retaining a wrongful gain, and that it will not result in unjust enrichment. Corp C §17501(a)(1).

In addition, the plaintiff must make detailed allegations in the complaint of how the company was notified of the claim and of the plaintiff's efforts to secure the desired action from the managers. Corp C §17501(a)(2). The plaintiff may be required to post a bond of up to $50,000 to cover anticipated expenses, including attorney fees. Corp C §17501(c)-(e).

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.40 C. Dissenters' Rights

§13.40 C. Dissenters' Rights

The Beverly-Killea Limited Liability Company Act provides members with dissenter's rights (Corp C §§17600-17613) when membership approval is required by the operating agreement or otherwise for the LLC to participate in the following transactions (defined in the Act as "reorganizations") (Corp C §17600(a)(1)-(4)):

- A conversion under Corp C §§17540.1-17540.9;
- A merger under Corp C §§17550-17556;
- The acquisition of membership interests or equity securities of another LLC or other business entity, in exchange in whole or in part for the acquiring LLC's membership interests (or the equity securities of the entity controlling the acquiring LLC) if, immediately after the acquisition, the acquiring LLC has control of the other LLC or other business entity; or
- The acquisition of all or substantially all of the assets of another LLC or other business entity, in exchange in whole or in part for one or more of the following (Corp C §17600(a)(3)):
- The acquiring LLC's membership interests;
- The membership interests or equity securities of the entity controlling the acquiring LLC;
- The debt securities of the acquiring LLC that are not adequately secured and that have a maturity date beyond 5 years after the acquisition closes; and
- The debt securities of the entity controlling the acquiring LLC that are not adequately secured and that have a maturity date beyond 5 years after the acquisition closes.

NOTE: For the above purposes, "control" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a limited liability company or other business entity. Corp C §17600(b).

If a membership interest is a dissenting interest, a member who complies with Corp C §§17600-17613 has the right to require the LLC to purchase for cash at its fair market value the interest owned by that member. Corp C §17601(a). To qualify as a "dissenting interest," the following criteria must be satisfied (Corp C §17601(b)):

(1) The membership interest was outstanding on the record date for members entitled to vote on the reorganization;

(2) The member voted against the reorganization (or, if approval for the reorganization was sought by written consent, withheld that consent);

(3) The member demanded that the company purchase the interest at its fair market value in accordance with Corp C §17602; and

(4) If evidence of the membership interest is shown by a certificate, the member submitted the certificate for endorsement in accordance with Corp C §17603.

The Act's dissenters' rights provisions do not apply under either of the following circumstances (Corp C §17612(a)(2), (b)):

- If the LLC is a foreign limited liability company whose non-California resident members hold at least 50 percent of the voting interest of the LLC; or
- If the operating agreement specifically sets forth the amount to be repaid in respect of membership interests in the event of a reorganization of the LLC.

In addition, if the LLC has no more than 35 members and the members have waived the application of Chapter 13 of the Act (Corp C §§17600-17613) in writing, any such waiver is ineffective if, at the time of reorganization, the LLC has more than 35 members. Corp C §17612(c).

If the LLC denies that a membership interest is a "dissenting interest," or if the LLC and a dissenting member fail to agree on the fair market value of a dissenting interest, then either the member or the company may, within six months after the date on which notice of the approval of the reorganization was mailed to the member (but not thereafter), file a complaint in superior court to determine whether the interest is a dissenting interest and to set its fair market value. The court may either set the fair market value of the dissenting interest or appoint one or more impartial appraisers to

do so. Corp C §17605(a), (c). The costs of the action (including reasonable compensation for the appraisers) may be assessed as the court deems equitable.

If a court-ordered appraisal results in a valuation that exceeds the price offered by the LLC, however, the company shall pay those costs. If the resulting valuation is more than 125 percent of the price offered by the LLC, the court in its discretion may also order the company to pay the member's attorney fees and expert witness fees. Corp C §17606(e).

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XIII. EMPLOYEE MATTERS

§13.41 A. Workers' Compensation

California law requires all employers to obtain workers' compensation insurance for employees. Various penalties are imposed for noncompliance. The workers' compensation laws impose responsibility on the employer for indemnifying any work-related accident, regardless of whether the employer is negligent. Workers' compensation insurance provides a schedule of benefits to an injured employee or the employee's heirs if the employee is killed. Workers' compensation coverage can be obtained either from the local office of the State Compensation Insurance Fund or from any state-licensed workers' compensation private carrier. Alternatively, the employer may obtain a certificate of consent to self-insure from the Director of Industrial Relations. See generally Lab C §3700. For a comprehensive treatment of California's workers' compensation law, see California Workers' Compensation Practice (4th ed Cal CEB 2000).

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§13.42 B. Other Labor Laws

Numerous federal and state laws regulate employment practices and prohibit discrimination on the basis of race, religious creed, color, national origin, ancestry, physical or mental disability, medical condition, marital status, sex, gender, age, and sexual orientation, as well as pregnancy, childbirth, or related medical conditions. These laws apply to almost every aspect of the employer-employee relationship, including hiring, compensation, promotions, work assignments, and working conditions.

The United States Department of Labor and the Equal Employment Opportunity Commission are the principal federal agencies regulating this area. The California Department of Fair Employment and Housing regulates employment practices to protect individuals from employment discrimination in California. California's antidiscrimination laws and regulations are generally more stringent than the federal requirements, and California LLCs are generally bound by the more stringent standards. Various laws also apply to hiring immigrant workers. These laws include the Immigration Reform and Control Act of 1986 (Pub L 99-603, 100 Stat 3359), which requires employers to verify the identity and right to work in the United States of all employees hired after November 6, 1986. 8 USC §1324a.

The Wage and Hour Division of the United States Department of Labor establishes minimum wages and regulates overtime in other aspects of working conditions for nearly all employees of firms engaged in interstate commerce. California also enforces laws on the payment of wages, the minimum wage, hours of work and overtime, conditions of employment, and equal pay for equal work.

The California Division of Industrial Safety of the Department of Industrial Relations conducts safety inspections to ensure that standards of safety and health are enforced and that unsafe conditions and practices are corrected. The California Occupational Safety and Health Standards Board also promulgates safety and health standards for California businesses.

Finally, various laws require employers to post notices to employees regarding their rights. Some of the notices most commonly required, and the agencies from which copies may be obtained, are:

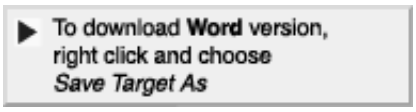
- Industrial Welfare Commission Orders (California Department of Industrial Relations, Division of Labor Standards Enforcement);
- Federal Minimum Wage Notice (Wage and Hour Division, United States Department of Labor);
- Safety and Health Protection on the Job Notice (California Department of Industrial Relations, Division of Occupational Safety and Health);
- Harassment or Discrimination in Employment Notice (California Department of Fair Employment and Housing);
- Federal Civil Rights Act Notice (United States Equal Employment Opportunity Commission);
- Notice of Pay Days and Time and Place of Payment (Department of Industrial Relations);
- Family and Medical Leave Act of 1993 Notice (Wage and Hour Division, United States Department of Labor);
- California Family Rights Act Leave Notice and Pregnancy Disability Leave Notice (California Department of Fair Employment and Housing); and
- Workers' Compensation Notice (obtained through the employer's workers' compensation insurance carrier).

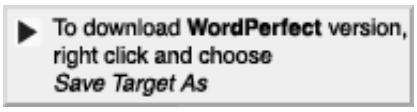
On all workplace issues, see Advising California Employers and Employees (Cal CEB 2005).

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Source: Business Law/Forming and Operating California Limited Liability Companies/13 Operating a Limited Liability Company/§13.43 XIV. FORM: SAMPLE MEMORANDUM TO CLIENT

§13.43 XIV. FORM: SAMPLE MEMORANDUM TO CLIENT





The following is a sample form of a memorandum to the client regarding the operation of an LLC. It is intended as a model only. Owing to the flexibility of most of the Beverly-Killea Limited Liability Company Act's provisions, the operational procedures relevant to a particular LLC may vary significantly. A detailed discussion of formalities will not be useful unless it is drafted for the specific LLC.

13.43-1 Memorandum to client

MEMORANDUM

To: _ _[*Client's name*]_ _

The legal requirements concerning the initial formation of Newco, a California Limited Liability Company ("the LLC"), have been satisfied, and our services with regard to its formation are concluded. The purpose of this memorandum is to discuss some of the legal requirements that will apply to Newco's operation. This memorandum *does not* address the specific operational requirements in your operating agreement; it is intended only to provide an overview of certain aspects of operating an LLC in California. If you wish further information on any matter discussed in this memorandum or any other matters regarding the operation of an LLC, please contact us.

1. *Operational Formalities*

The member or members and the managers, if any, of your LLC must carefully observe any operational formalities specified in the operating agreement or articles of organization, such as meetings and voting requirements to take various actions. It is important to observe these formalities whether yours is a single-member or multiple-member LLC. Observing these formalities will reduce the risk that a creditor can claim that your LLC is a mere sham created to improperly protect its member or members from personal liability. One indication that you are conducting your business in an appropriate manner will be the maintenance of proper books and records for the LLC, with properly executed minutes or written consents for actions taken with or without a meeting. The minutes should reflect that the LLC has complied with all necessary requirements for obtaining the approval of a course of action by the LLC's members or managers.

In addition to complying with specific operational formalities:

The LLC should be adequately capitalized to carry on the business activities in which it is engaged or proposes to engage, including anticipated liabilities of operation. Appropriate books and records should be maintained that show the adequacy of capitalization. The LLC should also obtain insurance for unanticipated liabilities.

The LLC's financial affairs should be kept separate from those of each member and manager because it is a separate legal entity. Its funds should not be commingled with those of any third party or of any member or manager. In addition, separate records for the LLC should be maintained, distinct from those of any other entity, member, or manager. It is important for the LLC to establish a bank account in its own name. Typically, a bank will allow a depository account to be opened when it is presented with a copy of the articles of organization. Banks also usually require a taxpayer identification number for opening an account.

The LLC should be sure to conduct all business in its own name and not in the individual name of any manager or member. All transactions between the LLC and its owners should be fully disclosed to all members and should be fair to the LLC. To ensure that there is no confusion on the part of outsiders dealing with the LLC, the following steps should be taken:

(1) All letterhead, bills, invoices, and other business forms used by the LLC should show its full legal name and its current address and telephone number;

(2) The LLC's telephone numbers should be listed under its name in all directories;

(3) The LLC's full legal or fictitious business name should appear on all LLC signs or advertisements, including any signs at its principal place of business;

(4) Employees' business cards should show the LLC's name as well as their own; and

(5) All contracts should be entered into in the name of the LLC and executed with signature blocks that clearly identify the signing party as an agent of the LLC.

The LLC should avoid improper distributions, as discussed in paragraph 7 below, and should properly withhold and pay over to the proper taxing authorities all tax payments required by applicable tax laws.

The LLC should be properly qualified to do business in each state requiring registration.

2. *Articles of Organization*

The LLC began when the articles of organization were filed and an agreement for its operation was reached between the members. The articles include the name of the LLC, the name and address of its initial agent for service of process, and a statement of whether the LLC will be member-managed or manager-managed. The articles (Secretary of State Form LLC-1) may contain various other information, including limits on admitting new members, events that will cause dissolution of the LLC, and the authority of managers or members to bind the LLC.

The articles of organization may be recorded at the office of the county recorder of any county in the state. Once recorded, they create a conclusive presumption favoring any bona fide purchaser or encumbrancer for value of the real property of the LLC located in that county with respect to all information contained in the recorded articles of organization. In deciding whether it is appropriate to record a copy of the articles of organization with any county recorder, various factors should be considered. Please contact us if you wish to consider recording articles of organization or if a title company or other entity or individual requests that of you, so we may advise you of various matters to consider.

The articles or organization may be amended by filing a Certificate of Amendment (Form LLC-2) with the Secretary of State's Office. A Certificate of Correction (Form LLC-11) may also be filed to correct any error. If the LLC has recorded a certified copy of its articles of organization with any county recorder, a certified copy of the amendment or correction should be recorded with the office of that county recorder.

3. *Operating Agreement*

Every member must be a party to the operating agreement. It is the primary document that defines the characteristics of the LLC, the relationship of its members, and the duties of its members and managers. Although an operating agreement may be either oral or written, it is far preferable to put it into writing to reduce the risk of a dispute.

Various rights and obligations under California law may be enforced *only if* they are mentioned in a written instrument. On the other hand, California law has many rules and procedures that will apply to the LLC *unless the operating agreement provides otherwise*. A short, simple form of operating agreement may be used that, by its silence, incorporates these rules and procedures. Even if a detailed operating agreement is adopted, you should contact us or refer to the California Corporations Code to ascertain the applicable rule or procedure.

The operating agreement may be amended by the vote the members as provided in the operating agreement.

4. *Management of the LLC*

An LLC may be managed either by managers or, if the articles of organization do not provide for managers, by the member individually or by the members as a group. The articles of organization must specify whether the LLC is managed by its members or by one or more managers. If the LLC does not provide for managers,

all members will be considered managers. The operating agreement will provide for the manner in which managers' decisions must be made. If the operating agreement is silent on this subject, managers' decisions are made by majority vote at a meeting or by unanimous written consent. No manager or officer is personally liable for LLC debts, obligations, or liabilities solely because of his or her or its status as manager or member of the LLC.

If the operating agreement provides for the appointment of an officer or officers, you should carefully review the agreement to determine their duties. If the agreement does not provide for officers, the managers, at their discretion, may appoint and remove officers. The officers carry out the day-to-day functions of the LLC under directions and policies established by the managers.

Under the Beverly-Killea Limited Liability Company Act all members must have certain voting rights, which to varying degrees may be modified by the operating agreement. You should carefully review the operating agreement to become familiar with voting rights and requirements. These rights include the members' right to approve a decision to continue the LLC after its dissolution, to transfer membership interests or admit an assignee of an interest as a member, or to amend the articles or the agreement.

Unless the operating agreement provides otherwise, the LLC must give members advance written notice of any meeting at which members must vote, and the notice must specify the matters to be voted on. If an action is taken by written consent, the LLC may have to give notice to all members before it completes the action. The LLC Act does *not* require that the members hold formal meetings to vote and take action. Please contact us to discuss the voting and notice requirements if you have any questions.

5. *Fiduciary Duties*

Every LLC manager has fiduciary duties that are the same as those of a general partner in a partnership. These duties include the duty of loyalty, the duty of care in performing managerial responsibilities, and the duty of good faith in dealing with fellow members and the LLC. These duties may be limited or defined in some respects in the operating agreement. All members in a member-managed LLC are also subject to these duties. Members who are not managers in a manager-managed LLC will not be subject to the same level of fiduciary duties, but may have other fiduciary duties that create responsibilities for the member. Please contact us if you wish to discuss the responsibilities imposed by these fiduciary duties with regard to the control and operation of your LLC.

6. *Obligation to Contribute Capital*

The articles or operating agreement will provide for initial capital contributions by the members and may provide for additional contributions. Contributions may be in money, property, services, or a note to contribute the same. Additional capital contributions will not be required of members unless the articles or agreement so provide. A member's obligation to make a contribution may be compromised only by the members' unanimous vote, unless the articles or agreement provide otherwise.

Your operating agreement may provide for additional contributions under specified circumstances and certain remedies if a member fails to make a required contribution. These remedies must be reasonable under the circumstances existing at the time the agreement was made.

Creditors of an LLC have a limited right to enforce a member's obligation to contribute additional capital. A conditional obligation to contribute is not enforceable unless the condition has been satisfied or waived.

7. *Limitations on Distributions*

You should be aware that your LLC may not distribute cash to its members if, after making the distribution (a) the LLC would be unable to pay its debts as they become due in the usual course of business or (b) the LLC's total assets would be less than its total liabilities (plus the amount that would be needed if the LLC were dissolved, to pay other members whose rights on dissolution are superior to the rights of the member receiving the distribution). Managers or members may be held personally liable for improper distributions.

8. *Securities Regulation*

Membership interests in the LLC are securities under California law unless all members are actively engaged

in the management of the LLC. In addition, an LLC may be a security under federal law.

The securities laws regulate the offering, issuance, and sale of securities (such as stock in a corporation). These laws may also apply to any LLC reorganization that changes the rights, preferences, or privileges available to a class of membership interests. Any issuance or offers to sell or the sale of a membership interest in the LLC must be done in accordance with California and federal securities laws.

The initial membership interests in Newco were issued under an exemption that is available under the securities laws or, if it is a single-member LLC without a manager, did not constitute a security. Before any future issuances, offers, or sales are made, you should contact us to ensure that you are complying with these laws.

9. *Books and Records*

An LLC must maintain an office in California in which the records described below are kept. This requirement may not be varied by the operating agreement or articles of organization. The following information must be maintained at that office:

A current alphabetical list of each member, manager, and holder of an economic interest, including the full name and address of each. The list must set forth the contributions and share in profits and losses of each member and holder of an economic interest.

A copy of the articles of organization and operating agreement and all amendments to either, plus any powers of attorney under which the articles, agreement, or amendments were executed.

Copies of federal, state, and local income tax or information returns and reports and financial statements for the LLC's last 6 taxable years.

All books and records of the LLC that relate to its internal affairs for the current and preceding 4 fiscal years.

An LLC that does not maintain the above records is subject to a $25 penalty for each day the failure continues, beginning 30 days after it receives a written request by any member of the LLC to comply with that requirement. A maximum penalty of $1500 may be assessed. This penalty is paid to the member(s) damaged by the failure to maintain the required records on the condition that they file a suit within 90 days after making the written request. The maximum daily penalty for failing to comply with any number of separate requests made on any one day is $250.

An LLC must also keep business records on the amounts, costs, and value of all property the LLC owns, possesses, or controls in each California county.

If certificates of interest are to be issued to members, a membership interest register should be kept to record the certificate numbers and the canceled or reissued shares.

10. *Voting Rights*

Members have the voting rights granted to them by the LLC's articles of organization or operating agreement. If neither document provides for voting rights, the Beverly-Killea Limited Liability Company Act's voting provisions will apply. Voting may be on a per capita, financial interest, class, group, or any other basis. Members vote in proportion to their interests in current profits or, for a member who has assigned his or her entire "economic interest" in the LLC but remains a member, in proportion to the interest in current profits he or she had immediately before the assignment.

Unless otherwise provided in the articles of organization or operating agreement, the following matters require the vote of a majority in interest of the members (excluding the members acquiring or transferring their interests as applicable): (a) a decision to continue the business of the LLC after a nonjudicial dissolution; (b) the issuance of a new membership interest; and (c) the admission of the assignee of a transferred interest in the LLC as a member of the LLC. An amendment of the articles of organization or operating agreement, unless otherwise provided in the articles or operating agreement, requires a unanimous vote of all the members.

Members may vary these voting requirements, but in no event may the following actions be accomplished by a vote of *less than a majority in interest* of the members: (a) an amendment to the articles of organization; (b) dissolution of the LLC; or (c) a merger or conversion of the LLC.

Members are free to agree in the operating agreement on all procedures by which managers make decisions, including whether meetings are required; the holding of meetings; the authority of any manager or officer to call a meeting; the time required for the notice of the meeting; the method of delivery of the notice; whether the notice must specify the purpose of the meeting; the ability of managers to waive notice and consent to holding the meeting; whether meetings may be held by telephone, electronic transmission, or video screen communication; quorum requirements; the number of managers required to adjourn a meeting; whether notice of adjournment must be given to managers who are not present at the time of adjournment; the location of the meeting; the ability of managers to participate in a meeting by using conference telephone equipment; and the ability of managers to appoint committees and the actions those committees may take.

11. *Reports, Information, and Inspection Rights*

Each member or holder of an economic interest (*i.e.,* someone who has paid for an interest in the LLC but is not a full-fledged member with voting rights) can require a manager to promptly deliver a copy of any written operating agreement of the LLC and copies of (a) a current list of the members' names and addresses, and their capital contributions and share of the LLC's profits and losses; (b) the full name and business or residence address of each manager; and (c) copies of the LLC's federal, state, and local income tax or information returns and reports. This right is limited to purposes reasonably related to the member's or interest holder's ownership interest. The LLC must pay for copying expenses.

An LLC is also required to send to each member or holder of an economic interest, within 90 days after the end of each taxable year, the information necessary to complete that member's or holder's federal income tax return.

Each member, manager, and holder of an economic interest has the right, on reasonable request, to inspect and copy during normal business hours any of the records required to be maintained at the principal office of the LLC and to obtain from the manager a copy of the LLC's federal, state, and local income or information returns for each year. Any such request must be for a purpose reasonably related to the interest of that person as a member, manager, or holder of an economic interest.

If the LLC has more than 35 members, its manager(s) must send each member an annual report within 120 days after the close of the fiscal year. The annual report must contain a balance sheet as of the end of the fiscal year and an income statement and statement of cash flows for the fiscal year.

12. *Employer Identification Number*

An application for a federal Employer Identification Number (EIN) should be filed to comply with the requirement that every taxable entity have such a number and that it be shown on all federal tax returns and other documents. An EIN may be obtained by telephone from the Internal Revenue Service Center for the county in which the LLC has its principal place of business. A telephone application must be made by a person authorized to sign Form SS-4. If the number is obtained by telephone, Form SS-4 must be prepared and filed after the telephone application. We will be glad to assist you in obtaining an EIN if you wish.

13. *Biennial Information Statement*

Newly formed LLCs must file a Statement of Information (Form LLC-12) with the Secretary of State within 90 days after filing the original articles of organization. You will receive a copy of the required form from the Secretary of State's office when the filed articles are mailed back. This statement must contain (a) the name of the LLC, the Secretary of State's file number and, if the LLC is a foreign LLC, the state in which it is organized; (b) the name and address of the LLC's agent for service of process; (c) the street address of its principal executive office and the office at which records are being maintained, if it is a domestic LLC; (d) the name and address of any managers and the chief executive officer, if any, or if no manager has been elected or appointed, the name and address of each member; and (e) the general type of business comprising the LLC's principal business activities.

There is a $250 penalty for late filing, and the powers, rights, and privileges of the LLC may be suspended

for failure to file a statement. In every second year, the LLC must file a Statement of Information Renewal (Form LLC-12R) during the calendar month in which the original articles of organization were filed, or during any of the immediately preceding 5 calendar months. Foreign LLCs must submit this filing biennially in the month in which its application for registration was filed, or during any of the preceding 5 months.

If the LLC changes its agent for service of process, it must file a current statement designating the new agent or address. A $250 penalty is imposed for late filing, and the LLC may have its powers, rights, and privileges suspended for failing to file this statement. If the LLC fails to file the statement, the Secretary of State will send it a notice of delinquency, noting its right to request relief for reasonable cause or unusual circumstances that justify its failure to file. If no statement is filed within the 60-day period prescribed by the notice, the Secretary of State will certify the LLC's name to the Franchise Tax Board, which will assess a penalty under the Revenue and Taxation Code.

14. *Licenses*

Various licenses are required to operate the business of the LLC, which may include federal licenses, such as licenses for export activities, and state and local licenses, including business licenses. If you are not sure which licenses you might need, please contact us to discuss those that are required for your particular business.

15. *Fictitious Business Names*

If the LLC plans to transact business under a name other than that listed in its articles of organization, it must file a fictitious business name statement with the clerk of the county in which it has its principal place of business. It must also file a statement in any other county where it will transact business. Once a statement is on file with the county clerk, it must be published in a newspaper of general circulation in the same county once a week for 4 consecutive weeks. Within 30 days after publication, an affidavit of publication must be filed with the county clerk's office. Fictitious business name forms may be obtained from the county clerk's office of the county in which you intend to file or from the newspaper that will publish the statement. We will be happy to assist you in filing any necessary fictitious business name statements.

16. *Payroll, Withholding, and Other Taxes*

Various procedures apply to withholding taxes for employees. It is essential that you become familiar with these practices and comply with their requirements. The federal procedures are detailed in IRS Circular E, Employer's Tax Guide, available on the Internet at http://www.irs.gov/formspubs/index.html. California's withholding requirements are set forth in Form DE-44, California Employer's Tax Guide, which may be obtained from most offices of the California Employment Development Department or on the EDD website (http://www.edd.ca.gov/taxrep/taxform.htm#Publications).

Willful failure to collect, account for, and pay withholding taxes subjects the employer and the individuals responsible for paying the taxes to a 100-percent monetary penalty and personal liability.

17. *Gross Receipts Fee*

California imposes a statutory fee each year on gross receipts of the LLC. The amount of the fee is zero if gross receipts are less than $250,000, $900 if gross receipts are between $250,000 and $500,000, $2500 if gross receipts are between $500,000 and $1 million, $6000 if gross receipts are between $1 million and $5 million, and $11,790 if gross receipts are $5 million or more.

18. *Insurance*

Generally, it is advisable to obtain insurance for the LLC's operations. You should promptly review the LLC's potential insurance requirements with its insurance agents.

19. *Trademarks, Trade Names, and Trade Secrets*

If the LLC has developed a unique name or symbol that has or will become associated with its services or products, the LLC should consider registering the name or symbol as a trademark or trade name. Registration with the U.S. Patent and Trademark Office will help protect the trademark or trade name against infringement or

loss. Product designs, or processes involved in making the LLC's products, may require patent protection. Customer lists and other trade secrets may need to be protected by requiring employees to sign trade secret and confidentiality agreements and taking other steps to keep such information confidential. Please seriously consider these issues, because you may lose important ownership rights if you fail to take proper precautions.

20. *Business in Other States*

The LLC may be required to be qualified to do business or register in other states in which it does business. Please contact us to discuss this if you suspect you need to qualify in any other state. Also, in the few states that do not yet have LLC legislation, the limited liability of members and managers may not be observed.

21. *Conclusion*

The foregoing is a generalized summary of some of the legal and accounting issues to consider as the LLC begins operating. Laws and regulations applicable to LLCs are changing rapidly and are much more detailed than specified above.

Although we cannot undertake the responsibility of providing updates to this memorandum, we are always available to discuss your legal concerns and to assist you with any aspect of the LLC's business or operations.

Date: _ _ _ _ _ _ _ _[*Name of firm*]_ _

By: __[*Signature*]__
_ _[*Typed name*]_ _

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14

Operating a Foreign Limited Liability Company in California

Mark D. Lubin

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Source: Business Law/Forming and Operating California Limited Liability Companies/14 Operating a Foreign Limited Liability Company in California/§14.1 I. SCOPE OF CHAPTER

§14.1 I. SCOPE OF CHAPTER

This chapter discusses the use of foreign limited liability companies to transact business in California and the legal requirements that apply to those entities.

A foreign LLC transacting intrastate business in California is regulated by Corp C §§17450-17457. None of those provisions may be varied in the LLC's articles of organization or operating agreement, except to the extent expressly provided in the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17655) (the Act). Corp C §17005(c).

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Source: Business Law/Forming and Operating California Limited Liability Companies/14 Operating a Foreign Limited Liability Company in California/§14.2 II. DEFINITION OF FOREIGN LLC

§14.2 II. DEFINITION OF FOREIGN LLC

Corporations Code §17001(q) defines a foreign LLC as an entity that is

- Formed under the limited liability company laws of any other state, or
- Organized under the laws of a foreign country under which an association may be formed that affords each of its members limited liability with respect to the liabilities of the entity,

and that is not a corporation, partnership, or business trust.

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III. CHOICE OF JURISDICTION

§14.3 A. Some Factors Determining Choice

Under Corp C §17450(a), the laws of the state or foreign country under which the foreign LLC is organized govern its organization and internal affairs as well as the liability and authority of its managers and members (the so-called "internal affairs doctrine"). The Secretary of State may not deny registration of a foreign LLC because of differences between the foreign state's or country's laws and the Beverly-Killea Limited Liability Company Act. Corp C §17450(b).

Although the major characteristics of LLCs formed under the laws of other states are similar to LLCs formed under California law, there are some differences that may warrant consideration of forming an LLC under the laws of another state, even if the LLC is intended to transact most or all of its business in California.

For example:

- Some states (such as Delaware) expressly permit members to waive the fiduciary duties that in California are owed by a member-manager to the other members; that waiver option could be preferable for tax-exempt entities for whom the assumption of fiduciary duties may jeopardize their tax-exempt status. See 6 Del Code §18-1101(c)(2); Sanders, Partnerships and Joint Ventures Involving Tax-Exempt Organizations §4.2 (3d ed 2007). See §3.95.
- Some states (see, *e.g.,* Conn Gen Stat §34-119) expressly authorize members of LLCs to render professional services through the LLC, while others, including California, generally prohibit professional LLCs. See §14.5.

Other factors that may vary from state to state include:

- Lawful purposes of the LLC;
- The need for a written operating agreement and whether members are required to enter into it;
- Remedies for a member's failure to make required contributions;
- Rights of creditors to require contributions;
- Restrictions on distributions to members;
- Agency powers of members and managers;
- Standards of conduct for members and managers and limitations on liability and rights of indemnification;
- Transfer of membership interests and admission of new members;
- Voting rights of members;
- Rights of withdrawal or resignation; and
- Dissolution and windup procedures.

Counsel also should take the following factors into account before recommending out-of-state formation:

- Exposure to suit in the courts of the jurisdiction in which the LLC is organized; and
- The costs of being organized in another jurisdiction, including annual taxes and fees, plus the cost of maintaining a registered office or agent for service of process.

Ultimately, all of the above factors should be weighed in making the decision to form an LLC under the laws of another state. Although another state's laws may be more advantageous regarding one issue of concern to the client, that advantage may be undermined by differences in other areas. The practitioner is strongly advised to obtain the assistance of counsel practicing in the jurisdiction under consideration.

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§14.4 1. Estate and Gift Tax Planning Considerations

Estate and gift tax planning considerations also may come into play in selecting the jurisdiction for formation of the LLC. For example, in many states, the gift of an LLC membership interest may be entitled to a "lack of marketability" or "illiquidity" discount, thereby allowing the donor to give a larger amount of property under the annual gift tax exclusion or use a smaller amount of the unified credit against estate and gift tax. See IRC §§2503(b), 2010(a). In California, such a discount should be available. While a member may withdraw at any time by giving written notice to the other members, unless the articles of organization or the written operating agreement provide otherwise, the withdrawn member is not entitled to payment for the member's interest, but is entitled only to an economic interest in distributions under the operating agreement. Corp C §17252(a). As a result, an LLC membership interest may not be easily transferable and should be entitled to a lack of marketability or illiquidity discount. See §§4.32-4.39.

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§14.5 2. Restrictions on Professional LLCs

Although other states might permit formation and operation of professional LLCs, California's Beverly-Killea Limited Liability Company Act does not. A foreign LLC cannot be used to circumvent this restriction. The Secretary of State's authority to issue a certificate of registration to a foreign LLC is subject to the licensing requirements of California law (Corp C §17452(a)) and California does not presently license LLCs to render professional services. Lawyers, accountants, and architects may, however, form limited liability partnerships. Corp C §§16101, 16951-16962. See §3.11. See generally Advising California Partnerships, chaps 6, 19 (3d ed Cal CEB 1999).

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§14.6 B. California Information and Inspection Rights Retained for "Pseudo-Foreign" LLCs

The laws of the state or foreign country of organization generally govern the internal affairs of a foreign LLC transacting business in California. One exception, however, is that California residents who are members of a foreign LLC are entitled to the same information and inspection rights that inure to members of a California LLC under Corp C §17106, if at least 25 percent of the voting interests of the foreign LLC are held by California residents. Corp C §17453. See §13.17.

If the foreign entity is a corporation doing business in California, Corp C §2115 subjects it to similar information and inspection rights for its California shareholders, as well as an array of other rights designed for the protection of shareholders who are California residents. Because the rights given to California shareholders are more extensive than those given to California members of foreign LLCs, it may occasionally be worthwhile to use a foreign LLC rather than a corporation for the sole purpose of avoiding the pseudo-foreign corporation rules.

NOTE: In *VantagePoint Venture Partners 1996 v Examen Inc.* (Del 2005) 871 A2d 1108, the Delaware Supreme Court held that Corp C §2115 violates the commerce clause of the U.S. Constitution. See also *CTS Corp. v Dynamics Corp. of Am.* (1987) 481 US 69, 95 L Ed 2d 67, 107 S Ct 1637 (asserting constitutional precedence of "internal affairs doctrine" that mandates state of incorporation should regulate corporation's internal affairs).

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§14.7 IV. TRANSACTING INTRASTATE BUSINESS

A foreign LLC is required to register with the Secretary of State only if it is transacting intrastate business in California. Corp C §17451(a). The phrase "transact intrastate business" is defined to mean "to enter into repeated and successive transactions of business in [California], other than in interstate or foreign commerce." Corp C §17001(ap). This statutory "definition" is not very helpful in that it fails to adequately distinguish between "intrastate" and "interstate or foreign" commerce and also fails to provide clear guidance regarding how many transactions must occur within a given period of time before they are deemed to be "repeated and successive."

The same definition for "transact intrastate business" is used in Corp C §191 for purposes of determining when a foreign *corporation* must qualify to do business in California. There have been several judicial interpretations of this definition for purposes of foreign corporations, and the analysis should be the same for LLCs. Several cases concern a foreign corporation selling goods in California through local salespersons. *Mediterranean Exports, Inc. v Superior Court* (1981) 119 CA3d 605, 174 CR 169 (leased office space was provided by corporation to independent contractors who solicited orders for corporation in lieu of reimbursing them for their expenses); *Detsch & Co. v Calbar, Inc.* (1964) 228 CA2d 556, 39 CR 626 (solicitation within California of orders for goods by local distributor or agency acting on behalf of foreign corporation, such orders being subject to acceptance or rejection by foreign corporation and when, on approval of orders, goods purchased were shipped directly from out of state to purchasers in California, sales and shipment constituted interstate commerce; prior solicitation incidental to it was part of that interstate transaction and was not intrastate commerce). But see *Neogard Corp. v Malott & Peterson-Grundy* (1980) 106 CA3d 213, 164 CR 813 (appellant's in-state activities, which included sending sales representatives, entering contracts, and supervising its product's use, taken together, constituted intrastate business). See also *Davies v Mt. Gaines Mining & Milling Co.* (1930) 104 CA 730, 286 P 740 (mere ownership of real property held not to constitute transacting intrastate business).

Additional assistance is provided by the creation of a list of safe-harbor activities that, without more, will not cause an LLC to be considered to be "transacting intrastate business." Corp C §17001(ap)(1)-(3). The list includes:

- Being a shareholder, a limited partner, a member or a manager;
- Holding meetings of managers or members;
- Maintaining bank accounts;
- Effecting sales through independent contractors;
- Borrowing money ("creating… evidences of debt or mortgages, liens, or security interests");
- Securing, collecting, and enforcing debts; and
- Engaging in certain isolated transactions.

Conspicuous by its absence is the "making" of loans in California. In other words, the definition of "transact intrastate business" does not exclude the initial making of the loan by the foreign LLC itself, but it does exclude activities ordinarily undertaken by the holder of a loan if the loan is acquired from a lender who originated the loan in this state. This is consistent with the treatment of foreign corporations under Corp C §191.

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V. REGISTRATION OF FOREIGN LLCs

§14.8 A. Filing Requirements

A foreign LLC seeking to register in California is required to apply for registration by submitting an application on a form available from the Secretary of State and paying the statutory fee. See §14.11. The signature on the form on behalf of the foreign LLC may be transmitted by facsimile if the form is submitted for filing to the Secretary of State by mail or by hand. Corp C §17.1(c). See §7.24. If the Secretary of State finds that the application conforms to law and the required fees have been paid, the application for registration must be granted, subject only to any licensing requirements for the particular business in which the applicant intends to engage. Corp C §17452(a). This limitation is not a trivial one. It effectively prevents a foreign LLC from engaging in businesses that are prohibited to domestic LLCs, such as the bank, trust, or insurance business, or the practice of any profession requiring a license—*e.g.,* law, medicine, accounting, dentistry, advertising, architecture, and contracting. See generally Bus & P C §§475-11421; Corp C §§13400-13410. With the registration materials, the Secretary of State will provide a notice that filing the registration will obligate the LLC to pay the $800 annual tax to the Franchise Tax Board under Rev & T C §17941. Corp C §17451(d).

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§14.9 1. Name

The name used by a foreign LLC in California must end with one of the required variants of "LLC," "L.L.C.," or "limited liability company" as set forth in Corp C §17052(a). Corp C §17452(b). If the name of the foreign LLC does not already conform to the requirements of Corp C §17052(a), then one of the required endings must be appended to the name for purposes of transacting business in California. Corp C §17452(b).

A foreign LLC is also subject to Corp C §17052(c), which prohibits the use of a name that the Secretary of State determines is likely to mislead the public or that is the same or deceptively similar to the name of a domestic LLC or a registered foreign LLC; also prohibited is use of a name that is under reservation under Corp C §17053. See generally §§7.2-7.6.

There is no express prohibition against the use of a name that is the same as, or similar to, the name of an existing California corporation or limited partnership; however, as with any choice of a business name, trade name protection, infringement, and other intellectual property concerns must be considered before choosing a name that is the same as, or similar to, an existing business regardless of its entity type.

If necessary to conform to the requirements of Corp C §17052, a foreign LLC may use an assumed name in California that is partially or entirely different from its real name, as long as it is acceptable to the Secretary of State. In that event, the foreign LLC must use the assumed name in all its business dealings in California. Corp C §17452(b)(2).

In addition to registering its name with the Secretary of State, a foreign LLC should also consider filing and publishing a fictitious business name statement at the county level and registering the assumed name as a trade name with the Secretary of State's office.

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§14.10 2. Other Required Information

The registration application must set forth the information required in Corp C §17451(a) and be accompanied by a certificate of good standing from the foreign LLC's jurisdiction of organization. If the foreign jurisdiction (*e.g.,* a foreign country) does not provide for the issuance of the equivalent of a good standing certificate, the applicant must so state. Corp C §17451(b).

An effective date for the registration may be designated by the applicant, as long as it is not more than 90 days after the date of filing the application. Corp C §17056(c).

PRACTICE TIP: In December 2006, the Secretary of State's office issued a clarification regarding future file dates and future effective dates. To summarize, a *future file date* is a request for the Secretary of State to hold a document and file on a future date not more than 90 days from the date of submission. A *future effective date* is a request for the Secretary of State to file a document on receipt, but with a future effective date not more than 90 days from the date of submission. To request a future file date or future effective date, the counter sheet or transmittal letter must include instructions specifying the type of request.

To request a future file date: Include instructions on the counter sheet to the effect: "Please file on _____."

To request a future effective date: Include instructions on the counter sheet specifying the file date, the future effective date, and the applicable code section, *e.g.,* "Under Corporations Code section ____, please file on ____ with a future effective date of ____." The document itself must also contain the future effective date.

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Source: Business Law/Forming and Operating California Limited Liability Companies/14 Operating a Foreign Limited Liability Company in California/§14.11 3. Form: Limited Liability Company Application for Registration (Secretary of State Form LLC-5)

§14.11 3. Form: Limited Liability Company Application for Registration (Secretary of State Form LLC-5)



LLC-5 File # _____

State of California
Secretary of State

LIMITED LIABILITY COMPANY APPLICATION FOR REGISTRATION

A $70.00 filing fee AND a certificate of good standing from an authorized public official of the jurisdiction of formation must accompany this form.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

ENTITY NAME (End the name in Item 1 with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively.)

1. NAME UNDER WHICH THE FOREIGN LIMITED LIABILITY COMPANY PROPOSES TO REGISTER AND TRANSACT BUSINESS IN CALIFORNIA

2. NAME OF THE FOREIGN LIMITED LIABILITY COMPANY, IF DIFFERENT FROM THAT ENTERED IN ITEM 1 ABOVE

DATE AND PLACE OF ORGANIZATION

3. THIS FOREIGN LIMITED LIABILITY COMPANY WAS FORMED ON _____ (MONTH) - _____ (DAY) - _____ (YEAR) IN _____ (STATE OR COUNTRY)

AND IS AUTHORIZED TO EXERCISE ITS POWERS AND PRIVILEGES IN THAT STATE OR COUNTRY.

AGENT FOR SERVICE OF PROCESS (If the agent is an individual, the agent must reside in California and both Items 4 and 5 must be completed. If the agent is a corporation, the agent must have on file with the California Secretary of State a certificate pursuant to Corporations Code section 1505 and Item 4 must be completed (leave Item 5 blank).

4. NAME OF AGENT FOR SERVICE OF PROCESS

5. IF AN INDIVIDUAL, ADDRESS OF INITIAL AGENT FOR SERVICE OF PROCESS IN CALIFORNIA | CITY | STATE | ZIP CODE

CA

APPOINTMENT (The following statement is required by statute and should not be altered.)

6. IN THE EVENT THE ABOVE AGENT FOR SERVICE OF PROCESS RESIGNS AND IS NOT REPLACED, OR IF THE AGENT CANNOT BE FOUND OR SERVED WITH THE EXERCISE OF REASONABLE DILIGENCE, THE SECRETARY OF STATE OF THE STATE OF CALIFORNIA IS HEREBY APPOINTED AS THE AGENT FOR SERVICE OF PROCESS OF THIS FOREIGN LIMITED LIABILITY COMPANY.

OFFICE ADDRESSES (Do not abbreviate the name of the city.)

7. ADDRESS OF THE PRINCIPAL EXECUTIVE OFFICE | CITY AND STATE | ZIP CODE

8. ADDRESS OF THE PRINCIPAL OFFICE IN CALIFORNIA, IF ANY | CITY | STATE | ZIP CODE

CA

EXECUTION

9. I DECLARE I AM THE PERSON WHO EXECUTED THIS INSTRUMENT, WHICH EXECUTION IS MY ACT AND DEED.

_____ DATE

_____ SIGNATURE OF AUTHORIZED PERSON

_____ TYPE OR PRINT NAME AND TITLE OF AUTHORIZED PERSON

Print

INSTRUCTIONS FOR COMPLETING THE APPLICATION FOR REGISTRATION (FORM LLC- 5)

For easier completion, this form is available on the Secretary of State's website at http://www.sos.ca.gov/business/ and can be viewed, filled in and printed from your computer. The completed form along with the applicable fees can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form is filed only in the Sacramento office.

Statutory filing requirements are found in California Corporations Code sections 17451 and 17452. All statutory references are to the California Corporations Code, unless otherwise stated.

- Attach a valid certificate of good standing from an authorized public official of the jurisdiction under which the foreign limited liability company is organized. If the issuance of such a certificate is not permissible in that jurisdiction, attach a statement by the foreign limited liability company indicating such.

FEES: The fee for filing Form LLC-5 is $70.00. There is an additional $15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document within a guaranteed time frame can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at http://www.sos.ca.gov/business/precexp.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

COPIES: The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the $8.00 per copy certification fee.

Pursuant to Section 17375, a foreign limited liability company may not render professional services, as defined in Sections 13401(a) and 13401.3, in this state. Professional services are defined as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act. If your business is required to be licensed, certified or registered, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional.

Filing this document shall obligate most limited liability companies to pay an annual minimum tax of $800.00 to the Franchise Tax Board pursuant to Revenue and Taxation Code section 17941.

Complete the Application For Registration (Form LLC- 5) as follows:

Item 1. Enter the name under which the foreign limited liability company is to be registered and transact business in California. The name must end with the words "Limited Liability Company," or the abbreviations "LLC" or "L.L.C." The words "Limited" and "Company" may be abbreviated to "Ltd." and "Co.," respectively. The name of the limited liability company may not contain the words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp.," and must not contain the words "insurer" or "insurance company" or any other words suggesting that it is in the business of issuing policies of insurance and assuming insurance risks.

Item 2. Enter the name of the foreign limited liability company as it appears on its articles of organization, if different from the name entered in Item 1. The name in Item 2 must agree exactly with the name on the certificate of good standing.

Item 3. Enter the date and state or country of formation and make the required statement concerning the authority of the limited liability company to exercise its powers and privileges in its state or country of formation.

Items 4 & 5 Enter the name of the agent for service of process in California. An agent is an individual, whether or not affiliated with the limited liability company, who resides in California or a corporation designated to accept service of process if the company is sued. The agent should agree to accept service of process on behalf of the limited liability company prior to designation.

If a corporation is designated as agent, that corporation must have previously filed with the Secretary of State, a certificate pursuant to Corporations Code section 1505. Note, **a limited liability company cannot act as its own agent** and no domestic or foreign corporation may file pursuant to Section 1505 unless the corporation is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State.

If an individual is designated as agent, complete Items 4 and 5. If a corporation is designated as agent, complete Item 4 and proceed to Item 6 (do not complete Item 5).

Item 6. This statement is required by statute and should not be altered.

Item 7. Enter the complete address, including the zip code, of the principal executive office of the foreign limited liability company. Please do not abbreviate the name of the city.

Item 8. Enter the complete address, including the zip code, of the principal office in California, if any. Please do not abbreviate the name of the city.

Item 9. Form LLC-5 must be signed by a person with authority to do so under the laws of the state of organization of the foreign limited liability company.

Print

Secretary of State
Business Programs Division

1500 11th Street, 3rd Floor
Sacramento, CA 94244-2300

Business Entities
(916) 657-5448

LIMITED LIABILITY COMPANIES

California Tax Information

Registration of a limited liability company with the California Secretary of State will obligate a limited liability company that is not taxed as a corporation to pay to the Franchise Tax Board an annual minimum tax of $800.00 and a fee based on the annual total income of the entity. The tax and fee are required to be paid for the taxable year of registration and each taxable year, or part thereof, until a Certificate of Cancellation is filed with the California Secretary of State. (Rev. and Tax. Code §§ 17941 and 17942.)

A limited liability company is not subject to the taxes and fees imposed by Revenue and Taxation Code sections 17941 and 17942 if the limited liability company did no business in California during the taxable year and the taxable year was 15 days or less. (Rev. and Tax. Code § 17946.)

For further information, please contact the Franchise Tax Board at:

From within the United States (toll free) .....(800) 852-5711
From outside the United States (not toll free).....(916) 845-6500
Automated Toll Free Phone Service.....(800) 338-0505

Professional Services Information

Pursuant to California Corporations Code section 17375, a domestic or foreign limited liability company may not render professional services, as defined in Corporations Code sections 13401(a) and 13401.3. Professional services are defined as:

> Any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act or the Yacht and Ship Brokers Act.

If your business is required to be licensed, registered or certified, it is recommended that you contact the appropriate licensing authority before filing with the Secretary of State's office in order to determine whether your services are considered professional.

LLC Info (REV 03/2005)

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§14.12 4. Appointment of Agent for Service of Process

The application for registration must provide the name and address of an agent for service of process on the foreign LLC in California. The agent may be either an individual residing in California or a corporation in good standing that has filed the certificate required by Corp C §1505. Corp C §§17061(d)(1), 17451(a)(3). If the agent is a corporation, it is not necessary for the application to include the agent's address. Corp C §17451(a)(3). If the agent resigns and is not replaced, or if the agent cannot be located or served with the exercise of reasonable diligence, then the foreign LLC is deemed to have appointed the Secretary of State as its agent for service of process. Corp C §17451(a)(4). The Secretary of State will also be deemed to be the agent for service of process for a foreign LLC transacting business in California without registration. Corp C §17456(d).

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Source: Business Law/Forming and Operating California Limited Liability Companies/14 Operating a Foreign Limited Liability Company in California/§14.13 5. Amendments to Registration

§14.13 5. Amendments to Registration

If any statements made in the initial application are or become erroneous, a certificate of amendment to the application must be promptly filed with the Secretary of State. Corp C §17454. The applicant can designate an effective date for the certificate of amendment not more than 90 days after the date of filing. Corp C §17056(c).

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Source: Business Law/Forming and Operating California Limited Liability Companies/14 Operating a Foreign Limited Liability Company in California/§14.14 6. Form: Limited Liability Company Application for Registration, Certificate of Amendment (Secretary of State Form LLC-6)

§14.14 6. Form: Limited Liability Company Application for Registration, Certificate of Amendment (Secretary of State Form LLC-6)



State of California
Secretary of State

LIMITED LIABILITY COMPANY
APPLICATION FOR REGISTRATION
CERTIFICATE OF AMENDMENT

A $30.00 filing fee must accompany this form
IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

1. Secretary of State File Number

2. Name under which this foreign limited liability company is conducting business in California:

3. **COMPLETE ONLY THE SECTIONS WHERE INFORMATION IS BEING CHANGED. ADDITIONAL PAGES MAY BE ATTACHED, IF NECESSARY. CONSULT THE INSTRUCTIONS BEFORE COMPLETING THIS FORM.**

   A. The name under which this foreign limited liability company conducts business in California. (End the name with the words "Limited Liability Company," or "Ltd. Liability Co.," or the abbreviations "LLC" or "L.L.C.")

   B. The name of the foreign limited liability company has been changed as follows and has been recorded in the home state or country:

   C. State or country of formation of the foreign limited liability company, if false or erroneous at time of registration.

   D. Date on which the foreign limited liability company was formed, if false or erroneous at time of registration.

   E. Address of the principal executive office: City State Zip Code

   F. Address of the principal office in California: City State **CA** Zip Code

4. Future effective date, if any: Month Day Year

5. Number of pages attached, if any:

6. **Declaration:** It is hereby declared that I am the person who executed this instrument, which execution is my act and deed.

Signature of Authorized Person

Type or Print Name and Title of Authorized Person

Date

RETURN TO:

NAME
FIRM
ADDRESS
CITY/STATE
ZIP CODE

Print

INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF AMENDMENT TO THE APPLICATION FOR REGISTRATION (LLC-6)

- If any statement in the Application of Registration (LLC-5) was false when made or any statements made have become erroneous, the foreign limited liability company shall promptly file with the Secretary of State of California a Certificate of Amendment to the Application for Registration (LLC-6). (Section 17454.)

- The Certificate of Amendment to the Application for Registration (LLC-6) may become effective not more than ninety (90) days after filing the Certificate. If such future effective date is desired, indicate in a cover letter the month, day, and year upon which the Certificate of Amendment of the Application for Registration (LLC-6) is to become effective. (Section 17056(c)).

DO NOT ALTER THIS FORM

Type or legibly print in black ink.

- Attach the fee for filing the Certificate of Amendment to the Application for Registration (LLC-6) with the Secretary of State. The fee is thirty dollars ($30).

- Make check(s) payable to the Secretary of State.

- Send the executed document and filing fee to:

California Secretary of State
Document Filing Support Unit
P.O. Box 944228
Sacramento, CA 94244-2280

- Fill in the items as follows:

Item 1. Enter the file number issued by the California Secretary of State.

Item 2. Enter the name of the foreign limited liability company as registered with the California Secretary of State.

Item 3. Enter only the information which is being amended. Provide the text of each amendment adopted, using the A-F space provided and/or attaching additional pages.

Item 4. Enter the future effective date of the Certificate of Amendment to the Application for Registration (LLC-6), if any. If none is entered, the amendment shall be effective upon filing with the California Secretary of State.

Item 5. Enter the number of pages attached, if any. All attachments should be 8½ " x 11", one-sided and legible.

Item 6. The Certificate of Amendment to the Application for Registration (LLC-6) shall be executed with an original signature and title.

If the Certificate of Amendment to the Application for Registration (LLC-6) is signed by an entity, the person who signs for the entity must note the exact entity name, his/her name and his/her position/title.

If the Certificate of Amendment to the Application for Registration (LLC-6) is signed by a trust, the certificate must be signed by a trustee as follows:
_____, trustee for _____trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5/1/94).

Item 7. Enter the name and address of the person or firm to whom a copy of the filing should be mailed.

- Statutory provisions can be found in Section 17454 of the California Corporations Code, unless otherwise indicated.

- For further information contact the Business Filings Section at (916) 657-5448.

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Source: Business Law/Forming and Operating California Limited Liability Companies/14 Operating a Foreign Limited Liability Company in California/§14.15 7. Biennial Statement of Information

§14.15 7. Biennial Statement of Information

A foreign LLC is required to file the same biennial statement of information that a domestic LLC is required to file under Corp C §17060. See §13.3.

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B. Effect of Failure to Register as a Foreign LLC

§14.16 1. No Right to Maintain California Court Proceedings

If a foreign LLC transacts intrastate business in California without registering, it may not maintain any action, suit, or proceeding in the California courts until it does register, although it is not precluded from defending an action, suit, or proceeding that may be brought against it. Corp C §17456(a). In addition, a foreign LLC that transacts intrastate business without registering is subject to monetary penalties of $20 per day, up to a maximum of $10,000. Corp C §17456(b). The Attorney General is empowered to restrain the transaction of intrastate business by foreign LLCs in violation of these provisions. Corp C §17457.

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§14.17 2. Voidability of Contracts

If a foreign LLC transacts intrastate business without first being registered with the Secretary of State and filing all required tax returns, it is subject to the sanction that all contracts entered into in California by the foreign LLC while unregistered are voidable by any other party to the contract. See Rev & T C §23304.1(b) (contracts of unqualified foreign taxpayer voidable) and Rev & T C §23305.5 (the term "taxpayer" includes LLC). See generally *White Dragon Prods. v Performance Guar., Inc.* (1987) 196 CA3d 163, 241 CR 745. A party seeking to void the LLC's contract must file a lawsuit to do so.

If a foreign LLC does fail to register or file tax returns and it becomes subject to the sanction effect of Rev & T C §23304.1(b), it can take corrective action to prevent the voidability of its contracts by filing all required tax returns and paying all taxes owed, including any interest and penalties. Rev & T C §23305.1. These curative steps may be taken even after a lawsuit has been filed by another party seeking to void a contract. Rev & T C §23304.5. However, a contract that has been rescinded by a final court order under Rev & T C §23304.5 cannot be subsequently restored by the LLC. Rev & T C §§23305.1(c)(1)(A), 23305a.

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§14.18 3. No Loss of Limited Liability

Members of a foreign LLC do not become liable for its debts and obligations merely because it transacted intrastate business in California without being registered. Corp C §17456(c). Thus, a foreign LLC's failure to register will not result in the loss of limited liability for members. This provides comfort that if the intrastate activities of an unregistered foreign LLC change or increase, so that registration becomes required, the company's failure to register in a timely fashion will not have any unanticipated catastrophic consequences.

A foreign LLC that transacts intrastate business in California without registration is deemed to have appointed the Secretary of State as its agent for service of process for claims arising from its business activities. Corp C §17456(d).

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§14.19 VI. ANNUAL TAX AND FEES

Foreign LLCs are required to pay the same annual $800 franchise tax that is payable by domestic LLCs, as well as the same annual fees based on gross income that is derived from or attributable to California. Rev & T C §§17941, 17942(a). See §§5.4-5.5. Moreover, the unitary tax method of apportioning a foreign corporation's worldwide income is also applied to foreign LLCs and their affiliated groups, including the effect of any "water's edge" election under Rev & T C §25110. Rev & T C §17942(b)(2). See §5.4.

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§14.20 VII. CALIFORNIA COURT JURISDICTION OVER FOREIGN LLCs

Whether a foreign LLC is subject to the jurisdiction of the California courts is an issue that is separate and distinct from whether it is required to register with the California Secretary of State because of the transaction of intrastate business. The California test for asserting jurisdiction over a nonresident defendant is identical to the "minimum contacts" test established by the United States Supreme Court in *International Shoe Co. v Washington* (1945) 326 US 310, 90 L Ed 95, 66 S Ct 154. See *Henry R. Jahn & Son, Inc. v Superior Court* (1958) 49 C2d 855, 323 P2d 437.

That test requires a much lower threshold of activity in California than the "transact[ion] of intrastate business" that is necessary to trigger the registration requirement of Corp C §17451. For example, a foreign manufacturer's goods may be distributed in California to an extent that will subject it to the jurisdiction of the California courts in a product liability case, even though the goods may be distributed entirely through independent contractors so that the foreign manufacturer would not be deemed to be transacting "intrastate business" for purposes of Corp C §17451. See, *e.g., Buckeye Boiler Co. v Superior Court* (1969) 71 C2d 893, 80 CR 113.

Thus, a California plaintiff may be able to sue a foreign LLC in a California court even though the defendant was not required to register with the Secretary of State. However, in that event the plaintiff would not be able to effect service of process by serving the Secretary of State, since the implied appointment of the Secretary of State applies only if the defendant was transacting intrastate business. See Corp C §17456(d). Instead, general means of service of process would have to be utilized. See generally California Civil Procedure Before Trial §17.22 (4th ed Cal CEB 2004).

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§14.21 VIII. CANCELLATION OF REGISTRATION

A foreign LLC registered with the Secretary of State under Corp C §17452 may cancel its registration by filing a certificate of cancellation (Form LLC-4/7; see §16.67). However, the filing of a certificate of cancellation does not terminate the authority of the Secretary of State to accept service of process on the foreign LLC for causes of action arising out of the transaction of business in California. Corp C §17455. The registration with the Secretary of State may be canceled when the foreign LLC has dissolved and wound up under the laws of the jurisdiction of its formation, or merely because it has ceased transacting intrastate business in California.

If the LLC files a tax return with the Franchise Tax Board designated as its final return, the LLC will continue to be subject to the annual tax until it files a certificate of cancellation with the Secretary of State under Rev & T C §17356 or §17455. Rev & T C §17941(b)(2).

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15

Series LLCs

Michael G. Schinner
Michael S. Powlen

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§15.1 I. INTRODUCTION

Clients often ask: "Should I form my limited liability company (LLC) in Delaware or Nevada rather than in California?" As noted in §3.93, LLC legislation varies significantly from state to state, and a comprehensive review of Delaware and Nevada LLC law is beyond the scope of this treatise. These states, as well as four others, offer a compelling advantage not found under the laws of California or most other states. Delaware and Nevada laws allow a single LLC to hold separate assets in separate "series." As of March 2007, seven states (Delaware, Nevada, Illinois, Iowa, Oklahoma, Tennessee, and Utah) have true series legislation that provides for the limitation of liabilities among the separate series. The principal benefit of the so-called series LLC is that it insulates the liabilities associated with the assets of any one particular series from the assets held in the other series. This ability to place multiple assets in a single LLC, yet insulate the liabilities associated with those assets, eliminates the administrative burden and expense of forming multiple LLCs. California will likely respect a validly formed foreign series LLC that qualifies to do business in California. Corporations Code §17450(b) provides that a foreign LLC "may not be denied registration by reason of any difference between those laws and the laws of this state."

NOTE: As of the publication date, series LLCs may not be *formed* in California.

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§15.2 II. DELAWARE ADVANTAGES

Of the series LLC states, Delaware was the first and is the most logical choice. The reputation that Delaware enjoys as a business-friendly haven is well documented and well deserved. Sixty percent of the Fortune 500 companies and 50 percent of the companies listed on the New York Stock Exchange are incorporated in Delaware. As one commentator remarked, "Delaware law seems to exert an almost gravitational pull on attorneys." Bishop & Kleinberger, Limited Liability Companies: Tax and Business Law ¶14.01 (1994).

Why do so many businesses choose to incorporate in tiny Delaware? The reasons are myriad:

- The Delaware General Corporation Law is one of the most advanced and flexible corporate statutes in the nation.
- Delaware has a specialized business court, the Court of Chancery, that has created business law precedents for over 200 years. The Court of Chancery is presided over by judges who have an extensive knowledge of corporate law matters.
- The Delaware courts and legislature actively ensure that the state's business laws evolve with the needs of the business community.

For example, in 1992, Delaware became one of the earliest states to recognize limited liability companies as a new form of legal entity; in contrast, it was not until 1996 that California became the 46th state to recognize LLCs. In 1996, Delaware became one of the first states to recognize single-member LLCs; California did not permit the formation of single-member LLCs until January 1, 2000. In 1996, Delaware became one of the first states to permit the conversion—as compared to the more complicated merger process—of a business entity such as a corporation, limited partnership, or foreign LLC into a Delaware LLC; California did not permit similar conversions until January 1, 2000. Last, the office of the Secretary of State in Delaware operates much like a business, rather than a government bureaucracy. Filed documents are returned in a matter of days, whereas in California, the Secretary of State often takes several weeks to return documents unless a filing service is used. Moreover, for years, Delaware has provided expedited filing service and has permitted facsimile filing. The California Secretary of State has only recently begun to offer expedited filing services.

NOTE: Effective October 2, 2006, the California Secretary of State has expanded its preclearance and expedited filing services to include all business entity documents, including interspecies mergers and conversions, filed with the Secretary of State under the California Corporations Code. On these services, see §§7.25-7.27.

Although most California attorneys form LLCs in California, where they practice and where most of their clients operate, they should seriously consider the Delaware option. Forming LLCs in California is undoubtedly convenient and appropriate in many circumstances, and, as noted above, California legislation has kept pace—albeit several years later—with most of the improvements found in the Delaware LLC statute. However, Delaware still offers one compelling advantage that is not found in the California LLC statute: the Delaware series LLC.

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§15.3 III. THE DELAWARE SERIES LLC

Effective August 1, 1996, Delaware amended its Limited Liability Company Act (6 Del C §§18-101—18-1109) to permit the designation of "series" of ownership interests. The Delaware LLC Act states (6 Del C §§18-215(a)):

A limited liability company agreement may establish or provide for the establishment of designated series of members, managers or limited liability company interests having separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations, and, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.

NOTE: Although Delaware was the first state to permit a series designation, several other states, including Iowa, Oklahoma, Illinois (see §15.5), Nevada (see §15.4), Tennessee, Florida, Minnesota, Mississippi, North Dakota, Utah, and Wisconsin, have since enacted similar legislation permitting the establishment of series LLCs. See Iowa C §490A.305; 18 Okla Stat §2054.4; 805 Ill Comp Stat 180/37-40; Nev Rev Stat §86.296; Tenn Code Ann §48-249-309; Fla Stat Ann §608.601(3)(c); Minn Stat §322B.03; Miss C Ann §79-29-214; ND Century C §10-32-02; Utah C §48-2c-606; Wis Stat Ann §183.0504.

The "series" described in 6 Del C §18-215(a) should not be confused with traditional "classes" or "series" of stock or partnership interests. Both Delaware and California law allow multiple *classes* of stock (*e.g.,* common and preferred) and *series* of stock within a class (*e.g.,* Series A Preferred and Series B Preferred) that have specified priorities over each other. See 8 Del C §151; Corp C §400. For example, the preferred shares as a whole may have dividend and liquidation priorities, but only certain preferred shares may be entitled to vote. In such a case, the voting preferred shares must be designated as a separate series (*e.g.,* Series A) and the nonvoting shares as another series (*e.g.,* Series B). Similarly, Delaware and California permit "classes" of membership interests having those relative rights, powers, and duties as the articles of organization or operating agreement provide, including rights, powers, and duties senior to other classes of members. See 6 Del C §18-302; Corp C §17102; see also 6 Del C §17-302 and Corp C §15903.07 (regarding classes of limited partnership interests). However, separate classes of interests do not allow for the compartmentalization of liabilities among the respective classes.

The great benefit of the Delaware "series" structure is that the owners of an LLC can hold separate property interests in separate series of an LLC that are *compartmentalized for liability purposes*. The profits and losses and liabilities of each series are legally separated from the other series. The main advantage of this structure is the ability of a business owner to hold all of his, her, or its investment properties or lines of business in one master LLC (with any number of other members), without the attendant cost of forming and maintaining multiple entities. The Delaware series LLC is similar in structure to a parent company with multiple tiers of subsidiaries, insofar as the liabilities with respect to each series of property interests are insulated from the risks and liabilities of every other series of property interests. However, unlike the "affiliated company" structure, a series LLC may significantly reduce legal, accounting, and other administrative expenses, including taxes. In brief, a series LLC has the effect of having multiple subsidiaries without the associated costs.

To create a Delaware series LLC, the filing fee is $90, with $30 extra for a certified copy, $100 extra for same-day service, or $50 extra for 24-hour service. See the Directory for the website giving Delaware series LLC fee information.

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§15.4 IV. THE NEVADA SERIES LLC

Clients often inquire about the Nevada series LLC because of the proximity of Nevada to California. Many clients have offices or residences in Nevada and are accustomed to using Nevada entities. The Nevada series LLC statute is modeled after the Delaware statute and is similar in operation and content. See Nev Rev Stat §86.296.

The articles of organization or operating agreement may create one or more series of members. A series may have separate powers, rights, or duties for specified property or obligations of the company, or profits and losses associated with specified property or obligations, and may have a separate business purpose or investment objective. Nev Rev Stat §86.296(2). The debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to a particular series are enforceable only against the assets of that series, and not against the assets of the LLC generally, or any other series, if (Nev Rev Stat §86.296(3)):

- Separate and distinct records are maintained for the series;
- The assets associated with the series are held, directly or indirectly (including through a nominee or otherwise), and accounted for separately from the other assets of the LLC and any other series; and
- The articles of organization comply, or an amendment to the articles complies, with Nev Rev Stat §86.161(1)(e).

The fee structure in Nevada is also attractive. To create a Nevada series LLC, the filing fee is $75, with $30 extra for a certified copy, $125 extra for 24 hour service. See the Directory for the Nevada LLC website.

NOTE: If the client is not in a hurry, Nevada is a less expensive forum in which to establish a series LLC than Delaware. However, if the client is in a hurry, Delaware is less expensive. Because of Delaware's more extensive body of corporate law and the expertise of the Chancery Court, one may prefer that jurisdiction for formation. Nevertheless, Nevada, particularly for clients with ties to Nevada, provides a reasonable alternative.

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§15.5 V. THE ILLINOIS SERIES LLC

The Illinois series LLC statute contains some significant substantive differences from the other series LLC statutes. The Illinois series LLC statute is the strongest with respect to the separate existence and powers of each series. The Illinois Act provides that (805 Ill Comp Stat 180/37-40(b)):

Each series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company under this Act. The limited liability company and any of its series may elect to consolidate their operations as a single taxpayer to the extent permitted under applicable law, elect to work cooperatively, elect to contract jointly or elect to be treated as a single business for purposes of qualification to do business in this or any other state.

Illinois requires that, in addition to the notice of a series that must be contained in the articles of organization, the LLC must have a certificate of designation on file with the Illinois Secretary of State that lists the members or managers if different from the LLC. 805 Ill Comp Stat 180/37-40(b), (d). Illinois requires that the name of the series contain the entire name of the LLC and be distinguishable from the names of the other series set forth in the articles. 805 Ill Comp Stat 180/37-40(c). In the case of a foreign limited liability company that has adopted an assumed business name, the name of the series with limited liability must contain the entire name under which the foreign LLC was admitted to transact business in the state.

NOTE: In contrast, states such as Delaware and Nevada provide that notice in the articles of organization is sufficient even if no series have yet been established and no particular series is referenced in the notice. See §§15.3-15.4.

Under Illinois law, a limited liability company and any of its series may elect to consolidate their operations as a single taxpayer (to the extent permitted under applicable law), elect to work cooperatively, elect to contract jointly, or elect to be treated as a single business for purposes of qualification to do business in Illinois or any other state. These elections do not affect the limitation of liability applicable to series LLCs except to the extent that the series specifically accepted joint liability by contract. 805 Ill Comp Stat 180/37-40(b).

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§15.6 VI. FORMATION REQUIREMENTS

The series LLC statutes generally allow for limitation on liabilities with respect to each series of interests by providing that (1) debts, liabilities, and obligations of a particular series are enforceable against the assets of that series only, and not against the assets of the LLC generally or any other series, and (2) none of the debts, liabilities, and obligations of the LLC generally or of any other series are enforceable against the assets of that series. See, *e.g.,* 6 Del C §18-215(b); Nev Rev Stat §86.296(3); 18 Okla Stat §2005; 805 Ill Comp Stat 180/37-40(b); Tenn Code Ann §48-249-309(a). This limitation on liabilities is available if the LLC does all of the following (see, *e.g.,* 6 Del C §§18-215(b); Nev Rev Stat §86.296(3); 18 Okla Stat §2054.4(B); 805 Ill Comp Stat 180/37-40(b); Iowa C §490A.305(2); Tenn Code Ann §48-249-309(b)):

- Sets forth notice of the limitation on liabilities of a series in the certificate of formation of the LLC on file in the appropriate state office;
- Creates one or more series in the LLC agreement;
- Provides in the LLC agreement for such limitation on liabilities;
- Maintains separate and distinct records for any such series; and
- Holds and accounts for the assets associated with any such series separately from the other assets of the LLC or any other series.

NOTE: Series LLC terminology differs slightly from state to state and from California's LLC terminology. For example, the Delaware statute refers to the "certificate of formation," which is the instrument filed with the Secretary of State to form an LLC, while the California statute refers to the "articles of organization" (also referred to as Form LLC-1). The Delaware statute refers to a "limited liability company agreement," the agreement among the members of the LLC governing such matters as management of the LLC, allocations and distributions of profits and losses, transfers of interests, and dissolution. The California statute refers to an "operating agreement," which is defined as "any agreement, written or oral, between all of the members as to the affairs of a limited liability company and the conduct of its business in any manner not inconsistent with law or the articles of organization." Corp C §17001(ab). The members of an LLC must enter into an operating agreement either before or after the filing of the articles of organization. Corp C §17050(a). Although an oral agreement is permissible, it is advisable to have a written operating agreement. A written operating agreement is also required to change any of the default provisions of the California LLC law. Corp C §17005(b)-(d).

Under series LLC law generally, the LLC agreement may provide for separate classes or groups of members or managers associated with a series. See, *e.g.,* 6 Del C §18-215(e); Nev Rev Stat §86.296(2); Iowa C §490A.305(1), (4); 18 Okla Stat §2054.4(D). The LLC agreement may provide for separate voting with respect to a series. See, *e.g.,* 6 Del C §18-215(f); Nev Rev Stat §86.296(2); Iowa C §490A.305(5); 18 Okla Stat §2054.4(D), (E). Unless otherwise provided in the LLC agreement, management of a series is vested in the members associated with that series in proportion to their interests. See, *e.g.,* 6 Del C §18-215(g); Iowa C §490A.305(6); 18 Okla Stat §2054.4(F).

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§15.7 VII. BENEFITS OF MULTISERIES LLC

The enactment of series LLC legislation is evidence of the respective state's responsiveness to the evolving needs of the business community. As discussed in §§15.8-15.20, the series LLC offers many benefits over the traditional LLC. A series LLC:

- May be used in lieu of forming multiple LLCs or subsidiaries (see §15.8);
- Provides superior asset protection by segregating liabilities (see §§15.11-15.13);
- Can reduce legal, accounting, and administrative costs and taxes (see §§15.14-15.18);
- Facilitates more flexible equity compensation arrangements (see §15.19); and
- Allows tax-free transfers within the LLC (see §15.20).

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§15.8 A. Avoids Multiple LLCs or Subsidiaries

The series LLC enables the formation of one LLC with separate series, each containing a different property or line of business. Each series functions as a stand-alone subsidiary insofar as the liabilities associated with each series are segregated from the liabilities of the other series, without the concomitant costs of multiple subsidiaries. The only way to achieve similar isolation of liabilities within a business structure formed in California, while maintaining pass-through tax treatment, would be to form separate LLCs (either parent-subsidiary or brother-sister affiliations) or qualified Subchapter S subsidiaries (see note below) for each property interest or line of business. However, the costs to establish multiple LLCs or subsidiaries are significant.

NOTE: Under IRC §1361(b)(3), an S Corporation has the ability to be the parent of a wholly owned C-corporation subsidiary. This provision allows an S corporation to drop separate business operations or assets, whether for liability insulation or other business reasons, into 100-percent-owned subsidiaries, while still maintaining S-status tax treatment for its overall business. The parent S corporation must elect to treat the subsidiary as a qualified Subchapter S subsidiary (QSSS, or QSub). The prerequisites are that 100 percent of the stock of the subsidiary be owned by the S parent and that the subsidiary be a domestic corporation that is not an ineligible corporation within the meaning of IRC §1361(b)(2). The subsidiary cannot itself be an S corporation because of the prohibition against an S corporation having a corporate shareholder. Thus, while the subsidiary is not an S corporation, it is treated for tax purposes as if it were part of the parent corporation, and its assets and liabilities, as well as its income, deduction, and credit items, are treated as belonging to the parent. The QSub is subject to California's $800 annual franchise tax, which is paid by the parent S corporation.

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§15.9 B. Ease of Adding and Dissolving Series

Another advantage to forming a series LLC is the ease of adding an additional series to the LLC or dissolving an existing series. When LLC members acquire additional assets that they want to segregate from the LLC's other assets, the series LLC spares them the time and expense of setting up a separate LLC to insulate liabilities. A new series can be added to the existing series LLC by a simple addendum to the LLC agreement; no instrument need be filed with the Delaware Secretary of State. The LLC agreement and the other series remain intact.

Similarly, any series within a series LLC can be easily dissolved without dissolving the entire entity. 6 Del C §18-801(a); 805 Ill Comp Stat 180/37-40(m); Tenn Code Ann §48-249-309(g); Iowa C §490A.305(10). For example, under 6 Del C §18-801(a), a series in an LLC is dissolved:

- As of a date specified in the LLC agreement;
- As of the occurrence of a certain event specified in the LLC agreement;
- On the affirmative vote or written consent of the LLC members associated with the series who own two-thirds in interest;
- Whenever there are no members in the series, unless specific steps are taken; or
- By judicial decree.

Section 18-215(j) of the Delaware LLC Act states that the dissolution of a series does not require the dissolution of the entire LLC. Accordingly, the series LLC spares its owners the time and expense of dissolving the entire LLC on the sale, exchange, or other disposition of an asset held in one series. As in the case of adding a series, the unneeded series can be dissolved by a simple addendum to the LLC agreement; no instrument need be filed with the Secretary of State.

NOTE: Illinois law requires that a certificate of designation for each series be filed with the Secretary of State. 805 ILCS §180/37-40(b).

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§15.10 C. Bankruptcy Remote Entities

Lenders often require borrowers to form a "bankruptcy remote" or "single purpose" subsidiary in connection with a loan. These entities are intended to protect the borrower's assets from the claims of the parent's creditors in the event of the parent's bankruptcy. An accommodating lender may be willing to permit the borrower to establish a series LLC (or to use an existing one) and put the assets that constitute collateral for the loan in the name of one of the series. The critical question for the lender is whether, in the event of the LLC's bankruptcy, the assets of the "bankruptcy remote" series will be subject to the claims of the general creditors of the LLC or the claims of creditors of any insolvent series.

Bankruptcy courts have the equitable power to "substantively consolidate" the assets and liabilities of related legal entities to ensure the equitable treatment of all creditors. See, *e.g., FDIC v Colonial Realty Co.* (2d Cir 1992) 966 F2d 57; *Eastgroup Props. v Southern Motel Assocs., Ltd.* (11th Cir 1991) 935 F2d 245. The courts are afforded a good deal of discretion in constructing an order of substantive consolidation, and its appropriateness will be determined by the court on a sui generis basis. *Moran v Hong Kong & Shanghai Banking Corp. (In re Deltacorp.)* (Bankr SDNY 1995) 179 BR 773, 777. Courts will examine all the facts and circumstances before applying the substantive consolidation doctrine. See, *e.g., In re Hutco Inc.* (Bankr ED Mo 2003) 302 BR 35 (applying three-factor test (necessity of consolidation because of interrelationship among debtors, whether benefits of consolidation outweigh harm to creditors, and whether prejudice will result from not consolidating debtors) but noting that test is illustrative only of type of fact-specific analysis that courts must conduct); *In re Giller* (8th Cir 1992) 962 F2d 796, 799 (same); *In re Augie/Restivo Baking Co., Ltd.* (2d Cir 1988) 860 F2d 515; *Drabkin v Midland-Ross Corp. (In re Auto-Train Corp. Inc.)* (DC Cir 1987) 810 F2d 270, 272 (circuit applies three-part burden-shifting test as part of searching inquiry to ensure that consolidation yields benefits offsetting harm it inflicts to objecting parties); *Reider v FDIC (In re Reider)* (11th Cir 1994) 31 F3d 1102, 1107.

NOTE: The proponent of consolidation bears the initial burden of proof. Substantive consolidation orders are final and appealable under 28 USC §158(a). *Alexander v Compton (In re Bonham)* (9th Cir 2000) 229 F3d 750, 762.

The Ninth Circuit has adopted the D.C. Circuit's analytical framework for determining the propriety of substantive consolidation in a bankruptcy case involving a debtor's estate and two nondebtor corporations estates that were run by the debtor. *Alexander v Compton (In re Bonham)* (9th Cir 2000) 229 F3d 750, 766; see *Drabkin v Midland-Ross Corp., supra.* Under this framework, courts examine two factors:

- Whether the creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit; or
- Whether the affairs of the debtor are so entangled that consolidation will benefit all creditors.

The first factor, reliance on the separate credit of the entity, is based on the consideration that lenders structure their loans according to their expectations regarding the borrower and do not anticipate either having the assets of a more sound company available in the case of insolvency, or having the creditors of a less sound debtor compete for the borrower's assets. Consolidation under the second factor, entanglement of the debtor's affairs, is justified only when the time and expense necessary even to attempt to unscramble them is so substantial as to threaten the realization of any net assets for all the creditors, or when no accurate identification and allocation of assets is possible. *Alexander*, 229 F3d at 766.

NOTE: No authority apparently exists regarding the treatment of separate series of Delaware series LLCs in bankruptcy. However, if the LLC follows the guidelines discussed in §15.23, a strong argument may be made that the court should not consolidate the LLC's series if the debtor can show that (1) creditors of the LLC and each series dealt with each series as a separate economic unit, and (2) the assets and liabilities of each series were sufficiently segregated so that commingling of assets never occurred. Nevertheless, in the absence of case authority on this subject, one can expect that most lenders would not sanction a Delaware series LLC as an alternative to the bankruptcy remote subsidiary.

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§15.11 D. Liability Protection

Courts have generally respected LLCs as separate legal entities and afforded them liability protection. It is well established that LLCs are superior to most other forms of entities in terms of liability protection. As the name implies, a limited liability company protects its owners from being held personally responsible for the company's debts, obligations, and liabilities; the most an investor can lose is the amount that he or she invested in the company. Corp C §17101(a). Compare Corp C §17101(a) with 6 Del C §18-303(a), which states:

Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.

LLCs should be contrasted with (1) general partnerships, the partners of which are each jointly and severally liable for the partnership's obligations; (2) limited liability partnerships (LLPs), the partners of which are not jointly and severally liable yet remain personally liable for the obligations of the partnership arising from a partner's negligence or misconduct; and (3) limited partnerships, the general partner(s) of which remain personally liable for the obligations of the partnership.

NOTE: Some jurisdictions now permit limited partnerships to register as "limited liability limited partnerships" (or "LLLPs"), which offer some additional protection to the general partner of the LLLP. See 6 Del C §17-214. However, the liability protection afforded to a managing member of an LLC is generally considered superior to the protection afforded to a general partner of an LLLP. See Bishop & Kleinberger, Limited Liability Companies: Tax and Business Law ¶15.03[4][b] (1994).

An LLC generally offers equal or better liability protection than a corporation, and generally more favorable tax treatment. For example, Corp C §17101(b) provides that a member of an LLC is subject to liability under the common law governing alter-ego liability, and is personally liable under a judgment of a court or for any debt, obligation, or liability of the limited liability company under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable for any debt, obligation, or liability of a corporation. The LLC's liability protection may be even stronger than a corporation's because LLC members are not required to maintain the same degree of formality in conducting the LLC's affairs as corporate shareholders. See Corp C §17101(b). Failure to observe corporate formalities is a common basis for imposing alter-ego liability on the shareholders of a corporation.

The Delaware LLC Act extends this liability protection to each series of a multiseries LLC. Section 18-215(b) of the Delaware LLC Act states:

Notwithstanding anything to the contrary set forth in this chapter or under other applicable law, in the event that a limited liability company agreement establishes or provides for the establishment of 1 or more series, and if the records maintained for any such series account for the assets associated with such series separately from the other assets of the limited liability company, or any other series thereof, and if the limited liability company agreement so provides, and if notice of the limitation on liabilities of a series as referenced in this subsection is set forth in the certificate of formation of the limited liability company, then the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof, and, unless otherwise provided in the limited liability company agreement, none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series. Assets associated with a series may be held directly or indirectly, including in the name of such series, in the name of the limited liability company, through a nominee or otherwise.

Further, series LLC statutes such as the Delaware LLC statute allow an LLC to engage in any *lawful* activity, whether or not for profit, with the exception of banking. See 6 Del C §18-215(c). Therefore, another benefit to the series LLC is that individuals who own high-risk, nonbusiness assets (such as noncommercial boats, airplanes, vehicles, and horses) may be able to place these assets into separate series to isolate potential liability. Even vacation homes and principal residences could potentially be placed in separate series.

PRACTICE TIP: Before placing a principal residence in a series LLC, counsel should consult with a tax advisor to ensure that the transfer will not jeopardize the owner's exclusion of gain from the sale of a principal residence under IRC §121. Section 121 allows an exclusion of $250,000 in gain for individual taxpayers and $500,000 in gain for married couples filing jointly (or for a surviving spouse selling or exchanging the residence within 2 years of his or her spouse's death), provided that the taxpayer used

the property as his or her principal residence at least 2 of the 5 years preceding the sale.

Thus, the series LLC statutes generally provide insulation for the assets of one series from the liabilities of the LLC generally and any other series, and vice versa. The series LLC's ability to limit liability with respect to separate classes of assets makes it the ideal vehicle for operating multiple real estate assets, investment funds, distinct lines of operating businesses, and even nonbusiness assets.

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§15.12 1. Real Estate

Isolating liability among several assets is particularly useful to the owner of real estate, when some of the properties may be more susceptible to liability than others. For example, assume that the Smith Family owned (1) Blackacre, a manufacturing facility that produced industrial solvents, (2) Whiteacre, a residential rental property, and (3) Greenacre, a vacation rental. Before the series LLC, the Smith Family's alternatives were either to hold all three properties in one (undifferentiated) entity or to establish three separate entities. The first alternative would not be desirable because the liabilities associated with Blackacre could wipe out the equity of Whiteacre and Greenacre. The second alternative is not desirable because forming and maintaining a separate entity (whether a wholly owned LLC or qualified S-corporation subsidiary) for each of the properties would be costly in terms of legal, accounting, and administrative fees. In addition, several thousand dollars in annual franchise taxes would be due. The optimal solution for the Smith Family would be to form a series LLC with a separate series for each of the three properties. By doing so, the Smith Family would be able to reduce dramatically its overall legal, accounting, and administrative fees and franchise taxes, while compartmentalizing the varying degrees of liabilities among the three properties.

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§15.13 2. Investment Funds

The series LLC can also be used to establish multiple investment funds. Historically, mutual funds have used the series trust structure to create series of regulated investment companies, each of which are treated as separate regulated investment companies for tax purposes. Venture capitalists (VCs) intending to establish multiple funds for investors would typically form a limited partnership or LLC for each fund. Now, however, a VC may form a single series LLC and create a separate series for each fund. Each series can have its own investment profile (*e.g.,* types of investment), risk profile (*e.g.,* start-up versus mature companies), liquidity parameters, minimum capitalization requirements, allocations of profits and losses, distribution priorities, and management fees.

NOTE: Although a different manager can manage each series, it may be desirable to have one manager manage all of the series. If each series is managed separately, it increases the risk that the LLC will not be treated as a single entity for tax purposes. See §15.21.

For example, the VC could establish a series LLC and create a separate series for each of its three funds: (1) Internet start-ups, (2) bio-tech, and (3) telecommunications, each series having a different degree of risk. Each investor could invest in one or more series and choose how to allocate his or her investments. For example, investor X could invest 100 percent in Series A; investor Y could invest 50 percent in Series B and 50 percent in Series C; and investor Z could invest 1/3 in each series. This option may be attractive to VCs and investors alike. For the VCs, the investment offering and ongoing administrative expenses may be reduced, and the LLC increases the likelihood of matching the appropriate investment funds with suitable and interested investors. For the investor, the array of investment options—with the possibility of shifting investments within the LLC, if permitted by the LLC agreement—coupled with simplicity of dealing with one set of offering materials, one LLC agreement, one set of quarterly or annual reports, and one Schedule K-1 at the end of the tax year, may be appealing.

Additional advantages may result from investing in a multiseries VC fund when each series represents a different investment profile, as distinct from investing in one VC fund with a broader portfolio mix. First, the investors' risk of loss with respect to their capital contributions can be limited to the particular assets or activities of a series. In the above example, if Series A collapsed but Series B and Series C managed to break even, investor Y's investment in Series B and Series C would not be adversely affected even if the LLC experienced losses on an aggregate basis; that is, investor Y's investment in Series B and Series C will not be "pulled down" by the demise of the Internet sector represented by Series A.

Moreover, under series LLC statutes, such as 6 Del C §18-215(i), distributions may be made for a series notwithstanding that on an aggregate basis, the distribution would render the LLC insolvent. Accordingly, investor Y could receive distributions from Series B and Series C—with no obligation to refund the distributions even though Series A was insolvent at the time and the distributions rendered the LLC insolvent on an aggregate basis.

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§15.14 E. Reduction of Legal, Accounting, and Administrative Costs and Taxes

The series LLC can reduce costs and administrative burdens. If multiple LLCs would otherwise have been formed to provide liability protection, then the Delaware series LLC reduces legal costs because only one entity need be formed, thereby avoiding duplicative state filing fees.

As discussed below, the multiseries LLC should be treated as a single entity for tax purposes. To date there are no published IRS rulings challenging the status of a series LLC as a single entity for tax purposes, or challenging the separate entity status of each series. Accordingly, depending on how the LLC is structured, the client has the flexibility to choose to file only one tax return, with one set of Schedules K-1 distributed to the investors, and the state minimum franchise tax paid only once, or to file separate returns for one or more of the series in the LLC. Moreover, in the case of series that have only one member, that series should qualify to be treated as a disregarded entity for federal tax purposes.

NOTE: California has indicated its intention to levy a separate franchise tax on each separate series of a series LLC. See also Note in §15.17.

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§15.15 F. Example: Ten Properties

Assume that the Smith Family has ten properties, each property has a net equity of $500,000, and each property generates $250,000 per year in gross revenues within California. Their choices might be to: (1) hold all ten properties in one entity, in which the liabilities associated with one property could drain the equity of the other properties; (2) form ten separate LLCs; or (3) form a Delaware series LLC with ten separate series.

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§15.16 1. Ten California LLCs

If the Smith Family were to form ten California LLCs, the family could expect to incur the following approximate costs in the first year of operations:

State filing fees: $1500 (fees include filing of LLC-1 (Articles of Organization) ($70 × 10), Statements of Information ($20 × 10), miscellaneous filing service fees (approximately $45 per filing), and over-the-counter fees ($15 per filing)). See Govt C §12190.

California Notice of Transaction under Corp C §25102(f) (if applicable): $500 ($50 × 10).

Legal fees: $15,000 (assuming a conservative figure of $1500 per LLC).

Accounting fees: $30,000 (assuming a conservative figure of $1500 per federal and state tax return).

Minimum franchise tax: $8000 ($800 per LLC under Rev & T C §§17941, 23153).

Gross receipts fee: $9000 (approximately $900 per LLC on gross receipts of $250,000, under Rev & T C §17942). See §§5.4-5.5.

Miscellaneous: $1000 (various additional overhead and expenses).

TOTAL: $65,000

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§15.17 2. One Delaware Series LLC

If the Smith Family formed a Delaware multiseries LLC, and qualified the LLC to conduct business in California (as discussed below), their expenses could be trimmed as follows:

Delaware state filing fees: $120 ($90 to file Certificate of Formation plus $30 for certified copy).

Registered agent fee: $90 (estimated).

California state filing fee: $90 ($70 to file LLC-5 (Application for Registration as a Foreign LLC) plus $20 (Statement of Information)).

California Notice of Transaction under Corp C §25102(f) (if applicable): $300

Legal fees: $2500 (assume higher one-time charge for additional complexity in structure).

Accounting fees: $5000 (assume higher rate for federal and state return for additional complexity in reporting multiseries).

Minimum franchise tax:

Delaware: $200 per year.

California: $800 per year (see Rev & T C §§17941, 23153, and see §15.25 for a discussion of whether the FTB could attempt to impose a franchise tax on each series conducting intrastate business in California).

Gross receipts fee: $6000 (on gross receipts of $2,500,000 under Rev & T C §§17942-17943).

TOTAL: $15,100

NOTE: Although Rev & T C §17942 allows the FTB to calculate the gross receipts fee based on the total income of a commonly controlled group if it determines that multiple LLCs were formed for the purpose of reducing LLC fees, the statute does not contain any provisions that allow the FTB to treat a Delaware series LLC as multiple LLCs for purposes of applying the gross receipts fee. Nevertheless, the Franchise Tax Board has announced its position that each series within a series LLC is a separate business entity. See FTB March/April 2006 Tax News, available on the FTB website. See Directory for URL. Thus, if a Delaware Series LLC is registered or doing business in California, each series must file its own tax return and pay its own separate LLC annual tax and fee.

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§15.18 3. Comparison; Total Savings

As illustrated below, the Smith Family could save approximately $50,000 in the year of formation by forming a Delaware series LLC instead of ten separate California LLCs.

Item	10 California LLCs	1 Delaware Series LLC	Savings
Filing Fees—Delaware	N/A	$120	($120)
Filing Fees—California	$1500	$90	$1410
Securities Filing Fee (Corp C §25102(f))	$500	$300	$200
Legal Fees	$15,000	$2500	$12,500
Accounting Fees	$30,000	$5000	$25,000
Minimum Franchise Tax	$8000	$200	$7800
Gross Receipts Fee	$9000	$6000	$3000
Misc. Admin. Costs	$1000	N/A	$1000
TOTAL	$65,000	$14,210	**$50,790**

The annual savings in future years could also be significant as a result of the elimination or reduction of some of the recurring charges, including franchise taxes, gross receipts fees, and accounting fees, as well as the costs associated with dissolving the California entities. Further, streamlining the business's operations into a single LLC would ease the administrative burden of monitoring and maintaining ten separate entities.

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§15.19 G. Equity Compensation Arrangements

When a business owner has discrete lines of business (for example manufacturing, on one hand, and sales and distribution on the other), the series LLC allows management to offer employees equity compensation or incentive arrangements based on the performance of the line of business in which they work. The fundamental purpose of equity compensation arrangements is to motivate employees. Employees are more likely to be motivated when their efforts and their equity compensation are tied directly to the success of the particular series of the LLC comprising their line of business, rather than to the LLC's entire operations.

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§15.20 H. Tax-Free Transfers Within the LLC

Under IRC §1031, an exchange of property solely for property of like kind ordinarily does not result in recognition of gain or loss, and thus avoids the imposition of tax on those who do not liquidate their investments in trade or business property. Several types of property are excluded from eligibility for nonrecognition treatment, including partnership interests. Treas Reg §1.1031(a)-1 states that the exclusion from the nonrecognition rule of IRC §1031(a) applies to exchanges of partnership interests, whether the interests are in the same partnership or in different partnerships.

Implicit in this rule, however, is that a taxable exchange of partnership interests involves some shifting of capital interests. Assume that X and Y form a Delaware series LLC, contributing undeveloped property A and B, thereby creating Series A and Series B. X and Y each own 50 percent of Series A and Series B, and their capital accounts in each series are equal. X should be able to exchange his interest in Series A for Y's interest in Series B on a tax-free basis. Although the exchange would cause the capital associated with each series to shift between members, assuming that the capital interests of the exchanged series are equal, there would be no overall net capital shift from one member to the other, and thus arguably no gain. See IRS Letter Ruling 9821051 (in which the IRS ruled that no tax consequences resulted from an amendment to a partnership agreement that fixed the partners' interests in certain appreciated assets). The exchange should also avoid any documentary transfer tax, because the exchange of interests would not affect title to the properties, which would continue to be held by the LLC, nor the aggregate capital interests in the LLC. Note, however, that if the LLC is not treated as a single entity, the exchange would likely be characterized as an exchange of partnership interests and therefore would not qualify for nonrecognition treatment under IRC §1031.

NOTE: This exchange should also avoid any reassessment under Proposition 13, since the transfer would not be considered a transfer of an "ownership interest" under Rev & T C §64(d), which treats any transfer of 50 percent or more of the ownership interests in an entity as a transfer by the entity, thereby triggering reassessment.

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§15.21 VIII. POTENTIAL PITFALLS

The Delaware series LLC should be respected in California. Corporations Code §17450 [emphasis added] states:

The laws of the state… under which a foreign limited liability company is organized shall govern its organization and internal affairs *and the liability… of its managers and members.*

A foreign limited liability company may not be denied registration by reason of any difference between those laws and the laws of this state.

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§15.22 A. Piercing the Veil

Notwithstanding the clear statutory provisions of the series LLC statutes, such as Corp C §17450 and 6 Del C §18-215, it is conceivable that a California court could determine that the series LLC violates public policy based on the lack of notice to trade creditors (*e.g.,* vendors), particularly in abusive situations. According to one commentator, if a series is operated in a manner truly independent and segregated from other series, there is no greater public policy reason for disregarding the "internal" shields of a series LLC than there is for disregarding the overall shield of an LLC or a corporation. However, when (1) assets or operations are commingled, (2) series are undercapitalized, (3) the conduct or representations of the LLC belie the constructive notice of segregation given in the certificate of formation, or (4) other abusive facts are present, courts can be expected to exercise their equitable powers to "pierce" the walls of the series LLC. See Bishop & Kleinberger, Limited Liability Companies: Tax and Business Law ¶14.06[1][c] (1994).

The piercing-the-veil doctrine is an equitable doctrine, and, as such, courts have discretion in applying it to prevent the members of an LLC from abusing their shield of limited liability. Trade creditors and tort claimants may argue that the LLC failed to provide sufficient notice of the separateness of each series, and therefore the court should exercise its equitable powers to disregard the separate status of each series and apply all of the LLC's assets to satisfy the creditor's claim.

NOTE: Both veil piercing and substantive consolidation (see §15.10) involve disregarding separate corporate structures. However, the two doctrines are intended to remedy two distinct problems. Veil piercing is used to defeat a corporation's limited liability when its shareholders dominate and control the corporation's activities. In contrast, substantive consolidation is intended to redistribute two or more debtors' collective assets when creditors detrimentally relied on the debtors' interconnectedness. Therefore, veil piercing and substantive consolidation are used to remedy two different problems and any analogy between the two is misplaced. *In re Hutco Inc.* (Bankr ED Mo 2003) 302 BR 35.

On its face, a creditor's lack-of-notice argument should fail. Series LLC statutes, such as 6 Del C §18-215(b), generally state that

> the fact that a certificate of formation that contains the… notice of the limitation on liabilities of a series is on file in the office of the Secretary of State shall constitute notice of such limitation on liabilities of a series.

Nevertheless, this author suggests that Delaware series LLCs take all feasible steps to give trade creditors actual notice of the existence of the separate series.

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§15.23 B. Avoiding the Pitfalls

The following are suggestions that a series LLC may use to increase the likelihood that creditors will receive actual notice of the segregated status of a particular series.

- Each series can adopt a fictitious business name (*i.e.*, a "dba") that is different from the registered name of the LLC. For example, if the Smith Family held Blackacre, Whiteacre, and Greenacre in different series in a series LLC, the LLC could file a fictitious business name statement for each of the series (calling them, for example, "Blackacre Properties," Whiteacre Properties," and "Greenacre Properties") in each county in which the respective properties were located. A creditor dealing with Blackacre Properties would have a difficult time establishing a justifiable belief that he or she was dealing with the entire Smith Family LLC in that instance.

- The manager of a series should sign all contracts, deeds, instruments, and other documents on behalf of that series in such a manner as to put the recipient or public at large on notice that the document is being executed solely on behalf of a particular series within a series LLC. The signature block of the contract might look like this:

Smith Family, LLC, Blackacre Series N

By: _____
Manager, Blackacre Series N

- Deeds and deeds of trust to real property should be recorded in the name of the series to provide constructive notice to creditors.

- Each series should be adequately capitalized. There is no rule of thumb to determine with mathematical certainty what dollar amount adequately capitalizes an LLC. Adequate capitalization is determined on a case-by-case basis in view of the size, nature, and reasonably expected hazards and risks of the particular business. See Schinner, *IRS Rulings Expand Opportunities for Using Single-Member LLCs in 1031 Exchanges*, 88 J Tax 286, 289 (May 1998).

- Assets of different series should not be commingled (see discussion above regarding the titling of assets).

- Establish a separate bank account for each series.

- Maintain separate books and records for each series.

- Properly document any loans between series, and prepare resolutions or minutes of the manager or members of each series involved in such loan.

- Ensure that transactions between series are conducted in an arm's length manner at fair market prices. When appropriate, appraisals should be obtained in connection with any sales, leases, and other transfers between series.

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§15.24 C. Multiple Taxable Entities

While the assets of each series within a series LLC are segregated for state law purposes, federal income tax treatment of the series LLC and each of its series remains uncertain. To date, there have not been any published rulings by the IRS relating specifically to a series LLC. Some commentators argue that one must examine the LLC's lines of business and profit-/loss-sharing arrangements to determine if the series within the LLC actually constitutes separate businesses for which separate returns will be required. If this approach is taken, one of the principal benefits of the series LLC is reduced. See, *e.g.,* Stephens & Schultz, *Segregating Assets Within a Single Partnership: Delaware Series Partnerships and LLCs*, 78 Taxes 231 (2000).

When the question of the number and classification of entities has presented itself previously, the case law and rulings have held that separate series of business trusts can be taxed as separate taxpayers. See *National Sec. Series—Industrial Stock Series v Commissioner* (1949) 13 TC 884, acq 1950-1 CB 4; see also Rev Rul 55-416, 1955-1 CB 416. Under these authorities, the analysis focused on the economic independence of each series and the rights of the owners. The private rulings in this area have been predicated on the representations that the holders of interests in each series are limited to the assets of that series on redemption, liquidation, or termination; that the interest holders of a series may share in the income only of that series; that, under state law, the payment of the expenses, charges, and liabilities of each series is limited to that series' assets; and that holders of interests in each series vote separately. See, *e.g.,* IRS Letter Ruling 9847013. See also IRS Letter Ruling 200540010, in which the IRS concluded that a contractual arrangement created a separate entity.

Based on this framework, the treatment of each series would depend on how the series was drafted and structured, giving the taxpayer some flexibility in planning. At one end of the spectrum is a series LLC drafted to mimic the mutual fund business trusts that were the recipients of many private rulings. In this paradigm, each series has separate owners, separate assets, separate voting, and no flow of products or services between them. These series should be considered separate entities for tax purposes. Not only would this result conform to the authorities that have addressed the series business trust, but it would also be consistent with the authorities on partnerships. The court in *Commissioner v Culbertson* (1949) 337 US 733, 742, 93 L Ed 1659, 69 S Ct 1210, required that for a partnership to exist, the parties must act with a business purpose intending to join together in the present conduct of an enterprise. In IRS Letter Ruling 199914006, a two-member LLC was not considered a partnership when one of the members was not entitled to receive any distributions, income, gain, profit, loss, deduction, credit, or other economic benefits from the LLC. Instead, the entity was disregarded and its assets and business were treated as owned by the other member. In the case of the series LLC in the series mutual fund paradigm, the owners of each series are not joining together in a business purpose with the owners of each other series and would not be entitled to receive any distributions, income, gain, profit, loss, deduction, credit, or other economic benefits from the other series. Thus, in the case of a series LLC that has a single member owning and controlling each series, each series would be a separate disregarded entity and the owner of each series would be treated as owning the assets of each series for tax purposes.

At the other end of the spectrum is the series LLC in which all series have identical ownership and management and the activities of the separate series are part of one overall business. An example would be Spa Series LLC with three series, in which each series was owned in identical proportions by the same members and Series A operated the hair studio, Series B operated the skin clinic, and Series C operated the massage facility all in the same building using the same trade marks. The separate series of this LLC should be treated as divisions of one taxable entity. Not only is the entity engaged in one overall business enterprise with common ownership, but the LLC could easily achieve this result by having three wholly owned LLC subsidiaries that would be disregarded for federal income tax purposes.

NOTE: For the very reason that the check-the-box elective regime makes sense, series LLCs falling in between these two extremes should be free to decide whether to file as one or more entities. In fact, the Illinois statute expressly takes this approach: "A series with limited liability shall be treated as a separate entity to the extent set forth in the articles of organization." 805 ILCS 180/37-40(b). Thus, it makes no sense for the classification complexity to resurrect itself for series LLCs. The availability of an elective system will eliminate uncertainty in the gray areas. Nonetheless, the elective system has its limits. In the case of series that have no overlapping ownership, assets, operations, or joint activities, saying that the series are one entity should not make it so. On the other hand, if the series are owned proportionately and share the same assets and activities, having each series elect to be a separate entity should be respected. However, the separate series should be treated as members of an overall partnership.

If the taxpayer desires that all the series of an LLC be taxed as one entity, then commonality of ownership should exist among the members in all of the series of the LLC. In other words, every member should own at least some interest—a conservative number would be at least 10 percent—in each of the series. For example, in a series LLC consisting of Series A, B, and C, and members X, Y, and Z, the ownership interests among each of the series may vary (*e.g.,* Series A: 10 percent, 40 percent, 50 percent; Series B: 1/3, 1/3, 1/3, and Series C: 40 percent, 40 percent, and 20 percent), but each member should own at least 10 percent of the

interest of each of the series. Consistent management structure is another factor supporting single-entity treatment. The series should not be managed by different managers. When a commonality of members and managers exists among each of the series, the IRS should have difficulty overcoming the single-entity treatment.

On the other hand, if separate-entity status is sought for each series, then no reason exists to have overlapping ownership among the series. Each series seeking to be taxed as a separate entity should have distinct assets, distinct operations, distinct governance, and distinct objectives. Given the history of separate-entity treatment in the series investment fund area, the IRS should have difficulty overcoming separate-entity treatment for series that have different assets and different business operations.

A third alternative is that one or more series could be treated as disregarded entities. Clearly, in the case of a series LLC with one owner, the LLC and each of the series should be disregarded. Similarly, each series of a series LLC owned by a single owner should be a disregarded entity for tax purposes.

The series LLC introduces several tax issues at the state level. Will the operations of one series in a given state subject the entire LLC to taxation in that state for unitary tax purposes? Will the California Franchise Tax Board regard a multiseries LLC as a single taxable entity, or will it try to impose a separate gross receipts tax on the earnings of each series of the multiseries LLC? Revenue and Taxation Code §17942(b)(2) allows the FTB to calculate the gross receipts fee based on the total income of a commonly controlled group if it determines that multiple LLCs were formed for the purpose of reducing LLC fees. However, the statute does not contain any provisions that would allow the FTB to treat a series LLC as multiple LLCs for purposes of applying the gross receipts fee. Moreover, the same statute states that only income "derived from or attributable to this state" is subject to the gross receipts fee. Rev & T C §17942(a). Accordingly, it would appear that if only one series of an LLC were conducting business in California, only the income of that series, as opposed to the total income of the entire LLC, should be considered for purposes of calculating the gross receipts fee.

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§15.25 D. California Tax Issues

The application of the California gross receipts fee under Rev & T C §17942, which constitutes a tax, is discussed in §§15.16-15.17.

Another California tax issue is whether the FTB will attempt to assess the $800 minimum franchise tax assessed on LLCs under Rev & T C §17941(a) on each separate series of a Delaware series LLC. The FTB has taken the position that each series is a separate entity for franchise tax purposes, although no statutory basis supports this position.

PRACTICE TIP: Based on conversations with the FTB in which they cited no authority for their assertion, each series should file as a separate LLC and pay the annual tax and total income fees. If the FTB takes this position, then the potential savings from a single series LLC over separate California LLCs described in the chart in §15.18 may be diminished. However, at the federal level the efficiency of generating a single tax return for the series LLC remains in effect.

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§15.26 E. Accounting Issues

An issue arises with regard to the proper accounting treatment for a series LLC. The Delaware LLC Act, for example, provides that if separate series are created, the assets associated with any series must be accounted for separately from the other assets of the LLC, or any other series of LLCs. 6 Del C §18-215(b). Of course, the members and managers of the LLC will want separate accounting records for each series so that the economic performance of each series can be determined, which may trigger allocations of profits and losses and distributions of cash and/or other property. The LLC's managers must also be able to ascertain the activity in each series for purposes of allocating general overhead expenses among the series (such as fees for accounting, legal, and other professional advisors, as well as operating expenses such as rent, filing fees, and taxes).

The LLC will need to issue its members Schedule K-1s so that the members may report their share of the LLC's income and losses on their personal tax returns. The appropriate method of generating each investor's K-1 would be to aggregate each investor's share of the profits and losses from each of the respective series, net all the results, and issue each investor a single K-1. From the investor's perspective, the ease of having to deal with only one K-1 is an attractive feature of the Delaware series LLC.

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§15.27 IX. CONCLUSION

Several states now permit the segregation and insulation of assets in separate series in an LLC. The principal benefit of the multiseries LLC is that it insulates the liability associated with the assets of any one particular series from the assets of the LLC generally, as well as assets held in other series. The ability to place multiple assets in a single LLC, yet insulate the liabilities, eliminates the administrative burden and expense of forming multiple LLCs to hold separate business or investment interests.

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16

Liquidating and Dissolving Limited Liability Companies

Steven M. Fleisher

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.1 I. SCOPE OF CHAPTER

§16.1 I. SCOPE OF CHAPTER

The chapter begins with a review of certain ethical issues an attorney must consider in representing an LLC or any of its members in the dissolution process. The statutory provisions for judicial and nonjudicial dissolution of LLCs are reviewed and compared with procedures under corporate and partnership law. The focus is on dissolution of the entity and not on withdrawal of individual members; that subject is covered in §§6.59-6.60 and 12.83-12.85. Alternatives to dissolution are presented and the effect of dissolution on pre- and postdissolution liabilities is discussed. Continuation of an LLC after dissolution is covered, followed ultimately by a discussion of winding up and terminating the LLC.

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II. ETHICAL ISSUES IN DISSOLUTION AND WINDING UP

A. Conflicts and Confidences

§16.2 1. Comparison With Other Legal Entities

Dissolution and termination of an entity can raise ethical concerns regardless of whether the entity is a partnership, corporation, or LLC. Partnerships present peculiar problems because they are regarded as an entity for some purposes and an aggregate of individuals for other purposes. See ABA Formal Opinion 91-361 (July 12, 1991) regarding representation of partnerships as entities. LLC dissolution issues are more comparable to those of corporations, since both are distinct legal entities, separate from their members or shareholders. However, in small closely held LLCs, many of the practical problems will be similar to those of partnerships.

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§16.3 2. Who Is the Client?

The discussion in this chapter assumes that the attorney is and has been representing the LLC itself. (On representation of individual members of an LLC as well as the entity, see chap 2.) California Rules of Professional Conduct 3-310 and the case law under prior versions of this rule make it clear that there is a hierarchy of duties to consider. Establishing exactly who is being represented will clarify the duties owed and to whom they are owed.

Counsel must avoid dual representation of conflicting interests at all costs. See, *e.g., Woods v Superior Court* (1983) 149 CA3d 931, 197 CR 185, in which the court held that an attorney who had represented a family-owned corporation for many years could not represent the husband in a marriage dissolution proceeding. Control of the corporation was at issue in the marital dissolution and the attorney could not represent either spouse.

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§16.4 3. Protection of Client Confidences

A second critical concept is confidentiality. The duty to guard the confidences and secrets of a client is even broader than the duty to protect the attorney-client privilege. See, *e.g., Goldstein v Lees* (1975) 46 CA3d 614, 120 CR 253. In that case, an attorney who had been former general counsel of a company was prohibited from representing a minority shareholder/director in a proxy fight. Because the attorney had confidential knowledge material to the proxy fight, he could not represent the director, even though the director himself was entitled to access to the same information.

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§16.5 4. Attorney-Client Privilege

A third important ethical issue raised by a dissolution is that of the attorney-client privilege. Generally, if an attorney has been representing a management group, none of the members of the group will be able to assert the privilege against other management group members. See Evid C §962.

Continued representation of the LLC as an entity through dissolution does not normally present a problem. However, prior representation of the entity may disqualify an attorney from representing any of its individual members in a subsequent dissolution proceeding. If the business is to be continued after dissolution, the attorney must clarify his or her role: Is it to represent the entity only, or to represent a member or group of members? This concern is particularly important when the attorney has previously represented one or more of the members individually. A full, written disclosure by counsel, signed by the members, is essential.

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§16.6 B. Prior Conflict Waiver Agreements

Some attorneys obtain advance consents from members of a closely held entity (partnership, corporation, or LLC) when they have a prior or existing relationship with one of the principals. The consent provides that the attorney will represent the entity, but in the event of a dispute among the principals, it provides that the attorney will be able to continue to represent "his" or "her" individual client. For an analysis of the effect of such a waiver and the standards for enforcing it, see *Zador Corp. v Kwan* (1995) 31 CA4th 1285, 37 CR2d 754.

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§16.7 C. Waiver Standards

Conflicts in representation can be waived. However, due to the fiduciary relationship of attorney and client and the high standard of conduct imposed on that relationship by the courts, counsel should obtain a proper waiver and ensure that it follows Rules of Professional Conduct guidelines strictly. The more specific the information provided in the waiver, including disclosure of potential harm, the more likely it is that the waiver will be found valid. See *Zador Corp. v Kwan* (1995) 31 CA4th 1285, 37 CR2d 754. See also *Visa U.S.A., Inc. v First Data Corp.* (ND Cal 2003) 241 F Supp 2d 1100.

Sanctions for failing to obtain a proper waiver include professional discipline, disqualification, loss of fees earned, and malpractice liability. The attorney should therefore pay particular attention to Cal Rules of Prof Cond 3-310, 3-300, 3-600 and 3-700. The seminal law review article in the area is *Developments in the Law—Conflicts of Interest in the Legal Profession*, 94 Harv L Rev 1244 (1981).

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III. DISSOLUTION OF AN LLC

§16.8 A. Statutory Dissolution Events

Corporations Code §17350 provides that an LLC shall be dissolved and its affairs wound up on the happening of the first to occur of the events listed in §§16.9-16.12.

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§16.9 1. At Time Specified in Articles

An LLC may dissolve at the time, if any, stated in its articles of organization. Corp C §§17051(c)(3), 17350(a). A specific date for termination of an LLC may be important to investors or members who want assurance that the specific activity of the LLC will be for a limited duration. Before its expiration, the dissolution date may be amended or deleted. See §7.17.

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§16.10 2. On Event Specified in Articles or Operating Agreement

An LLC may dissolve on the happening of events specified in the articles of organization or written operating agreement. Corp C §17350(a). This provision is particularly useful in LLCs undertaken for a specific venture or project. For example, on the development and sale of a real estate project or the completion of a concert tour, the members can be assured that the LLC established for that particular purpose will be dissolved and wound up. The provision may also specify a condition such as gross sales or net profits being below a certain minimum for a designated period of time.

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§16.11 3. By Majority Vote

Dissolution can commence on the vote of a majority in interest of the members (or a greater percentage of voting interests if specified in the articles or operating agreement) (Corp C §17350(b)). A provision allowing dissolution by a designated vote of members is an important escape valve for unforeseen conditions. Depending on the level of vote required in the articles or operating agreement, the members can regulate the degree of access to this opportunity. The operating agreement cannot withdraw the right of members to vote on dissolution (Corp C §§17005(b)(3), 17103(c)), but it can increase the vote from majority up to unanimity. Corp C §17350(b).

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§16.12 4. On Decree of Judicial Dissolution

An LLC may dissolve on the entry of a decree of judicial dissolution in a court action initiated by a manager or member under Corp C §17351. Corp C §17350(c). See §16.13.

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§16.13 B. Judicial Dissolution

Any manager or member may bring a court action for a decree of dissolution under certain circumstances; the following grounds for judicial dissolution cannot be modified in the articles or operating agreement (Corp C §§17005(c), 17351(a)):

(1) It is not reasonably practicable to carry on the business in conformity with the articles or operating agreement. Corp C §17351(a)(1). This provision is similar to provisions for judicial dissolution of general partnerships (Corp C §16801(5)(C)) and limited partnerships (Corp C §15908.02(a)).

(2) Dissolution is reasonably necessary for the protection of the rights or interests of the complaining members. Corp C §17351(a)(2). This provision finds counterparts in provisions relating to limited partnerships (Corp C §15908.03(d)(2)) and corporations with 35 or fewer shareholders (Corp C §1800(b)(5)). This provision is broader in scope than the "not reasonably practicable" standard mentioned in (1) above.

(3) The LLC is being abandoned. Corp C §17351(a)(3). Parallel language relating to corporations is found in Corp C §1800(b)(1). In the event the LLC has ceased operating, this provision can be utilized to obtain a formal judicial dissolution and winding up.

(4) The management of the LLC is deadlocked or subject to internal dissension. Corp C §17351(a)(4). Similar language relating to corporations is found in Corp C §1800(b)(2)-(3). However, it is striking that Corp C §1800(b)(2)-(3) contains additional express requirements before its provisions can be invoked, such as internal dissension resulting in the inability to carry on business or the failure at two consecutive annual meetings to elect successor directors. In contrast, Corp C §17351(a)(4) states merely that internal dissension or a deadlock must exist without the necessity of satisfying any further specific requirements. See also *Bauer v Bauer* (1996) 46 CA4th 1106, 54 CR2d 377; *Buss v J.O. Martin Co.* (1966) 241 CA2d 123, 50 CR 206.

(5) Parties in control have been guilty of, or knowingly permitted, persistent and pervasive fraud, mismanagement, or abuse of authority. Corp C §17351(a)(5). This provision is also paralleled in Corp C §15908.03(d)(2), relating to limited partnerships, and in Corp C §1800(b)(4), relating to corporations. Similar acts may give rise to judicial dissolution of a general partnership if the court finds that another partner has engaged in conduct relating to the partnership business that makes it not reasonably practicable to carry on the business in partnership with that partner. Corp C §16801(5)(B).

Thus, while the Beverly-Killea Limited Liability Company Act's provisions for judicial dissolution of LLCs are similar to those for dissolution of partnerships and corporations, they also appear to be broader and more liberal. It is likely, however, that the courts will employ the body of case law dealing with the dissolution of limited partnerships and corporations. See, *e.g., Dickson v Rehmke* (2008) 164 CA4th 469, 474, 78 CR3d 874. In any event, the other members of the LLC may avoid judicial dissolution by purchasing the interests of the members initiating the proceeding at their fair market value in a statutory buyout. See §16.14.

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§16.14 C. Statutory Buyout to Avoid Dissolution

In provisions similar to the law for corporations (Corp C §2000), the Beverly-Killea Limited Liability Company Act provides a means through which the interests of complaining members in a court action for judicial dissolution are purchased by the noncomplaining members. See Corp C §17351(b). If the noncomplaining members seek to pursue this option but are unable to come to an agreement with the moving parties on the value of the latter's interests, they may post a bond and apply to the court either in the pending dissolution action or in an independent proceeding initiated in superior court for a stay of the dissolution proceeding, at which point the court "shall proceed to ascertain and fix" the fair market value of the interest of the moving parties. Corp C §17351(b)(3). The court must appoint three appraisers, and make an order referring the matter to these appraisers for the purpose of ascertaining that value. The order shall also prescribe the time and manner of producing evidence. The unanimous or majority award of the appraisers is final and conclusive on all parties on its confirmation by the court. The court must thereafter enter a decree that alternately directs the winding up and dissolution to proceed unless payment for the membership interests is tendered within the time specified by the decree. If the purchasing parties do not tender payment by the deadline, the court must enter judgment on their bond for the moving parties' expenses (including legal fees). Corp C §17351(b)(3). Any member aggrieved by the court's action (*i.e.,* the issuance of the alternative decree) may appeal. *Dickson v Rehmke* (2008) 164 CA4th 469, 474, 78 CR3d 874.

The absence of either a unanimous or majority appraisers' award does not render Corp C §17351's procedures inapplicable. It is, after all, the court that ascertains and fixes the fair market value of the membership interests. Nor does the appraisers' award bind the trial court; the court is free to select among conflicting opinions or decide the matter de novo. 164 CA4th at 474.

One significant difference is the Act's omission of a provision stating that the fair market value should be determined on the basis of liquidation value (taking into account the possibility, if any, of the sale of the business as a going concern in a liquidation). The omission of this provision from the Act may have some effect on valuation analysis of LLCs. See *Brown v Allied Corrugated Box Co.* (1979) 91 CA3d 477, 154 CR 170 (minority discounts under Corp C §2000). See also *Trahan v Trahan* (2002) 99 CA4th 62, 120 CR2d 814 (value of uncompleted contracts not included in liquidation value under Corp C §2000).

Damages resulting from the initiation of a judicial action in breach of any agreement with the purchasing parties, including the LLC's operating agreement, may be deducted from the purchase price. If an appraisal is required, the purchasing parties must post a bond of adequate security to pay estimated expenses (including attorney fees) of the parties seeking the dissolution. Corp C §17351(b)(2).

The bond may be recovered if the purchasing parties do not make payment for the membership interests as specified in the court order. However, a member suing for dissolution of the LLC on the grounds of abandonment, deadlock, or bad conduct cannot be assessed damages under this section. Corp C §17351(b)(1).

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D. Alternatives to Dissolution

§16.15 1. Negotiated Withdrawal and Redemption

In some instances, there may be one or more members or managers who either demand dissolution or are a cause of dissension; this situation often leads others to demand dissolution of the LLC. It may be possible to negotiate the purchase of their interests and the withdrawal of those members or managers from the LLC. A well-drafted operating agreement will contain provisions concerning the buyout of members' interests. See chap 9. Any redemption payment made by the LLC must be proper under Corp C §17254, limiting redemptions. For comparable provisions concerning corporate redemptions, see Corp C §§500-511. A negotiated withdrawal may contain provisions prohibiting competition under Bus & P C §16602.5.

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§16.16 2. Expulsion or Removal

The operating agreement can provide for the expulsion of a member on designated terms. It is important that the terms and conditions for expulsion or removal of a member be carefully stated because such provisions are likely to lead to litigation. Because of the fiduciary obligations of members, the expulsion of a member must be in good faith and in accordance with the terms of the agreement. See Corp C §17153. It is likely that law similar to that utilized in partnership circumstances will apply. See Corp C §16601(3). Note that Corp C §17100(c) gives a member the right to challenge the terms of an operating agreement governing termination of a member's interest, but only on grounds that it was unreasonable at the time the agreement was made. This right cannot be abridged. Corp C §17005(b)(2). Counsel should therefore take care to ensure that expulsion provisions in the operating agreement are reasonable and fair.

NOTE: Managers may be removed by the vote of a majority in interest of the members at a meeting called expressly for that purpose. Removal may be with or without cause, but without prejudice to any contractual rights the manager may have. Corp C §17152(b).

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§16.17 3. Renegotiated Operating Agreement

This alternative is self-explanatory and will depend in part on the requirements under the operating agreement for its amendment. Amendments must, at a minimum, be authorized by a majority in interest of the members. Corp C §17103(b). This cannot be reduced. Corp C §17005(b)(3).

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§16.18 4. Alternative Dispute Resolution

Alternative dispute resolution, including mediation and arbitration, has become common. If the members want alternative dispute resolution procedures to be available, the operating agreement should so provide. While individual practitioners' experience varies, mediation may be a very helpful and inexpensive means of resolving developing disputes. It does require the good faith of the parties to be effective. A member may, in a written operating agreement or other writing, consent to nonexclusive jurisdiction in another state or exclusive jurisdiction in California—generally, or for arbitration in particular. Corp C §17061(f)-(g). If the arbitration provision in the operating agreement is broad enough, claims for dissolution may be subject to resolution by arbitration. See *Larkin v Williams, Woolley, Cogswell, Nakazawa & Russell* (1999) 76 CA4th 227, 90 CR2d 195.

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§16.19 5. Conversion to Manager-Managed LLC

Another alternative to dissolution of a member-managed LLC is to obtain agreement that certain designated persons shall become manager-members, and that others who have been participating in management will agree to withdraw from that activity. The articles of organization will have to be amended to indicate manager, rather than member, management. Corp C §§17051(a)(6), 17151(b).

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E. Related Procedures

§16.20 1. Inspection Rights Enforcement

If the alternatives discussed in §§16.15-16.19 are not appropriate or effective to resolve problems, counsel may consider other procedures. Corporations Code §17106 provides a variety of inspection rights to members, managers, and holders of economic interests in an LLC. While not quite as broad as the unlimited rights of access of a director or of a general partner, an LLC member's information rights are much broader than those of a shareholder or limited partner. See Corp C §§1600, 15903.04, 15904.07(h). Note that under Corp C §17005(b)(4), neither the articles of organization nor the operating agreement may vary a member's rights under this provision or the parallel provision for members of a foreign LLC. See Corp C §17453. A member is entitled to obtain a list of names and addresses of all members and holders of economic interests (assignees who are not members), a statement of their contributions, the profit share of each, the name and address of each manager, and the LLC's tax returns for the last 6 years.

NOTE: This information is to be provided at the LLC's expense on showing a purpose reasonably related to the member's or holder's interest in the LLC. Additional records kept under Corp C §17058 must be made available for inspection and copying at the LLC's office, including:

- The articles of organization, all amendments, and any powers of attorney related to them;
- The operating agreement, all amendments to it, and any powers of attorney under which the operating agreement and any amendments were executed;
- Financial statements, if any, for the 6 most recent fiscal years; and
- Books and records related to the "internal affairs" of the LLC for the 4 past fiscal years.

Expanded information and inspection rights are available to LLCs with more than 35 members. Corp C §17106(c). See §13.17.

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§16.21 2. Rescission

General contract law provides for rescission of an agreement obtained by fraud, duress, or undue influence. See CC §1689.

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§16.22 3. Class and Derivative Actions

Members of domestic and foreign LLCs can bring class or derivative actions on behalf of all the members of a class to enforce a common claim by those members. Class actions are governed by the general class action rules of CCP §378. Corp C §17500. However, Corp C §17501 sets forth certain requirements that must be met before any member may institute or maintain a derivative action. In larger LLCs, consideration of such actions may be appropriate in lieu of dissolution.

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§16.23 4. Actions by the Attorney General

Under certain limited circumstances, the Attorney General may bring actions on behalf of or for the benefit of members of limited liability companies. See Corp C §§17107, 17457. Except for the largest LLCs, this step is not likely to be a satisfactory remedy.

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F. Effect of Dissolution

§16.24 1. On Agreements

Generally, an LLC's dissolution will have no effect on the validity of its existing agreements or on its obligation to perform them. However, members must be aware of agreements (often used when a partnership is a party to such agreements) that provide that dissolution is an event of default.

Under Corp C §17354(a), once dissolution has occurred, the LLC is not to continue in business except for the purposes of winding up its affairs. However, unless a party to a contract had actual knowledge of the dissolution, any postdissolution contract entered into by the LLC would be enforceable against it. See Corp C §17157(a). In manager-managed LLCs, *only* a manager has authority to enter into agreements and bind the LLC. Only *if* the manager had no authority for the specific transaction *and* the other party was aware of that lack of authority would the transaction not be binding. Corp C §17157(b). Presumably, members would have a claim against a manager who entered into agreements after dissolution that were not necessary for winding up the affairs of the LLC.

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§16.25 2. On Creditors

Unlike partnerships, in which dissolution can have an effect on creditors, the obligations of an LLC to its creditors are unchanged by dissolution. However, dissolution may constitute a default under certain agreements; see §16.24. Creditors' rights after dissolution are discussed in §16.30. Three or more creditors, as well as any manager or any member, can petition the court for a decree ordering that the winding up of an LLC be done under judicial supervision. Corp C §17352(b). The decree is required to set forth the managers or members who will do the winding up of the LLC's affairs.

The Tenth Circuit has held that a dissolved LLC cannot thereafter file for bankruptcy. The entity ceased to exist on dissolution; therefore, it was not an eligible debtor. *In re Midpoint Dev.* (10th Cir 2006) 466 F3d 1201.

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§16.26 3. On Pending Actions

The occurrence of an event of dissolution has no effect on a pending action to which the LLC is a party. Corp C §17354(b).

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§16.27 4. On Tax Issues

Dissolution can have significant tax consequences, including termination for tax purposes under IRC §708 and liability for liquidation distributions.

On tax consequences, see §§5.86-5.90.

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IV. CONTINUATION AFTER DISSOLUTION

§16.28 A. Agreement to Continue

An event of dissolution does not inevitably mean the LLC will soon cease to exist. Notwithstanding an event of dissolution, the members of the LLC may agree to continue the business of the LLC.

It is advisable to put any decision to continue the business of the LLC in writing. The writing should recite at least the following:

- The event(s) giving rise to the dissolution;
- The parties to the resolution (the remaining members) and their vote consistent with the terms of the operating agreement; and
- A statement of the agreement to continue the business of the LLC.

The effect of an agreement to continue the LLC is to void the dissolution. If a Certificate of Dissolution has already been filed, the LLC must file a Certificate of Continuation. See §16.29.

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§16.29 B. Certificate of Continuation; Voiding Certificate of Dissolution

The Beverly-Killea Limited Liability Company Act provides a method for retroactively voiding a Certificate of Dissolution once it has been filed. See §16.63. Notwithstanding the filing of a Certificate of Dissolution (Secretary of State Form LLC-3; see §16.64), a majority in interest of the members may agree to the filing of a Certificate of Continuation (Secretary of State Form LLC-8; see §16.65). Corp C §17357. The certificate must state that one of the following circumstances has occurred:

(1) Remaining members of the LLC have unanimously voted to continue the business;

(2) The dissolution was under Corp C §17350(b) and each member who consented to dissolution has agreed in writing to revoke his, her, or its vote agreeing to the dissolution; or

(3) The LLC was not, in fact, dissolved.

The filing of the Certificate of Continuation completely voids the Certificate of Dissolution "from the time of the filing." Corp C §17357(c). No time limit is specified in Corp C §17357 for filing the Certificate of Continuation.

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§16.30 C. Rights of Creditors

Because LLC members have no individual liability unless they have signed a personal guaranty or other voluntary consent to be liable for LLC obligations, the rights of creditors continue as they would with a corporate entity. That is, in the absence of an agreement creating personal liability, creditors may look only to the assets of the LLC, not those of its members. If there has been a significant delay before the continuation has been legitimated, however, and creditors have exercised some of the rights discussed in §§16.36-16.40, the LLC may have difficulty extricating itself from the creditors' proceedings, particularly if prejudice can be shown.

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§16.31 D. Rights of Former Members

Unlike a partnership, in which there is personal liability among the general partners, the limitation on members' liability in an LLC means that many of the complex problems involving rights of former partners in dissolved partnerships simply do not arise. Members are entitled to the appropriate payment for their interests in the LLC under the terms of the operating agreement, unless the member seeking to invalidate the provision establishes that it was unreasonable under the circumstances existing at the time the agreement was made. Corp C §17100(c). Under certain circumstances, creditors may seek the return of distributions made to former members. See §16.38.

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§16.32 E. New Members

Restructuring that occurs in an LLC that continues after dissolution may require the inclusion of new members. This may be an occasion for renegotiation of certain provisions of the operating agreement. At the very least, the new members should give written assent to the terms of the existing operating agreement. Any applicable securities laws must be complied with. See chap 12.

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V. WINDING UP OF AN LLC

§16.33 A. Filing of Certificate

Once dissolution has occurred, the managers, or members if there are no managers, are obligated to file a Certificate of Dissolution (Secretary of State Form LLC-3; see §16.64). Corp C §17356(a)(1). On the details of the certificate, see §16.63.

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§16.34 B. Responsible Persons

Managers who have not wrongfully dissolved the LLC or members, if there are no managers, can wind up the LLC's affairs unless there is a judicial dissolution. Corp C §17352(a). If the operating agreement does not specify the individual responsible for winding up, it is important that the person delegated responsibility for that task confirm his or her authority immediately. Confirmation should be in writing with the acknowledgment of at least all the managers and, in smaller LLCs, all of the members. If the operating agreement is not sufficiently detailed in this respect, or if circumstances have substantially changed since the preparation of the operating agreement, a dissolution and winding up agreement may be in order. See §§16.43-16.62. In the event of a dispute, a manager, member, or three or more creditors can petition the court to supervise the winding up for the protection of any parties in interest. If judicial supervision is shown to be necessary, the court will designate the individual(s) responsible for winding up. Corp C §17352(b).

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§16.35 C. Duties in Winding Up

Individuals responsible for winding up have a fiduciary obligation to the remaining members under Corp C §§17153 and 17150 (depending on whether the winding up is by a manager or a member). The person(s) in charge of winding up must:

- File the Certificate of Dissolution (Corp C §17356(a));
- Send a written notice of the commencement of the winding up by mail to all known creditors and claimants who appear on the records of the business (Corp C §17352(a)); and
- Ensure that all LLC debts have been paid or adequately provided for. Corp C §17353(c).

NOTE: Effective September 29, 2006, AB 2341 amended California law to eliminate the requirement that a terminating LLC obtain a Tax Clearance Certificate from the Franchise Tax Board.

The notification requirement is noteworthy because the specific obligation to notify creditors is not provided by law either for limited or general partnerships. The General Corporation Law (GCL) has provisions for notice to creditors in involuntary dissolutions. Corp C §§1806-1807. In voluntary corporate dissolutions, the certificate of dissolution must state that provisions have been made for all of the corporation's known debts and liabilities, but there is no specific obligation of notification. Corp C §1905(a)(2). See *Gateway Structure, Inc. v Carpenters* (ND Cal 1987) 681 F Supp 1437; *Hartman v Hollingsworth* (1967) 255 CA2d 579, 63 CR 563.

The individuals winding up the affairs of the LLC are entitled to reasonable compensation except as otherwise provided in the articles of organization or a written operating agreement. If the operating agreement does not specify how that compensation will be calculated, the dissolution and winding up agreement should (see §16.46). In addition to the filing and notice formalities, winding up includes payment of creditors and distribution of the LLC's assets to its members.

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D. Creditors' Rights and Remedies

§16.36 1. Provision for Debts

One of the obligations of the individual(s) winding up an LLC is to make sure that all debts and liabilities have been paid or adequately provided for. Corporation Code §17353(c) defines this obligation, whether the creditor's whereabouts is known or not, as (1) having a financially responsible individual assume or guarantee such obligation in good faith, or (2) depositing the amount of the obligation with the State Controller as provided in Corp C §2008. The statute also states that these methods are not the exclusive means of adequately providing for debts and liabilities. Therefore, a creditor whose obligation has not been paid should be able to seek redress either from the deposit with the State Controller or by means of the individual who guaranteed or assumed the liability.

Typically, the individual(s) winding up the LLC will seek to reach a compromise with its creditors as part of the winding up process. In some instances, an individual guarantor will have to step forward if litigation is to be avoided. An LLC with large debts and limited assets may need to consider bankruptcy. In situations when there are few assets and no concern about the personal liability of the members (including claims for improper distributions; see §§6.32-6.33, 16.38), bankruptcy may not be necessary. The LLC can dissolve and make appropriate filings with the Secretary of State. The risk posed to members is that a creditor will seek relief under Corp C §17353(c), which requires that all creditors' claims be adequately provided for in the winding up. Members with significant personal assets may prefer to insist on a bankruptcy filing.

An LLC that has been dissolved continues to exist not only to wind up its affairs, but also to defend actions against it concerning its obligations and the disposition and conveyancing of its property and other assets. Corp C §17354(a).

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§16.37 2. Enforcement of Contribution Rights

An individual who has a claim against an LLC may enforce contribution obligations of LLC members that have not been fulfilled, provided the contribution obligation was not compromised before the date on which the claim arose. Corp C §17201(b)(2).

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§16.38 3. Recovery of Improper Distributions

Individuals with claims against an LLC that is winding up may enforce the obligation of a member or the assignee of a member to return distributions that were improper under Corp C §17254. In terms partially similar to limited partnership obligations under Corp C §15905.08(b), a distribution is improper if, when made, the LLC would not be able to pay its debts in the usual course of business or the LLC's total assets would be less than the sum of its total liabilities, plus amounts needed to satisfy superior preferential rights of other members. Individual members and their assignees are obligated to return a distribution if they or their assignees had actual knowledge that it was improperly made, and after making it the LLC's liabilities, with certain exceptions, exceeded the fair market value of its assets, subject again to certain exclusions. Corp C §17254(e). There is a 4-year statute of limitations from the date of distribution on such claims. Corp C §17254(f).

In addition to obligations of members and assignees of members to return distributions, a member or manager who votes for a distribution in violation of the operating agreement (see Corp C §17254) or in violation of rules governing provisions for creditors in dissolution (see Corp C §17353) is personally liable to the LLC for the amount by which the distribution exceeds that which could be properly made. Corp C §17255(a). A member or manager found liable under Corp C §17255 may be entitled to compel contributions from other culpable members or managers who had knowledge of facts indicating the improper distribution. There is also a 4-year statute of limitations from the date of the distribution for claims under this section. Corp C §17255(c).

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§16.39 4. Litigation

The Beverly-Killea Limited Liability Company Act provides several avenues for claims against a dissolved LLC, whether the claims arise before or after dissolution. Claims may be enforced against the dissolved LLC to the extent of its undistributed assets, including insurance assets, and against members, to the extent LLC assets have been distributed to them as part of the dissolution. Corp C §17355(a)(1). Members compelled to return assets in excess of their pro rata share may be able to seek contribution from other members or managers. The statute of limitations for such claims is the lesser of 4 years from the date of dissolution or the expiration of the statute of limitations applicable to the cause of action. Corp C §17355(a)(2)(A)-(B).

As a matter of procedure only, members of dissolved LLCs may be sued in the name of the limited liability company on any claim against the company. This is separate from rights of creditors under Corp C §§17254-17255 or any potential fraudulent conveyance claims. Summons can be served on a manager, a member, a person in charge of its assets, or on the appropriate showing of diligence, the Secretary of State.

An LLC has perpetual existence for the purpose of being sued in a quiet title action. Corp C §17355(c).

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§16.40 5. Sales Tax Liability

Any officer—member or manager—or any person charged with filing or supervising the filing of a sales tax return, including those responsible for winding up, may be personally liable for any unpaid tax and interest in penalties, if that person willfully fails to pay taxes due from the LLC. Rev & T C §6829. This personal liability is limited to periods when the individual had control or supervision. Rev & T C §6829(b). Willful failure to make payment means simply an intentional, conscious, and voluntary course of conduct. Rev & T C §6829(d).

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E. Distributions

§16.41 1. Priorities

Corporations Code §17353 impliedly establishes a distribution priority once liabilities to creditors, including members, have been satisfied. However, it is unclear in its intent, listing first the rights and preferences to members in satisfaction of liabilities for distributions under Corp C §17201, 17202, or 17255, none of which involve any liabilities that would not have been already satisfied as a part of the liabilities to creditors, *including members*. Implied is that there would be a first priority to reimburse a member who has made a contribution on behalf of a defaulted capital contribution obligation of another member and a reimbursement to a member who has been required to restore a distribution made by the LLC because the member voted in favor of the distribution with knowledge that it was improper. Otherwise, the provisions duplicate the next priority, to return capital contributions, and then divide the balance in accordance with capital contributions, repeating in each instance that all this is variable if the operating agreement has provided otherwise.

Distribution is normally dealt with in detail in the operating agreement. See chap 9. Distributions in kind are permitted in dissolution. Corp C §17253(c).

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§16.42 2. Court-Supervised Winding Up

If a winding up is supervised by the court, distributions may not be made until the expiration of any period for presentation of claims that has been prescribed in a court order. Corp C §17353(b).

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F. Form: Dissolution and Winding Up Agreement

§16.43 1. Form: Heading and Preamble

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.43-1 Heading and preamble

DISSOLUTION AND WINDING UP AGREEMENT
OF
_ _[*NAME OF COMPANY*]_ _,
A CALIFORNIA LIMITED LIABILITY COMPANY

This Dissolution and Winding Up Agreement ("Agreement") is entered into on _ _[*date*]_ _**, among** _ _[*names of members*]_ _ **and** _ _[*name of company*]_ _ **("Company"), a California limited liability company, with regard to the following facts:**

Comment: This agreement is intended to present important issues that should be addressed in the dissolution and winding up of an LLC. It is not intended to be merely a form to fill in. In many instances, some or all of these issues will have been addressed in the operating agreement. This agreement is designed for a smaller, member-managed domestic LLC. Counsel should make appropriate changes for a manager-managed LLC.

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§16.44 2. Form: Recitals

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.44-1 Recitals

A. _ _[*Names of members*]_ _ are all of the members of the Company, a California limited liability company. Company is member managed. Company was formed on _ _[*date*]_ _, and a Form LLC-1 was filed on _ _[*date*]_ _. The members executed an Operating Agreement dated _ _[*specify date*]_ _. The Operating Agreement _ _[*has/has not*]_ _ been modified since that date.

B. _ _[*State here the reason(s) for dissolution consistent with the Articles and Operating Agreement. State effective date of dissolution*]_ _.

C. The members of the Company wish to provide for the winding up and termination of the Company under the terms of this Agreement.

Comment: These recital statements will be conclusive between the parties. Evid C §622.

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§16.45 3. Form: Effective Date and Cessation of Business

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16.45-1 Effective date and cessation of business

The dissolution will be effective as of _ _[*date*]_ _. From and after that date, the Company will conduct no business except as necessary for winding up the affairs of the Company.

Comment: In some instances the parties can control the effective date—*e.g.,* by choosing when to dissolve—and it may be advantageous to do so. The effectiveness of certificates filed with the Secretary of State can be delayed for up to 90 days. Corp C §17056(c).

PRACTICE TIP: In December 2006, the Secretary of State's office issued a clarification regarding future file dates and future effective dates. To summarize, a *future file date* is a request for the Secretary of State to hold a document and file on a future date not more than 90 days from the date of submission. A *future effective date* is a request for the Secretary of State to file a document on receipt, but with a future effective date not more than 90 days from the date of submission. To request a future file date or future effective date, the counter sheet or transmittal letter must include instructions specifying the type of request.

To request a future file date: Include instructions on the counter sheet, *e.g.,* : "Please file on _____."

To request a future effective date: Include instructions on the counter sheet specifying the file date, the future effective date and the applicable code section, *e.g.,* "Under Corporations Code section ____, please file on ____ with a future effective date of ____." The document itself must also contain the future effective date.

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§16.46 4. Form: Appointment of Liquidating Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.46-1 Appointment of liquidating member

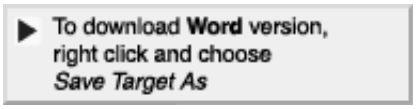
_ _[*Name*]_ _ is appointed as the Liquidating Member exclusively responsible for winding up and terminating the Company. _ _[*He/She*]_ _ will ensure that all statutory and contractual obligations of the Company are performed before termination. No other member may act for or on behalf of the Company after this date or participate in its management and control. As compensation for the performance of these duties, the Liquidating Member will receive the sum of _ _[*dollar amount*]_ _, on _ _[*describe when*]_ _. If the Liquidating Member fails to perform his or her duties, then _ _[*specify consequences*]_ _. These funds will be considered an expense of the Company in winding up and will not be charged to the capital account of _ _[*name*]_ _. If the Liquidating Member is unable, refuses, or fails to perform the designated duties, _ _[*name of successor member*]_ _ will succeed the Liquidating Member and will complete _ _[*his/her*]_ _ designated duties.

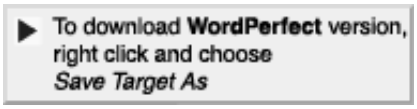
Comment: It is crucial that one or more individuals be designated as liquidating member, to be responsible for winding up. In manager-managed LLC's, the manager(s) not wrongfully causing the dissolution conduct the winding up; if the LLC is member managed, winding up is conducted by the members. Corp C §17352(a). The responsible party is entitled to reasonable compensation for these services except as otherwise provided in the articles of organization or operating agreement. It is also wise to provide for a successor in the event the designated person cannot perform winding up duties. Counsel should describe how compensation will be handled if the initial responsible person is replaced.

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§16.47 5. Form: Powers of Liquidating Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62





16.47-1 Powers of liquidating member

The Liquidating Member will have authority to wind up the business of the Company, including full power and authority to:

(a) Sell, transfer, hypothecate, pledge, or otherwise encumber or dispose of all the Company's assets, in whole or part, including but not limited to its goodwill and its name, for cash or a cash equivalent at a price and on terms that the Liquidating Member will deem necessary or appropriate to accomplish an orderly and timely liquidation of the Company _ _[*at the best price and*]_ _ on the best terms available.

(b) Represent and act on behalf of the Company in all matters affecting it during the winding up period, including the power to engage professional and technical services of others (including without limitation, accountants, attorneys, appraisers, brokers, and auctioneers), and to institute and defend any legal proceedings that may be brought by or pending against the Company.

(c) Prepare, execute, file, record, and publish on behalf of the members and the Company any agreements, documents, or instruments connected with the dissolution and winding up of the business and affairs of the Company.

(d) Pay or otherwise settle or discharge all of the debts, liabilities, and other obligations of the Company.

(e) Distribute any Company assets, including the proceeds of any sale of assets, remaining after payment of debts, liabilities, and other obligations, to members in accordance with their respective interests.

(f) Take all other action necessary, appropriate, or incidental to the foregoing powers or to the performance of the duties of the Liquidating Member under this Agreement.

[*Add if appropriate*]

[(g)] Agree, in connection with the sale of the assets of the Company as a going concern, to limit the right of any or all of the members to compete with the purchaser in the _ _[*specify type of business*]_ _ business for a period not to exceed _ _[*number*]_ _ years in the following _ _[*counties/cities/(describe other territorial limitations)*]_ _: _ _[*list*]_ _

[*Continue*]

The Liquidating Member will use _ _[*his/her*]_ _ best efforts to complete liquidation of the Company by _ _[*date*]_ _ (the "Termination Date").

[*Add if appropriate*]

If all the assets have not been sold or contracted for sale by the _ _[*e.g., 60th*]_ _ day preceding the Termination Date, the Liquidating Member will obtain an appraisal of the fair market value _ _[*number*]_ _ of the remaining assets, if this has not already been done, and develop a plan ("the Plan") for distribution of the assets in kind to the members on the basis of their respective membership interests in the Company. Notwithstanding this appraisal or Plan, the Liquidating Member may sell any or all of the remaining assets before the Termination Date in accordance with this Agreement, and may revise the Plan at a time and in a manner that the Liquidating Member considers to be in the members' best interests.

[*Continue*]

The Liquidating Member will submit the Plan, as revised, to the members not less than _ _[*number*]_ _ days before the Termination Date. Approval of the Plan by a majority in interest of the members will be required to authorize the distribution of assets in kind by the Liquidating Member according to the Plan. In the event the members do not approve the Plan and no alternative plan is approved by the members before the Termination Date, the Liquidating Member will take whatever action is appropriate or required to obtain supervision of the balance of the winding up process by a court of competent jurisdiction.

On the Termination Date, the Liquidating Member will have authority to execute any deeds, bills of sale, or other conveyance by and for the Company that will be necessary or appropriate to evidence or effect the transfer of the remaining assets to the members according to the Plan.

Comment: Note that effective January 1, 2007, Bus & P C §16601, governing noncompete agreements in connection with the sale of a business as a going concern, was amended to specifically extend to series LLCs formed under the laws of a jurisdiction that recognizes them. On series LLCs, see chap 15.

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§16.48 6. Form: Duties of Liquidating Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.48-1 Duties of liquidating member

The Liquidating Member will devote such time as _ _[*he/she*]_ _ deems necessary to liquidate the Company in the manner provided in this Agreement. In addition, the Liquidating Member will:

(a) Report in writing to the other members at least _ _[*monthly/weekly*]_ _ the action taken toward liquidation of the Company business, including specific reports on the disposition of any Company assets and the proceeds of the disposition.

(b) Arrange for an independent, certified public accountant to observe a complete physical inventory of the Company assets as of the date of dissolution.

(c) Notify each of the Company's known creditors (including suppliers with unpaid accounts) of the Company's dissolution and the lack of authority of nonliquidating members.

(d) Prepare, file, publish, and record in a timely manner all appropriate agreements, documents, and instruments, including federal and state tax returns, to reflect the dissolution and termination of the Company and the cessation of the use of its name; obtain any necessary or desirable permits or other authorizations; to the extent required by law, cancel any existing authorizations, licenses, or permits; and resolve or dispose of other matters related to the dissolution in a manner required by law or consistent with the purposes of this Agreement.

In the performance of these duties, the Liquidating Member will act diligently, honestly, and in good faith and will account to the Company for any benefit or profits derived from transactions connected with the liquidation.

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.49 7. Form: Indemnification of Liquidating Member

§16.49 7. Form: Indemnification of Liquidating Member

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.49-1 Indemnification of liquidating member

The members, jointly and severally, will indemnify and hold the Liquidating Member harmless from all losses, claims, expenses, damages, liabilities, or obligations of any kind (including legal fees and expenses) arising from or connected with the winding up and liquidation of the Company and the performance of _ _[*his/her*]_ _ duties under this Agreement, except for losses, claims, expenses, damages, liabilities, or obligations (including legal fees and expenses) arising from the Liquidating Member's breach of _ _[*his/her*]_ _ obligations under this Agreement or willful misconduct, or breach of _ _[*his/her*]_ _ other obligations as a member.

Comment: Members in member-managed LLCs owe the other members the same fiduciary duties as partners in a general partnership. Corp C §§17150, 17153. Fiduciary obligations may be modified with the members' informed consent. Corp C §17005(d). It is important that the liquidating member file certificates of dissolution (Corp C §17356(a)) and cancellation (Corp C §17356(b)), file a final annual tax return (Rev & T C §17947), and pay any sales tax due.

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§16.50 8. Form: Payment of Creditors

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.50-1 Payment of creditors

The Liquidating Member will determine all known debts and liabilities, including obligations due to members, and make adequate provision for their payment. Payment is deemed adequately provided for, whether the creditor's whereabouts are known or unknown, when:

(a) The payment has been assumed or guaranteed in good faith by one or more financially responsible persons who have been selected with reasonable care by the Liquidating Member to be adequate at the time of any distribution; or

(b) The amount of the debt has been deposited as provided in Corporations Code §2008.

The Liquidating Member may provide for payment of creditors by other reasonable means.

Comment: Corporations Code §17353(c) prescribes these procedures.

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§16.51 9. Form: Distributions

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.51-1 Distributions

After providing for the payment of all debts and obligations, the Liquidating Member will distribute the remaining assets of the Company to the members in the following order of priority: (a) first, in satisfaction of distributions under Corporations Code §§17201, 17202, or 17255; (b) second, to the members for the return of their contributions; and (c) third, to members in the proportion in which they share in distributions.

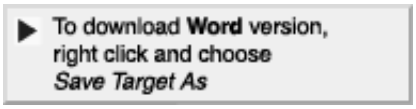
Comment: These are the Beverly-Killea Limited Liability Company Act's default provisions. See Corp C §17353. Usually, the operating agreement will state the terms of distribution on winding up. Distribution provisions have significant tax implications. See chap 5. To the extent the members are concerned about complying with safe harbor tax regulations for partnership distributions, different language will be required, focused on positive capital account balances. See §§5.37-5.41.

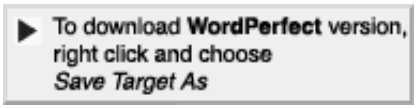
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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.52 10. Form: Obligations of Members

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The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62





16.52-1 Obligations of members

During the winding up, each member will pay any remaining unpaid capital contribution or prior distribution that must be returned under Corporations Code §17254 or §17255.

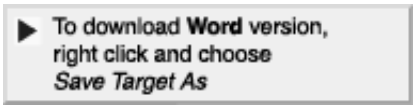
Comment: Under the circumstances described in Corp C §§17254-17255, members must return certain prior distributions. Also, unpaid capital contributions must be paid. Corp C §17201. Creditors may pursue members for these funds.

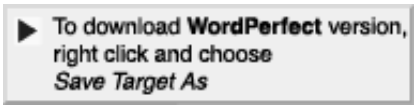
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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.53 11. Form: Release of Claims

§16.53 11. Form: Release of Claims

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62





16.53-1 Release of claims

Each member hereby releases each of the other members and the Company from all known claims arising under the operating agreement, except as stated elsewhere in this Agreement _ _[*or in the Company's financial statements dated _ _ _/attached Schedule _ _, incorporated here by this reference*]**_ _.**

[*Add language of Corporations Code §1542 waiver if desired*]

Comment: The above provision should not be included without the informed consent of the members.

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§16.54 12. Form: Mutual Representations

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16.54-1 Mutual representations

Each member represents and warrants to each of the other members that _ _[*except as stated in the Company's books and reflected in the Company's financial statements dated _ _ _/attached Schedule _ _, incorporated by reference in this dissolution agreement*]**_ _, (a) the member has not incurred any obligation or liability on behalf of or as apparent agent of the Company or the other members, or for which the member or any other member may be charged, or for which the member intends to claim refund or reimbursement from the Company, and (b) the member has not received, discharged, or transferred any credit, money, property, or other assets of the Company. These representations and warranties will survive the final termination of the Company.**

Comment: Like partners in a partnership, in member-managed LLCs, the members have authority to bind the company. See Corp C §17157. That authority makes the foregoing provision useful.

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§16.55 13. Form: Disputed Matters

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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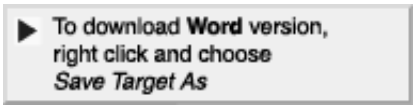
16.55-1 Disputed matters

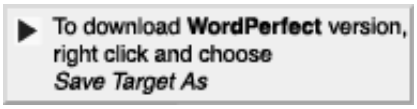
Except as otherwise provided in this Agreement, any controversy or dispute arising out of this Agreement, the interpretation of any of its provisions, or the action or inaction of any member under it will be submitted to arbitration in _ _[*location*]_ _, California before _ _[*designate entity*]_ _, under the commercial arbitration rules then in force for that organization. Any award or decision obtained from that arbitration proceeding will be final and binding on the members, and judgment on any award thus obtained may be entered in any court having jurisdiction. No action at law or in equity based on any claim arising out of or related to this Agreement will be instituted in any court by any member except (a) an action to compel arbitration under this provision, or (b) an action to enforce an award obtained in an arbitration proceeding in accordance with this provision.

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§16.56 14. Form: Retention of Records

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62





16.56-1 Retention of records

After termination of the Company, _ _[*the Liquidating Member/the Company's independent auditors*]_ _ will retain custody of the Company's books and records for a period of six years. Each member will have access to those books and records at reasonable times during normal business hours. Documents may be copied at the member's expense.

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.57 15. Form: Successors

§16.57 15. Form: Successors

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16.57-1 Successors

This agreement will benefit and be binding on the respective heirs, executors, administrators, legatees, distributees, devisees, representatives, assignees, and other successors of each member.

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§16.58 16. Form: Notices

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.58-1 Notices

All notices, requests, demands, and other communications under this Agreement will be in writing, and will be deemed to have been duly given on the date of delivery if personally delivered to the person to whom notice is to be given, or on the _ _[*e.g., third*]_ _ day after mailing if mailed to the person to whom notice is to be given by first class mail, postage prepaid, and properly addressed to that person's last known address shown in the Company's records or such other address as may be set forth in a written notice of change of address received by the Liquidating Member.

Comment: For discussion of notice provisions, see Drafting Business Contracts: Principles, Techniques & Forms §§17.3-17.4 (Cal CEB 1994).

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.59 17. Form: Governing Law

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16.59-1 Governing law

This Agreement will be governed by and construed in accordance with the laws of the state of California.

Comment: For discussion of choice of law provisions, see Drafting Business Contracts: Principles, Techniques & Forms §§16.55-16.56 (Cal CEB 1994).

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.60 18. Form: Entire Agreement

§16.60 18. Form: Entire Agreement

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16.60-1 Entire agreement

This Agreement constitutes the entire agreement of the parties concerning the dissolution, winding up, and termination of the Company. No prior negotiations, agreements, or representations will be of any further force or effect.

Comment: Additional provisions may be appropriate, such as a provision for disposition of life insurance, if any; a power of attorney if there is a large number of members; and a cooperation clause regarding execution of other documents. For discussion of other boilerplate provisions, see Drafting Business Contracts: Principles, Techniques & Forms, chap 17 (Cal CEB 1994).

Integration or merger clauses are covered in Drafting Contracts §§17.11-17.12.

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§16.61 19. Form: Execution

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16.61-1 Execution

In witness whereof, the members and the Company have duly executed and delivered this Agreement on the day and year written above.

_ _[*Name of company*]_ _

By __[*Signature of liquidating member*]__
Liquidating Member

__[*Signatures of all other members*]__

[*Add, if corporation is a member*]

_ _[*Name of corporation*]_ _
By __[*Signature of officer*]__
_ _[*Title of officer*]_ _

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§16.62 20. Form: Consent of Spouse or Registered Domestic Partner

The form text in this section is part of a larger form. For your convenience, downloading any one of the sections included in the form will download the entire form. The form begins in §16.43 and ends in §16.62

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16.62-1 Consent of spouse or registered domestic partner

In consideration of the execution of the foregoing Agreement by the other members in _ _[*name of company*]**_ _, I, _ _**[*name of member's spouse or domestic partner*]**_ _, spouse or domestic partner of _ _ _ _ _ _, a member, do join with him or her in executing this Agreement and agree to be bound by its terms in lieu of any marital or statutory rights as a domestic partner to which I might otherwise be entitled.**

Dated: _ _ _ _ _ _ __[*Signature of spouse or domestic partner*]__
_ _[*Typed name*]_ _

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G. Mechanics and Formalities of Winding Up

§16.63 1. Certificate of Dissolution

On dissolution, the individuals responsible for the winding up must file a certificate of dissolution (Secretary of State Form LLC-3; see §16.64) unless the dissolution was by a vote of all of the members of the LLC and the appropriate box is checked on the certificate of cancellation of articles of organization (Form LLC-4/7; see §16.67). Corp C §17356(a). There is no fee for filing this certificate. The certificate sets forth the name and file number of the LLC and any other information the manager or member filing the certificate wishes to include. The certificate of dissolution may have a future effective date that is not more than 90 days after filing the certificate. The effective date should be indicated in a cover letter. The signature on the form on behalf of the LLC may be transmitted by facsimile if the form is submitted for filing to the Secretary of State by mail or by hand. Corp C §17.1(c). See §7.24.

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.64 2. Form: Limited Liability Company Certificate of Dissolution (Secretary of State Form LLC-3)

§16.64 2. Form: Limited Liability Company Certificate of Dissolution (Secretary of State Form LLC-3)



LLC-3

State of California
Secretary of State

LIMITED LIABILITY COMPANY
CERTIFICATE OF DISSOLUTION

NOTE: The domestic limited liability company must also file a Certificate of Cancellation (Form LLC-4/7) to complete the cancellation process.

There is no fee for filing a Certificate of Dissolution.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

FILE NUMBER	**ENTITY NAME** (Enter the exact name of the domestic limited liability company.)
1. Secretary of State File Number	2. Name of Limited Liability Company

ADDITIONAL INFORMATION (Enter any other information the managers or members filing the Certificate of Dissolution determine to include. Attach additional pages, if necessary. Additional information set forth on attached pages, if any, is incorporated herein by this reference and made part of this certificate. If no other information is to be included, leave Item 3 blank and proceed to Item 4.)

3.

EXECUTION

4. I declare I am the person who executed this instrument, which execution is my act and deed.

Signature of Authorized Person — Date — Type or Print Name and Title of Authorized Person

Signature of Authorized Person — Date — Type or Print Name and Title of Authorized Person

RETURN TO (Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.)

5. NAME [ ]

FIRM

ADDRESS

CITY/STATE/ZIP [ ]

Print

INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF DISSOLUTION (FORM LLC-3)

For easier completion, this form is available on the Secretary of State's website at http://www.ss.ca.gov/business and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered. This form is only filed in the Sacramento office.

It is recommended for proof of submittal that if Form LLC-3 is mailed to the Secretary of State, it be sent by Certified Mail with Return Receipt Requested.

Statutory filing provisions are found in California Corporations Code section 17356.

- Form LLC-3 **is required** when the vote to dissolve was made by less than 100 percent of the members. To complete the cancellation process the limited liability company (LLC) must also file a Certificate of Cancellation (Form LLC-4/7) pursuant to Section 17356(b). Note: The Articles of Organization of the LLC will not be cancelled until Form LLC-4/7 is filed.
- Form LLC-3 **is not required** when the vote to dissolve was made by 100 percent of the members and a statement to that effect is indicated on Form LLC-4/7.
- It is recommended that legal counsel be consulted prior to submitting cancellation documents to ensure that all issues are appropriately addressed.

FEES: There is no fee for filing Form LLC-3. However, there is a $15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at http://www.ss.ca.gov/business/precexp.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

COPIES: The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the $8.00 per copy certification fee.

Complete Form LLC-3 as follows:

Item 1. Enter the file number issued by the California Secretary of State.

Item 2. Enter the name of the limited liability company exactly as it is of record with the California Secretary of State, including the entity ending.

Item 3. Enter any other information the managers or members filing Form LLC-3 determine to include. Attach additional pages, if necessary. If no other information is to be included, leave Item 3 blank and proceed to Item 4.

Item 4. Form LLC-3 should be signed by an authorized person, i.e., manager.

- If Form LLC-3 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of person)."
- If Form LLC-3 is signed by an entity, the person who signs on behalf of the entity should note their name and position/title, the exact entity name and the entity's relation to the dissolving limited liability company. Example: If a limited liability company ("Smith LLC") is the manager of the dissolving limited liability company, the signature of the person signing on behalf of Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Manager.
- If Form LLC-3 is signed by a trust, the trustee should sign as follows: _____, trustee for _____ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

Item 5. Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.65 3. Form: Limited Liability Company Certificate of Continuation (Secretary of State Form LLC-8)

§16.65 3. Form: Limited Liability Company Certificate of Continuation (Secretary of State Form LLC-8)



State of California
Secretary of State

LIMITED LIABILITY COMPANY
CERTIFICATE OF CONTINUATION

A $30.00 filing fee must accompany this form.
IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

1. Secretary Of State file number:

2. Name of the limited liability company:

3. The grounds for filing this Certificate of Continuation for this limited liability company are:

[ ] The business of the limited liability company is to be continued pursuant to unanimous vote of the remaining members.

[ ] The dissolution of the limited liability company was by vote of the members pursuant to subdivision (c) of Section 17350 and each member who consented to the dissolution has agreed in writing to revoke his or her vote in favor of or consent to the dissolution.

[ ] The limited liability company was not, in fact, dissolved.

4. **Declaration:** It is hereby declared that I am the person who executed this instrument, which execution is my act and deed.

Signature of Authorized Person

Type or Print Name and Title of Authorized Person

Date

5. **RETURN TO:**

NAME

FIRM

ADDRESS

CITY/STATE

ZIP CODE

Print

INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF CONTINUATION (LLC-8)

- Upon filing the Certificate of Continuation (LLC-8), the Certificate of Dissolution (LLC-3) will be of no effect from the time of the filing of the Certificate of Dissolution (LLC-3).
- The Certificate of Continuation (LLC-8) may become effective not more than ninety (90) days after filing the certificate. If such a future effective date is desired, indicate in a cover letter the month, day, and year upon which the Certificate is to become effective. (Section 17056(c)).

DO NOT ALTER THIS FORM

Type or legibly print in black ink.

- Attach the fee for filing the Certificate of Continuation (LLC-8) with the Secretary of State. The fee is thirty dollars ($30).
- Make check(s) payable to the Secretary of State.
- Send the executed document and filing fee to:

California Secretary of State
Document Filing Support Unit
P.O. Box 944228
Sacramento, CA 94244-2280

- Fill in the items as follows:

Item 1. Enter the file number issued by the California Secretary of State.

Item 2. Enter the name of the limited liability company as filed with the California Secretary of State.

Item 3. Check the reason for the continuation of the limited liability company.

Item 4. The Certificate of Continuation (LLC-8) must be executed with an original signature.

If the Certificate of Continuation (LLC-8) is signed by an entity, the person who signs for the entity must note the exact entity name, his/her name and his/her position/title.

If an attorney-in-fact is signing the Certificate of Continuation (LLC-8), the signature must be followed by the words "Attorney-in-fact for (name of person)."

If the Certificate of Continuation (LLC-8) is signed by a trust, the certificate must be signed by a trustee as follows:
_____, trustee for _____trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5/1/94).

Item 5. Enter the name and address of the person or firm to whom a copy of the filing should be mailed.

- Statutory provisions can be found in Section 17357 of the California Corporations Code, unless otherwise indicated.
- For further information contact the Business Filings Section at (916) 657-5448.

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4. Filing Certificate of Cancellation

§16.66 a. Required and Discretionary Information

A certificate of cancellation (Secretary of State Form LLC-4/7; see §16.67) must be filed when the winding up is complete. Corp C §17356(b)(1). The signature on the form on behalf of the LLC may be transmitted by facsimile if the form is submitted for filing to the Secretary of State by mail or by hand. Corp C §17.1(c). There is no fee for the filing of this certificate. The certificate requires the name of the LLC and the file number of the Secretary of State, an indication of whether a certificate of dissolution is required (see §16.63), and any other information the manager or member filing the certificate wishes to include. Under some circumstances, the inclusion of additional information on this certificate may be useful as a form of notice. There are no provisions obligating individuals to check the certificates, but statements made on them may be valuable for memorialization of certain facts relating to the dissolution and cancellation.

As of September 29, 2006, the certificate of cancellation is required to include the following statement:

> A final franchise tax return, as described by Section 23332 of the Revenue and Taxation Code, or a final annual tax return, as described by Section 17947 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.67 b. Form: Limited Liability Company Certificate of Cancellation (Secretary of State Form LLC-4/7)

§16.67 b. Form: Limited Liability Company Certificate of Cancellation (Secretary of State Form LLC-4/7)



LLC-4/7

State of California
Secretary of State

LIMITED LIABILITY COMPANY
CERTIFICATE OF CANCELLATION

There is no fee for filing a Certificate of Cancellation.

IMPORTANT – Read instructions before completing this form.

This Space For Filing Use Only

FILE NUMBER	**ENTITY NAME** (Enter the exact name of the limited liability company.)
1. Secretary of State File Number	2. Name of Limited Liability Company

TAX LIABILITY (The following statement should not be altered.)

3. A final franchise tax return, as described by Section 23332 of the Revenue and Taxation Code, or a final annual tax return, as described by Section 17947 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

DISSOLUTION (Domestic limited liability companies ONLY: Check the "YES" or "NO" box, as applicable. Note: If the "NO" box is checked, a Certificate of Dissolution (Form LLC-3) pursuant to Corporations Code section 17356(a) must be filed prior to or together with this Certificate of Cancellation.)

4. The dissolution was made by a vote of all of the members. ☐ YES ☐ NO

ADDITIONAL INFORMATION (Enter any other information the managers or members filing the Certificate of Cancellation determine to include. Attach additional pages, if necessary. Additional information set forth on attached pages, if any, is incorporated herein by this reference and made part of this certificate. If no other information is to be included, leave Item 5 blank and proceed to Item 6.)

5.

EXECUTION

6. I declare I am the person who executed this instrument, which execution is my act and deed.

Signature of Authorized Person	Date	Type or Print Name and Title of Authorized Person
Signature of Authorized Person	Date	Type or Print Name and Title of Authorized Person

RETURN TO (Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.)

7. NAME [ ]

FIRM

ADDRESS

CITY/STATE/ZIP [ ]

Print

INSTRUCTIONS FOR COMPLETING THE CERTIFICATE OF CANCELLATION (FORM LLC-4/7)

For easier completion, this form is available on the Secretary of State's website at http://www.ss.ca.gov/business and can be viewed, filled in and printed from your computer. The completed form can be mailed to Secretary of State, Document Filing Support Unit, P.O. Box 944228, Sacramento, CA 94244-2280 or delivered in person to the Sacramento office, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. If you are not completing this form online, please type or legibly print in black or blue ink. This form should not be altered. This form is only filed in the Sacramento office.

It is recommended for proof of submittal that if Form LLC-4/7 is mailed to the Secretary of State, it be sent by Certified Mail with Return Receipt Requested.

Statutory filing provisions are found in California Corporations Code section 17356 (domestic limited liability companies) or 17455 (registered foreign limited liability companies).

- Domestic LLC: Form LLC-4/7 must be filed after or together with a Certificate of Dissolution (Form LLC-3) pursuant to Section 17356(a). However, if all the members vote to dissolve, only Form LLC-4/7 is required.
- Upon filing Form LLC-4/7, the LLC will be cancelled and the powers, rights and privileges will cease in California.
- It is recommended that legal counsel be consulted prior to submitting cancellation documents to ensure that all issues are appropriately addressed.

FEES: There is no fee for filing Form LLC-4/7. However, there is a $15.00 special handling fee for processing a document delivered in person to the Sacramento office. The special handling fee must be remitted by separate check for each submittal and will be retained whether the document is filed or rejected. The preclearance and/or expedited filing of a document *within a guaranteed time frame* can be requested for an additional fee (in lieu of the special handling fee). Please refer to the Secretary of State's website at http://www.ss.ca.gov/business/precexp.htm for detailed information regarding preclearance and expedited filing services. The special handling fee or preclearance and expedited filing services are not applicable to documents submitted by mail. Check(s) should be made payable to the Secretary of State.

COPIES: The Secretary of State will certify two copies of the filed document(s) without charge, provided that the copies are submitted to the Secretary of State with the document(s) to be filed. Any additional copies submitted will be certified upon request and payment of the $8.00 per copy certification fee.

Complete Form LLC-4/7 as follows:

Item 1. Enter the file number issued by the California Secretary of State.

Item 2. Enter the name of the limited liability company exactly as it is of record with the California Secretary of State, including the entity ending.

Item 3. This statement should not be altered. For information regarding final tax returns, contact the Franchise Tax Board at (800) 852-5711 (from within the U.S.) or (916) 845-6500 (from outside the U.S.) or visit their website at http://www.ftb.ca.gov.

Item 4. Domestic limited liability companies only - check the appropriate box. NOTE: If the dissolution was not made by the vote of all the members, a Certificate of Dissolution (Form LLC-3) must be filed prior to or together with Form LLC-4/7.

Item 5. Enter any other information the managers or members filing Form LLC-4/7 determine to include. Attach additional pages, if necessary. If no other information is to be included, leave Item 5 blank and proceed to Item 6.

Item 6. Form LLC-4/7 should be signed by an authorized person, i.e., manager.

- If Form LLC-4/7 is signed by an attorney-in-fact, the signature should be followed by the words "Attorney-in-fact for (name of person)."
- If Form LLC-4/7 is signed by an entity, the person who signs on behalf of the entity should note their name and position/title, the exact entity name and the entity's relation to the canceling limited liability company. Example: If a limited liability company ("Smith LLC") is the manager of the canceling limited liability company, the signature of the person signing on behalf of Smith LLC should be reflected as Joe Smith, Manager of Smith LLC, Manager.
- If Form LLC-4/7 is signed by a trust, the trustee should sign as follows: _____, trustee for _____ trust (including the date of the trust, if applicable). Example: Mary Todd, trustee of the Lincoln Family Trust (U/T/A 5-1-94).

Item 7. Enter the name and the address of the person or firm to whom a copy of the filed document should be returned.

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Source: Business Law/Forming and Operating California Limited Liability Companies/16 Liquidating and Dissolving Limited Liability Companies/§16.68 5. Fictitious-Name Abandonment

§16.68 5. Fictitious-Name Abandonment

If the LLC is operated under a fictitious name, an abandonment should be filed and published under Bus & P C §17922. Except as possible evidence of termination, little consequence flows from failure to file the abandonment.

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§16.69 6. Bulk Sales Notice

If part of the winding up involves sales subject to the bulk sales provisions of Com C §§6101-6111, an appropriate bulk sales notice may need to be filed. See California UCC Sales and Leases, chap 14 (Cal CEB 2002).

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§16.70 7. Cancellation of Recorded Certified Copy of Articles of Organization

LLCs are allowed to record in the office of the county recorder a certified copy of the LLC's articles of organization that have been filed in the Secretary of State's office. Similarly, a foreign LLC may record in the county recorder's office a certified copy of the LLC's application for registration, certificate of registration, or any amendment to it that has been filed with the Secretary of State. Corp C §17052(f). On dissolution, the person in charge of dissolution should cancel any such statement recorded with a county recorder's office.

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§16.71 8. Final Considerations

Winding up involves many details. Clearly, the most important activities are the satisfaction of outstanding obligations and the distribution of the LLC's assets to its members. It is critical that the individuals responsible for winding up, and their counsel as well, keep careful calendars of all events. If there are insufficient assets to satisfy all creditors' claims, careful attention should be paid to members' potential liabilities under Corp C §§17201, 17254, 17255, and 17353. The propriety of prior distributions should be examined as well as the risk of litigation by creditors seeking to recover those distributions. In some situations, filing for bankruptcy may need to be considered. It is unlikely that any individual will be willing to assume liabilities for the purpose of dissolution under such circumstances.

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Appendix A

Long-Form Operating Agreement

▶ To download **Word** version, right click and choose *Save Target As*

▶ To download **WordPerfect** version, right click and choose *Save Target As*

OPERATING AGREEMENT for _ _[*NAME*]_ _, _ _[*e.g., LLC/a limited liability company*]_ _

A. This operating agreement is entered into as of _ _[*date*]_ _ **by** _ _[*names*]_ _ **(referred to individually as a Member and collectively as the Members).**

[*Use one of the following alternatives*]

[*Alternative 1: LLC not yet formed*]

B. The Members desire to form a limited liability company (Company) under the Beverly-Killea Limited Liability Company Act.

C. The Members enter into this Agreement to form and provide for the governance of the Company and the conduct of its business, and to specify their relative rights and obligations.

[*Alternative 2: LLC already formed by filing articles of organization*]

B. The Members have formed a limited liability company under the Beverly-Killea Limited Liability Company Act. The Articles of Organization of the Company filed with the California Secretary of State on _ _[*date*]_ _**, are adopted and approved by the Members.**

C. The Members enter into this Agreement to provide for the governance of the Company and the conduct of its business, and to specify their relative rights and obligations.

[*Continue*]

Now therefore, the Members agree as follows:

ARTICLE I: DEFINITIONS

Capitalized terms used in this Agreement have the meanings specified in this Article or elsewhere in this Agreement and when not so defined will have the meanings set forth in California Corporations Code §17001.

1.1. "Act" means the Beverly-Killea Limited Liability Company Act (California Corporations Code §§17000-17656), including amendments from time to time.

1.2. "Adjusted Capital Contribution" is defined in Article IV, Section 4.6(a).

1.3. "Adjusted Capital Account Deficit" is defined in Article IV, Section 4.3(a).

1.4. "Affiliate" of a Member or Manager means any Person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Member or Manager. The term "control" (including the terms "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a Person, whether through membership, ownership of voting securities, by contract, or otherwise.

1.5. "Agreement" means this operating agreement, as originally executed and as amended from time to time.

1.6. "Articles of Organization" is defined in Corporations Code §17001(b) as applied to this Company.

1.7. "Assignee" means a Person who has acquired a Member's Economic Interest in the Company, by way of a Transfer in accordance with the terms of this Agreement, but who has not become a Member.

1.8. "Assigning Member" means a Member who by means of a Transfer has transferred an Economic Interest in the Company to an Assignee.

1.9. "Available Cash" means all net revenues from the Company's operations, including net proceeds from all sales, refinancings, and other dispositions of Company property that the Manager, in the Manager's sole discretion, deems in excess of the amount reasonably necessary for the operating requirements of the Company, including debt reduction and Reserves.

1.10. "Book Adjustments" means, for any item of Company property for a given fiscal year, adjustments with respect to Book Value for depreciation, cost recovery, or other amortization deduction or gain or loss computed in accordance with Treasury Reg §1.704-1(b)(2)(iv)(g), including Book Depreciation.

1.11. "Book Depreciation" means, for any item of Company property for a given fiscal year, a percentage of depreciation or other cost recovery deduction allowable for federal income tax purposes for that item during that fiscal year equal to the result (expressed as a percentage) obtained by dividing (1) the Gross Asset Value of that item at the beginning of the fiscal year (or the acquisition date during the fiscal year) by (2) the federal adjusted tax basis of the item at the beginning of the fiscal year (or the acquisition date during the fiscal year). If the adjusted tax basis of an item is zero, the Manager may determine Book Depreciation, provided that he or she does so in a reasonable and consistent manner.

1.12. "Capital Account" means, with respect to any Member, the account reflecting the capital interest of the Member in the Company, consisting of the Member's initial Capital Contribution maintained and adjusted in accordance with Article III, Section 3.5.

1.13. "Capital Contribution" means, with respect to any Member, the amount of money _ _[*, or services rendered or to be rendered,*]_ _ and the fair market value of any property contributed to the Company (net of liabilities secured by the contributed property that the Company is considered to assume or take "subject to" under IRC §752) in consideration of a Percentage Interest held by that Member. A Capital Contribution will not be deemed a loan.

1.14. "Capital Event" means a sale or disposition of any of the Company's capital assets, the receipt of insurance and other proceeds on account of an involuntary conversion of Company property, the receipt of proceeds from a refinancing of Company property, or a similar event with respect to Company property or assets.

1.15. "Company" means the company named in Article II, Section 2.2 of this Agreement.

1.16. "Company Minimum Gain" is defined in Article IV, Section 4.3(b).

1.17. "Confidential Information" is defined in Article X, Section 10.2.

1.18. "Corporations Code" ("Corp C") means the California Corporations Code.

1.19. "Economic Interest" means a Person's right to share in the income, gains, losses, deductions, credit, or similar items of the Company, and to receive distributions from the Company under this Agreement or under the Act, but does not include any other rights of a Member, including the right to vote, the right to participate in the management of the Company, or, except as provided in Corp C §17106, any right to information concerning the business and affairs of the Company.

1.20. "Electronic transmission by the Company" and "electronic transmission to the Company" have the meanings set out in Corp C §17001(o)(1)-(2).

1.21. "Encumber" means the act of creating or purporting to create an Encumbrance, whether or not perfected under applicable law.

1.22. "Encumbrance" means, with respect to any Membership Interest, or any part of it, a mortgage, pledge, security interest, lien, proxy coupled with an interest (other than as contemplated in this Agreement), option, or

preferential right to purchase.

1.23. "Gross Asset Value" means, for any item of property of the Company, the item's adjusted basis for federal income tax purposes, except as follows:

(a) The initial Gross Asset Value of any item of property contributed by a Member to the Company will be the fair market value of that property, as mutually agreed by the contributing Member and the Company;

(b) The Gross Asset Value of any item of Company property will be adjusted as of the following times: (1) the acquisition of an interest or additional interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (2) the distribution of money or other property (other than a de minimis amount) by the Company to a Member as consideration for an Economic Interest in the Company; and (3) the liquidation of the Company within the meaning of Treasury Reg §1.704-1(b)(2)(ii)(g), provided, however, that adjustments under clauses (1) and (2) above will be made only if the Members have determined that the Company must revalue its assets in accordance with Treasury Reg §1.704-1(b)(2)(iv)(f);

(c) The Gross Asset Value of any Company asset distributed to any Member will be the book value of that asset on the date of distribution; and

(d) The Gross Asset Value of Company assets will be increased (or decreased) to reflect any adjustments to the adjusted tax basis of those assets under IRC §734(b) or 743(b), subject to the limitations imposed by IRC §755 and only to the extent that those adjustments are taken into account in determining Capital Accounts under Treasury Reg §1.704-1(b)(2)(iv)(m), and if the Gross Asset Value of an asset has been determined or adjusted under paragraph (a), (b), or (d) of this Section 1.23, that Gross Asset Value will thereafter be adjusted by the Book Adjustments, if any, taken into account for the asset for purposes of computing Profits and Losses.

1.24. "Initial Members" means those Persons whose names are set forth _ _[*in the first sentence of/in Exhibit A to***]_ _this Agreement.**

1.25. "Involuntary Transfer" means, with respect to any Membership Interest, or any part of it, any Transfer or Encumbrance, whether by operation of law, under court order, foreclosure of a security interest, execution of a judgment or other legal process, or otherwise, including a purported transfer to or from a trustee in bankruptcy, receiver, or assignee for the benefit of creditors.

1.26. "IRC" means the Internal Revenue Code of 1986, as amended, and any successor provision.

1.27. "Losses." See Article IV, Section 4.2.

1.28. "Majority of Members" means a Member or Members whose Percentage Interests represent more than 50 percent of the Percentage Interests of all the Members.

1.29. "Manager" means the Person named in Article II, Section 2.9, or the Person who from time to time succeeds any Person as a Manager and who, in either case, is serving at the relevant time as a Manager.

1.30. "Member" means an Initial Member or a Person who otherwise acquires a Membership Interest, as permitted under this Agreement, and who has not ceased to be a Member under Article VIII or for any other reason.

1.31. "Member Nonrecourse Debt" is defined in Article IV, Section 4.3(c).

1.32. "Member Nonrecourse Debt Minimum Gain" is defined in Article IV, Section 4.3(d).

1.33. "Member Nonrecourse Deductions" is defined in Article IV, Section 4.3(e).

1.34. "Membership Interest" means a Member's entire interest and rights in the Company, collectively, including the Member's Economic Interest, any right to Vote or participate in management, and any right to information concerning the business and affairs of the Company.

1.35. "Nonrecourse Deductions" is defined in Article IV, Section 4.3(f).

1.36. "Nonrecourse Liability" is defined in Article IV, Section 4.3(g).

1.37. "Notice" means a notice in writing required or permitted under this Agreement. A notice will be deemed given or sent when deposited, as certified mail or for overnight delivery, postage and fees prepaid, in the United States mails; when delivered to Federal Express, United Parcel Service, DHL WorldWide Express, or Airborne Express, for overnight delivery, charges prepaid or charged to the sender's account; when personally delivered to the recipient; when transmitted by electronic transmission by or to the Company (see §1.20); or when delivered to the home or office of a recipient in the care of a person whom the deliverer has reason to believe will promptly communicate the notice to the recipient.

Addresses for the purpose of giving notice are as follows:

_ _[*Name of party*]_ _: _ _[*address*]_ _ _ _[*e-mail*]_ _ _ _[*fax number*]_ _

_ _[*Name of party*]_ _: _ _[*address*]_ _ _ _[*e-mail*]_ _ _ _[*fax number*]_ _

_ _[*Name of party*]_ _: _ _[*address*]_ _ _ _[*e-mail*]_ _ _ _[*fax number*]_ _

Any correctly addressed notice that is refused, unclaimed, or undeliverable because of an act or omission of the party to be notified will be deemed effective as of the first date that the notice was refused, unclaimed, or deemed undeliverable by the postal authorities, messenger, or overnight delivery service.

Any party may change its address, electronic mail address, or fax number by giving the Manager Notice of the change.

1.38. "Percent of the Members" means the specified total of Percentage Interests of all the Members.

1.39. "Percentage Interest" means a fraction, expressed as a percentage, the numerator of which is the total of a Member's Capital Account and the denominator of which is the total of all Capital Accounts of all Members.

1.40. "Person" means an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign.

1.41. "Profits" and "Losses" are defined in Article IV, Section 4.2.

1.42. "Proxy" has the meaning set forth in the first paragraph of Corp C §17001(ai). A Proxy may not be transmitted orally.

1.43. "Regulations" ("Reg" or "Treasury Reg") means the income tax regulations promulgated by the United States Department of the Treasury and published in the Federal Register for the purpose of interpreting and applying the provisions of the Code, as those Regulations may be amended from time to time, including corresponding provisions of applicable successor regulations.

1.44. "Reserves" means the aggregate of reserve accounts that the Manager, in the Manager's sole discretion, deems reasonably necessary to meet accrued or contingent liabilities of the Company, reasonably anticipated operating expenses, and working capital requirements.

1.45. "Successor in Interest" means an Assignee, a successor of a Person by merger or otherwise by operation of law, or a transferee of all or substantially all of the business or assets of a Person.

1.46. "Tax Item" means each item of income, gain, loss, deduction, or credit of the Company.

1.47. "Tax Matters Partner" means the Person designated under Article VI, Section 6.6.

1.48. "Transfer" means any sale, assignment, gift, Involuntary Transfer, Encumbrance, or other disposition of a Membership Interest or any part of a Membership Interest, directly or indirectly, other than an Encumbrance that is expressly permitted under this Agreement.

1.49. "Triggering Event" is defined in Article VIII, Section 8.4.

1.50. "Vote" means a written consent or approval, a ballot cast at a meeting, or a voice vote.

1.51 "Voting Interest" means, with respect to a Member, the right to Vote or participate in management and any right to information concerning the business and affairs of the Company provided under the Act, except as limited by the provisions of this Agreement. A Member's Voting Interest will be directly proportional to that Member's Percentage Interest.

1.52. "Writing" includes any form of recorded message capable of comprehension by ordinary visual means, and when used to describe communications between the Company and its Members, "writing" will include electronic transmissions by and to the Company as defined in Corp C §17001(o)(1)-(2).

1.53. "Written" or "in writing" includes facsimile and other electronic communication authorized by the Corporations Code.

ARTICLE II: ARTICLES OF ORGANIZATION

[*Use one of the following alternatives*]

[*Alternative 1: Articles not yet filed*]

2.1. Promptly following execution of this Agreement, the Manager will cause Articles of Organization, in the form attached to this Agreement as Exhibit _ _ _, to be filed with the California Secretary of State.

2.2. The name of the Company will be _ _[*name*]_ _. The business of the Company may be conducted under that name, or, on compliance with applicable laws, any other name that the Manager deems appropriate.

[*Alternative 2: Articles already filed*]

2.1. The Articles of Organization were filed with the California Secretary of State on _ _[*date*]_ _, File Number _ _ _ _ _ _. A copy of the Articles of Organization as filed is attached to this Agreement as Exhibit _ _ _.

2.2. The name of the Company is _ _[*name*]_ _. The business of the Company may be conducted under that name, or, on compliance with applicable laws, any other name that the Manager deems appropriate.

[*Continue*]

2.3. The principal executive office of the Company will be at _ _[*address*]_ _, California _ _[*zip code*]_ _, or any other place or places determined by the Manager from time to time.

2.4. The initial agent for service of process on the Company will be _ _[*name*]_ _, whose address is _ _[*address*]_ _, California _ _[*zip code*]_ _. The Manager may from time to time change the Company's agent for service of process. If the agent ceases to act as such for any reason, the Manager will promptly designate a replacement agent and notify the Secretary of State of the change.

2.5. The Company will engage in the business of _ _[*description of business*]_ _.

2.6. The Members intend the Company to be a limited liability company under the Act, classified as a partnership for federal and, to the maximum extent possible, state income taxes. The rights and liabilities of the Members and Manager will be determined under the Act and this Agreement. To the extent that the rights or obligations of any Member or Manager are different because of any provision of this Agreement than those rights and obligations would be in the absence of that provision, this Agreement will control to the extent permitted by the Act. Neither the Manager nor any Member will take any action inconsistent with the express intent of the parties to this Agreement.

2.7. The term of existence of the Company will commence on the effective date of filing of Articles of Organization with the California Secretary of State, and will continue until terminated by the provisions of this Agreement or as provided by law.

2.8. The names and addresses of the Initial Members are as set forth in Exhibit _ _ _.

[*If manager to be other than all members*]

2.9. The Manager of the Company will be _ _[*name*]_ _, whose address is _ _[*address*]_ _, California _ _[*zip code*]_ _.

[*If all members are to be managers*]

2.9. The Members will be the Managers of the Company.

ARTICLE III: CAPITAL AND CAPITAL CONTRIBUTIONS

3.1. Each Member will contribute to the capital of the Company as the Member's initial Capital Contribution the money or property _ _[*or services*]_ _ specified in Exhibit _ _ _. The initial Fair Market Value of each item of contributed property (net of liabilities secured by that property) which the Company is considered to assume or to take "subject to" under IRC section 752, is also set forth in Exhibit _ _ _, together with the description and amount of these liabilities. If a Member fails to make the initial Capital Contributions specified in this Section within 30 days after the effective date of this Agreement, that Member's entire Membership Interest will terminate, and that Member will indemnify and hold the Company and the other Members harmless from any loss, cost, or expense, including reasonable attorney fees caused by the failure to make the initial Capital Contribution.

[*Use one of the following alternatives*]

[*Alternative 1: Additional contributions not required*]

3.2. No Member will be required to make any additional Capital Contributions. No Member may voluntarily make any additional Capital Contribution.

[*Alternative 2: Additional contributions are required*]

3.2. The Manager may determine from time to time that Capital Contributions in addition to the Members' initial Capital Contributions are needed to enable the Company to conduct its business. On making such a determination, the Manager will give notice to all Members in writing at least 90 days before the date on which the additional Capital Contribution is due. The Notice will set forth the amount of additional Capital Contribution needed, the purpose for which it is needed, and the date by which the Members will contribute. Each Member will be required to make an additional Capital Contribution in an amount that bears the same proportion to the total additional Capital Contribution that the Member's Capital Account balance bears to the total Capital Account balances of all Members. No Member may voluntarily make any additional Capital Contribution.

[*If appropriate, add the following option*]

[*Option: Capital calls are limited*]

The maximum amount of additional Capital Contributions that a Member may be required to make is _ _[*number*]_ _ percent of the amount of the Member's initial Capital Contribution under section 3.1 of this Agreement.

[*Continue*]

3.3. If a Member fails to make an additional Capital Contribution required under Section 3.2 of this Agreement within 30 days after it is required to be made (a Defaulting Member), the Manager will within 5 days after that failure notify each other Member (a Nondefaulting Member) in writing of the total amount of Defaulting Member Capital Contributions not made (the Additional Capital Shortfall), and will specify a number of days within which each Nondefaulting Member may make an additional Capital Contribution, which will not be less than an amount bearing the same ratio to the amount of Additional Capital Shortfall as the Nondefaulting Member's Capital Account balance bears to the total Capital Accounts of all Nondefaulting Members. If the total amount of Additional Capital Shortfall is not so contributed, the Manager may use any reasonable method to provide Members the opportunity to make additional Capital Contributions, until the Additional Capital Shortfall is as fully contributed as possible. Following the Nondefaulting Members' making of those additional Capital Contributions, each Member's Percentage Interest will be adjusted to reflect the ratio that the Member's Capital Account bears to the total Capital Accounts of all Members.

3.4. If a Member fails for 30 days to make an additional Capital Contribution required under Section 3.2:

(a) The Defaulting Member will indemnify and hold the Company and the other Members harmless from any loss, cost, or expense, including reasonable attorney fees caused by the failure to make the additional Capital Contribution. In this Agreement, those additional Capital Contributions that are not made by a Defaulting Member are referred to as Additional Capital Shortfall. A Member who makes the required additional Capital Contributions (Nondefaulting Member) will have the right, but not the obligation, to advance an amount bearing the same ratio to the total amount of the Additional Capital Shortfall as a Nondefaulting Member's Capital Account bears to the total Capital Accounts of all Nondefaulting Members. A Member advancing an additional Capital Contribution for a Defaulting Member under this Section 3.4(a) will (1) be paid interest by the Defaulting Member on the amount of the advance at an annual rate, from the date of the advance until paid, equal to the floating rate of _ _[*number*]_ _ percent over the prime rate charged by _ _[*name*]_ _ Bank, or the highest rate permitted by applicable law, whichever rate is lower, and (2) receive all distributions that the Defaulting Member would otherwise be entitled to receive under the provisions of this Agreement as though the advances by the Nondefaulting Member were Capital Contributions made by the Nondefaulting Member, which distributions will be applied first to attorneys' fees, costs, and expenses, if any; then to accrued and unpaid interest; and, finally, in reduction of the principal amount of the advance. The Defaulting Member grants any Nondefaulting Members who make advances to the Company in accordance with this Section 3.4(a) a security interest in the Defaulting Member's Membership Interest to secure the Defaulting Member's obligations under this Section 3.4(a). The Defaulting Member will, within 5 days of written notice, execute any documents or instruments reasonably necessary to enable Nondefaulting Members who make advances under this Section to perfect the foregoing security interests. Each Member irrevocably appoints each other Member, and any one of them acting alone, as his, her, or its attorney-in-fact for the limited purpose of executing, on behalf of the Member, if the Member becomes a Defaulting Member, any of the foregoing documents or instruments.

(b) If the Defaulting Member fails to pay all sums due and owing to any Members who make advances under Section 3.4(a), for a period of 180 days after the advance, each Member who has made advances under Section 3.4(a) may foreclose on any security interest granted under this Section 3.4 by causing the principal amount of the advance to be transferred from the Defaulting Member's Capital Account and added to the Capital Account of the Member who has made the advances, with a corresponding adjustment in that Member's and the Defaulting Member's Percentage Interests. Accrued and unpaid interest and other amounts owed to Members who have made those advances (the Noncapital Costs) will also be paid out of the Defaulting Member's Capital Account, and if the Capital Account is not sufficient to fully pay Noncapital Costs, the available balance will be shared pro rata in accordance with the amounts of the Nondefaulting Members' respective advances. The Defaulting Member's Percentage Interest will be further adjusted (but not below zero) following application to Noncapital Costs. All Members agree that the foregoing constitutes and will constitute a disposition of collateral in a commercially reasonable manner within the meaning of California Commercial Code §9610. Reduction of a Defaulting Member's Capital Account to satisfy that member's repayment obligations under this Section 3.4(b) will be deemed a return of capital to that Member to the extent of the reduction.

(c) On the occurrence of, and for the duration of, a Default by any Member, the Defaulting Member will not have any right to vote the Defaulting Member's Membership Interest or otherwise participate in the management or control of the business and affairs of the Company, and any and all provisions of this Agreement relating to management and control will be implemented without including the Membership Interest of the Defaulting Member. The foregoing provisions will be in addition to the Company's remedies under Corporations Code §17201(a)(2). On satisfaction of a Defaulting Member's obligations (whether by enforcement of a remedy or otherwise) under Section 3.4(b), that Member will be restored to full membership status to the extent of any remaining Percentage Interest.

3.5. An individual Capital Account for each Member will be maintained in accordance with the requirements of Treasury Reg §1.704-1(b)(2)(iv) and adjusted in accordance with the following provisions:

(a) A Member's Capital Account will be increased by that Member's Capital Contributions, that Member's share of Profits, and any items in the nature of income or gain that are specially allocated to that Member under Article IV.

(b) A Member's Capital Account will be increased by the amount of any Company liabilities assumed by that Member subject to and in accordance with the provisions of Treasury Reg §1.704-1(b)(2)(iv)(c).

(c) A Member's Capital Account will be decreased by (a) the amount of cash distributed to that Member; (b) the Fair Market Value of any property of the Company so distributed, net of liabilities secured by the distributed property that the distributee Member is considered to assume or to be subject to under IRC §752;

and (c) the amount of any items in the nature of expenses or losses that are specially allocated to that Member under Article IV.

(d) A Member's Capital Account will be reduced by the Member's share of any expenditures of the Company described in IRC §705(a)(2)(B) or which are treated as IRC §705(a)(2)(B) expenditures under Treasury Reg §1.704-1(b)(2)(iv)(i) (including syndication expenses and losses nondeductible under IRC §267(a)(1) or 707(b)).

(e) If any Economic Interest (or portion thereof) is Transferred, the transferee of the Economic Interest or portion will succeed to the transferor's Capital Account corresponding to the interest or portion.

(f) The principal amount of a promissory note that is not readily traded on an established securities market and that is contributed to the Company by the maker of the note will not be included in the Capital Account of any Person until the Company makes a taxable disposition of the note or until (and to the extent) principal payments are made on the note, all in accordance with Treasury Reg §1.704-1(b)(2)(iv)(d)(2).

(g) Each Member's Capital Account will be increased or decreased as necessary to reflect a revaluation of the Company's property assets in accordance with the requirements of Treasury Reg §§1.704-1(b)(2)(iv)(f) and 1.704-1(b)(2)(iv)(g), including the special rules under Treasury Reg §1.701-1(b)(4), as applicable. The provisions of this Agreement respecting the maintenance of Capital Accounts are intended to comply with Treasury Reg §1.704-1(b) and will be interpreted and applied in a manner consistent with those Regulations.

3.6. A Member will not be entitled to withdraw any part of the Member's Capital Contribution or to receive any distributions, whether of money or property, from the Company except as provided in this Agreement.

3.7. No interest will be paid on Capital Contributions or on the balance of a Member's Capital Account.

3.8. A Member will not be bound by, or be personally liable for, the expenses, liabilities, or obligations of the Company except as otherwise provided in the Act or in this Agreement.

3.9. _ _[*Except as otherwise expressly provided in this Agreement, no/No*]**_ _ Member will have priority over any other Member with respect to the return of a Capital Contribution or distributions or allocations of income, gain, losses, deductions, credits, or items thereof.**

ARTICLE IV: ALLOCATIONS AND DISTRIBUTIONS

[*Use one of the following alternatives*]

[*Alternative 1: No priority—Allocation according to members' interests*]

4.1. The Profits and Losses of the Company and all items of Company income, gain, loss, deduction, or credit will be allocated, for Company book purposes and for tax purposes, to each Member in accordance with that Member's Percentage Interest.

[*Alternative 2: Disproportionate allocation of profits and losses based on book values*]

4.1. The Profits and Losses of the Company and items of Company income, gain, loss, deduction, or credit will be allocated for Company book purposes in the manner set forth in Exhibit _ _ _ to this Agreement.

[*Alternative 3: Preferential allocation of losses*]

4.1. The Profits of the Company and all items of income, gain, or credit will be allocated, for Company book purposes and for tax purposes, to the Members in accordance with their respective Percentage Interests. Losses of the Company and all items of loss or deduction will be allocated as set forth in Exhibit _ _ _ to this Agreement.

[*Alternative 4: Preferential allocation of profits*]

4.1. The Profits and Losses of the Company and all items of Company income, gain, loss, deduction, or credit will be allocated, for Company book purposes and for tax purposes, to a Member in accordance with the Member's Percentage Interest, provided that Profits, including Profits from Capital Events, will first be allocated to those Members whose names are set forth in Exhibit _ _ _, attached to this Agreement, pro rata in accordance with their respective Percentage Interests, until they each have received distributions equal to

_ _[*number*]_ _ percent of their initial Capital Contribution.

[*Alternative 5: Preferential allocation of profits and losses*]

4.1. The Profits and Losses of the Company and items of Company income, gain, loss, deduction, or credit will be allocated as set forth in Exhibit _ _ _ attached to this Agreement. Notwithstanding the foregoing sentence, those Members listed in Exhibit _ _ _ who are identified as Priority Members will receive all Company distributions of Profits and Losses before any distributions are made to any other Members until each Priority Member has received total distributions equal to that Member's initial Capital Contribution.

[*Continue*]

4.2 As used in this Agreement, "Profits and Losses" means, for each fiscal year or other period specified in this Agreement, an amount equal to the Company's taxable income or loss for that year or period, determined in accordance with IRC §703(a), including all Tax Items required to be stated separately under IRC §703(a)(1), with the following adjustments:

(a) Any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Profits or Losses will be added to taxable income or loss;

(b) Any expenditures of the Company described in IRC §705(a)(2)(B) or treated as IRC §705(a)(2)(B) expenditures under Treasury Reg §1.704-1(b)(2)(iv)(i) and not otherwise taken into account in computing Profits or Losses will be subtracted from taxable income or will increase that loss; _ _[*and*]_ _

[*Add the following subsections when book values are to be used*]

[(c)] Gain or loss resulting from any disposition of Company property with respect to which gain or loss is recognized for federal income tax purposes will be computed by reference to the Fair Market Value of the property disposed of, notwithstanding that the adjusted tax basis of the property differs from its Fair Market Value;

[(d)] In lieu of depreciation, amortization, and other cost recovery deductions taken into account in computing taxable income or loss, there will be taken into account Book Depreciation for that fiscal year or other period, computed in accordance with the definition of "Book Depreciation" in Section 1.11; and

[*Continue*]

[(e)] Notwithstanding the foregoing provisions of this Section 4.2, any items of income, gain, loss, or deduction that are specially allocated will not be taken into account in computing Profits or Losses under Section 4.1.

4.3. The following definitions will apply with respect to this Article IV.

(a) "Adjusted Capital Account Deficit" means, with respect to any Member, the deficit balance, if any, in the Member's Capital Account as of the end of the relevant fiscal year of the Company, after the Member's Capital Account has been adjusted as follows: (1) increased by the amount of the Member's share of Company Minimum Gain and Member Nonrecourse Debt Minimum Gain, and (2) decreased by the amount of the items described in Treasury Reg §1.704-1(b)(2)(ii)(d)(4), (5), and (6).

This definition of Adjusted Capital Account Deficit is intended to comply with the provisions of Treasury Reg §1.704-1(b)(2)(ii)(d) and will be interpreted consistently with that Regulation.

(b) "Company Minimum Gain" has the meaning set forth in Treasury Reg §1.704-2(d)(1).

(c) "Member Nonrecourse Debt" is defined in Treasury Reg §1.704-2(b)(4).

(d) "Member Nonrecourse Debt Minimum Gain" for a fiscal year of the Company means the net increase in Minimum Gain attributable to Member Nonrecourse Debt, determined as set forth in Treasury Reg §1.704-2(i)(2).

(e) "Member Nonrecourse Deductions" has the meaning set forth in Treasury Reg §1.704-2(i)(2). For any Company fiscal year, the amount of Member Nonrecourse Deductions with respect to a Member Nonrecourse Debt equals the net increase during that fiscal year in Member Nonrecourse Debt Minimum Gain attributable to

such Member Nonrecourse Debt during that fiscal year, reduced (but not below zero) by the amount of any distributions during that year to the Member bearing the economic risk of loss for Member Nonrecourse Debt if the distributions are both from the proceeds of the Member Nonrecourse Debt and are allocable to an increase in Member Nonrecourse Debt Minimum Gain attributable to the Member Nonrecourse Debt, all as determined according to the provisions of Treasury Reg §1.704-2(i)(2). In determining Member Nonrecourse Deductions, the ordering rules of Treasury Reg §1.704-2(j) will be followed.

(f) "Nonrecourse Deductions" has the meaning set forth in Treasury Reg §1.704-2(c). The amount of Nonrecourse Deductions for a Company fiscal year equals the net increase in the amount of Company Minimum Gain during that fiscal year, reduced (but not below zero) by the aggregate amount of any distributions during that fiscal year of proceeds of a Nonrecourse Liability that are allocable to an increase in Company Minimum Gain.

(g) "Nonrecourse Liability" has the meaning set forth in Treasury Reg §1.752-1(a)(2).

4.4. The following special allocations will be made in the following order:

(a) *Company Minimum Gain Chargeback*. If there is a net decrease in Company Minimum Gain during a fiscal year, each Member will be allocated, before any other allocation under this Section, items of Company income and gain for the fiscal year equal to that Member's share of the net decrease in Company Minimum Gain as determined in accordance with Treasury Reg §1.704-2(g)(2).

(b) *Member Nonrecourse Debt Minimum Gain Chargeback.* If there is a net decrease in Member Nonrecourse Debt Minimum Gain during a fiscal year (as defined in the Regulations), any Member with a share of the Member Nonrecourse Debt Minimum Gain attributable to that Member's Nonrecourse Debt as of the beginning of the fiscal year should be allocated items of Company income and gain for that year (and, if necessary, subsequent years) equal to that Member's share of the net decrease in Member Nonrecourse Debt Minimum Gain. A Member's share of net decrease in Member Nonrecourse Debt Minimum Gain will be determined under Treasury Reg §1.704-2(g)(2). A Member will not be subject to the foregoing chargeback to the extent permitted under Treasury Reg §1.704-2(i)(4).

(c) *Qualified Income Offset*. If any Member unexpectedly receives an adjustment, allocation, or distribution described in Treasury Reg §1.704-1(b)(2)(ii)(d)(4), (5), or (6), that Member will be allocated items of Company income and gain (consisting of a pro rata portion of each item of Company income, including gross income and gain for that fiscal year) in an amount and manner sufficient to eliminate, to the extent required by the Regulations, the Adjusted Capital Account Deficit of that Member as quickly as possible, provided that an allocation under this Section 4.4(c) will be made only if and to the extent that the Member would have an Adjusted Capital Account Deficit after all other allocations provided for in this Agreement have been made as if this Section 4.4(c) were not in the Agreement.

(d) *Gross Income Allocation.* In the event any Member has a deficit Capital Account at the end of any Company fiscal year in excess of the sum of:

(1) The amount the Member is obligated to restore under any provision of this Agreement, and

(2) The amount the Member is deemed to be obligated to restore under Treasury Reg §1.704-2(g)(1), (i)(5),

each such Member will be specially allocated items of Company income in the amount of the excess as quickly as possible; except that an allocation under this Section 4.4(d) will be made only if and to the extent that the Member would have a deficit Capital Account in excess of that sum after all other allocations provided for in this Article 4 have been made as if Section 4.4(c) and this Section 4.4(d) were not in the Agreement.

(e) *Member Nonrecourse Deductions.* Any Member Nonrecourse Deductions for any Company fiscal year will be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which those Member Nonrecourse Deductions are attributable in accordance with Treasury Reg §1.704-2(i)(1).

(f) *Nonrecourse Deductions*. Nonrecourse Deductions for any fiscal year will be specially allocated in proportion to their respective allocations of Profits for that fiscal year.

(g) *Section 754 Adjustments*. To the extent an adjustment to the adjusted tax basis of any Company asset under IRC §734(b) or 743(b) is required under Treasury Reg §1.704-1(b)(2)(iv)(m)(2) or 1.704-1(b)(2)(iv)(m)(4) to be taken into account in determining Capital Accounts as the result of a distribution to a Member in complete liquidation of the Member's interest in the Company, the amount of the adjustment to Capital Accounts will be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases the basis), and the gain or loss will be specially allocated to the Members in accordance with their interests in the Company in the event that Treasury Reg §1.704-1(b)(2)(iv)(m)(2) applies, or to the Partner to whom the distribution was made in the event that Treasury Reg §1.704-1(b)(2)(iv)(m)(4) applies.

4.5. Member Nonrecourse Deductions for any fiscal year of the Company will be allocated to the Members in the same proportion as Profits are allocated under Section 4.1, provided that any Member Nonrecourse Deductions for any fiscal year or other period will be allocated to the Member who bears (or is deemed to bear) the economic risk of loss with respect to the Member Nonrecourse Debt to which those Member Nonrecourse Deductions are attributable in accordance with Treasury Reg §1.704-2(i)(2).

4.6. In any fiscal year of the Company, Profits in excess of Losses of the Company resulting from a Capital Event in that fiscal year will be allocated to the Members in the following order:

(a) To Members whose Adjusted Capital Contributions are in excess of their Capital Accounts, in proportion to those excesses, until all of those excesses have been eliminated. "Adjusted Capital Contributions" means, with respect to each Member, the excess of that Member's contribution to the capital of the Company over all prior distributions to the Member that have resulted from Capital Events.

(b) Among the Members in the proportion that the Capital Contribution of each Member bears to the total Capital Contributions of all Members.

4.7. In any Company fiscal year, Losses in excess of Profits of the Company, resulting from a Capital Event in that fiscal year, will be allocated to the Members with positive Capital Accounts, in proportion to their positive Capital Account balances, until no Member has a positive Capital Account. For this purpose, Capital Accounts will be reduced by the adjustments set forth in Treasury Reg §1.704-1(b)(2)(ii)(d)(4)-(6).

4.8. Any Unrealized Appreciation or Unrealized Depreciation in the values of Company property distributed in kind to Members will be deemed to be Profits or Losses realized by the Company immediately before the distribution of the property and those Profits or Losses will be allocated to the Capital Accounts in the same proportions as Profits are allocated under Section 4.1. Any property so distributed will be treated as a distribution to the Members to the extent of the Fair Market Value of the property, less the amount of any liability secured by and related to the property. Nothing in this Agreement is intended to treat or cause those distributions to be treated as sales for value. For the purposes of this Section 4.8, "Unrealized Appreciation" or "Unrealized Depreciation" will mean the difference between the Fair Market Value of that property and the Company's federal adjusted tax basis for the property.

4.9. Any item of income, gain, loss, or deduction with respect to any property (other than cash) that has been contributed by a Member to the capital of the Company, or that has been revalued under the provisions of Article III, Section 3.5(g), and that is required or permitted to be allocated to the Member for income tax purposes under IRC §704(c) so as to take into account the variation between the tax basis of the property and its Fair Market Value at the time of its contribution, will be allocated solely for income tax purposes in the manner required or permitted under IRC §704(c) using the "traditional" method described in Treasury Reg §1.704-3(b), except that any other method allowable under applicable Regulations may be used for any contribution of property with respect to which there is agreement among the contributing Member and the Manager (and, if the Manager and the contributing Member are Affiliates, a Majority of Members who are not Affiliates of the Manager).

4.10. In the case of a Transfer of an Economic Interest during any fiscal year of the Company, the Assigning Member and Assignee will each be allocated Profits or Losses based on the number of days each held the Economic Interest during that fiscal year. If the Assigning Member and Assignee agree to a different proration and advise the Manager of the agreed proration before the date of the Transfer, Profits or Losses from a Capital Event during that fiscal year will be allocated to the holder of the Interest on the day the Capital Event occurred. If an Assignee makes a subsequent Assignment, the Assignee will be considered an "Assigning Member" with respect to the subsequent Assignee for purposes of these allocations.

4.11. (a) The Gross Asset Value of all Company property will be adjusted at the following times: (1) on the acquisition of an interest or additional interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (2) on the distribution of money or other property (other than a de minimis amount) by the Company to a Member as consideration for an Economic Interest in the Company; and (3) on the liquidation of the Company within the meaning of Treasury Reg §1.704-1(b)(2)(ii)(g), provided, however, that adjustments under clauses (1) and (2) above will be made only in the event of a revaluation of Company property under Article III, Section 3.5(g) in accordance with Treasury Reg §1.704-1(b)(2)(iv)(f).

(b) The Gross Asset Value of Company property will be increased or decreased to reflect adjustments to the adjusted tax basis of the property under IRC §§732, 733, or 743, subject to the limitations imposed by IRC §755 and Treasury Reg §1.704-1(b)(2)(iv)(m).

(c) If the Gross Asset Value of an item of property has been determined or adjusted under Article I, Section 1.24, or subsection (a) or (b) of this Section 4.11, the Gross Asset Value will be adjusted by the Book Depreciation, if any, taken into account with respect to that property for purposes of computing Profits and Losses.

4.12. It is the intent of the Members that each Member's allocated share of Company Tax Items be determined in accordance with this Agreement to the fullest extent permitted by IRC §704(b)-(c). Notwithstanding anything to the contrary in this Agreement, if the Company is advised that, as a result of the adoption of new or amended regulations under IRC §704(b)-(c), or the issuance of authorized interpretations, the allocations provided in this Agreement are unlikely to be respected for federal income tax purposes, the Manager is granted the power to amend the allocation provisions of this Agreement, on advice of accountants and legal counsel, to the minimum extent necessary for the allocation provisions to be respected for federal income tax purposes.

4.13. All Available Cash, other than revenues or proceeds from a Capital Event or the dissolution of the Company, will be distributed among the Members in the same manner as Profits. The parties intend that Available Cash will be distributed as soon as practicable following the Manager's determination that cash is available for distribution. The parties acknowledge that no assurances can be given about when or whether cash will be available for distributions to the Members.

4.14. All Available Cash resulting from a Capital Event (as distinguished from normal business operations or the dissolution of the Company) will be distributed to the Members in accordance with their respective Percentage Interests as soon as practicable following the Manager's determination that cash is available for distribution.

4.15. If the proceeds from a sale or other disposition of an item of Company property consist of property other than cash, the value of that property will be as determined by the Manager. If noncash proceeds are subsequently reduced to cash, that cash will be taken into account by the Manager in determining Available Cash and the Manager will determine whether the cash has resulted from operations or from a Capital Event.

4.16. Notwithstanding any other provisions of this Agreement to the contrary, when there is a distribution in liquidation of the Company, or when any Member's interest is liquidated, all items of income and loss first will be allocated to the Members' Capital Accounts under this Article IV, and other credits and deductions to the Members' Capital Accounts will be made before the final distribution is made. The final distribution to the Members will be made as provided in Article IX, Section 9.2(d) of this Agreement. The provisions of this Section 4.16 and Article IX, Section 9.2(d), will be construed in accordance with the requirements of Treasury Reg §1.704-1(b)(2)(ii)(b)(2).

ARTICLE V: MANAGEMENT

[*Use one of the following alternatives*]

[*Alternative 1: Single manager*]

5.1. The business of the Company will be managed by the Manager named in Article II, Section 2.9, or a successor Manager selected in the manner provided in Article V, Section 5.3. Except as otherwise set forth in this Agreement, all decisions concerning the management of the Company's business will be made by the Manager.

[*Alternative 2: More than one manager (member or nonmember) but fewer than all members are managers*]

5.1. The business of the Company will be managed by the Persons named as Managers in Article II, Section 2.9, or any successors, selected as provided in Section 5.3. Except as otherwise provided in this Agreement, all decisions concerning the management of the Company's business will be made by the Vote of a majority, by number, of the Managers.

[*Alternative 3: All members are managers*]

5.1. The business of the Company will be managed by all the Members. A Member will be a Manager only during the time the Member is a Member of the Company. All decisions concerning the management of the Company's business will be made by the Vote of a Majority of Members.

5.2. _ _[*The manager/Each manager*]_ _ will serve until the earlier of (1) the Manager's resignation, retirement, death, or disability; (2) the Manager's removal by the Members; and (3) the expiration of the Manager's term as Manager, if a term has been designated by a Majority of Members. A new Manager will be appointed by a Majority of Members on the occurrence of any of the foregoing events.

5.3. Each Manager will be appointed by a Majority of Members for (a) a term expiring with the appointment of a successor, or (b) a term expiring at a definite time specified by a Majority of Members in connection with the appointment. A Manager who is not also a Member may be removed with or without cause at any time by action of a Majority of Members. A Manager who is a Member may be removed only on the Vote of all other Members.

5.4. The Manager, who will be the President of the Company, will have the powers and duties described in Section 5.8 of this Agreement and any other powers and duties that may be prescribed in this Agreement or by the Members. Notwithstanding the foregoing, the Manager will not take any of the following actions on behalf of the Company unless a Majority of Members has consented to the taking of that action.

(a) Any act that would make it impossible to carry on the ordinary business of the Company;

(b) Any confession of a judgment against the Company;

(c) The dissolution of the Company;

(d) The disposition of all or a substantial part of the Company's assets not in the ordinary course of business;

(e) The incurring of any debt not in the ordinary course of business;

(f) A change in the nature of the principal business of the Company;

(g) The incurring of any contractual obligation or the making of any capital expenditure with a total cost of more than _ _[*dollar amount*]_ _;

(h) The filing of a petition in bankruptcy or entering into an arrangement among the Company's creditors; and

(i) The entering into, on behalf of the Company, of any transaction constituting a "reorganization" within the meaning of Corp C §17600.

[*Use when the LLC has more than one manager*]

5.5. Actions of the Managers will be taken at meetings or as otherwise provided in this Section 5.5 by a majority. No regular meetings of the Managers need be held. Any two Managers may call a meeting of the Managers by giving Notice of the time and place of the meeting at least 48 hours before the time of the holding of the meeting. The Notice need not specify the purpose of the meeting, nor the location if the meeting is to be held at the principal executive office of the Company.

A majority of Managers will constitute a quorum for the transaction of business at any meeting of the Managers.

The transactions of the Managers at any meeting, however called or noticed, or wherever held, will be as valid as though transacted at a meeting duly held after call and notice if a quorum is present and if, either before or after the meeting, each Manager not present signs a written waiver of notice or a consent to the holding of the meeting or an approval of the minutes of the meeting.

Any action required or permitted to be taken by the Managers under this Agreement may be taken without a meeting if a majority of the Managers individually or collectively consent in writing to the action.

Managers may participate in the meeting through the use of a conference telephone or similar communications equipment, provided that all Managers participating in the meeting can hear one another.

The Managers will keep or cause to be kept with the books and records of the Company full and accurate minutes of all meetings, notices and waivers of notices of meetings, and all written consents to actions of the Managers.

5.6. It is acknowledged that the Manager has other business interests to which the Manager devotes part of the Manager's time. The Manager will devote as much time to the conduct of the business of the Company as the Manager, in the Manager's own good faith and discretion, deems necessary.

5.7. The Manager will be entitled to compensation for the Manager's services as determined by the Members, and to reimbursement for all expenses reasonably incurred by the Manager in the performance of the Manager's duties.

5.8. The Company will have a President, who will be a Manager. The President will be the chief executive officer of the Company and will have general supervision of the business and affairs of the Company, will preside at all meetings of Members and of Managers, and will have any other powers and duties usually vested in a chief executive officer. A Majority of the Members may provide for additional officers of the Company, may alter the powers and duties of the President, and will establish the powers and duties of all other officers and the compensation of all Company officers.

5.9. The Manager will cause all assets of the Company, whether real or personal, to be held in the name of the Company.

5.10. All funds of the Company will be deposited in one or more accounts with one or more recognized financial institutions in the name of the Company, at locations determined by the Manager. Withdrawal from those accounts will require only the signature of the Manager or any other person or persons as the Manager may designate.

ARTICLE VI: ACCOUNTS AND ACCOUNTING

6.1. Complete books of account of the Company's business, in which each Company transaction will be fully and accurately entered, will be kept at the Company's principal executive office and at any other locations as the Manager will determine from time to time, and will be open to inspection and copying on reasonable Notice by any Member or the Member's authorized representatives during normal business hours. The costs of inspection and copying will be borne by the Member.

6.2. Financial books and records of the Company will be kept on the _ _[*accrual/cash***]_ _ method of accounting, _ _[***which will be the method of accounting followed by the Company for federal income tax purposes***]_ _. The financial statements of the Company _ _[***will be prepared in accordance with generally accepted accounting principles and***]_ _ will be appropriate and adequate for the Company's business and for carrying out the provisions of this Agreement. The fiscal year of the Company will be January 1 through December 31.**

6.3. At all times during the term of existence of the Company, and beyond that term if the Manager deems it necessary, the Manager will keep or cause to be kept the books of account referred to in Section 6.2, together with:

(a) A current list of the full name and last known business or residence address of each Member, together with the Capital Contribution and the share in Profits and Losses of each Member;

(b) A current list of the full name and business or residence address of each Manager;

(c) A copy of the Articles of Organization, as amended;

(d) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years;

(e) An original executed copy or counterparts of this Agreement, as amended;

(f) Any powers of attorney under which the Articles of Organization or any amendments to said articles were executed;

(g) Financial statements of the Company for the six most recent fiscal years; and

(h) The books and Records of the Company as they relate to the Company's internal affairs for the current and past four fiscal years.

If the Manager deems that any of the foregoing items will be kept beyond the term of existence of the Company, the repository of those items will be as designated by the Manager.

6.4. At the end of each fiscal year, the books of the Company will be closed and examined, statements reflecting the financial condition of the Company and its Profits or Losses will be prepared, and a report about those matters will be issued by the Company's certified public accountants. Copies of the financial statements will be given to all Members. In addition, all Members will receive, not less frequently than at the end of each calendar quarter, copies of such financial statements regarding the previous calendar quarter as may be prepared in the ordinary course of business by the Manager or accountants selected by the Manager. The Manager will cause an annual report to be sent to each Member within 120 days after the end of the fiscal year of the Company. The annual report may be sent by electronic transmission by the Company and will include:

(a) A balance sheet and income statement, and a statement of changes in the financial position of the Company as of the close of the fiscal year; and

(b) A statement showing the Capital Account of each Member as of the close of the fiscal year and the distributions, if any, made to each Member during the fiscal year. Members representing at least 30 percent of the Members, by number, may request interim balance sheets and income statements, and may, at their own discretion and expense, obtain an audit of the Company books by certified public accountants selected by them, provided, however, that not more than one such audit will be made during any fiscal year of the Company.

6.5. Within 90 days after the end of each taxable year of the Company, the Manager will send to each of the Members all information necessary for the Members to complete their federal and state income tax or information returns and a copy of the Company's federal, state, and local income tax or information returns for that year.

[*Use one of the following alternatives*]

[*Alternative 1: Sole manager to serve as tax matters partner*]

6.6. The Manager will act as Tax Matters Partner of the Company under IRC §6231(a)(7).

[*Alternative 2: One among multiple managers to serve as tax matters partner*]

6.6. _ _[*Name*]_ _ will act as Tax Matters Partner of the Company under IRC §6231(a)(7).

[*Continue*]

6.7. The Tax Matters Partner is authorized to do the following:

(a) Keep the Members informed of administrative and judicial proceedings for the adjustment of Company items (as defined in IRC §6231(a)(3)) at the Company level, as required under IRC §6223(g) and the implementing Regulations;

(b) Enter into settlement agreements under IRC §6224(c)(3) and applicable Regulations with the Internal Revenue Service or the Secretary of the Treasury (the Secretary) with respect to any tax audit or judicial review, in which agreement the Tax Matters Partner may expressly state that the agreement will bind the other Members, except that the settlement agreement will not bind any Member who (within the time prescribed under the Code and Regulations) files a statement with the Secretary providing that the Tax Matters Partner will not have the authority to enter into a settlement agreement on behalf of that Member;

(c) On receipt of a notice of a final Company administrative adjustment, to file a petition for readjustment of the Company items with the Tax Court, the District Court of the United States for the district in which the Company's principal place of business is located, or the United States Court of Federal Claims, all as contemplated under IRC §6226(a) and applicable Regulations;

(d) File requests for administrative adjustment of Company items on Company tax returns under IRC §6227(b) and applicable Regulations; and, to the extent those requests are not allowed in full, file a petition for adjustment with the Tax Court, the District Court of the United States for the district in which the Company's principal place of business is located, or the United States Court of Federal Claims, all as contemplated under IRC §6228(a); and

(e) To take any other action on behalf of the Members or the Company in connection with any administrative or judicial tax proceeding to the extent permitted by law or regulations, including retaining tax advisers (at the expense of the Company) to whom the Tax Matters Partner may delegate such rights and duties as deemed necessary and appropriate.

ARTICLE VII: MEMBERSHIP—MEETINGS, VOTING, INDEMNITY

7.1. There will be only one class of membership and no Member will have any rights or preferences in addition to or different from those possessed by any other Member, except as specifically provided in Article IV. Members will have the right and power to appoint, remove, and replace Managers and officers of the Company and the right to Vote on all other matters with respect to which this Agreement or the Act requires or permits Member action. Each Member will Vote in proportion to the Member's Percentage Interest as of the governing record date, determined in accordance with Section 7.2. If a Member has assigned all or part of the Member's Economic Interest to a person who has not been admitted as a Member, the Assigning Member will Vote in proportion to the Percentage Interest that the Assigning Member would have had if the assignment had not been made.

Without limiting the foregoing, all of the following acts will require the unanimous Vote of the Members:

(a) The Transfer of a Membership Interest and the admission of the Assignee as a Member of the Company;

(b) Any amendment of the articles of organization or this Agreement; and

(c) A compromise of the obligation of a Member to make a Capital Contribution under Article III.

7.2. The record date for determining the Members entitled to receive Notice of any meeting, to Vote, to receive any distribution, or to exercise any right in respect of any other lawful action, will be the date set by the Manager or by a Majority of Members, provided that the record date will not be more than 60 or less than 10 calendar days before the date of the meeting and not more than 60 calendar days before any other action. In the absence of any action setting a record date, the record date will be determined in accordance with Corp C §17104(k).

7.3. The Company may, but is not required to, issue certificates evidencing Membership Interests (Membership Interest Certificates) to Members of the Company. Once Membership Interest Certificates have been issued, they will continue to be issued as necessary to reflect current Membership Interests held by Members. Membership Interest Certificates will be in a form approved by the Manager, will be manually signed by the Manager, and will bear conspicuous legends evidencing the restrictions on Transfer and the purchase rights of the Company and Members set forth in Article VIII. All issuances, reissuances, exchanges, and other transactions in Membership Interests involving Members will be recorded in a permanent ledger as part of the books and records of the Company.

7.4. Meetings of the Members may be called at any time by the Manager, or by Members representing more than 10 percent of the Interests of the Members, for the purpose of addressing any matters on which the Members may Vote. If a meeting of the Members is called by the Members, Notice of the call will be delivered to the Manager. Meetings may be held at the principal executive office of the Company or at any other location designated by the Manager. Following the call of a meeting, the Manager will give Notice of the meeting not less than 10, nor more than 60 calendar days before the meeting date to all Members entitled to Vote at the meeting. The Notice will state the place, date, and hour of the meeting, the means of electronic transmission by and to the Company or electronic video screen communication, if any, and the general nature of business to be transacted. No other business may be transacted at the meeting. A quorum at any meeting of Members will consist of a Majority of Members, represented in person or by Proxy. The Members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of a sufficient number of Members to leave less than a quorum, if the action taken, other than adjournment, is approved by the requisite Percentage of Members as specified in this Agreement or the Act.

7.5. A meeting of Members at which a quorum is present may be adjourned to another time or place and any business that might have been transacted at the original meeting may be transacted at the adjourned meeting. If a quorum is not present at an original meeting, that meeting may be adjourned by the Vote of a majority of Voting Interests represented either in person or by Proxy. Notice of the adjourned meeting need not be given to Members entitled to Notice if the time and place of the adjourned meeting are announced at the meeting at which the adjournment is taken, unless (a) the adjournment is for more than 45 days, or (b) after the adjournment, a new record date is fixed for the adjourned meeting. In the situations described in clauses (a) and (b), Notice of the adjourned meeting will be given to each Member of record entitled to Vote at the adjourned meeting.

7.6. The transactions of any meeting of Members, however called and noticed, and wherever held, will be as valid as though consummated at a meeting duly held after regular call and notice, if (a) a quorum is present at that meeting, either in person or by Proxy, and (b) either before or after the meeting, each of the persons entitled to Vote, not present in person or by Proxy, signs either a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. Attendance of a Member at a meeting will constitute waiver of notice, unless that Member objects, at the beginning of the meeting, to the transaction of any business on the ground that the meeting was not lawfully called or convened. Attendance at a meeting is not a waiver of any right to object to the consideration of matters required to be described in the notice of the meeting and not so included, if the objection is expressly made at the meeting.

7.7. At all meetings of Members, a Member may Vote in person or by Proxy. The Proxy will be filed with the Manager before or at the time of the meeting, and may be filed by facsimile transmission to the Manager at the principal executive office of the Company or any other address given by the Manager to the Members for those purposes.

7.8. A meeting of the Members may be conducted, in whole or in part, by electronic transmission by and to the Company or by electronic video screen communication if (1) the Company implements reasonable measures to provide Members (in person or by Proxy) a reasonable opportunity to participate in the meeting and to vote on matters submitted to the Members, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with those proceedings, and if (2) any Member Votes or takes other action at the meeting by means of electronic transmission to the Company or electronic video screen communication, a record of that vote or action is maintained by the Company.

7.9. Any action that may be taken at any meeting of the Members may be taken without a meeting if a consent in writing, setting forth the action so taken, is signed by Members having not less than the minimum number of Votes that would be necessary to authorize or take that action at a meeting at which all Members entitled to Vote were present and voted. If the Members are requested to consent to a matter without a meeting, each Member will be given notice of the matter to be voted on in the manner described in Section 7.4. Any action taken without a meeting will be effective when the required minimum number of Votes have been received. Prompt Notice of the action taken will be given to all Members who have not consented to the action.

7.10. No Member acting solely in the capacity of a Member is an agent of the Company, nor can any Member acting solely in the capacity of a Member bind the Company or execute any instrument on behalf of the Company. Accordingly, each Member will indemnify, defend, and hold harmless each other Member and the Company from and against any and all loss, cost, expense, liability, or damage arising from or out of any claim

based on any action by the Member in contravention of the first sentence of this Section 7.10.

ARTICLE VIII: TRANSFERS OF MEMBERSHIP INTERESTS

[*Use one of the following alternatives*]

[*Alternative 1: Right to withdraw*]

8.1. A Member may withdraw from the Company at any time by giving Notice of withdrawal to _ _[*all other Members/the Managers*]_ _ at least 180 calendar days before the effective date of withdrawal. Withdrawal will not release a Member from any obligations and liabilities under this Agreement accrued or incurred before the effective date of withdrawal. A withdrawing Member will divest the Member's entire Membership Interest before the effective date of withdrawal in accordance with and subject to the provisions of this Article VIII.

[*Alternative 2: No right to withdraw*]

8.1. A Member may not withdraw from the Company without the written consents of all remaining Members. Withdrawal will not release a Member from any obligations and liabilities under this Agreement accrued or incurred before the effective date of withdrawal. A withdrawing Member will have only the rights of a holder of an Economic Interest in the Company in respect of the Member's Membership Interest in the Company. Unless all remaining Members consent to the withdrawal, the withdrawing Member will not be entitled to a distribution of its Economic Interest until the dissolution and liquidation of the Company. For purposes of this Section 8.1, the term "Economic Interest" will not mean or include any right to share in the income, gains, losses, deductions, credits, or similar items of the Company attributable to any period following withdrawal, or any right to information concerning the business and affairs of the Company, except as provided in Corp C §17106.

[*Continue*]

8.2. Except as expressly provided in this Agreement, a Member will not Transfer any part of the Member's Membership Interest in the Company, whether now owned or later acquired, unless (a) the other Members unanimously approve the transferee's admission to the Company as a Member on that Transfer and (b) the Membership Interest to be Transferred, when added to the total of all other Membership Interests Transferred in the preceding 12 months, will not cause the termination of the Company under the Code. No Member may Encumber or permit or suffer any Encumbrance of all or any part of the Member's Membership Interest in the Company unless the Encumbrance has been approved in writing by the Manager. Approval may be granted or withheld in the Manager's sole discretion. Any Transfer or Encumbrance of a Membership Interest without that approval will be void. Notwithstanding any other provision of this Agreement to the contrary, a Member who is a natural person may Transfer all or any portion of his or her Membership Interest to any revocable trust created for the benefit of the Member, or any combination between or among the Member, the Member's spouse, and the Member's issue, provided that the Member retains a beneficial interest in the trust and all of the Voting Interest included in the Membership Interest. A Transfer of a Member's beneficial interest in the trust, or failure to retain the Voting Interest, will be deemed a Transfer of a Membership Interest.

8.3. If a Member wishes to Transfer any or all of the Member's Membership Interest in the Company under a Bona Fide Offer (as defined below), the Member will give Notice to _ _[*the Manager/all other Members*]_ _ at least 30 days in advance of the proposed sale or Transfer, indicating the terms of the Bona Fide Offer and the identity of the offeror. The Company and the other Members will have the option to purchase the Membership Interest proposed to be transferred at the price and on the terms provided in this Agreement. If the price for the Membership Interest is other than cash, the fair value in dollars of the price will be as established in good faith by the Company. For purposes of this Agreement, "Bona Fide Offer" means an offer in writing setting forth all relevant terms and conditions of purchase from an offeror who is ready, willing, and able to consummate the purchase and who is not an Affiliate of the selling Member. For 30 days after the Notice is given, the Company will have the right to purchase the Membership Interest offered, on the terms stated in the Notice, for the lesser of (a) the price stated in the Notice (or the price plus the dollar value of noncash consideration, as the case may be) and (b) the price determined under the appraisal procedures set forth in Section 8.8.

If the Company does not exercise the right to purchase all of the Membership Interest, then, with respect to the portion of the Membership Interest that the Company does not elect to purchase, that right will be given to the other Members for an additional 30-day period, beginning on the day that the Company's right to purchase expires. Each of the other Members will have the right to purchase, on the same terms, a part of the interest of the offering Member in the proportion that the Member's Percentage Interest bears to the total Percentage

Interests of all of the Members who choose to participate in the purchase, provided, however, that the Company and the participating Members may not, in the aggregate, purchase less than the entire interest to be sold by the offering Member.

If the Company and the other Members do not exercise their rights to purchase all of the Membership Interest, the offering Member may, within 90 days from the date the Notice is given and on the terms and conditions stated in the Notice, sell or exchange that Membership Interest to the offeror named in the Notice. Unless the requirements of Section 8.2 are met, the offeror under this Section 8.3 will become an Assignee, and will be entitled to receive only the share of Profits or other compensation and the return of Capital Contribution to which the assigning Member would have been entitled.

8.4. On the happening of any of the following events (Triggering Events), the Company and the other Members will have the option to purchase the Membership Interest of a Member (Selling Member) at the price and on the terms provided in Section 8.8 of this Agreement:

(a) The death, incapacity, bankruptcy, or withdrawal of a Member, or the winding up and dissolution of a corporate Member, or the merger or other corporate reorganization of a corporate Member as a result of which the corporate Member does not survive as an entity.

(b) The failure of a Member to make the Member's Capital Contribution under the provisions of Article III of this Agreement.

(c) The occurrence of any other event that is, or that would cause, a Transfer in contravention of this Agreement.

Each Member agrees to promptly give Notice of a Triggering Event to _ _[*the Managers/all other Members*]_ _.

8.5. Notwithstanding any other provisions of this Agreement:

[*Use one of the following alternatives*]

[*Alternative 1: Right to purchase membership interest*]

(a) If, in connection with the divorce or dissolution of the marriage of a Member, any court issues a decree or order that transfers, confirms, or awards a Membership Interest, or any portion of it, to that Member's spouse (an "Award"), then, notwithstanding that the transfer would constitute an unpermitted Transfer under this Agreement, that Member will have the right to purchase from his or her former spouse the Membership Interest, or portion of it, that was so transferred, and the former spouse will sell the Membership Interest or portion of it to that Member at the price set forth below in Section 8.8 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the court Award (the Expiration Date), the Company and the other Members will have the option to purchase from the former spouse the Membership Interest or portion of it under Section 8.6 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the Award.

[*Alternative 2: Transfer of economic interest*]

(a) In the event of a dissolution of marriage of any married Member decreed by a court of competent jurisdiction, the Membership Interest will be allocated and distributed between the Member and the Member's spouse as the court may decree, provided, however, that:

(1) No spouse will become a Member by virtue of any allocation or distribution of the Membership Interest in any dissolution proceeding;

(2) The spouse will have only the status of an assignee of the Member's right to receive Profits and Losses under Corporations Code §17301;

(3) As between the Member and the Member's spouse, the Member will continue to have the exclusive right and authority to act as a Member on behalf of and bind the Company as specified in this Agreement; and

(4) Any action, consent, or approval taken or given or any document or instrument executed by the Member on his or her own behalf (and on behalf of the Member's spouse as an assignee under this Agreement) will be

binding on the Member and the Member's spouse, and the other Members and any third party will be entitled to rely on any action so taken by that Member in accordance with this Agreement.

[*Continue*]

(b) If, by reason of the death of a spouse of a Member, any portion of a Membership Interest is transferred to a Transferee other than (1) that Member or (2) a trust created for the benefit of that Member (or for the benefit of that Member and any combination between or among the Member and the Member's issue) in which the Member is the sole Trustee and the Member, as Trustee or individually possesses all of the Voting Interest included in that Membership Interest, then the Member will have the right to purchase the Membership Interest or portion of it from the estate or other successor of his or her deceased spouse or Transferee of the deceased spouse, and the estate, successor, or Transferee will sell the Membership Interest or portion of it at the price set forth in Section 8.8 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the date of death (the Expiration Date), the Company and the other Members will have the option to purchase from the estate or other successor of the deceased spouse the Membership Interest or portion of it under Section 8.6 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the death.

8.6. On the receipt of Notice by the Manager and the other Members as contemplated by Sections 8.1, 8.3, and 8.5, and on receipt of actual notice of any Triggering Event as determined in good faith by the Manager (the date of the receipt is hereinafter referred to as the "Option Date"), the Manager will promptly cause a Notice of the occurrence of a Triggering Event to be sent to all Members, and the Company will have the option, for a period ending 30 calendar days following the determination of the purchase price as provided in Section 8.8, to purchase the Membership Interest in the Company to which the option relates, at the price and on the terms set forth in Section 8.8 of this Agreement, and the other Members, pro rata in accordance with their prior Membership Interests in the Company, will then have the option, for a period of 30 days thereafter, to purchase the Membership Interest in the Company not purchased by the Company, on the same terms and conditions as apply to the Company. If all other Members do not elect to purchase the entire remaining Membership Interest in the Company, then the Members electing to purchase will have the right, pro rata in accordance with their prior Membership Interests in the Company, to purchase the additional Membership Interest in the Company available for purchase. The transferee of the Membership Interest in the Company that is not purchased will hold the Membership Interest in the Company subject to all of the provisions of this Agreement.

8.7. Neither the Member whose interest is subject to purchase under this Article, nor that Member's Affiliate, will participate in any Vote or discussion of any matter pertaining to the disposition of the Member's Membership Interest in the Company under this Agreement.

8.8. The purchase price of the Membership Interest that is the subject of an option under Section 8.6. will be the "Fair Option Price" of the interest as determined under this Section 8.8. "Fair Option Price" means the cash price that a willing buyer would pay to a willing seller when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts on the Option Date. Each of the selling and purchasing parties will use his, her, or its best efforts to mutually agree on the Fair Option Price. If the parties are unable to so agree within 30 days of the Option Date, the selling party will appoint, within 40 days of the Option Date, one appraiser, and the purchasing party will appoint within 40 days of the Option Date, one appraiser. The two appraisers will within a period of 5 additional days, agree on and appoint an additional appraiser. The three appraisers will, within 60 days after the appointment of the third appraiser, determine the Fair Option Price of the Membership Interest in writing and submit their report to all the parties.

The Fair Option Price will be determined by disregarding the appraiser's valuation that diverges the most from each of the other two appraisers' valuations, and the arithmetic mean of the remaining two appraisers' valuations will be the Fair Option Price. Each purchasing party will pay for the services of the appraiser selected by it, plus one-half of the fee charged by the third appraiser, and one-half of all other costs relating to the determination of Fair Option Price. The Fair Option Price as so determined will be payable in cash.

8.9. Except as expressly permitted under Section 8.2, a prospective transferee (other than an existing Member) of a Membership Interest may be admitted as a Member with respect to the Membership Interest (Substituted Member) only (a) on the unanimous Vote of the other Members in favor of the prospective transferee's admission as a Member, and (b) on the prospective transferee's executing a counterpart of this Agreement as a party to it. Any prospective transferee of a Membership Interest will be deemed an Assignee, and, therefore, the owner of only an Economic Interest until the prospective transferee has been admitted as a

Substituted Member. Except as otherwise permitted in the Act, any such Assignee will be entitled only to receive allocations and distributions under this Agreement with respect to the Membership Interest and will have no right to Vote or exercise any rights of a Member until the Assignee has been admitted as a Substituted Member. Until the Assignee becomes a Substituted Member, the Assigning Member will continue to be a Member and have the power to exercise any rights and powers of a Member under this Agreement, including the right to Vote in proportion to the Percentage Interest that the Assigning Member would have had if the assignment had not been made.

8.10. Any person admitted to the Company as a Substituted Member will be subject to all the provisions of this Agreement that apply to the Member from whom the Membership Interest was assigned, except that the assigning Member will not be released from liabilities as a Member solely as a result of the assignment, both with respect to obligations to the Company and to third parties incurred before the assignment.

8.11. The initial sale of Membership Interests in the Company to the Initial Members has not been qualified or registered under the securities laws of any state, including California, or registered under the Securities Act of 1933, in reliance on exemptions from the registration provisions of those laws. Notwithstanding any other provision of this Agreement, Membership Interests may not be Transferred unless registered or qualified under applicable state and federal securities laws unless, in the opinion of legal counsel satisfactory to the Company, qualification or registration is not required. A Member who desires to transfer a Membership Interest will be responsible for all legal fees incurred in connection with that opinion.

ARTICLE IX: DISSOLUTION AND WINDING UP

9.1. The Company will be dissolved on the first to occur of the following events:

(a) The written agreement of a Majority of Members to dissolve the Company.

(b) The sale or other disposition of substantially all of the Company's assets.

(c) Entry of a decree of judicial dissolution under Corp C §17351.

9.2. On the dissolution of the Company, the Company will engage in no further business other than that necessary to wind up the business and affairs of the Company. The Manager or, if there is no Manager, the Members, will wind up the affairs of the Company. The Manager or Members winding up the affairs of the Company will give Notice of the commencement of winding up by mail to all known creditors and claimants against the Company whose addresses appear in the records of the Company. After paying or adequately providing for the payment of all known debts of the Company (except debts owing to Members), the remaining assets of the Company will be distributed or applied in the following order:

(a) To pay the expenses of liquidation;

(b) To the establishment of reasonable reserves for contingent liabilities or obligations of the Company. On the determination that reserves are no longer necessary, they will be distributed as provided in this Section 9.2;

(c) To repay outstanding loans to Members. If there are insufficient funds to pay those loans in full, each Member will be repaid in the ratio that the Member's loan, together with accrued and unpaid interest, bears to the total of all loans from Members, including all accrued and unpaid interest. Repayment will first be credited to unpaid principal and the remainder will be credited to accrued and unpaid interest; and

(d) Among the Members with Positive Capital Account Balances as provided in Article IV, Section 4.16.

9.3. Each Member will look solely to the assets of the Company for the return of the Member's investment, and if Company property remaining after the payment or discharge of the Company's debts and liabilities is insufficient to return the investment of each Member, the Member will have no recourse against any other Members for indemnification, contribution, or reimbursement, except as specifically provided in this Agreement.

ARTICLE X: NONCOMPETITION AND CONFIDENTIALITY

10.1. Each Member covenants with the Company and each other Member that on the Transfer of the

Member's Membership Interest, whether voluntary, involuntary, by operation of law, or by reason of any provision of this Agreement, the Member will not, directly or indirectly, through an Affiliate or otherwise, in the following geographic area: _ _[*e.g., counties*]_ _, or elsewhere where the Company conducts its business, for a period of _ _[*number*]_ _ years following the date of the Transfer,

(a) engage in any business in any way similar to or competitive with the business of the Company;

(b) enter into any agreement or understanding, written or oral, relating to the services of any employee of the Company;

(c) solicit the business of, enter into any agreement, written or oral, or otherwise deal with any customers of the Company, who were customers at the time of the Transfer; or

(d) use or disclose in any manner any Confidential Information.

10.2. "Confidential Information" means all trade secrets, "know-how," customer lists, pricing policies, operational methods, programs, and other business information of the Company created, developed, produced, or otherwise arising before the date of the Transfer.

10.3. Each Member stipulates that a breach of the provisions of this Article X will result in irreparable damage and injury to the Company for which no money damages could adequately compensate it. If the Member breaches the provisions of this Agreement, in addition to all other remedies to which the Company may be entitled, and notwithstanding the provisions of Article XI, Section 11.2, the Company will be entitled to an injunction to enforce the provisions of this Agreement, to be issued by any court of competent jurisdiction, to enjoin and restrain the Member and each and every Person concerned or acting in concert with the Member from the continuance of that breach. Each Member expressly waives any claim or defense that an adequate remedy at law might exist for any such breach.

10.4. If any provision in this Article X is deemed to exceed the time or geographic limits or any other limitation imposed by applicable law in any jurisdiction, that provision will be deemed reformed in that jurisdiction to the maximum extent permitted by applicable law.

ARTICLE XI: INDEMNIFICATION AND ARBITRATION

11.1. The Company will have the power to indemnify any Person who was or is a party, or who is threatened to be made a party, to any Proceeding by reason of the fact that the Person was or is a Member, Manager, officer, employee, or other agent of the Company, or was or is serving at the request of the Company as a director, officer, employee, or other Agent of another limited liability company, corporation, partnership, joint venture, trust, or other enterprise, against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred by that Person in connection with the proceeding, if that Person acted in good faith and in a manner that the Person reasonably believed to be in the best interests of the Company, and, in the case of a criminal proceeding, the Person had no reasonable cause to believe that the Person's conduct was unlawful. The termination of any proceeding by judgment, order, settlement, conviction, or on a plea of nolo contendere or its equivalent, will not, of itself, create a presumption that the Person did not act in good faith and in a manner that the Person reasonably believed to be in the best interests of the Company, or that the Person had reasonable cause to believe that the Person's conduct was unlawful.

To the extent that an agent of the Company has been successful on the merits in defense of any Proceeding, or in defense of any claim, issue, or matter in any Proceeding, the agent will be indemnified against expenses actually and reasonably incurred in connection with the Proceeding. In all other cases, indemnification will be provided by the Company only if authorized in the specific case by a Majority of Members.

"Agent," as used in this Section 11.1, will include a trustee or other fiduciary of a plan, trust, or other entity or arrangement described in Corp C §207(f).

"Proceeding," as used in this Section 11.1, means any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative.

Expenses of each Person indemnified under this Agreement actually and reasonably incurred in connection

with the defense or settlement of a proceeding may be paid by the Company in advance of the final disposition of the proceeding, as authorized by the Managers who are not seeking indemnification or, if there are none, by a Majority of the Members, on receipt of an undertaking by that Person to repay that amount unless it will ultimately be determined that the Person is entitled to be indemnified by the Company. "Expenses," as used in this Section 11.1, includes, without limitation, attorney fees and expenses of establishing a right to indemnification, if any, under this Section 11.1.

11.2. Any action to enforce or interpret this Agreement, or to resolve disputes with respect to this Agreement between the Company and a Member, or between or among the Members, will be settled by arbitration in accordance with the rules of the American Arbitration Association. Arbitration will be the exclusive dispute resolution process in the state of California, but arbitration will be a nonexclusive process elsewhere. Any party may commence arbitration by sending a written demand for arbitration to the other parties. The demand will set forth the nature of the matter to be resolved by arbitration. The Manager will select the place of arbitration. The substantive law of the state of California will be applied by the arbitrator to the resolution of the dispute. The parties will share equally all initial costs of arbitration. The prevailing party will be entitled to reimbursement of attorney fees, costs, and expenses incurred in connection with the arbitration. All decisions of the arbitrator will be final, binding, and conclusive on all parties. Judgment may be entered on any such decision in accordance with applicable law in any court having jurisdiction of it. The arbitrator (if permitted under applicable law) or the court may issue a writ of execution to enforce the arbitrator's decision.

ARTICLE XII: ATTORNEY-IN-FACT AND AGENT

12.1. Each Member, by execution of this Agreement, irrevocably constitutes and appoints each Manager and any of them acting alone as the Member's true and lawful attorney-in-fact and agent, with full power and authority in the Member's name, place, and stead to execute, acknowledge, and deliver, and to file or record in any appropriate public office: (a) any certificate or other instrument that may be necessary, desirable, or appropriate to qualify the Company as a limited liability company or to transact business as one in any jurisdiction in which the Company conducts business; (b) any certificate or amendment to the Company's articles of organization or to any certificate or other instrument that may be necessary, desirable, or appropriate to reflect an amendment approved by the Members in accordance with the provisions of this Agreement; (c) any certificates or instruments that may be necessary, desirable, or appropriate to reflect the dissolution and winding up of the Company; and (d) any certificates necessary to comply with the provisions of this Agreement. This power of attorney will be deemed to be coupled with an interest and will survive the Transfer of the Member's Economic Interest. Notwithstanding the existence of this power of attorney, each Member agrees to join in the execution, acknowledgment, and delivery of the instruments referred to above if requested to do so by a Manager. This power of attorney is a limited power of attorney and does not authorize any Manager to act on behalf of a Member except as described in this Article XII.

ARTICLE XIII: GENERAL PROVISIONS

13.1. This Agreement constitutes the whole and entire agreement of the parties with respect to its subject matter, and it will not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the Members and Managers or any of them.

13.2. This Agreement may be executed in one or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

13.3. This Agreement will be construed and enforced in accordance with the laws of the state of California. If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision will, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid that invalidity, illegality, or unenforceability or, if that is not possible, the provision will, to the extent of that invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement will remain in effect.

13.4. This Agreement will be binding on and inure to the benefit of the parties and their heirs, personal representatives, and permitted successors and assigns.

13.5. Whenever used in this Agreement, the singular will include the plural and the plural will include the singular, and the neuter gender will include the male and female as well as a trust, firm, company, or

corporation, all as the context and meaning of this Agreement may require.

13.6. The parties to this Agreement will promptly execute and deliver any and all additional documents, instruments, notices, and other assurances, and will do any and all other acts and things reasonably necessary in connection with the performance of their respective obligations under this Agreement and to carry out the intent of the parties.

13.7. Except as provided in this Agreement, no provision of this Agreement will be construed to limit in any manner the Members in the carrying on of their own respective businesses or activities.

13.8. Except as provided in this Agreement, no provision of this Agreement will be construed to constitute a Member, in the Member's capacity as such, the agent of any other Member.

13.9. Each Member represents and warrants to the other Members that the Member has the capacity and authority to enter into this Agreement.

13.10. The article, section, and paragraph titles and headings in this Agreement are inserted as matters of convenience and for ease of reference only and will be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

13.11. This Agreement may be altered, amended, or repealed only by a writing signed by all of the Members.

13.12. Time is of the essence for every provision of this Agreement that specifies a time for performance.

13.13. This Agreement is made solely for the benefit of the parties to this Agreement and their respective permitted successors and assigns, and no other person or entity will have or acquire any right by virtue of this Agreement.

In witness whereof, the parties have executed or caused to be executed this Agreement on the day and year first above written.

__[*Signature*]__
_ _[*Typed or printed name*]_ _
Member

__[*Additional signature(s); repeat above block as necessary*]__

_ _[*name of partnership*]_ _

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _
Its: General Partner

_ _[*name of partnership*]_ _

By: _ _[*name of corporation*]_ _**, General Partner**

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _**, President**

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _**, Secretary**

_ _[*name of partnership*]_ _

By: _ _[*name of corporation*]_ _**, General Partner**

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _**,**

Its: President

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _**, Secretary**
Its: Secretary

By: __[*Signature*]__
_ _[*Typed or printed name*]_ _, **Trustee of** _ _[*Name of trust*]_ _**, u/t/d** _ _[*date*]_ _

Estate of _ _[*Name*]_ _**, Deceased**

__[*Signature*]__
_ _[*Typed or printed name*]_ _,
Executor

SPOUSAL CONSENT

The undersigned is the spouse of _ _[*name*]_ _ **and acknowledges that** _ _[*he/she*]_ _ **has read the foregoing Agreement dated** _ _[*date*]_ _**, and understands its provisions. The undersigned is aware that, by the provisions of the Agreement,** _ _[*he/she*]_ _ **and** _ _[*his/her*]_ _ **spouse have agreed to sell or transfer all** _ _[*his/her*]_ _ **Membership Interest in the Company, including any community property interest or quasi-community property interest, in accordance with the terms and provisions of the Agreement. The undersigned expressly approves of and agrees to be bound by the provisions of the Agreement in its entirety, including, but not limited to, those provisions relating to the sales and transfers of Membership Interests and the restrictions on them. If the undersigned predeceases** _ _[*his/her*]_ _ **spouse when** _ _[*his/her*]_ _ **spouse owns any Membership Interest in the Company,** _ _[*he/she*]_ _ **agrees not to devise or bequeath whatever community property interest or quasi-community property interest** _ _[*he/she*]_ _ **may have in the Company in contravention of the Agreement.**

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name*]_ _

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Source: Business Law/Forming and Operating California Limited Liability Companies/Appendix B Short-Form Multimember Operating Agreement

Appendix B

Short-Form Multimember Operating Agreement

▶ To download **Word** version, right click and choose *Save Target As*

▶ To download **WordPerfect** version, right click and choose *Save Target As*

OPERATING AGREEMENT for _ _[*NAME*]_ _, _ _[*e.g., LLC/a limited liability company*]_ _

This Operating Agreement is entered into as of _ _[*date*]_ _**, by** _ _[*names*]_ _ **(referred to individually as a Member and collectively as the Members).**

A. The Members desire to form a limited liability company (Company) under the Beverly-Killea Limited Liability Company Act.

B. The Members enter into this Operating Agreement to form and provide for the governance of the Company and the conduct of its business and to specify their relative rights and obligations.

Now therefore, the Members agree as follows:

ARTICLE I: DEFINITIONS

The following capitalized terms used in this Agreement have the meanings specified in this Article or elsewhere in this Agreement and when not so defined will have the meanings set forth in California Corporations Code §17001.

1.1. "Act" means the Beverly-Killea Limited Liability Company Act (California Corporations Code §§17000-17656), including amendments from time to time.

1.2. "Agreement" means this operating agreement, as originally executed and as amended from time to time.

1.3. "Articles of Organization" is defined in California Corporations Code §17001(b) as applied to this Company.

1.4. "Assignee" means a Person who has acquired a Member's Economic Interest in the Company, by way of a Transfer in accordance with the terms of this Agreement, but who has not become a Member.

1.5. "Assigning Member" means a Member who by means of a Transfer has transferred an Economic Interest in the Company to an Assignee.

1.6. "Book Adjustments" means, for any item of Company property for a given fiscal year, adjustments with respect to Book Value for depreciation, cost recovery, or other amortization deduction or gain or loss computed in accordance with Treasury Reg §1.704-1(b)(2)(iv)(g), including Book Depreciation.

1.7. "Book Depreciation" means, for any item of Company property for a given fiscal year, a percentage of depreciation or other cost recovery deduction allowable for federal income tax purposes for that item during that fiscal year equal to the result (expressed as a percentage) obtained by dividing (1) the Gross Asset value of that item at the beginning of the fiscal year (or the acquisition date during the fiscal year) by (2) the federal adjusted tax basis of the item at the beginning of the fiscal year (or the acquisition date during the fiscal year). If the adjusted tax basis of an item is zero, the Company may determine Book Depreciation, provided that it is done in a reasonable and consistent manner.

1.8. "Capital Account" means, for any Member, a separate account maintained and adjusted in accordance with Article III, Section 3.3.

1.9. "Capital Contribution" means, with respect to any Member, the amount of money _ _[*, or services rendered or to be rendered,*]_ _ and the fair market value of any property contributed to the Company (net of liabilities secured by the contributed property that the Company is considered to assume or take "subject to" under IRC §752) in consideration of a Percentage Interest held by that Member. A Capital Contribution will not be deemed a loan.

1.10. "Capital Event" means a sale or disposition of any of the Company's capital assets, the receipt of insurance and other proceeds on account of an involuntary conversion of Company property, the receipt of proceeds from a refinancing of Company property, or a similar event with respect to Company property or assets.

1.11. "Company" means the company named in Article II, Section 2.2.

1.12. "Corporations Code" ("Corp C") means the California Corporations Code.

1.13. "Economic Interest" means a Person's right to share in the income, gains, losses, deductions, credit, or similar items of the Company, and to receive distributions from the Company under this Agreement or under the Act, but does not include any other rights of a Member, including the right to vote, the right to participate in the management of the Company, or, except as provided in Corp C §17106, any right to information concerning the business and affairs of the Company.

1.14. "Electronic transmission by the Company" and "electronic transmission to the Company" have the meanings set out in California Corp C §17001(o)(1)-(2).

1.15. "Encumber" means the act of creating or purporting to create an Encumbrance, whether or not perfected under applicable law.

1.16. "Encumbrance" means, with respect to any Membership Interest, or any part of it, a mortgage, pledge, security interest, lien, proxy coupled with an interest (other than as contemplated in this Agreement), option, or preferential right to purchase.

1.17. "Gross Asset Value" means, with respect to any item of property of the Company, the item's adjusted basis for federal income tax purposes, except as follows:

(a) The Gross Asset Value of any item of property contributed by a Member to the Company will be the fair market value of that property, as mutually agreed by the contributing Member and the Company;

(b) The Gross Asset Value of any item of Company property will be adjusted as of the following times: (1) on the acquisition of an interest or additional interest in the Company by any new or existing Member in exchange for more than a de minimis Capital Contribution; (2) on the distribution of money or other property (other than a de minimis amount) by the Company to a Member as consideration for an Economic Interest in the Company; and (3) on the liquidation of the Company within the meaning of Treasury Reg §1.704-1(b)(2)(ii)(g), provided, however, that adjustments under clauses (1) and (2) above will be made only if the Members have determined that the Company must revalue its assets in accordance with Treasury Reg §1.704-1(b)(2)(iv)(f);

(c) The Gross Asset Value of any Company asset distributed to any Member will be the fair market value of the asset on the date of distribution;

(d) The Gross Asset Value of Company assets will be increased (or decreased) to reflect any adjustments to the adjusted tax basis of the assets under Internal Revenue Code §734(b) or §743(b), subject to the limitations imposed by IRC §755 and only to the extent that the adjustments are taken into account in determining Capital Accounts under Treasury Reg §1.704-1(b)(2)(iv)(m), and if the Gross Asset Value of an asset has been determined or adjusted under paragraph (a), (b), or (d) of this Section 1.17, the Gross Asset Value will thereafter be adjusted by the Book Adjustments, if any, taken into account with respect to the asset for purposes of computing Profits and Losses.

1.18. "Initial Member" or "Initial Members" means those Persons whose names are set forth in _ _[*the first sentence of/in Exhibit A to*]_ _ this Agreement. A reference to an "Initial Member" means any of the Initial Members.

1.19. "Involuntary Transfer" means, with respect to any Membership Interest, or any part of it, any Transfer or Encumbrance, whether by operation of law, under court order, foreclosure of a security interest, execution of a judgment or other legal process, or otherwise, including a purported transfer to or from a trustee in bankruptcy, receiver, or assignee for the benefit of creditors.

1.20. "IRC" means the Internal Revenue Code of 1986, as amended, and any successor provision.

1.21. "Losses." See "Profits and Losses."

1.22. "Majority of Members" means a Member or Members whose Percentage Interests represent more than 50 percent of the Percentage Interests of all the Members.

1.23. "Meeting" is defined in Article V, Section 5.2.

1.24. "Member" means an Initial Member or a Person who otherwise acquires a Membership Interest, as permitted under this Agreement, and who remains a Member.

1.25. "Notice" means a written notice required or permitted under this Agreement. A notice will be deemed given or sent when deposited, as certified mail or for overnight delivery, postage and fees prepaid, in the United States mails; when delivered to Federal Express, United Parcel Service, DHL WorldWide Express, or Airborne Express, for overnight delivery, charges prepaid or charged to the sender's account; when personally delivered to the recipient; when transmitted by electronic transmission by or to the Company (see §1.14); or when delivered to the home or office of a recipient in the care of a person whom the deliverer has reason to believe will promptly communicate the notice to the recipient.

1.26. "Percentage Interest" means a fraction, expressed as a percentage, the numerator of which is the total of a Member's Capital Account and the denominator of which is the total of all Capital Accounts of all Members.

1.27. "Person" means an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign.

1.28. "Profits and Losses" means, for each fiscal year or other period specified in this Agreement, an amount equal to the Company's taxable income or loss for the year or period, determined in accordance with IRC §703(a).

1.29. "Proxy" has the meaning set forth in the first paragraph of California Corporations Code §17001(ai). A Proxy may not be transmitted orally.

1.30. "Regulations" ("Reg") means the income tax regulations promulgated by the United States Department of the Treasury and published in the Federal Register for the purpose of interpreting and applying the provisions of the Internal Revenue Code, as those Regulations may be amended from time to time, including corresponding provisions of applicable successor regulations.

1.31. "Substituted Member" is defined in Article VIII, Section 8.8.

1.32. "Successor in Interest" means an Assignee, a successor of a Person by merger or otherwise by operation of law, or a transferee of all or substantially all of the business or assets of a Person.

1.33. "Transfer" means any sale, assignment, gift, Involuntary Transfer, Encumbrance, or other disposition of a Membership Interest or any part of a Membership Interest, directly or indirectly, other than an Encumbrance that is expressly permitted under this Agreement.

1.34. "Triggering Event" is defined in Article VIII, Section 8.3.

1.35. "Vote" means a written consent or approval, a ballot cast at a Meeting, or a voice vote.

1.36. "Voting Interest" means, with respect to a Member, the right to Vote or participate in management and any right to information concerning the business and affairs of the Company provided under the Act, except as limited by the provisions of this Agreement. A Member's Voting Interest will be directly proportional to that

Member's Percentage Interest.

1.37 "Writing" includes any form of recorded message capable of comprehension by ordinary visual means, and when used to describe communications between the Company and its Members, "writing" will include electronic transmissions by and to the Company as defined in California Corporations Code §17001(o)(1)-(2).

1.38. "Written" or "in writing" includes facsimile and other electronic communication authorized by the California Corporations Code.

ARTICLE II: ARTICLES OF ORGANIZATION

2.1. Promptly following execution of this Agreement, the Members will cause Articles of Organization, in the form attached to this Agreement as Exhibit _ _[*letter/number*]_ _, to be filed with the California Secretary of State.

2.2. The name of the Company will be _ _[*name*]_ _.

2.3. The principal executive office of the Company will be at _ _[*address*]_ _, California _ _[*zip code*]_ _, or any other place or places determined by the Members from time to time.

2.4. The initial agent for service of process on the Company will be _ _[*name*]_ _. A Majority of Members may from time to time change the Company's agent for service of process.

2.5. The Company will be formed for the purposes of engaging in the business of _ _[*description of business*]_ _.

2.6. The term of existence of the Company will commence on the effective date of filing of Articles of Organization with the California Secretary of State, and will continue until terminated by the provisions of this Agreement or as provided by law.

2.7. The Members will be the managers of the Company.

ARTICLE III: CAPITALIZATION

3.1. Each Member will contribute to the capital of the Company as the Member's Capital Contribution the money or property specified in Exhibit _ _[*letter/number*]_ _ to this Agreement. The Fair Market Value of each item of contributed property as agreed between the Company and the Member contributing the property is set forth in Exhibit _ _[*letter/number*]_ _. Unless otherwise agreed in writing by all Members, no Member will be required to make additional Capital Contributions.

3.2. If a Member fails to make a required Capital Contribution within 30 days after the effective date of this Agreement, that Member's entire Membership Interest will terminate and that Member will indemnify and hold the Company and the other Members harmless from any loss, cost, or expense, including reasonable attorney fees, caused by the failure to make that Capital Contribution.

3.3. An individual Capital Account will be maintained for each Member consisting of that Member's Capital Contribution, (1) increased by that Member's share of Profits, (2) decreased by that Member's share of Losses, and (3) adjusted as required in accordance with applicable provisions of the Code and Regulations.

3.4. A Member will not be entitled to withdraw any part of the Member's Capital Contribution or to receive any distributions, whether of money or property from the Company except as provided in this Agreement.

3.5. No interest will be paid on funds or property contributed to the capital of the Company or on the balance of a Member's Capital Account.

3.6. A Member will not be bound by, or be personally liable for, the expenses, liabilities, or obligations of the Company except as otherwise provided in the Act or in this Agreement.

3.7. No Member will have priority over any other Member with respect to the return of a Capital Contribution

or distributions or allocations of income, gain, losses, deductions, credits, or items thereof.

ARTICLE IV: ALLOCATIONS AND DISTRIBUTIONS

4.1. The Profits and Losses of the Company and all items of Company income, gain, loss, deduction, or credit will be allocated, for Company book purposes and for tax purposes, to each Member in accordance with that Member's Percentage Interest.

4.2. If any Member unexpectedly receives any adjustment, allocation, or distribution described in Treasury Reg §1.704-1(b)(2)(ii)(d)(4)-(6), items of Company gross income and gain will be specially allocated to that Member in an amount and manner sufficient to eliminate any deficit balance in the Member's Capital Account created by the adjustment, allocation, or distribution as quickly as possible. Any special allocation under this Section 4.2 will be taken into account in computing subsequent allocations of Profits and Losses, so that the net amount of allocations of income and loss and all other items will, to the extent possible, be equal to the net amount that would have been allocated if the unexpected adjustment, allocation, or distribution had not occurred. The provisions of this Section 4.2 and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Treasury Reg §§1.704-1(b) and 1.704-2 and will be interpreted and applied in a manner consistent with those Regulations.

4.3. Any unrealized appreciation or unrealized depreciation in the values of Company property distributed in kind to all the Members will be treated in accordance with applicable law.

4.4. In the case of a Transfer of an Economic Interest during any fiscal year, the Assigning Member and Assignee will each be allocated the Economic Interest's share of Profits or Losses based on the number of days each held the Economic Interest during that fiscal year.

4.5. All cash resulting from the normal business operations of the Company and from a Capital Event will be distributed among the Members in proportion to their Percentage Interests at such times as the Members may agree.

4.6. If the proceeds from a sale or other disposition of a Company asset consist of property other than cash, the value of the property will be as determined by the Members. Noncash proceeds will then be allocated among all the Members in proportion to their Percentage Interests. If noncash proceeds are subsequently reduced to cash, the cash will be distributed to each Member in accordance with Section 4.5.

4.7. Notwithstanding any other provisions of this Agreement to the contrary, when there is a distribution in liquidation of the Company, or when any Member's Interest is liquidated, all items of income and loss first will be allocated to the Members' Capital Accounts under this Article IV, and other credits and deductions to the Members' Capital Accounts will be made before the final distribution is made. The final distribution to the Members will be made to the Members to the extent of and in proportion to their positive Capital Account balances.

ARTICLE V: MANAGEMENT

5.1. The business of the Company will be managed by all the Members. A Member will be a manager only during the time the Member is a Member of the Company. Unless otherwise provided in this Agreement, all decisions concerning the management of the Company's business will be made by the Vote of a Majority of Members.

5.2. The Members are not required to hold meetings, and decisions may be reached through one or more informal consultations followed by agreement among a Majority of Members, provided that all Members are consulted (although all Members need not be present during a particular consultation), or by a written consent signed by a Majority of Members. In the event that Members wish to hold a formal meeting (a "Meeting") for any reason, the following procedures will apply:

(1) Any two Members may call a Meeting of the Members by giving Notice of the time and place of the Meeting at least 48 hours before the time of the holding of the Meeting. The Notice need not specify the purpose of the Meeting, or the location if the Meeting is to be held at the principal executive office of the Company.

(2) A majority of Members will constitute a quorum for the transaction of business at any Meeting of the Members.

(3) The transactions of the Members at any Meeting, however called or noticed, or wherever held, will be as valid as though transacted at a Meeting duly held after call and notice if a quorum is present and if, either before or after the Meeting, each Member not present signs a written waiver of Notice, a consent to the holding of the Meeting, or an approval of the minutes of the Meeting.

(4) Any action required or permitted to be taken by the Members under this Agreement may be taken without a Meeting if a Majority of the Members individually or collectively consent in writing to that action.

(5) Members may participate in the Meeting through the use of a conference telephone or similar communications equipment, provided that all Members participating in the Meeting can hear one another.

(6) The Members will keep or cause to be kept with the books and records of the Company full and accurate minutes of all Meetings, Notices, and waivers of Notices of Meetings, and all written consents in lieu of Meetings.

5.3. The Members as such and as managers will not be entitled to compensation for their services.

5.4. The Company may have a President, who may be, but need not be, a Member. A Majority of the Members may provide for additional officers of the Company and for their election, and may alter the powers, duties, and compensation of the President and of all other officers. The President, if there is one, will attend any Meetings of Members called under Section 5.2(1)-(6).

5.5. All assets of the Company, whether real or personal, will be held in the name of the Company.

5.6. All funds of the Company will be deposited in one or more accounts with one or more recognized financial institutions in the name of the Company, at locations determined by a Majority of Members. Withdrawal from those accounts will require the signature of the person or persons designated by a Majority of Members.

ARTICLE VI: ACCOUNTS AND RECORDS

6.1. Complete books of account of the Company's business, in which each Company transaction will be fully and accurately entered, will be kept at the Company's principal executive office and will be open to inspection and copying by each Member or the Member's authorized representatives on reasonable Notice during normal business hours. The costs of inspection and copying will be borne by the Member.

6.2. Financial books and records of the Company will be kept on the _ _[*accrual/cash*]_ _ method of accounting, which will be the method of accounting followed by the Company for federal income tax purposes. A balance sheet and income statement of the Company will be prepared promptly following the close of each fiscal year in a manner appropriate to and adequate for the Company's business and for carrying out the provisions of this Agreement. The fiscal year of the Company will be January 1 through December 31.

6.3. At all times during the term of existence of the Company, and beyond that term if a Majority of the Members deem it necessary, the Members will keep or cause to be kept the books of account referred to in Section 6.2, and the following:

(a) A current list of the full name and last known business or residence address of each Member, together with the Capital Contribution and the share in Profits and Losses of each Member;

(b) A copy of the Articles of Organization, as amended;

(c) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years;

(d) Executed counterparts of this Agreement, as amended;

(e) Any powers of attorney under which the Articles of Organization or any amendments were executed;

(f) Financial statements of the Company for the six most recent fiscal years; and

(g) The books and records of the Company as they relate to the Company's internal affairs for the current and past four fiscal years.

If a Majority of Members deem that any of the foregoing items will be kept beyond the term of existence of the Company, the repository of those items will be as designated by a Majority of Members.

6.4. Within 90 days after the end of each taxable year of the Company, the Company will send to each of the Members all information necessary for the Members to complete their federal and state income tax or information returns, and a copy of the Company's federal, state, and local income tax or information returns for that year.

ARTICLE VII: MEMBERS AND VOTING

7.1. There will be only one class of membership and no Member will have any rights or preferences in addition to or different from those possessed by any other Member. Each Member will Vote in proportion to the Member's Percentage Interest as of the governing record date, determined in accordance with Section 7.2. Any action that may or that must be taken by the Members will be by a Majority of Members, except that the following actions will all require the *unanimous* Vote of the Members:

(a) The transfer of a Membership Interest and the admission of the Assignee as a Member of the Company;

(b) Any amendment of the Articles of Organization or this Agreement; or

(c) Compromise of the obligation of a Member to make a Capital Contribution.

7.2. The record date for determining the Members entitled to Notice of any Meeting, to Vote, to receive any distribution, or to exercise any right in connection with any other lawful action, will be the date set by a Majority of Members, provided that the record date may not be more than 60, nor less than 10 days before the date of the Meeting, nor more than 60 days before any other action.

In the absence of any action setting a record date, the record date will be determined in accordance with California Corporations Code §17104(k).

7.3. At all Meetings of Members, a Member may Vote in person or by Proxy. The Proxy will be filed with any Member before or at the time of the Meeting, and may be filed by facsimile transmission to a Member at the principal executive office of the Company or any other address given by a Majority of Members to the Members for that purpose.

ARTICLE VIII: TRANSFERS OF MEMBERSHIP INTERESTS

8.1. A Member may withdraw from the Company at any time by giving Notice of Withdrawal to all other Members at least 180 calendar days before the effective date of withdrawal. Withdrawal will not release a Member from any obligations and liabilities under this Agreement accrued or incurred before the effective date of withdrawal. A withdrawing Member will divest the Member's entire Membership Interest before the effective date of withdrawal in accordance with the transfer restrictions and option rights set forth below.

8.2. Except as expressly provided in this Agreement, a Member will not Transfer any part of the Member's Membership Interest in the Company, whether now owned or later acquired, unless (1) the other Members unanimously approve the transferee's admission to the Company as a Member and (2) the Membership Interest to be Transferred, when added to the total of all other Membership Interests Transferred in the preceding 12 months, will not cause the termination of the Company under IRC §708(b)(1)(B). No Member may Encumber or permit or suffer any Encumbrance of all or any part of the Member's Membership Interest in the Company unless the Encumbrance has been approved in writing by all the other Members. Any Transfer or Encumbrance of a Membership Interest without that approval will be void. Notwithstanding any other provision of this Agreement to the contrary, a Member who is a natural person may transfer all or any portion of his or her Membership Interest to any revocable trust created for the benefit of the Member, or any combination between or among the Member, the Member's spouse, and the Member's issue if the Member retains a beneficial interest

in the trust and all of the Voting Interest included in the Membership Interest. A transfer of a Member's entire beneficial interest in the trust or failure to retain a Voting Interest will be deemed a Transfer of a Membership Interest.

8.3. On the happening of any of the following events (Triggering Events) with respect to a Member, the Company and the other Members will have the option to purchase all or any portion of the Membership Interest in the Company of the Member (Selling Member) at the price and on the terms provided in Section 8.7 of this Agreement:

(a) The death or incapacity of a Member;

(b) The bankruptcy of a Member;

(c) The winding up and dissolution of a corporate Member, or the merger or other corporate reorganization of a corporate Member as a result of which the corporate Member does not survive as an entity;

(d) The withdrawal of a Member; or

(e) Except for the events stated in Section 8.4, the occurrence of any other event that is, or that would cause, a Transfer in contravention of this Agreement.

8.4. Each Member agrees to promptly give Notice of a Triggering Event to all other Members.

(a) If, in connection with the divorce or dissolution of the marriage of a Member, any court issues a decree or order that transfers, confirms, or awards a Membership Interest, or any portion of it, to that Member's spouse (an Award), then, notwithstanding that that transfer would constitute an unpermitted Transfer under this Agreement, that Member will have the right to purchase from his or her former spouse the Membership Interest, or portion of it, that was so transferred, and the former spouse will sell the Membership Interest or portion of it to that Member at the price set forth in Section 8.7 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the Award (the Expiration Date), the Company and the other Members will have the option to purchase from the former spouse the Membership Interest or portion of it under Section 8.5 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the Award.

(b) If, by reason of the death of a spouse of a Member, any portion of a Membership Interest is Transferred to a Transferee other than (1) that Member or (2) a trust created for the benefit of that Member (or for the benefit of that Member and any combination between or among the Member and the Member's issue) in which the Member is the sole Trustee and the Member, as Trustee or individually, possesses all of the Voting Interest included in that Membership Interest, then the Member will have the right to purchase the Membership Interest or portion of it from the estate or other successor of his or her deceased spouse or Transferee of his or her deceased spouse, and the estate, successor, or Transferee must sell the Membership Interest or portion of it at the price set forth in Section 8.7 of this Agreement. If the Member has failed to consummate the purchase within 180 days after the date of death (the Expiration Date), the Company and the other Members will have the option to purchase from the estate or other successor or Transferee of the deceased spouse the Membership Interest or portion of it under Section 8.5 of this Agreement, provided that the option period will commence on the later of (1) the day following the Expiration Date, or (2) the date of actual notice of the death.

8.5. On the receipt of Notice of any Triggering Event (the date of receipt being referred to in this Agreement as the Option Date), the Company will have the option, for a period ending 30 calendar days following the determination of the purchase price as provided in Section 8.7, to purchase the Membership Interest in the Company to which the option relates, at the price and on the terms provided in Section 8.7, and the other Members, pro rata in accordance with their prior Membership Interests in the Company, will then have the option, for a period of 30 days thereafter, to purchase the Membership Interest in the Company not purchased by the Company, on the same terms and conditions as apply to the Company. If all other Members do not elect to purchase the entire remaining Membership Interest in the Company, then the Members electing to purchase will have the right, pro rata in accordance with their prior Membership Interests in the Company, to purchase the additional Membership Interest in the Company available for purchase. The Transferee of the Membership Interest in the Company that is not purchased will hold the Membership Interest in the Company subject to all of the provisions of this Agreement.

8.6. No Member will participate in any Vote or decision in any matter pertaining to the disposition of that Member's Membership Interest in the Company under this Agreement.

8.7. The purchase price of a Membership Interest that is the subject of an option under this Agreement will be the Fair Market Value of the Membership Interest as determined under this Section 8.7. Each of the selling and purchasing parties will use his, her, or its best efforts to mutually agree on the Fair Market Value. If the parties are unable to so agree within 30 days of the date on which the option is first exercisable (the Option Date; see Section 8.5), the selling party will appoint, within 40 days of the Option Date, one appraiser, and the purchasing party will appoint within 40 days of the Option Date, one appraiser. The two appraisers will within a period of 5 additional days, agree on and appoint an additional appraiser. The three appraisers will, within 60 days after the appointment of the third appraiser, determine the Fair Market Value of the Membership Interest in writing and submit their report to all the parties. The Fair Market Value will be determined by disregarding the appraiser's valuation that diverges the most from each of the other two appraisers' valuations, and the arithmetic mean of the remaining two appraisers' valuations will be the Fair Market Value. Each party will pay for the services of the appraiser selected by it, plus one-half of the fee charged by the third appraiser. The option purchase price as so determined will be payable in cash.

8.8. Except as expressly permitted under Section 8.2, a prospective Transferee (other than an existing Member) of a Membership Interest may be admitted as a Member with respect to the Membership Interest (Substituted Member) only (1) on the unanimous Vote of the other Members in favor of the prospective Transferee's admission as a Member, and (2) on the prospective Transferee's executing a counterpart of this Agreement as a party to it. Any prospective Transferee of a Membership Interest will be deemed an Assignee, and, therefore, the owner of only an Economic Interest until the prospective Transferee has been admitted as a Substituted Member.

8.9. Any person admitted to the Company as a Substituted Member will be subject to all provisions of this Agreement.

8.10. The initial sale of Membership Interests in the Company to the initial Members has not been qualified or registered under the securities laws of any state, or registered under the Securities Act of 1933, as amended, in reliance on exemptions from the registration provisions of those laws. No attempt has been made to qualify the offering and sale of Membership Interests to Members under the California Corporate Securities Law of 1968, as amended, also in reliance on an exemption from the requirement that a permit for issuance of securities be procured. Notwithstanding any other provision of this Agreement, Membership Interests may not be Transferred or Encumbered unless registered or qualified under applicable state and federal securities laws or unless, in the opinion of legal counsel satisfactory to the Company, qualification or registration is not required. A Member who desires to transfer a Membership Interest will be responsible for all legal fees incurred in connection with that opinion.

ARTICLE IX: DISSOLUTION AND WINDING UP

9.1. The Company will be dissolved on the first to occur of the following events:

(a) The written agreement of a Majority of Members to dissolve the Company.

(b) The sale or other disposition of substantially all of the Company assets.

(c) Entry of a decree of judicial dissolution under California Corp C §17351.

9.2. On the dissolution of the Company, it will engage in no further business other than that necessary to wind up its business and affairs. The Members winding up the Company's affairs will give written Notice of the commencement of winding up by mail to all known creditors and claimants against the Company whose addresses appear in the Company's records. After paying or adequately providing for the payment of all known debts of the Company (except debts owing to Members) the remaining assets of the Company will be distributed or applied in the following order of priority:

(a) To pay the expenses of liquidation.

(b) To repay outstanding loans to Members. If there are insufficient funds to pay those loans in full, each Member will be repaid in the ratio that the Member's respective loan, together with accrued and unpaid interest,

bears to the total of all those loans from Members, including all interest accrued and unpaid on those loans. Repayment will first be credited to unpaid principal and the remainder will be credited to accrued and unpaid interest.

(c) Among the Members in accordance with the provisions of Article IV, Section 4.7.

9.3. Each Member will look solely to the assets of the Company for the return of the Member's investment, and if the Company property remaining after the payment or discharge of the debts and liabilities of the Company is insufficient to return the investment of any Member, the Member will have no recourse against any other Members for indemnification, contribution, or reimbursement.

ARTICLE X: ARBITRATION

10.1. Any action to enforce or interpret this Agreement, or to resolve disputes over this Agreement between the Company and a Member, or between or among the Members, will be settled by arbitration in accordance with the rules of the American Arbitration Association. Arbitration will be the exclusive dispute resolution process in the state of California, but arbitration will be a nonexclusive process elsewhere. Any party may commence arbitration by sending a written demand for arbitration to the other parties. The demand will set forth the nature of the matter to be resolved by arbitration. The Members will select the place of arbitration. The substantive law of the state of California will be applied by the arbitrator to the resolution of the dispute. The parties will share equally all initial costs of arbitration. The prevailing party will be entitled to reimbursement of attorney fees, costs, and expenses incurred in connection with the arbitration. All decisions of the arbitrator will be final, binding, and conclusive on all parties. Judgment may be entered on any such decision in accordance with applicable law in any court having jurisdiction of it. The arbitrator (if permitted under applicable law) or the court may issue a writ of execution to enforce the arbitrator's decision.

ARTICLE XI: GENERAL PROVISIONS

11.1. This Agreement constitutes the whole and entire agreement of the parties with respect to the subject matter of this Agreement, and it will not be modified or amended in any respect except by a written instrument executed by all the parties. This Agreement replaces and supersedes all prior written and oral agreements by and among the Members or any of them.

11.2. This Agreement may be executed in one or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

11.3. This Agreement will be construed and enforced in accordance with the laws of the state of California. If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision will, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid that invalidity, illegality, or unenforceability or, if that is not possible, the provision will, to the extent of that invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement will remain in effect.

11.4. This Agreement will be binding on and inure to the benefit of the parties and their heirs, personal representatives, and permitted successors and assigns.

11.5. Whenever used in this Agreement, the singular will include the plural, the plural will include the singular, and the neuter gender will include the male and female as well as a trust, firm, company, or corporation, all as the context and meaning of this Agreement may require.

11.6. The parties to this Agreement will promptly execute and deliver any and all additional documents, instruments, notices, and other assurances, and will do any and all other acts and things reasonably necessary in connection with the performance of their respective obligations under this Agreement and to carry out the intent of the parties.

11.7. Except as provided in this Agreement, no provision of this Agreement will be construed to limit in any manner the Members in the carrying on of their own respective businesses or activities.

11.8. Except as provided in this Agreement, no provision of this Agreement will be construed to constitute a Member, in the Member's capacity as such, the agent of any other Member.

11.9. Each Member represents and warrants to the other Members that the Member has the capacity and authority to enter into this Agreement.

11.10. The article, section, and paragraph titles and headings in this Agreement are inserted as a matter of convenience and for ease of reference only and will be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

11.11. This Agreement may be altered, amended, or repealed only by a writing signed by all of the Members.

11.12. Time is of the essence of every provision of this Agreement that specifies a time for performance.

11.13. This Agreement is made solely for the benefit of the parties to this Agreement and their respective permitted successors and assigns, and no other person or entity will have or acquire any right by virtue of this Agreement.

11.14. The Members intend the Company to be a limited liability company under the Act. No member will take any action inconsistent with the express intent of the parties to this agreement.

In witness whereof, the parties have executed or caused to be executed this Agreement on the day and year first above written.

SPOUSAL CONSENT

The undersigned is the spouse of _ _[*name*]_ _ and acknowledges that _ _[*he/she*]_ _ has read the foregoing Agreement dated _ _[*date*]_ _, and understands its provisions. The undersigned is aware that, by the provisions of the Agreement, _ _[*he/she*]_ _ and _ _[*his/her*]_ _ spouse have agreed to sell or transfer all _ _[*his/her*]_ _ Membership Interest in the Company, including any community property interest or quasi-community property interest, in accordance with the terms and provisions of the Agreement. The undersigned expressly approves of and agrees to be bound by the provisions of the Agreement in its entirety, including, but not limited to, those provisions relating to the sales and transfers of Membership Interests and the restrictions on them. If the undersigned predeceases _ _[*his/her*]_ _ spouse when _ _[*his/her*]_ _ spouse owns any Membership Interest in the Company, _ _[*he/she*]_ _ agrees not to devise or bequeath whatever community property interest or quasi-community property interest _ _[*he/she*]_ _ may have in the Company in contravention of the Agreement.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name*]_ _

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Appendix C

Single-Member Operating Agreement

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OPERATING AGREEMENT for _ _[*NAME*]_ _, _ _[*e.g., LLC /a limited liability company*]_ _

A. The Sole Member desires to form a limited liability company (Company) under the Beverly-Killea Limited Liability Company Act (the Act) (California Corporations Code §§17100-17656).

B. The Member desires to execute this Operating Agreement in order to form and provide for the governance of the Company and the conduct of its business.

Now, therefore, the Sole Member declares the following to be the Operating Agreement of the Company:

ARTICLE I: ARTICLES OF ORGANIZATION

1.1. Promptly following execution of this Agreement, the Sole Member will cause Articles of Organization, in the form attached to this Agreement as Exhibit _ _[*letter/number*]_ _, to be filed with the California Secretary of State.

1.2. The name of the Company will be _ _[*name*]_ _.

1.3. The principal executive office of the Company will be at _ _[*address*]_ _, California _ _[*zip code*]_ _, or any other place or places determined by the Sole Member from time to time.

1.4. The initial agent for service of process on the Company will be _ _[*name*]_ _. The Sole Member may from time to time change the Company's agent for service of process.

1.5. The Company will be formed for the purposes of engaging in the business of _ _[*description of business*]_ _.

1.6. The term of existence of the Company will commence on the effective date of filing of Articles of Organization with the California Secretary of State and will continue until terminated by the provisions of this Agreement or as provided by law.

1.7. The Sole Member will be the manager of the Company.

ARTICLE II: CAPITALIZATION

2.1. The Sole Member will contribute to the capital of the Company the money and property specified in Exhibit _ _[*letter/number*]_ _ to this Agreement. The Sole Member may from time to time and at any time contribute cash or property to the Company as the Sole Member may determine.

2.2. The Sole Member will not be bound by, or be personally liable for, the expenses, liabilities, or obligations of the Company except as otherwise provided in the Act or in this Agreement.

ARTICLE III: ALLOCATIONS AND DISTRIBUTIONS

3.1. If any membership interest, or part of an interest, is assigned during any fiscal year in compliance with the provisions of this Article III, profits, losses, each item thereof, and all other items attributable to the membership interest for that fiscal year will be divided and allocated between the transferor and the transferee by taking into account their varying membership interests during the period in accordance with IRC §706(d),

using any convention permitted by law selected by the Sole Member. All distributions on or before the date of the assignment will be made to the transferor, and all distributions thereafter will be made to the transferee. Solely for purposes of making the allocations and distributions, the Company will recognize the assignment not later than the end of the calendar month during which the assignment occurs. Neither the Company nor the Sole Member will incur any liability for making allocations and distributions in accordance with the provisions of this Section 3.1.

3.2. All cash resulting from the operations of the Company will be distributed to the Sole Member at such times as the Sole Member deems appropriate.

ARTICLE IV: MANAGEMENT

4.1. The business of the Company will be managed by the Sole Member. The Sole Member may appoint one or more nonmembers as comanagers or may resign as manager at any time and appoint a nonmember as the manager of the Company on such terms and conditions as the Sole Member and the manager may agree.

4.2. The Company may have a President who may, but need not, be the Sole Member. The Sole Member may provide for additional officers of the Company and may alter the powers, duties, and compensation of the President and of any other officer.

4.3. All Company assets, whether real or personal, will be held in the name of the Company.

4.4. All Company funds will be deposited in one or more accounts with one or more recognized financial institutions in the name of the Company, at locations determined by the Sole Member. Withdrawal from those accounts will require the signature of the person or persons designated by the Sole Member.

ARTICLE V: ACCOUNTS AND RECORDS

5.1. Complete books of account of the Company's business, in which each Company transaction will be fully and accurately entered, will be kept at the Company's principal executive office.

5.2. Financial books and records of the Company will be kept on the cash method of accounting. A balance sheet and income statement of the Company will be prepared promptly following the close of each fiscal year in a manner appropriate to and adequate for the Company's business and for carrying out the provisions of this Agreement. The fiscal year of the Company will be January 1 through December 31.

5.3. At all times during the Company's term of existence, and beyond that term if the Sole Member deems it necessary, the Sole Member will keep or cause to be kept the books of account referred to in Section 5.2, and the following:

(a) A current list of the full name and last known business or residence address of the Sole Member, together with the capital contributions and the share in profits and losses of the Sole Member;

(b) A copy of the Articles of Organization, as amended;

(c) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years;

(d) Executed counterparts of this Agreement, as amended;

(e) Any powers of attorney under which the Articles of Organization or any amendments to them were executed;

(f) Financial statements of the Company for the six most recent fiscal years; and

(g) The books and records of the Company as they relate to the Company's internal affairs for the current and past four fiscal years.

ARTICLE VI: RESTRICTIONS ON TRANSFER OF MEMBERSHIP INTEREST

6.1. The Sole Member will not transfer any part of the Sole Member's membership interest in the Company. Notwithstanding any other provision of this Agreement to the contrary, the Sole Member may transfer all or any portion of _ _[*his/her*]_ _ membership interest to any revocable trust created for the benefit of the Sole Member, or any combination between or among the Sole Member, the Sole Member's spouse, and the Sole Member's issue. A transfer of the Sole Member's entire beneficial interest in the trust will be deemed a transfer of _ _[*his/her*]_ _ membership interest in the Company.

ARTICLE VII: DISSOLUTION AND WINDING UP

7.1. The Company will be dissolved on the first to occur of the following events:

(a) The decision of the Sole Member to dissolve the Company.

(b) The sale or other disposition of substantially all of the Company's assets.

(c) Entry of a decree of judicial dissolution under California Corporations Code §17351.

7.2. On the dissolution of the Company, it will engage in no further business other than that necessary to wind up its business and affairs. The Sole Member will wind up the affairs of the Company and give written Notice of the commencement of winding up by mail to all known creditors and claimants against the Company whose addresses appear in the records of the Company. After paying or adequately providing for the payment of all known debts of the Company (except debts owing to the Sole Member), the remaining assets of the Company will be distributed or applied in the following order of priority:

(a) To pay the expenses of liquidation.

(b) To repay outstanding loans to the Sole Member.

(c) To the Sole Member.

ARTICLE VIII: GENERAL PROVISIONS

8.1. This Agreement constitutes the whole and entire agreement with respect to the subject matter of this Agreement.

8.2. This Agreement will be construed and enforced in accordance with the laws of the state of California. If any provision of this Agreement is determined by any court of competent jurisdiction or arbitrator to be invalid, illegal, or unenforceable to any extent, that provision will, if possible, be construed as though more narrowly drawn, if a narrower construction would avoid that invalidity, illegality, or unenforceability or, if that is not possible, that provision will, to the extent of that invalidity, illegality, or unenforceability, be severed, and the remaining provisions of this Agreement will remain in effect.

8.3. The article, section, and paragraph titles and headings in this Agreement are inserted as a matter of convenience and for ease of reference only and will be disregarded for all other purposes, including the construction or enforcement of this Agreement or any of its provisions.

8.4. This Agreement may be altered, amended, or repealed only by a writing signed by the Sole Member.

8.5. Time is of the essence for every provision of this Agreement that specifies a time for performance.

8.6. This Agreement is made solely for the benefit of the Sole Member and the Sole Member's permitted successors and assigns, and no other person or entity will have or acquire any right by virtue of this Agreement.

8.7. The Sole Member intends the Company to be a limited liability company under the Act.

In witness whereof, the Sole Member has executed or caused to be executed this Agreement on the day and year first above written.

__[*Signature*]__
_ _[*Typed or printed name*]_ _
Sole Member

SPOUSAL CONSENT

The undersigned is the spouse of _ _[*name*]_ _ and acknowledges that _ _[*he/she*]_ _ has read the foregoing Agreement dated _ _[*date*]_ _, and understands its provisions. The undersigned is aware that by the provisions of the Agreement _ _[*he/she*]_ _ and _ _[*his/her*]_ _ spouse have agreed to sell or transfer all _ _[*his/her*]_ _ membership interest in the Company, including any community property interest or quasi-community property interest, in accordance with the terms and provisions of the Agreement. The undersigned expressly approves of and agrees to be bound by the provisions of the Agreement in its entirety, including, but not limited to, those provisions relating to the sales and transfers of membership interests and the restrictions on them. If the undersigned predeceases _ _[*his/her*]_ _ spouse when _ _[*his/her*]_ _ spouse owns any membership interest in the Company, _ _[*he/she*]_ _ agrees not to devise or bequeath whatever community property interest or quasi-community property interest _ _[*he/she*]_ _ may have in the Company in contravention of the Agreement.

Date: _ _ _ _ _ _ __[*Signature*]__
_ _[*Typed name*]_ _

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Appendix D

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California
Corporations Code §§17000-17656
I. General
A. Short Title.

Beverly-Killea Limited Liability Company Act. 17000.
B. Definitions.

Articles of Organization: Articles filed under 17050, including all amendments. 17001(b).

Bankrupt or bankruptcy: Person subject of order for relief under USC Title 11. 17001(c).

Capital account: Amount of capital interest of a member in the LLC consisting of original contribution increased by additional contributions and share of profits and decreased by distributions and share of losses. 17001(d).

Constituent limited liability company: LLC merged with or into other LLC or other business entity. 17001(e).

Constituent other business entity: Other entity merged with or into other LLC. 17001(f).

Contribution: Any money, property, services rendered or promissory note or other obligation to contribute the same that a member contributes to the LCL as a

Delaware
6 Delaware Code Annotated §§18-101-18-1109

A. Short Title.

Delaware Limited Liability Company Act. 18-1102.
B. Definitions.

Certificate of formation: Certificate referred to in 18-201 and its amendments. 18-101(2).

Bankruptcy: Event that causes a person to cease to be a member under 18-304. 18-101(1).

Contribution: Any cash, property, services rendered or promissory note or other obligation to contribute the same that a person contributes to the LLC in capacity as a member. 18-101(3).

Foreign limited liability company: LLC formed under the laws of any state or foreign country. 18-101(4).

Knowledge: A person's actual knowledge of a fact rather than constructive knowledge. 18-101(5).

Limited liability company or domestic limited liability company: LLC formed under Delaware law and having 1 or more members. 18-101(6).

Liquidating trustee: Person carrying out the winding up

member. 17001(g).

Disappearing limited liability company: Constituent LLC that is not surviving LLC. 17001(h).

Disappearing other business entity: Constituent other entity that is not surviving entity. 17001(i).

Distribution: Transfer of money or property by an LLC to its members without consideration. 17001(j).

Economic interest: Person's right to share in income, gains, losses, deductions, credit, or similar items, and to receive distributions from LLC, but does not include any other rights of a member, including the right to vote or participate in management. Does include limited information rights. 17001(n).

Foreign corporation: Corporation formed under laws of state other than California or under laws of United States or foreign country. 17001(p).

Foreign limited liability company: LLC formed under laws of state other than California or entity organized under laws of foreign country that:

- Is an unincorporated association;
- Provides limited liability for all members; and
- Is not a corporation or partnership.

17001(q).

Foreign limited partnership: Partnership formed under laws of a state other than California or under a foreign country, including an LLP, having one or more general partners and one or more limited partners. 17001(r).

Foreign other business entity: Other entity formed under laws of any state other than California or under laws of United States or foreign country. 17001(s).

Limited liability company or Domestic limited liability company: LLC organized under California law and having one or more members. 17001(t).

Mail: Unless provided in operating agreement, first-class mail, postage prepaid, unless registered mail is specified. Registered mail includes certified mail. 17001(u).

Majority in interest of the members: Unless otherwise provided in operating agreement, more than 50 percent of interests of members in current profits of LLC. 17001(v).

Manager: Person elected by the members to manage if articles contain required statement or, if articles do not, then manager means each member of the LLC. 17001(w).

of the LLC. 18-101(9).

Manager: Person named as a manager of an LLC pursuant to an LLC agreement or similar instrument. 18-101(10).

Member: Person who is admitted to an LLC as a member under 18-301 or applicable foreign law for a foreign LLC. 18-101(11).

Limited liability company interest: Member's share of profits and losses of LLC and member's right to receive distributions. 18-101(8).

Limited liability company agreement: Any agreement (whether referred to as LLC agreement, operating agreement, or otherwise), written, oral or implied, of members as to affairs of LLC and conduct of its business. 18-101(*7*). Member or manager bound whether or not he/she/it executes agreement. LLC not required to execute its agreement, and is bound whether or not it executes the agreement. LLC agreement may provide rights to any person, including a person who is not a party to the LLC agreement. Written LLC agreement may provide that a person may be admitted as member upon execution of LLC agreement or without such execution if conditions complied with, and such agreement shall not be unenforceable by reason of not having been signed by person becoming a member. 18-101(*7*).

Other business entity: Corporation, statutory trust, business trust, association, REIT, common-law trust, or any other unincorporated business or entity, including general or limited partnership, and including foreign LLC, but not domestic LLC. 18-209(a).

Person: Natural person, partnership, LLC, trust, estate, association, corporation, government, custodian, nominee, or any other individual or entity (or series thereof) in its own or any representative capacity, whether domestic or foreign. 18-101(12).

Personal representative: As to a natural person, the executor, administrator, guardian, conservator, or other legal representative and as to other than a natural person, the legal representative or successor thereof. 18-101(13).

Transacting intrastate business *not*:

- Maintaining, defending or settling an action or proceeding;
- Holding meetings of members or managers or carrying on internal affairs;
- Maintaining bank accounts;
- Maintaining offices or agencies for LLC's own securities;
- Selling through independent contractors;

Member: Person who has been admitted to an LLC as a member under the articles or operating agreement, or assignee who has become a member. Has not resigned, withdrawn, or been expelled as a member and, if other than an individual, has not been dissolved. 17001(x).

Member of record: Member named as a member on LLC list of members required to be maintained. 17001(y).

Membership interest: Member's rights in the LLC, including member's economic interest, any right to vote or participate in management, and any right to information. 17001(z).

Officer: Any person elected or appointed as such by LLC pursuant to California law. 17001(aa).

Operating agreement: Any agreement, written or oral, between all of the members as to the affairs of LLC and conduct of its business. May just include agreement to organize. 17001(ab).

Other business entity: Corporation, limited partnership, general partnership, business trust, REIT, unincorporated association (other than a nonprofit association), excluding domestic and foreign LLC. 17001(ac).

Parent: Person who owns, directly or indirectly, membership interests possessing more than 50 percent of the voting power of the specified LLC. 17001(ad).

Person: Individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign. 17001(ae).

Proxy: Unless provided in operating agreement means written authorization signed or electronic transmission authorized by a member or the member's attorney-in-fact giving another person the right to exercise the voting rights of the member. Signed means placing name on proxy (by signature, typewriting, or electronic transmission or otherwise) by the member or the member's attorney-in-fact. Proxy may be transmitted by an oral telephonic transmission if submitted with information from which it may be determined that the proxy was authorized by the proper person. 17001(ai).

Return of capital: Unless otherwise provided in operating agreement, any distribution to a member to the extent that the member's capital account, immediately after the distribution, is less than the amount of that member's contribution to the LLC as reduced by prior distributions that were a return of capital. 17001(aj).

Subsidiary of a specified limited liability company: LLC or other business entity in which shares, interests, or other securities with more than 50 percent of the

- Selling through independent contractors;
- Soliciting or obtaining orders if orders require acceptance outside Delaware;
- Selling by outside-Delaware contract and agreeing to deliver machinery, plants, or equipment requiring the supervision of technical engineers over the time period;
- Creating or acquiring indebtedness with or without a mortgage or other security interest;
- Collecting debts or foreclosing mortgages and holding, protecting and maintaining such property;
- Conducting an isolated transaction that is not in the course of similar transactions;
- Doing business in interstate commerce; or
- Doing business in Delaware as an insurance company.

18-911(a).

Members or managers not deemed to be doing business in Delaware. 18-911(b).

Transacting intrastate business rules do not apply in determining whether foreign LLC is subject to service, taxation, or regulation. 18-911(c).

voting power are owned by specified LLC. 17001(al).

Surviving limited liability company: LLC into which one or more other LLCs or other business entities are merged. 17001(am).

Surviving other business entity: Other business entity into which one or more LLCs are merged. 17001(an).

Transact intrastate business: To enter into repeated and successive transactions of business in California, other than in interstate or foreign commerce.

Transacting intrastate business by a foreign LLC is *not*:

- Maintaining, defending, or settling an action or proceeding;
- Holding meetings of members or managers or carrying on internal affairs;
- Maintaining bank accounts;
- Maintaining offices or agencies for LLCs own securities;
- Selling through independent contractors;
- Soliciting or obtaining orders if orders require acceptance outside California;
- Creating or acquiring indebtedness or security interests in real or personal property;
- Collecting debts or enforcing security interests; or
- Conducting an isolated transaction that is completed within 180 days and is not in the course of similar transactions.

Foreign LLC *not* transacting business merely because of status as owner of domestic entity or foreign entity transacting intrastate business (other than general partner). 17001(ap)(1), (2).

Person not deemed to be transacting intrastate business merely because of status as member or manager of domestic LLC or registered foreign LLC. 17001(ap)(3).

Vote: Includes authorization by written consent. 17001(aq).

Voting power: Power to vote on any matter at the time any determination of voting power is made. Does not include right to vote upon happening of condition or event that has not occurred. 17001(ar).

Withdrawal: Includes resignation or retirement of a member. 17001(as).

C. Permissible Business Activities; Powers.

C. Permissible Business Activities; Powers.

LLCs may engage in any lawful activity, even nonprofit activities, except banking, insurance, or trust company business. 17002(a).

California also permits health care service plans to be LLCs. 17002(b).

D. Powers of LLC.

LLCs have all the powers of a natural person in carrying out business activities. 17003.

E. Member Rights.

Members who transact business with an LLC have the same rights and obligations as nonmembers. 17004(a).

No member entitled to remuneration unless operating agreement or other agreement authorizes it, or obtained in winding up affairs pursuant to 17352(c). 17004(b).

F. Variance of Statutory Provisions by Articles or Operating Agreement.

Generally, relations among members and between members and LLC governed by operating agreement. 17005(a).

Generally can vary terms by operating agreement, but variance of sections 17059, 17103, 17104, 17152, 17154 and 17155 must be by articles or written operating agreement. 17005(b).

No variance of definitions in 17001 unless specifically provided therein. No elimination of right to assert operating agreement provision governing return of contribution and termination of membership unreasonable under 17100(c). No varying voting requirements or voting rights in 17103 (voting). No varying member's rights under 17106 (information rights) and 17453 (information rights of foreign members residing in California). 17005(b)(1)-(4).

Changes to formation chapter 2 (17050-17052), dissolution chapter 8 (17350-17357), foreign LLC chapter 10 (17450-17457), class action chapter 11 (17500-17501), merger chapter 12 (17550-17556) and dissenter's rights chapter 13 (17600-17613) may only be made by articles or written operating agreement to the extent expressly provided in those sections. 17005(c).

Manager's fiduciary duties may only be modified in a written operating agreement with the informed consent of the members. 17005(d).

Not necessary to include "unless otherwise provided in operating agreement." 17005(e).

Articles control in conflict between articles and written

LLCs may engage in any lawful activity, even nonprofit activities, except banking. 18-106(a).

D. Powers of LLC.

LLC has all powers granted by Delaware law or by LLC agreement. 18-106(b).

LLC can specifically engage in guaranty and suretyship, enter into interest rate, basis, currency, hedge or other swap agreements or derivative agreements. 18-106(c).

E. Member Rights.

Except as provided in LLC agreement, members or managers who transact business with LLC have same rights and obligations as nonmembers or nonmanagers. 18-107.

F. Construction and Application of Chapter and LLC Agreement.

It is the policy of Delaware LLC law to give the maximum effect to the principle of freedom of contract and to the enforceability of the LLC agreement. 18-1101(b).

Unless LLC agreement provides otherwise, member or manager or other person shall not be liable to anyone for breach of fiduciary duty for good faith reliance on LLC agreement. 18-1101(d).

LLC agreement may provide for limitation or elimination of any and all liabilities for breach of contract and breach of duties of a member, manager, or other person to an LLC or to another member or manager or party, provided that no elimination of liability for bad faith violation of implied contractual covenant of good faith and fair dealing. 18-1101(e).

Fiduciary duties may be expanded or restricted or eliminated by provisions in an LLC agreement, except LLC agreement may not eliminate the implied contractual covenant of good faith and fair dealing. 18-1101(c).

Rule that statutes in derogation of the common law are to be strictly construed shall have no application to Delaware LLC law. 18-1101(a).

Restrictions on assignment of promissory notes (6 Del Code Ann §§9-406, 9-408) invalid. 18-1101(g).

Actions validly taken pursuant to one provision of this chapter shall not be deemed invalid solely because identical or similar to an action that could have been taken pursuant to some other provision but fails to satisfy that other provision (so-called "doctrine of

operating agreement. 17005(f).

II. Formation

A. Formation.

One or more persons execute and file articles. Operating agreement either before or after filing. Members need not execute articles. 17050(a).

One or more members. 17050(b).

Existence begins upon filing articles. 17050(c).

Secretary of State must include tax notice for annual franchise tax under Rev & T C §17941. 17050(d).

B. Articles of Organization.

Articles must contain LLC name; purpose statement; name (and address of individual) of agent for service of process; member or manager managed or one manager. 17051(a).

Not necessary to set forth powers in articles. 17051(b).

Articles may contain any other provision not inconsistent with law. 17051(c).

No ultra vires except proceeding by member or state to enjoin unauthorized business; proceeding to dissolve; or derivative proceeding. 17051(d).

Secretary of State may cancel if check bounces. 17051(e).

C. Company Name.

Name must contain words LLC or L.L.C. 17052(a).

Name may contain name of one or more members. 17052(b).

Name may not mislead public or be same as or resemble closely another name. 17052(c).

Name may not include bank, trust, trustee, incorporated, inc., corporation, corp., insurer, or insurance company. 17052(d).

Use of name may be enjoined even if articles or registration accepted. 17052(e).

Recordation of certified copy of articles or registration permitted. 17052(f).

D. Reservation of Name.

Name reserved for 60 days upon payment of fee. No consecutive name registrations. 17053.

independent legal significance"). 18-1101(h).

A. Formation.

One or more authorized persons execute and file certificate of formation. 18-201(a).

LLC agreement either before or after filing. 18-201(d).

One or more members. 18-101(6).

Existence begins upon filing certificate or at later date specified if there is substantial compliance with requirements of 18-201. 18-201(b).

Existence until cancellation of LLC certificate of formation. 18-201(b).

B. Certificate of Formation.

Certificate must contain LLC name, address of registered office, name and address of registered agent. 18-201(a).

Certificate may contain any other matters the members determine to include. 18-201(a)(3).

C. Company Name.

Name must contain words "limited liability company" or "L.L.C." or "LLC." 18-102(1).

Name may contain name of member or manager. 18-102(2).

Name must be distinguishable from records of any existing or reserved name, unless written consent filed. 18-102(3).

Name may contain "company," "association," "club," "foundation," "fund," "institute," "society," "union," "syndicate," "limited," or "trust," or abbreviations thereof. 18-102(4).

D. Reservation of Name.

Name reserved for 120 days upon payment of fee. Same applicant may reserve same name for successive 120 day periods. Reservation may be transferred by notice filed with Secretary of State (Secretary of State). Reservation may be cancelled by filing notice of cancellation with Secretary of State. 18-103(b).

Fee paid upon initial reservation or renewal thereof, and at time of filing notice of transfer or cancellation. 18-103(c).

Name may be reserved by any:

- Person intending to organize LLC;
- Domestic LLC or registered foreign LLC which proposes to change name;
- Foreign LLC intending to register; or
- Person intending to organize foreign LLC and register it in Delaware.

18-103(a).

E. Amendment/ Restatement to Formation Document.

Articles may be amended (by at least a majority of members) at any time and in any manner as members may determine, as long as valid at the time of amendment. 17054(a).

Amended by certificate of amendment executed by at least one manager, unless more required by articles. Certificate must be filed on Secretary of State form and shall have name and file number of LLC and text of amendment. 17054(b).

Certificate shall be filed to effect change in LLC name, change of statement of number of managers, change in time for dissolution if stated, change in events of dissolution if stated. 17054(c).

Certificate of amendment must be filed within 30 days of discovery of any false or erroneous material statement in articles or amendment. 17054(d).

Manager liable for statement materially inconsistent with operating agreement or any material misstatement of fact if manager knew or should have known and person suffering loss relied on statement or misstatement. 17054(e).

Articles may be restated in their entirety. 17054(f).

E. Amendment/ Restatement to Formation Document.

Certificate of formation may be amended at any time for any proper purpose. 18-202(c).

Certificate of amendment shall have name of LLC and text of amendment. 18-202(a).

Certificate of amendment must be filed by manager or any member upon discovery of any false or erroneous material information in certificate. 18-202(b).

Certificate may be restated in its entirety. 18-208(a).

If no amendments, it must be called a "Restated Certificate" but if amended, then "Amended and Restated Certificate" and in either case executed by 1 authorized person. 18-208(b).

Restated certificate shall state name, changed name if any, date of filing of original certificate of formation and future effective date or time, if any, that it was duly executed, and if it does not make amendments, that fact as well. 18-208(c).

Upon filing or future effective date, restated certificate becomes certificate of formation but does not change original date of formation. 18-208(d).

Any amendments or change must comply with other provisions of Delaware LLC law. 18-208(e).

Certificate effective at time of filing, unless later effective date or time provided in certificate of amendment. 18-202(d).

F. Correction.

Certificate of correction may correct typographical error, error of transcription, technical error, or defective execution. 17055(a).

Certificate of correction shall be filed on Secretary of State form and shall contain name and file number of LLC, title of document being corrected, name of each party to said document, date document being corrected was filed, provision being corrected. 17055(b).

F. Correction.

Certificate of correction may correct inaccurate record of action or defective or erroneous execution. 18-211(a).

Certificate of correction filed with Secretary of State and shall specify inaccuracy or defect, set forth portion of certificate in corrected form. 18-211(a).

In lieu of filing certificate of correction, may file corrected certificate, specifically designated as such,

No other changes or amendments permitted. 17055(c).

Executed in same manner as document being corrected was required. 17055(d).

No change of effective date of document being corrected or affecting any right or liability accrued or incurred by person who detrimentally relied on original document. 17055(e).

G. Execution.

Unless specified, documents executed by:

- Organizers before formation;
- Any manager;
- Fiduciary; or
- According to laws of foreign LLC.

17056(a).

Any person may execute one of these documents by an attorney-in-fact, no filing or acknowledgment of power of attorney necessary. 17056(b).

Instruments may be effective not more than 90 days after filing date. May revoke prior to that date by filing revocation. 17056(c).

If Secretary of State returns a filing, the written opinion of an attorney can correct, and Secretary of State shall rely on written opinion, other than applying 17052 (name), 17053 (reservation of name), 17451 (foreign LLC registration) and 17452 (foreign LLC certificate to transact business). Date of filing is date instrument received on resubmission. 17056(d).

H. Registered Office; Registered Agent.

Must maintain office in California. 17057(a).

Must have California agent for service of process. Can be individual or domestic corporation. 17057(b).

along with inaccuracy or defect. 18-211(b).

Certificate of correction shall be executed as required by Delaware LLC law. 18-211(a).

Effective as of date original certificate filed, except as to those persons who are substantially and adversely affected by correction and as to those persons certificate shall be effective from filing date. 18-211(a)-(b).

G. Execution.

Documents executed by one or more authorized persons. 18-204(a).

Any person may execute by an attorney-in-fact. No filing or acknowledgment of power of attorney necessary. 18-204(b).

Execution constitutes oath or affirmation under penalties of perjury in the third degree that to the best of such person's knowledge or belief, facts stated therein are true. 18-204(c).

H. Registered Office; Registered Agent.

Must maintain registered office in Delaware. 18-104(a)(1).

Must have Delaware agent for service of process with identical business office as registered Delaware office. Can be LLC itself, individual resident in Delaware, domestic entity, or foreign entity. 18-104(a)(2).

Agent must have office in Delaware and if foreign, authorized to transact business in Delaware, and must accept service of process and forward same to its LLCs. Agent must forward annual tax statement to LLCs. 18-104(e).

Registered agent for more than 50 entities ("commercial registered agent") must:

- Maintain principal residence or business office in Delaware;
- Maintain Delaware business license;

- Be generally present at designated location to accept service; and
- Provide Secretary of State upon request with communication information.

18-104(f)(1).

I. Information at Office.

Must maintain:

- Current list of full name and last-known business or residence address of each member and each economic interest holder, set forth in alphabetical order, together with contribution and share in profits and losses of each;
- Current list of full name and business or residence address of each manager;
- Copy of articles and all amendments, together with any powers of attorney for execution;
- Copies of LLC's federal, state, and local income tax or information returns and reports for 6 most recent taxable years;
- Copy of LLC's operating agreement and any amendments, together with any powers of attorney for execution;
- Copies of LLC financial statements, if any, for 6 most recent fiscal years; and
- Books and records of LLC as they relate to LLC's internal affairs for at least current and past 4 fiscal years.

17058(a).

Assessor may request and LLC must make available at principal California office (or California office for records) true copy of all business records relevant to amount, cost, and value of all property that LLC owns, claims, possesses or controls within the county. 17058(b).

I. Information at Office.

Records may be maintained in other than written form if form is capable of conversion to written form within reasonable time. 18-305(d).

J. Operating Agreement.

Power to adopt, alter, amend, or repeal is vested in the members. Articles or written operating agreement may prescribe method of alteration, amendment, or repeal of operating agreement. 17059.

J. Limited Liability Company Agreement.

If LLC provides manner it may be amended, may be amended only in that manner or as otherwise permitted by law, including by certificate of merger, provided that approval may be waived. 18-302(e).

K. Statement of Information.

Filing within 90 days of filing of articles and biennially thereafter on form prescribed by Secretary of State, containing:

- Name and file number (and state of foreign LLC);
- Name and address of agent for service of process;

K. Statement of Information.

- Street address of principal executive office and California office for records;
- Name and address of managers, chief executive officer if any, or if no managers, name and address of each member; and
- General type of business that constitutes principal business activity of LLC.

17060(a).

If no change since last statement, LLC may advise Secretary of State on Secretary of State form of no changes. 17060(b).

Applicable filing period is calendar month during which original articles were filed and immediately preceding 5 calendar months. Form sent by Secretary of State not prerequisite for compliance. 17060(c).

LLC may file new statement of information at any time, but if agent name or address changes, then all information must be set forth. Change supersedes previous statements, and agent supersedes statements in articles, amendments or restatements. 17060(d).

Secretary of State may destroy old statements of information if superseded. 17060(e).

This law does not place any person dealing with the LLC on notice of or duty to inquire about the existence or content of a statement of information. 17060(f).

L. Service of Process.

Process served as set forth in Code of Civil Procedure. 17061(a).

Personal service by delivery to agent or to any person named in corporate agent certificate. For foreign LLCs designating Secretary of State, must deliver by hand, include one copy of process for each defendant, together with a copy of the court order setting forth address to which process shall be sent and fee. 17061(b).

Can serve Secretary of State by court order if agent resigned without being replaced or cannot with reasonable diligence be found and shown by affidavit that process cannot be served. Service complete on 10th day after delivery of process. Secretary of State shall give notice to LLC. Secretary of State shall keep records of process served and forwarding for prima facie evidence of service. 17061(c).

Must designate agent in articles or registration, together with address. Agent may resign by filing a written statement of resignation. Upon filing, authority of agent shall cease and Secretary of State shall give notice to LLC. If agent terminates for any reason, LLC shall promptly file an amended statement designating a new agent. 17061(d).

L. Service of Process.

Process served personally on manager or liquidating trustee or on LLC's registered agent, or if none, on Secretary of State. Managers include those who materially participate in management of LLC. 18-109(a).

Nothing affects any other legal method of serving process. 18-109(e).

Court of Chancery and Superior Court may make any necessary rules. 18-109(f).

Personal service to any manager or registered agent. 18-105(a).

Can serve Secretary of State if cannot locate people to serve by due diligence. No court order necessary. Service complete when received by Secretary of State. Secretary of State shall give notice to LLC. Secretary of State shall keep records of process served, for a maximum period of 5 years from receipt of service. 18-105(b).

Can serve Secretary of State if no registered agent, and in any proceeding Prothonotary or Register in Chancery must send registered mail to LLC. 18-109(b).

Time to respond computed from date of mailing by

new agent. 17061(d).

California court may, order production of books and records of California LLC in any case, whether or not LLC is a party. 17061(e).

Member may, in written operating agreement or other writing, agree to be subject to nonexclusive jurisdiction of courts of another jurisdiction or exclusive jurisdiction of California. 17061(f).

Member may in written operating agreement or other writing, agree to be subject to nonexclusive arbitration in another state or exclusive arbitration in California. 17061(g).

Member may consent to be served with legal process in manner prescribed in written operating agreement or other writing. 17061(h).

M. Filing.

Instrument filed upon Secretary of State receiving document plus required fee. Can request delay of filing for period not to exceed 90 days, including Saturday, Sunday or legal holiday if document received by Secretary of State at least 1 business day prior to requested date of filing. Secretary of State may microfilm or reproduce any filings and destroy original. 17062.

Prothonotary or Register in Chancery, unless continued by the court. 18-109(c).

Agent may change address or name by filing certificate with Secretary of State, which shall furnish certified copy of certificate to agent. LLC need not file any amendment to certificate of formation. Agent may resign and appoint its own successor agent; must be ratified and approved by LLC. Certificate must be filed with Secretary of State. No further amendment to certificate of formation necessary by LLC. Agent may resign without appointing new agent, but resignation not effective for 30 days after certificate filed, and must give notice to LLC. LLC must obtain and designate new agent within 30 days after agent files certificate of resignation or certificate of formation will be cancelled. 18-104(b), 18-104(c), 18-104(d).

Member or manager may in writing consent to be subject to nonexclusive jurisdiction of courts of another jurisdiction or exclusive jurisdiction of Delaware. 18-109(d).

Member or manager may in a writing consent to be subject to nonexclusive arbitration in another state or exclusive arbitration in Delaware. 18-109(d).

Member or manager may consent to be served with legal process in a manner prescribed in writing. 18-109(d).

Member who is not a manager may not waive right to maintain action in Delaware with respect to organization or internal affairs of LLC, but agreement to arbitration permitted. 18-109(d).

M. Filing.

Instrument filed with Secretary of State. Person need not exhibit evidence of authority to sign. Signature may be by facsimile. Upon delivery, Secretary of State shall record date and time, and if instrument conforms to law, Secretary of State shall:

- Certify that document was filed and date and time of filing;
- File and index document;
- Prepare and return to filer copy of signed, endorsed document;
- Cause to be entered into computer system (and may permit direct access to registered agents); and
- Upon request made upon or prior to delivery, establish date and time of filing at a date or time after its delivery.

If Secretary of State refuses to file, and a replacement and proper fees are filed within 5 business days after notice of suspension, then original filing date is date and time of filing. Secretary of State shall not issue good

standing certificate to suspended LLC. Secretary of State may establish as date and time of filing the time at which information entered into computer system if certificate delivered on same date and within 4 hours after information entered. If separate affidavit of extraordinary condition is submitted, that an earlier effort to deliver certificate and tender fees was made in good faith or Secretary of State in its discretion provides written waiver of such affidavit and Secretary of State determines that an extraordinary condition existed at such date and time, and actual delivery and tender is made within a reasonable period (not to exceed 2 business days) after cessation of condition, then Secretary of State may establish earlier date and time for filing. 18-206(a).

Upon filing certificate of amendment, correction, corrected or restated certificate or upon future effective date, certificate of formation shall be amended, etc. Upon filing certificate of cancellation or canceling certificate of merger/consolidation or certificate of conversion, certificate of formation is cancelled. Upon filing certificate of domestication or upon future effective date, LLC is domesticated. Other certificates (conversion, revival, transfer, and domestic continuance) are effective upon filing or upon a future specified effective date. 18-206(b).

If prior to future effective date or time transaction is terminated or terms are amended to change effective date or time or any other matter so as to make certificate false or inaccurate, such certificate shall be terminated or amended by filing certificate of termination or amendment, identifying certificate terminated or amended and shall state that it has been terminated or the manner in which it is amended. Effective upon filing or future effective date. 18-206(c).

All fees must be paid at time of filing certificate. 18-206(d).

Secretary of State shall collect and deposit courthouse municipality fee ($20) with respect to each filed instrument. Municipality to receive fee shall be municipality in county of LLC's registered office in Delaware. No fee to be charged for foreign LLC filings. 18-206(e).

Fee paid for certified copy of any filing and for each page copied. 18-204\6(f).

N. Notice.

N. Notice.

Certificate of formation filed with Secretary of State is constructive notice of formation of Delaware LLC and all matters required by law in certificate or of series provisions in certificate.

O. Contested Votes.

O. Contested Votes.

Upon application of any member or manager, Court of Chancery may determine validity of any admission, election, appointment, removal, or resignation of a manager and right to become or continue to be a

	manager, or determine managerial contests. LLC shall be named as a party. Service on registered agent is service on LLC and all managers or potential managers. 18-110(a). Upon application of any member or manager, Court of Chancery may determine result of any vote of members or managers. LLC shall be named a party. 18-110(b). Manager means actual manager or someone who participates materially in the management of the LLC; however, the power to elect a manager shall not, by itself, constitute participation in the management. 18-110(c). Nothing limits or affects right to serve process in any other legal manner. 18-110(d).
P. Interpretation of Operating Agreement.	**P. Interpretation of LLC Agreement.** Any action to interpret, apply or enforce LLC agreement or duties of LLC to members or managers or duties among members or managers or any provision of this chapter may be brought in Court of Chancery. Managers include members or nonmembers who participate materially in the management of the company, even if not designated as a manager. 18-111.
Q. Series.	**Q. Series.** LLC agreement may provide for 1 or more series of members, managers, LLC interests or assets. Any series may have separate rights, powers or duties and each series may have a separate business purpose. 18-215(a). If LLC agreement establishes series and records maintained account for assets of such series separately from other series, and notice of limitation of liabilities in certificate of formation, then debts, liabilities, obligations and expenses incurred with respect to particular series shall be enforceable against the assets of that series only, and not against assets of LLC generally or any other series, and none of debts, liabilities, obligations, and expenses of LLC generally or any other series may be charged to that series. Assets associated with a series may be held directly or indirectly, including in the name of the series, the name of the LLC, through a nominee or otherwise. Records maintained that reasonably identify its assets (including percent of assets) will be deemed to account separately. No specific series need be referenced in certificate of formation. 18-215(b). Series may carry on any business, whether or not for profit, with exception of banking business. Unless LLC agreement provides otherwise, series may in its own name contract, hold title to assets including real, personal and intangible property, grant liens and security interests, and sue and be sued. 18-215(c). Under LLC agreement or other agreement, member or manager may agree to be obligated personally for one or more series. 18-215(d). LLC agreement may provide for classes or groups of

members or managers associated with a series. May make provision for future creation of classes, even with priority to existing classes. May provide for taking of action without vote or approval of any member or manager or class or group of members or managers, including amendment or creation of a class. LLC agreement may provide that any member or class or group of members associated with a series shall have no voting rights. 18-215(e).

LLC agreement may grant to all or certain identified members or managers or class associated with a series the right to vote separately with all or any class or group of the members or managers, on any matter. Voting may be on a per capita, number, financial interest, class, group, or any other basis. 18-215(f).

Unless LLC agreement provides otherwise, management of a series vested in the members associated with such series in proportion to then current percentage or other interest of members in the profits of such series, more than 50 percent of said interests control, unless LLC agreement vests powers in a manager or managers. Ceasing to be a manager of one series does not automatically terminate manager for other series or LLC generally. 18-215(g).

Member of a series entitled to a distribution becomes a creditor. 18-215(h).

LLC shall not make a distribution to members of a series if the distribution would cause the liabilities of the series to exceed the fair value of the assets of the series, except for secured debt to the extent of the security and for obligations to distribute. Payments of reasonable compensation or pursuant to bona fide retirement or benefits program shall not be considered a distribution. Member who knew distribution violated this subsection must return it, but if member didn't know, then member is not liable to return. Three-year statute of limitations to recover wrongful distribution applies. 18-215(i).

Upon assignment, member ceases to be associated with a series, but does not affect member's rights with respect to other series or LLC in general. Even if series has no members, series does not terminate. 18-215(j).

Series may be terminated and wound up without dissolving LLC. Termination of series does not affect limitation of liabilities. Series terminated at time or upon events specified in operating agreement, or upon vote of 2/3 of profits interest of the series or each class thereof as applicable, or by court order. 18-215(k).

Manager or member approved by majority of members of series or each class thereof may wind up series that has been terminated. Court of Chancery may appoint liquidating trustee. Persons winding up may take all necessary actions on behalf of LLC, may make provision for claims, and may distribute assets to members of series. Actions do not affect liability of members of series or persons winding up LLC. 18-215(*l*).

On application by member or manager of a series, Court of Chancery may decree termination of series when it is not reasonably practicable to carry on business of series in conformity with LLC agreement. 18-215(m).

Foreign LLC registering to do business in Delaware with separate series must state such on application for registration. 18-215(n).

III. Members

A. Acquisition.

Acquiring from LLC or as assignee, need consent of a majority of members (unless operating agreement provides otherwise), compliance with articles or operating agreement, and member/assignee becoming party to operating agreement. 17100(a).

Member shall be added to list of members required to be kept under 17058(a). 17100(b).

Operating agreement may provide for termination of membership or economic interest in whole or part. Member may demand return of contribution. Enforceable unless provision unreasonable under the circumstances existing at the time the agreement was made. 17058(a) list must be amended after termination. 17100(c).

Labor Code §§406 and 407 do not apply to membership interests issued to employees or to transactions in connection with securing employment. 17100(d).

A. Acquisition.

Admitted as member in connection with formation upon later of formation or time provided by LLC agreement or if not provided, when reflected in records. 18-301(a).

After formation, admitted upon unanimous consent of all members if not assignee, and if assignee, approval of all members other than assignor member or compliance with LLC agreement. If person admitted as member to surviving LLC pursuant to merger or consolidation, then as provided in LLC agreement or agreement of merger or consolidation and if inconsistent, agreement of merger or consolidation controls. 18-301(b).

For domestication or conversion to domestic LLC, person admitted as a member as provided in LLC agreement. 18-301(c).

Member has no preemptive right to subscribe to additional issue of LLC interests. 18-301(e).

B. Liability.

Unless a member has received a distribution or agrees, he/she is not liable for the debts of the LLC solely by reason of being a member. 17101(a).

Corporation-type alter-ego theory applies, but LLCs do not generally have to have meetings unless their articles or operating agreement expressly require them. 17101(b).

Members can still be liable for their tortuous conduct or for their guarantees. 17101(c).

LLCs shall carry insurance to the same extent as necessary for corporations. 17101(d).

Members may agree to be liable for debts of LLC as long as the articles or written operating agreement contain the agreement and reference this subdivision. 17101(e).

B. Liability.

Unless chapter provides otherwise, member is not liable for debts of LLC solely by reason of being a member. 18-303(a).

Members may agree to be liable for debts of LLC in LLC agreement or other agreement. 18-303(b).

C. Classes.

May have classes of members as articles or operating agreement may provide. 17102.

C. Classes.

May have classes or groups of members as LLC agreement may provide. May provide for taking action without vote or approval or any member or class or group. 18-302(a).

D. Voting.

D. Voting.

Articles or written operating agreement govern voting. If not, then members vote in proportion to their interest in current profits of LLC. Also if not, then unanimous consent to amend articles or operating agreement. Also if not, then default vote on all other matters is a majority in interest of the members. 17103(a).

In no event (even in articles or operating agreement) may the articles be amended by a vote of less than a majority in interest of the members. 17103(b).

No matter what operating agreement or articles say, members have the right to vote on dissolution (17350) and merger (17551). 17103(c).

E. Meetings.

Broad location, electronic, within or without California. If no place in articles or operating agreement, then at principal executive office. 17104(a).

Meetings may be called by any manager or by members representing more than 10 percent of the interest of members. 17104(b).

Notice not less than 10 nor more than 60 days before meeting. Notice must state place, date, hour, means of electronic communication, and general nature of business. No other business may be transacted at meeting. Notice given personally, by electronic transmission, or by mail or other means of written communication at last known address, or if none, by publication. If returned by Post Office as undeliverable, then all future notices deemed given without further mailing if available for member at principal executive office for one year from date of giving notice to all other members. Notice by electronic transmission must comply with 17001(o)(1), but not valid if LLC unable to deliver two consecutive notices by electronic transmission or inability to deliver becomes known to delivering agent for LLC. Manager must give notice immediately after request. If not given within 20 days after receipt, person making request may give notice or may apply to superior court where principal office located. 17104(c).

When adjourned, notice need not be given of adjourned meeting if time and place of new meeting announced at meeting at which adjournment is taken. If adjournment more than 45 days, or new record date fixed, notice shall be given. 17104(d).

Actions taken at meeting if quorum is present in person or by proxy, and either before or after meeting members provide waiver of notice or consent or approve meeting. Attendance at meeting is waiver of notice unless objection made. 17104(e).

Members may participate electronically as long as all members can hear one another. 17104(f).

Any action approved at meeting valid only if general

May provide that any member or class or group shall have no voting rights. 18-302(a). May grant to all or certain members or specified class the right to vote separately or with all or any class or group of members or managers, on any matter, on any basis. 18-302(b).

E. Meetings.

LLC Agreement may set forth provisions relating to notice of time, place or purpose of any meeting, or any other matter. 18-302(c).

Meetings may be held by means of conference telephone or other communication by which all members can hear each other. 18-302(d).

Any action at meeting can be taken by written consent if minimum number of members sign consent. Consent may be transmitted by electronic transmission. 18-302(d).

Members may vote by proxy, which may be granted by electronic transmission or otherwise as permitted by law. 18-302(d).

nature of proposal stated in notice of meeting or written waiver of notice. 17104(g).

Majority in interest by person or proxy constitutes a quorum. Members can keep meeting after they lose a quorum as long as correct percentage approves action. Majority present at meeting can adjourn it. 17104(h).

Action by written consent OK if signed and delivered by required vote of interests within 60 days of record date. Unless consents of all members have been solicited in writing:

- Notice of approval of amendment to articles or operating agreement, dissolution, or merger must be given at least 10 days prior to action.
- Prompt notice given of taking of any other action to those members who have not consented in writing.

Can revoke consent personally or by proxy before vote becomes effective by delivery to LLC. 17104(i).

Proxies same as corporations. 17104(j).

Record date fixed by manager or greater than 10 percent members, must be not more than 60 nor less than 10 days prior to date of meeting and not more than 60 days prior to any other action. If no record date fixed, then record date for purposes of determining notice of or to vote at meeting of members is close of business on business day next preceding the day on which notice is given, or if notice waived, close of business on business day next preceding meeting date. Action by written consent record date is the day on which first written consent is given. For all other purposes, record date is close of business on the day on which the managers adopt the resolution or the 60th day prior to the date of the action, whichever is later. 17104(k).

Meeting may be conducted by electronic transmission if LLC implements reasonable measures to provide reasonable opportunity for member participation, and record is held. 17104(*l*).

F. Certificates.

Operating agreement may provide for certificates. 17105(a).

Operating agreement may provide signature by manager or officer, by facsimile, even if manager has ceased to be manager or officer before certificate issued. Worn out or lost certificates may be renewed by satisfactory proof of loss and any indemnity as may be required. 17105(b).

G. Access to Information.

Upon request by member or economic interest holder, for purposes reasonably related to his/her/its interest, manager shall deliver list of members, list of managers,

F. Certificates.

LLC Agreement may provide for certificates. 18-702(c).

Certificates may not be issued in bearer form. 18-702(c).

G. Access to Information.

Each member has right, for purpose reasonably related to member's interest and subject to reasonable standards (including what information is to be furnished at what

and copies of tax returns required to be kept, along with any written operating agreement. 17106(a).

Such members/interest holders may also inspect and copy any records required to be kept, and obtain copies of latest tax returns. 17106(b).

LLCs with more than 35 members must produce annual report to members no later than 120 days after close of fiscal year, which may be sent by electronic transmission and must contain a balance sheet, income statement, and statement of cash flows for fiscal year. Members representing at least 5 percent of the voting interests, or three or more members, may make a written request to a manager for an income statement for a 3-, 6-, or 9-month period of the current fiscal year ended more than 30 days prior to the date of request, and balance sheet as of end of period, and such statement must be delivered or mailed within 30 days. Financial statements shall be accompanied by report, if any, of independent accountants, or if not, then certificate of manager that financial statements were prepared without audit. 17106(c).

Manager shall promptly furnish member copy of amendment to articles or operating agreement executed by manager pursuant to power of attorney from the member. 17106(d).

LLC shall send to each member or holder of economic interest within 90 days after end of each taxable year information necessary to complete federal and state income tax or information returns and, if 35 or fewer members, copy of tax returns. 17106(e).

Court may enforce this section, and may extend time for good cause. 17106(f).

If court finds failure to comply without justification, may award attorney fees and reasonable expenses to person bringing action. 17106(g).

Waivers of this section are unenforceable. 17106(h).

Any request, inspection, or copying may be made by member/interest holder's agent or attorney. 17106(i).

H. Failure to Disclose Information.

If LLC fails to comply with 17106 or its own operating agreement, Attorney General may send notice of complaint to LLC office. 17107(a).

If Attorney General does not receive LLC answer

time and at whose expense) as may be set forth in LLC agreement or established by manager or, if none, then by members, to obtain:

- True and full information regarding the status of the business and financial condition of the LLC;
- Copies of LLC's federal, state and local income tax returns for each year;
- Current list of name and last known business, residence or mailing address of each member and manager;
- Copy of written LLC agreement and certificate of formation and all amendments, together with powers of attorney for execution;
- True and full information regarding amount of cash and description and statement of agreed value of any other property or services contributed by each member and future contribution obligations, and date when each became a member; and
- Other information as is just and reasonable.

18-305(a).

Each manager has these rights for a purpose reasonably related to the manager's position. 18-305(b).

Court may enforce this section. 18-305(f).

Court may order demanding member to pay reasonable cost of obtaining and furnishing information. Court of Chancery has exclusive jurisdiction. 18-305(f).

LLC Agreement or amendment approved or adopted by all the members can restrict rights of member or manager to obtain information in addition to the rights of this section. 18-305(g).

Request must be made in writing and shall state the purpose of such demand. 18-305(e).

Manager has right to keep confidential, for such period of time as manager deems reasonable, any information that the manager reasonably believes to be in the nature of trade secrets or other information, disclosure of which manager in good faith believes is not in the best interest of the LLC or could damage the LLC or its business or which the LLC is required by law or by agreement to keep confidential. 18-305(c).

H. Failure to Disclose Information.

within 30 days of date of notice or if answer not satisfactory, and enforcement of rights by private civil action is so burdensome or expensive as to be impracticable, Attorney General may intervene in court by way of injunction, dissolution, appointment of receivers, or any other remedy as may be appropriate. 17107(b).

I. Termination Due to Bankruptcy.

I. Termination Due to Bankruptcy.

Person ceases to be a member if person:

- Makes an assignment for benefit of creditors;
- Files voluntary petition in bankruptcy;
- Is adjudged bankrupt or insolvent;
- Files petition or answer seeking reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief;
- Files answer or other pleading admitting or failing to contest material allegations against member; or
- Seeks, consents to, or acquiesces in appointment of trustee, receiver or liquidator of member.

18-304(1).

120 days after commencement of proceeding against member, if proceeding has not been dismissed, or within 90 days after, *e.g.,* appointment of trustee, appointment is not vacated or stayed, or within 90 days after expiration of stay, appointment is not vacated. 18-304(2).

J. Remedies for Breach of LLC Agreement by Member.

J. Remedies for Breach of LLC Agreement by Member.

LLC Agreement may provide that member who fails to perform in accordance with or to comply with terms and conditions of LLC agreement shall be subject to specified penalties or specified consequences and at time or upon happening of events specified in LLC Agreement, member shall be subject to specified penalties or specified consequences. Such specified penalties or consequences (see 18-502(c)) may include reducing or eliminating interest of breaching member, subordinating interest to that of non-breaching members, forced sale of LLC interest, forfeiture of LLC interest, fixing value by appraisal or formula and redeeming or selling LLC interest at such value, or other penalty or consequence. 18-306.

IV. Managers

A. Member-Managed.

Default without articles statement is member-managed, subject to the classes in the operating agreement. 17150.

A. Member-Managed.

Default without agreement is member-managed, in proportion to profits interest. 18-402.

B. Manager-Managed.

B. Manager-Managed.

Articles may provide for one or more managers who may but need not be members. 17151(a).

Articles shall state whether managed by one or more managers. 17151(b).

Articles or operating agreement may prescribe number and qualifications of managers who may, but need not be, natural persons. 17151(c).

C. Elections of Managers.

Election of managers by vote of majority in interest of members. 17152(a).

Managers may be removed with or without cause by majority of members at a meeting, does not affect rights under employment agreement. 17152(b).

Managers may resign at any time upon written notice, does not affect LLC rights under employment agreements. 17152(c).

Managers hold office until expiration of their term, or if none, until successors elected and qualified. 17152(d).

D. Fiduciary Duties.

Manager owes same fiduciary duties to LLC and members as a partner does to a partnership and its partners. 17153.

E. Officers.

Written operating agreement may provide for appointment of officers. Officers need not be members, and same person may hold more than one office. 17154(a).

Officers appointed in accordance with written operating agreement, or if not, by managers. Officers may resign at any time. 17154(b).

Without actual knowledge of third party, document signed by chairperson of board, president, or any VP and any secretary, CFO, or assistants thereto is not invalidated by lack of authority. 17154(c).

F. Indemnification and Insurance.

Except for breach of fiduciary duty, articles or written operating agreement may provide for indemnification of any person. 17155(a).

LLC has power to purchase and maintain insurance to protect against liability. 17155(b).

G. More Than One Manager.

Unless articles or operating agreement provide

Person may be named as manager by LLC agreement or similar instrument. 18-401, 18-101(10).

May have more than one manager. 18-402.

Managers may make contributions to LLC and may have membership interests. 18-403.

C. Elections of Managers.

Managers may resign according to LLC agreement. LLC agreement may provide that manager may not resign, but manager may still resign and pay damages. 18-602.

D. Fiduciary Duties.

Managers, members, or liquidation trustee may rely in good faith upon records of LLC and upon information presented by another manager, member or liquidating trustee, officers, employees of the LLC, or by any other expert. 18-406.

Member or manager may delegate powers to manage and control LLC. Delegation shall not cause member or manager to cease to be so or cause the delegatee to become a member or manager of the LLC. 18-407.

E. Officers.

F. Indemnification and Insurance.

Subject to LLC agreement, LLC may provide for indemnification of any person. 18-108.

G. More Than One Manager.

LLC agreement may provide for classes of managers,

otherwise, manager decisions are by majority if at a meeting or by unanimous written consent if not.

and may provide for action without manager vote. 18-404(a).

LLC agreement may grant managers right to vote on any basis, separately or per class. 18-404(b).

LLC agreement may set forth provisions regarding notice of meeting, waiver of notice, action by consent, record date, quorum, voting by proxy, or any other matter. 18-404(c).

Meetings of managers may be by teleconference where everyone can hear each other. Managers may take action by written consent of number necessary to approve. Managers may vote by proxy, including by electronic transmission.

H. Agents of the Company.

Unless articles state manager-managed, every member can bind the LLC unless third person has actual knowledge of no authority. 17157(a).

If articles state manager-managed, no member is an agent of LLC, but every manager can bind the LLC unless third person has actual knowledge of no managerial authority. 17151(b).

No act of manager or member can bind LLC to person having actual knowledge of restriction of authority. 17151(c).

Contracts signed by at least 2 managers (or one for a single manager) are not invalidated for lack of authority. 17157(d).

H. Agents of the Company.

Unless provided in LLC agreement, each member and manager has right to bind LLC. 18-402.

I. Liability of Managers.

No manager or officer is personally liable for LLC obligations solely by reason of being manager or officer. 17158(a).

Manager may agree to be personally obligated by agreement in articles or written operating agreement referencing this subsection or by guarantee or contract. 17158(b).

I. Liability of Managers.

No personal liability for LLC obligations solely by reason of being a manager. 18-303(a).

Manager may agree to be personally obligated by agreement. 18-303(b).

M. Remedies for Breach by Manager.

M. Remedies for Breach by Manager.

LLC agreement may provide that manager who fails to comply with LLC agreement shall be subject to specified penalties or specified consequences upon happening of events specified in LLC agreement. 18-405.

V. Finance

A. Capital Contributions.

Articles or operating agreement may provide money, property, services, or obligation to contribute. 17200(a).

Unless articles or operating agreement provide otherwise, no member is required to make additional contribution. 17200(b).

A. Capital Contributions.

May be admitted as member without making contribution or being obligated to make contribution. May be admitted as member without acquiring LLC interest. 18-301(d). Contribution may be in cash, property, services rendered, or a promissory note or obligation to contribute. 18-501.

B. Obligation to Contribute.

B. Obligation to Contribute.

No excuse from obligation because of death, disability, dissolution, or any other reason. If no contribution made, member required to contribute cash, in addition to any remedy in articles or operating agreement. Operating agreement may provide that interest of member who fails to contribute is subject to specific remedies, including reduction of economic rights. 17201(a).

Unless otherwise provided by articles or operating agreement, obligation may be compromised only by unanimous vote of other members. Third parties have the right to demand contribution if they did not know of compromise and they did know of contribution obligation. Third parties have the right to demand contribution if there was no compromise. 17201(b).

Third party may not enforce conditional contribution obligation unless all conditions are satisfied or waived, including capital contributions payable on discretionary call of LLC. 17201(c).

Third party creditors may still seek equitable remedies or rights under Uniform Fraudulent Transfer Act. 17201(d).

C. Allocation of Profits and Losses.

Profits and losses allocated in manner provided in operating agreement, and if not provided therein, in proportion to contributions of each member. 17202.

VI. Distributions and Withdrawals
A. Distributions.

Distributions made in manner provided in operating agreement, and if not provided therein, return of capital distributions made in proportion to contributions, distributions not a return of capital made in proportion to allocation of profits. Member has status of creditor with respect to distribution. 17250.

B. No Entitlement to Distributions.

Operating agreement determines extent and times of distributions before withdrawal and before dissolution. 17251.
C. Withdrawals.

Articles or written operating agreement governs ability to withdraw, resign or retire. Even if restricted from withdrawal, a member may withdraw at any time by giving notice to members. Unless articles or written operating agreement provide otherwise, withdrawn member not entitled to payment, and is just an economic interest holder, and is not a member. LLC can offset damages for wrongful withdrawal. 17252(a).

List of members shall be updated upon withdrawal of a member. 17252(b).
D. Form of Distribution.

Unless LLC agreement provides otherwise, member is obligated to perform promise to contribute, even if member's ability to perform is affected by death, disability, or any other reason. If no contribution made, member required to contribute cash, in addition to any remedy by LLC agreement or law. 18-502(a).

LLC agreement may provide that interest of a member who fails to contribute is subject to specific remedies, including reduction of economic rights. 18-502(c).

Unless otherwise provided by LLC agreement, obligation may be compromised only by consent of all members. Third parties have the right to demand contribution if they did not know of compromise and they reasonably relied on contribution obligation. 18-502(b).

Conditional obligations may not be enforced unless all conditions are satisfied or waived, including contributions payable on discretionary call of LLC. 18-502(b).

No defense of usury available for obligation of member or manager arising under LLC agreement or separate agreement or writing. 18-505.
C. Allocation of Profits and Losses.

Profits and losses allocated among the members in manner provided in LLC agreement, and if not provided therein, in proportion to contributions of each member. 18-503.

A. Distributions.

Distributions made in manner provided in LLC agreement, and if not provided therein, distributions made in proportion to contributions of each member. 18-504.

Member has the status of a creditor with respect to distribution. 18-606.
B. No Entitlement to Distributions.

LLC agreement determines extent and times of distributions before withdrawal and before dissolution. 18-601.
C. Withdrawals.

Member may resign only at time specified in LLC agreement. Unless LLC agreement provides otherwise, a member may not resign prior to dissolution. This does not apply to LLCs formed in Delaware on or before 7/31/1996. 18-603.

Resigning member entitled to receive any distribution is entitled to receive any distribution to which entitled under LLC agreement, and if not provided, member is entitled to receive fair value of member's LLC interest as of the date of resignation. 18-604.
D. Form of Distribution.

Member has no right to demand and receive any distribution from an LLC in a form other than money. 17253(a).

No member may be compelled to accept distribution of in kind asset in lieu of money being distributed to other members. 17253(b).

Except upon dissolution, no member may be compelled to accept a distribution of any asset in kind. 17253(c).

E. Prohibited Distributions.

No distribution if LLC not able to pay debts as they become due in the usual course of business. No distribution if LLC's total assets less of total liabilities plus amount needed for distribution to satisfy preferential rights of other members than the one receiving the distribution. 17254(a).

LLC may base nonprohibition of distribution on financial statements, fair valuation, any other method reasonable in the circumstances. 17254(b).

Prohibited distribution effect is measured as of the date the distribution is authorized if the payment occurs within 120 days after authorization or date payment is made if later. 17254(c).

If indebtedness terms reference payment of principal and interest is to be made only if payment of a distribution to members could then be made under this section, then indebtedness is not a liability. If indebtedness is issued as a distribution, then payments of principal and interest are treated as a distribution, effect measured on date payment is actually made. 17254(d).

Member or assignee must return distribution if member or assignee had actual knowledge of impropriety of distribution and immediately after giving effect to distribution and notwithstanding any compromise of a contribution obligation, all liabilities other than distribution liabilities to members or assignees and liabilities of secured creditors exceed the fair market value of the LLC's assets, except for assets securing obligations to secured creditors to the extent of such security. 17254(e).

Statute of limitations for wrongful distribution is four years after distribution is made. 17254(f).

F. Liability for Wrongful Distribution.

Member or manager who votes for a distribution in violation of operating agreement or 17254(a) or wrongful distribution on dissolution is personally liable for the impermissible amount if it is determined that the member or manager did not act in compliance with 17254 or 17353. 17255(a).

Each member or manager held liable herein is entitled to compel contribution from each other member or

Member has no right to demand and receive distribution from an LLC in any form other than cash. 18-605.

No member may be compelled to accept distribution in kind to the extent that the percentage of the asset distributed exceeds the member's percentage in the LLC. 18-605.

Member may be compelled to accept distribution in kind if percentage of asset distributed is equal to member's percentage in LLC. 18-605.

E. Prohibited Distributions.

No distribution if LLC's total liabilities exceed total assets (not including assets securing liabilities to the extent of such security and not including liabilities to members for distribution). Payments of reasonable compensation or pursuant to bona fide retirement or benefits program shall not be considered a distribution. 18-607(a).

Member liable for distribution if member knew at the time of the distribution that it was unlawful. Member need not return distribution if did not know at time of distribution that it was unlawful. Does not affect any obligation of a member under an agreement or other applicable law. 18-607(b).

Statute of limitations for wrongful distribution is three years after distribution is made. 18-607(c).

F. Liability for Wrongful Distribution.

manager who could be held liable under this section and from each member for the amount the member received with knowledge that the distribution was prohibited. 17255(b).

Statute of limitations is four years after the date on which the effect of the distribution is measured. 17255(c).

VII. Assignment of Interests

A. Company Property.

Membership interest and economic interest are personal property of the member or assignee. Neither has any interest in specific LLC property. 17300.

B. Membership Interests.

Unless provided in articles or operating agreement membership interest or economic interest is assignable (for membership interest with consent of majority of other members). Assignment of economic interest does not dissolve LLC or entitle assignee to vote or participate in management or to become a member. Assignment of economic interest only entitles assignee to receive distributions and allocations. Upon assignment, assignee must give address, and list of members/interest holders must be updated. Until assignee becomes member, assignor continues to be a member and has all rights and powers of a member, including right to vote. 17301(a).

Unless assumed by agreement, assignee has no liability to LLC under finance and distributions chapter solely as a result of the assignment. Assignor is not released from liability as a member solely as a result of the assignment. 17301(b).

Pledge of or grant of security interest in or against any or all of the membership interest shall not cause the member to cease to be a member or to grant to anyone else the power to exercise the rights of a member. 17301(c).

C. Charging Order.

Court may charge assignable membership interest to satisfy judgment upon application. Court may appoint a receiver. 17302(a).

Charging order constitutes a lien on the judgment debtor's interest. Court may order foreclosure on membership interest. Purchaser has rights of an assignee. 17302(b).

Before foreclosure, charged membership interest may be redeemed:

- By judgment debtor;
- With property other than property of LLC by one or more other members; or
- With property of LLC by one or more of other members with consent of all members whose

A. Company Property.

LLC interest is personal property. Member has no interest in specific LLC property. 18-701.

B. Membership Interests.

LLC agreement may provide that LLC interest may not be assigned prior to dissolution. 18-603. If not, LLC interest is assignable. 18-702(a).

Assignee has no right to participate in management unless provided in LLC agreement and upon vote of all members other than assignor and compliance with LLC agreement procedures. 18-702(a).

Assignee has no right to become a member. Assignment only entitles assignee to receive distributions and allocations. Assignor ceases to be a member upon assignment of all of the LLC interest. 18-702(b).

Unless LLC agreement provides or assumed by agreement, assignee has no liability as a member solely as the result of the assignment. 18-702(d).

Pledge of or grant of security interest in or against any or all of the LLC interest shall not cause the member to cease to be a member or grant to anyone else the power to exercise the rights of a member. 18-702(b)(3).

LLC may acquire LLC interest or other interest of a member or manager. Such interest shall be deemed cancelled. 18-702(e).

C. Charging Order.

Court may charge interest of member or assignee to satisfy judgment upon application. Judgment creditor only has the right to receive distributions of judgment debtor. 18-703(a).

Charging order constitutes a lien on the judgment debtor's interest. No foreclosure. 18-703(b).

Does not deprive member or assignee of benefits of exemption laws. 18-703(c).

No creditor has right to obtain possession of or exercise remedies with respect to LLC property. 18-703(e).

Court of Chancery has jurisdiction to hear and determine any matter relating to a charging order. 18-703(f).

membership interests are not charged.

17302(c).

Does not deprive member or assignee of membership interest of benefits of any exemption laws. 17302(d).

Exclusive remedy by which judgment creditor of a member or member's assignee may satisfy a judgment out of the judgment debtor's membership interest in the LLC. 17302(e).

D. Assignees.

Except as provided in articles or operating agreement, assignee may become a member only upon vote of a majority interest of other members. 17303(a).

Assignee who becomes a member has rights, powers, liabilities of a member under the articles and any operating agreement. Assignee is liable for obligations of assignor to make contributions and to return any unlawful distributions. Not obligated for liabilities unknown to assignee at time assignee became a member and that could not be ascertained from the articles or operating agreement. 17303(b).

Assignor not released from liability to contribute or for wrongful distributions, whether or not assignee becomes a member. 17303(c).

E. Deceased or Incompetent Members.

Individual dies or is adjudged to be incompetent, legal representative may exercise all member's rights for purposes of settling member's estate or administering member's property. 17304(a).

If a member is a corporation, trust, or other entity and is dissolved or terminated, powers of that member may be exercised by its legal representative or successor. 17304(b).

VIII. Dissolution

A. Dissolution Conditions.

LLC dissolved and wound up at time specified in articles or upon happening of events specified in articles or written operating agreement. 17350(a).

LLC dissolved and wound up by vote of a majority in interest of the members or a greater percentage as may be specified in the articles or a written operating agreement. 17350(b).

LLC dissolved and wound up by entry of decree of judicial dissolution. 17350(c).

D. Assignees.

Except as provided in LLC agreement, assignee may become a member only as provided in LLC agreement and upon approval of all members other than assignor and upon compliance with procedure of LLC agreement. 18-704(a).

Assignee who becomes a member has rights, powers, liabilities of a member under the LLC agreement. Unless otherwise provided in LLC Agreement, assignee is liable for obligations of assignor to make contributions, but is not liable to return any unlawful distributions. Not obligated for liabilities unknown to assignee at time assignee became a member and that could not be ascertained from the LLC agreement. 18-704(b).

Assignor not released from liability to contribute or for wrongful distributions, whether or not assignee becomes a member. 18-704(c).

E. Deceased or Incompetent Members.

Individual dies or is adjudged to be incompetent, personal representative may exercise all member's rights for purpose of settling member's estate or administering member's property. 18-705.

If member is corporation, trust, or other entity and is dissolved or terminated, powers of that member may be exercised by its personal representative. 18-705.

A. Dissolution Conditions.

LLC dissolved and wound up at time specified in LLC agreement or upon happening of events specified in LLC agreement. 18-801(a)(1), (2).

LLC dissolved and wound up by vote of 2/3 of members or each class of members or as may be specified in an LLC agreement. 18-801(a)(3).

LLC dissolved and wound up by entry of decree of judicial dissolution. 18-801(a)(5).

LLC dissolved and wound up if there are no members, unless:

- Within 90 days or such other period provided for in LLC agreement, the personal representative of the last member agrees in writing to continue the

LLC and to the admission of personal representative or its nominee or designee to the LLC as a member effective as of the occurrence of the event terminating the last member (LLC agreement may obligate personal representative's members to do this); or

- Member is admitted to LLC effective as of occurrence of event within 90 days or other period provided by LLC agreement, pursuant to provision of LLC agreement.

18-801(a)(4).

B. Short Form Certificate of Cancellation.

If Domestic LLC has not conducted any business, majority of members, or if none, majority of managers, or if none, then person signing articles may execute certificate of cancellation on form prescribed by Secretary of State stating:

- Name of LLC and file number;
- That certificate being filed within 12 months from formation;
- That LLC has no debts or other liabilities;
- That final franchise tax return or annual tax return has been or will be filed;
- That known assets of LLC remaining after payment of or provision for known debts and liabilities have been distributed to the persons entitled thereto, or the LLC had no assets;
- That the LLC has not conducted any business from the filing of articles;
- That a majority of managers or members voted or, if none, person signing voted to dissolve LLC; and
- That if LLC has received payments from investors, those payments have been returned.

17350.5(a).

Must be filed within 12 months from date of articles filing. Secretary of State must notify FTB. 17350.5(b).

Upon filing certificate of cancellation, LLC shall be cancelled. 17350.5(c).

Domestic LLC that filed articles on or after January 1, 2004, and that meets the conditions herein may file certificate of cancellation. 17350.5(d).

B. Short Form Certificate of Cancellation.

C. Judicial Decree and Avoidance.

Action filed by manager or any member, court may dissolve LLC if:

- (1) Not reasonably practicable to carry on

C. Judicial Decree and Avoidance.

Application by or for a member or manager, Court of Chancery may dissolve LLC whenever it is not reasonably practicable to carry on the business in conformity with LLC agreement. 18-802.

business of LLC;

- (2) Dissolution reasonably necessary for protection of the rights or interests of the complaining members;
- (3) Business of LLC has been abandoned;
- (4) Management is deadlocked or subject to internal dissension; or
- (5) Those in control of the LLC have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, or abuse of authority.

17351(a).

Other members may avoid dissolution by purchasing membership interests from moving parties for cash at fair market value. Damages for wrongful dissolution may be deducted from amount, unless (3), (4), or (5) above are reasons for dissolution. If purchasing parties elect to purchase but are unable to agree on price, and purchasing parties post bond, court can proceed to determine fair market value. To determine value, court shall appoint 3 disinterested appraisers, and a decision by a majority of them when confirmed by the court shall be final and conclusive. If purchasing parties do not purchase within time set by court, moving parties may collect bond for expenses, including attorney fees. Order is appealable. Purchasing parties must purchase to stop dissolution, and on receiving payment, moving parties shall transfer membership interests. Valuation date is date on which judicial dissolution action was commenced, unless court for good cause designates some other date. 17351(b).

D. Winding Up.

If nonjudicial dissolution occurs, managers who have not wrongfully dissolved or, if none, the members may wind up. Persons winding up shall give notice by mail to all known creditors. 17352(a).

Upon petition of manager, any member, or 3 or more creditors, court may order winding up if necessary for protection. 17352(b).

Except as provided in articles or written operating agreement, managers or members winding up shall be entitled to reasonable compensation. 17352(c).

E. Distribution Following Dissolution.

Except as provided in articles or written operating agreement, if all debts (including those to members) are paid or adequately provided for, remaining assets shall be distributed to members:

- In satisfaction of liabilities for distribution pursuant to 17201, 17202 or 17255;
- For return of contributions; and

D. Winding Up.

Unless otherwise provided, manager who has not wrongfully dissolved or, if none, the members or person appointed by more than 50 percent of members, voting by class. 18-803(a).

Upon application of any member, manager or their personal representative or an assignee, Court of Chancery may appoint liquidating trustee. 18-802(a).

E. Distribution Following Dissolution.

Assets distributed to:

- Creditors, including members and managers who are creditors;
- Members and former members in satisfaction of liabilities for past declared distributions;
- Members for return of contributions, then in

- In proportions in which members share distributions.

17353(a).

If winding up subject to court, distribution not made until expiration of claims period. 17353(b).

Payment of debt or liability is adequately provided for if payment has been assumed or guaranteed in good faith by financially responsible person, determined in good faith and with reasonable care to be adequate at the time of distribution of assets. Payment of debt or liability can also be adequately provided for if the amount has been deposited with the Controller pursuant to Corp C §2008. These means are not exclusive for adequate provision of debts. 17353(c).

F. Continuation of Business.

Dissolved LLC continues to exist for purpose of winding up affairs, but shall not continue business except to the extent necessary for winding up. 17354(a).

No abatement of actions involving LLC by reason of dissolution or winding up. 17354(b).

Assets omitted from the winding up continue in dissolved LLC for benefit of persons entitled upon distribution and on realization shall be distributed accordingly. 17354(c).

G. Causes of Action.

Causes of action may be enforced against:

- Dissolved LLC to the extent of undistributed assets; and
- Members to the extent of LLC assets distributed to members upon dissolution.

Such members may seek contribution for excess of share from any other member or manager up to pro rata share. All causes of action against members expire on earlier of statute of limitations for cause of action or four years after distribution. Members may be sued in name of LLC upon any cause of action against LLC as a member of procedure and not liability. 17355(a).

Summons may be served on any manager, member, officer, or person having charge of assets, or to Secretary of State upon affidavit to court that none can be found with due diligence. Service on Secretary of State deemed complete on 10th day after delivery of process. Secretary of State shall give notice if served. 17355(b).

LLC shall survive and continue to exist indefinitely for the purpose of any quiet title action. Judgment rendered shall bind all members and assignees to the extent of their interest. 17355(c).

proportions in which members share distributions.

18-804(a).

F. Continuation of Business.

Dissolved LLC continues to exist and persons dissolving have all rights and powers to dissolve, without affecting their liability. 18-803(b).

Dissolved LLC shall pay or make reasonable provision for payment of all creditors, including any claim which is the subject of a pending action to which LLC is a party, or for unknown claims that are likely to arise or become known within 10 years after date of distribution. 18-804(b).

G. Causes of Action.

Member who receives wrongful liquidating distribution is liable if the member knew the distribution was wrongful, and not if the member did not know at the time of the distribution. Payments of reasonable compensation or made pursuant to a bona fide retirement plan or other benefits program are not distributions. 18-804(c).

All causes of action expire three years after date of distribution. 18-804(d).

Regular limitations on distribution under 18-607 do not apply. 18-804(e).

If certificate of cancellation filed, upon application of any creditor, member, or manager of the LLC and upon showing of good cause, the Court of Chancery may appoint managers of LLC to be trustees, or appoint 1 or more receivers to take charge of LLC property and to take actions of the cancelled LLC, including all suits thereof or thereon, and to do any acts that may be necessary for final settlement of unfinished business of LLC. Powers and duties may be continued as long as the Court of Chancery shall think necessary. 18-805.

Liability is a liability at law with respect to a dissolved LLC for purposes of Revenue & Taxation Code. 17355(d).

H. Certificate of Dissolution/Cancellation.

Managers shall file on Secretary of State form a certificate of dissolution upon dissolution of LLC unless judicial dissolution, when managers or members winding up LLC shall have obligation to file. Certificate of dissolution sets forth:

- Name and file number; and
- Any other information filers determine to include.

If dissolution made by vote of all members and statement added to certificate of cancellation of articles, separate filing of certificate of dissolution not required. 17356(a).

Filers of certificate of dissolution shall cause to be filed on Secretary of State form a certificate of cancellation upon completion of winding up of affairs of LLC, unless judicial dissolution, when winders up file. Certificate of cancellation shall set forth:

- Name and file number; final franchise tax return or final annual tax return has been or will be filed; and
- Any other information filers determine to include.

Secretary of State shall notify Franchise Tax Board of the filing. 17356(b).

I. Certificate of Continuation.

Even if Certificate of Dissolution filed, majority in interest of members may file on Secretary of State form a certificate of continuation if either:

- Business of LLC is continued pursuant to unanimous vote of remaining members;
- Dissolution by vote of members and each member who consented has agreed to revoke in writing; or
- LLC not in fact dissolved.

17357(a).

Certificate of continuation shall set forth:

- Name and file number; and
- Grounds that are the basis for filing the certificate.

17357(b).

Upon filing certificate, certificate of dissolution has no

H. Certificate of Cancellation.

Cancelled upon dissolution and winding up or failure to designate new agent in time or failure to pay taxes or upon filing of certificate of merger or consolidation if LLC not surviving entity or upon filing of certificate of transfer or upon filing of certificate of conversion to non-Delaware entity or upon future effective date or time. Certificate of cancellation shall be filed with Secretary of State and shall set forth:

- Name and date of filing of certificate of formation;
- Future effective date or time, if any; and
- Any other information filer determines to include. Secretary of State shall not issue certificate of good standing to LLC if certificate cancelled.

18-203.

I. Certificate of Continuation.

Even if event of dissolution has occurred (other than judicial dissolution), the LLC shall not be dissolved and wound up if LLC is continued prior to filing certificate of cancellation, by vote of all members of the LLC and any other person required by LLC agreement, provided that dissolution by vote of members and each member who consented has agreed to revoke in writing. Personal representative of last remaining member must agree to admission of a member to continue. 18-806.

effect. 17357(c).

IX. Professional LLCs

No permission of domestic or foreign LLC to render professional services in California. 17375.

X. Foreign LLCs

A. Conflicts of Law.

Foreign laws under which foreign LLC is organized govern organization and internal affairs and liability and authority of its managers and members. 17450(a).

Foreign LLC may not be denied registration because of differences in laws with California. 17450(b).

B. Registration.

Registration necessary before transacting business in California. Submit application to register signed by person with authority under organizing statute, on Secretary of State form setting forth:

- Name in foreign jurisdiction and name in California;
- State and date of organization and statement of authority to exercise powers and privileges;
- Name and address of agent for service of process in California;
- Statement that Secretary of State is appointed agent if California agent resigns and cannot be replaced or cannot be found; and
- Address of principal executive office and principal office in California, if any.

17451(a).

Certificate of good standing in foreign jurisdiction must be attached if available, or if not, then statement that not permitted under laws of foreign jurisdiction. 17451(b).

If filing fee check bounces, Secretary of State may cancel after giving notice to submitter or agent and opportunity to pay by cashier's check or equivalent. If not, then second notice canceling foreign LLC application become effective if given 20 days or more after first notice and 90 days or less after original filing. 17451(c).

Secretary of State shall include tax notice with registration with amount of franchise tax. 17451(d).

C. Certificate of Registration.

If OK, Secretary of State shall issue certificate of registration, subject to state licensing requirements.

A. Conflicts of Law.

Foreign laws under which foreign LLC is organized govern organization and internal affairs and liability of members and managers, subject to Delaware Constitution. 18-901(a)(1).

Foreign LLC may not be denied registration because of differences in laws with Delaware. 18-901(a)(2).

Foreign LLC subject to 18-106, which prohibits banking business for LLCs.

B. Registration.

Registration necessary before transacting business in Delaware. Submit application signed by authorized person setting forth:

- Name in foreign jurisdiction and name in Delaware;
- State and date of formation and statement of valid existence;
- Nature of business or purpose in Delaware;
- Address of registered office and name and address of registered agent; and
- Statement that Secretary of State is appointed agent if Delaware agent resigns and cannot be replaced or cannot be found.

18-902.

C. Certificate of Registration.

If Secretary of State finds that application for registration conforms to law, Secretary of State shall

No certificate may be issued for confusing name. 17452(a).

If name is confusing, then foreign LLC may:

- Add words "limited liability company" or "LLC" to name for use in California; or
- Use an assumed name that is available.

May use name of foreign LLC with distinguishing word or words acceptable to Secretary of State. Must use this name in California. 17452(b).

D. Information Rights.

If California members of foreign LLC represent 25 percent or more of the voting interests of foreign LLC members, those members shall be entitled to information and inspection rights under 17106. 17453.

E. False Statements.

If false or erroneous statements in application for registration, foreign LLC shall file amendment to application, signed by a person with authority under the foreign LLC laws. 17454.

F. Certificate of Cancellation.

Foreign LLC may cancel registration by filing certificate of cancellation signed by person with authority. Cancellation does not terminate authority of Secretary of State to accept service with respect to causes of action arising out of transaction of business in California. 17455.

G. In-State Lawsuit.

Foreign LLC transacting business in California shall not maintain any lawsuit until it has registered in California. 17456(a).

Any foreign LLC transacting business in California without registration is subject to penalty of $20 per day, up to a maximum of $10,000. Action to recover under Corp C §2258, brought by Attorney General or any district attorney. 17456(b).

Member of foreign LLC is not liable for debts and obligations of foreign LLC solely by reason of foreign LLC transacting business in California without registration. 17456(c).

Foreign LLC transacting business in California without registration appoints Secretary of State as agent for service of process with respect to causes of action arising out of transaction of business in California. 17456(d).

certify that application has been filed and file and index endorsed application. 18-903(a).

Secretary of State shall return copy of original signed application, similarly endorsed. 18-903(b).

May not use confusing name to other Delaware or registered foreign entity. Must use "Limited Liability Company" "L.L.C." or "LLC" in name. 18-904(a).

D. Information Rights.

E. False Statements.

If false or erroneous or changed statements in application for registration, foreign LLC shall file amendment to application, signed by authorized person. 18-905.

F. Certificate of Cancellation.

Foreign LLC may cancel registration by filing certificate of cancellation signed by authorized person. Also cancelled if fails to appoint new agent or fails to pay taxes. Cancellation does not terminate authority of Secretary of State to accept service with respect to causes of action arising out of transaction of business in Delaware. 18-906.

G. In-State Lawsuit.

Foreign LLC transacting business in Delaware shall not maintain any lawsuit until it has registered in Delaware and paid all penalties and fees for nonregistration. 18-907(a).

Any foreign LLC transacting business in Delaware without registration is subject to penalty of $200 per year or part thereof. 18-907(d).

Member of foreign LLC is not liable for obligations of foreign LLC solely by reason of foreign LLC transacting business in Delaware without registration. 18-907(c).

Foreign LLC transacting business in Delaware without registration appoints Secretary of State agent for service of process with respect to causes of action arising out of transaction of business in Delaware. 18-911(a).

Doing business in Delaware shall mean the courts or practice of carrying on any business in Delaware, including the solicitation of business or orders in Delaware. 18-911(b).

Failure to register in Delaware does not impair validity of any contract or act of foreign LLC, right of any other

	party to maintain any action on a contract, and it does not prevent the foreign LLC from defending any action in Delaware. 18-907(b).
H. Action to Restrain.	**H. Action to Restrain.**
Attorney General may bring action to restrain a foreign LLC from transacting business in California without registration. 17457.	Attorney General may bring action in Court of Chancery to restrain a foreign LLC from transacting business in Delaware without registration or with false application for registration. 18-908.
I. Registered Office; Registered Agent.	**I. Registered Office; Registered Agent.**
	Must maintain registered office in Delaware. 18-904(b)(1).
	Must have Delaware agent for service of process with identical business office as registered Delaware office. Can be individual resident in Delaware, domestic entity, or foreign entity. 18-904(b)(2).
	Agent may change address or name by filing certificate with Secretary of State, which shall furnish certified copy of certificate to agent. LLC need not file any amendment to application. Agent may resign and appoint its own successor agent, must be ratified and approved by LLC. Certificate must be filed with Secretary of State. No further amendment to application necessary by LLC. Agent may resign without appointing new agent, but resignation not effective for 30 days after certificate filed, and must give notice to LLC. LLC must obtain and designate new agent within 30 days after agent files certificate of resignation or certificate of formation will be cancelled. 18-904(c), 18-904(d), 18-904(e).
J. Execution; Liability.	**J. Execution; Liability.**
	Execution constitutes oath or affirmation under penalties of perjury in the third degree that to the best of such person's knowledge or belief, facts stated therein are true. 18-909.
K. Service of Process on Registered Foreign LLCs.	**K. Service of Process on Registered Foreign LLCs.**
	Process served personally on manager or managing or general or on LLC's registered agent or if none on Secretary of State. If registered agent is corporation, then can serve president, vice president, secretary, assistant secretary or director of the corporate registered agent. Service at dwelling house to be effective must be delivered at least 6 days before the return of the process, in the presence of an adult person. 18-910(a).
	Can serve Secretary of State if cannot locate people to serve by due diligence. No court order necessary. Service complete when received by Secretary of State. Secretary of State shall give notice to LLC. Secretary of State shall keep records of process served, for a maximum period of 5 years from receipt of service. Pay $50 for costs of service, which shall be taxed as part of costs of proceeding. 18-910(b).
L. Service of Process on Unregistered Foreign LLCs.	**L. Service of Process on Unregistered Foreign LLCs.**
	If service upon Secretary of State, Secretary of State shall notify by certified mail. No court order necessary. Service complete when received by Secretary of State.

Secretary of State shall give notice to LLC. Secretary of State shall keep records of process served, for a maximum period of 5 years from receipt of service. Pay $50 for costs of service, which shall be taxed as part of costs of proceeding. 18-911(c).

XI. Class Actions and Derivative Actions
A. Class Actions.

Any member of LLC may bring class action on behalf of class. No requirement that to maintain class action the class be so numerous that joinder of all members of the class is impracticable. 17500.

B. General Rules.

No action maintained by any member unless plaintiff alleges that plaintiff was a member of record or beneficiary at time of transaction complained of, or plaintiff's interest devolved by operation of law from someone who was a member at time of transaction. If not, court can approve member continuing action if all of the following are considered:

- There is a strong prima facie case in favor of the claim asserted on behalf of the LLC;
- No other similar action has been or is likely to be instituted;
- Plaintiff acquired the interest before disclosure to the public or to the plaintiff of wrongdoing;
- Unless action can be maintained, defendant may retain a gain derived from defendant's willful breach of a fiduciary duty; and
- Requested relief will not result in unjust enrichment of LLC or any member thereof.

Plaintiff must also allege with particularity plaintiff's efforts to secure from managers action desired or reasons for not making that effort, and plaintiff has either informed managers or LLC in writing of ultimate facts of each cause of action or delivered to LLC or managers a true copy of proposed complaint. 17501(a).

Within 30 days after service of summons, LLC or defendant may move court for order upon notice and hearing, requiring plaintiff to furnish security, based on:

- No reasonable possibility that the prosecution of the cause of action alleged will benefit LLC or its members; and/or
- The moving party, if not the LLC, did not participate in the transaction in any capacity.

Court may extend 30-day period for an additional period not exceeding 60 days. 17501(b).

A. Derivative Actions.

Any member or assignee may bring an action in a Court of Chancery in the right of an LLC to recover a judgment in its favor of managers or members with authority have refused or if effort to cause those with authority to bring action is not likely to succeed. 18-1001.

B. General Rules.

Plaintiff must be a member or assignee at the time of the transaction complained of, or plaintiff's interest devolved by operation of law from someone who was a member or an assignee at the time of the transaction. 18-1002. Complaint shall set forth with particularity effort, if any, of plaintiff to secure initiation of the action by a manager or member or the reasons for not making the effort. 18-1003.

Court may award successful plaintiff reasonable expenses, including attorney fees. 18-1004.

At hearing, court shall consider evidence regarding ground of motion and determination of reasonable expenses, including attorney fees of LLC and moving party. If court determines probability of grounds, then court shall fix nature and amount of security, not to exceed $50,000. May be increased or decreased, but not over $50,000 in the aggregate for all defendants. Action may be dismissed if security not furnished within reasonable time. LLC and moving party have recourse to security in court-determined amount upon termination. 17501(c).

Good and sufficient bond in amount of $50,000 is compliance with section. 17501(d).

No pleadings need be filed by LLC or any other defendant in prosecution of action until 10 days after motion for security has been disposed. 17501(e).

XII. Conversion

A. Definitions.

Converted entity means other business entity that results from conversion of domestic LLC. 17540.1(a).

Converted LLC means domestic LLC that results from conversion of another business entity. 17540.1(b).

Converting LLC means domestic LLC that converts to another business entity. 17540.1(c).

Converting entity means other business entity that converts to domestic LLC. 17540.1(d).

B. Conversion to Foreign Other Business Entity or Foreign LLC.

LLC may convert if pursuant to conversion into domestic or foreign GP or LP or foreign LLC, each member of converting LLC receives equal percentage interest in profits and capital as of effective time of conversion. LLC may convert if pursuant to conversion into another business entity, each membership interest of the same class is treated equally unless all members of the class consent, and the nonredeemable membership interests of the LLC are converted only into nonredeemable interests of the converted entity, unless all holders thereof consent. 17540.2(a).

Conversion of LLC into other business entity may be effected only if law under which converted entity will exist expressly permits formation of entity and LLC complies with any and all other requirements of any other applicable law. 17540.2(b).

C. Plan of Conversion.

LLC that desires to convert shall approve plan of conversion, stating:

- Terms and conditions of conversion;
- Place of organization of converted entity and converting LLC and the name of the converted

A. Definitions.

Other entity means corporation, statutory trust, business trust, association, REIT, common-law trust or any other unincorporated business or entity including a general or limited partnership or foreign LLC. 18-214(a).

B. Conversion to Foreign Other Business Entity or Foreign LLC.

Domestic LLC may convert to corporation, statutory trust, business trust, association, REIT, common-law trust, unincorporated association or entity, including a general or limited partnership, or foreign LLC. 18-216(a). Conversion by LLC agreement, or if not provided and not prohibited by same way as merger provided in LLC agreement, and if none, by majority of members or each class voting separately. 18-216(b).

LLC agreement may provide that conversion is not authorized. 18-216(i).

C. Plan of Conversion.

Rights or interests in domestic LLC may be exchanged for other entity interests or into another entity or may be cancelled. 18-216(d).

entity after conversion;

- Manner of converting membership interests into interests in converted entity;
- Provisions of governing documents for the converted entity to which holders of interests in converted entity are to be bound;
- Any other details required by laws of converted entity or desired by the parties.

17540.3(a).

Plan of conversion approved by majority in interest of members of converting LLC or greater specified in articles or written operating agreement. If members of converting LLC will become personally liable after owning converted entity, then must be approved by all, unless plan of conversion provides that all members have dissenters' rights. 17540.3(b).

If LLC converting into LP, then plan of conversion must be approved by members who will become general partners of the converted LP. 17540.3(c).

Upon effectiveness of conversion, nondissenting members shall be deemed parties to any governing documents for converted entity, whether or not the member has signed the plan of conversion or the governing documents. Adoption of governing documents effective at the effective time or date of the conversion. 17540.3(d).

Plan of conversion may be amended, even if approved, before conversion takes effect if amendment approved by members in same manner as was required for approval of original plan. 17540.3(e).

Plan of conversion may be abandoned by the members in the manner required for approval of the plan of conversion, at any time before effective. 17540.3(f).

Converted entity shall keep the plan of conversion at its principal place of business. Upon request of member of converting LLC, authorized person of converted entity shall deliver a copy of the plan. Waiver of these rights is unenforceable. 17540.3(g).

D. Effective Date.

Conversion effective on earliest date all of the following occur:

- Approval of plan of conversion by members of converting LLC;
- Filing of all documents required to effect conversion and create converted entity; and
- Occurrence of effective date in plan of conversion.

17540.4(a).

D. Effective Date.

Conversion effective on filing date or future effective date. 18-216(f).

Copy of statement of partnership authority or certificate of LP with statement of conversion, duly certified by Secretary of State, is conclusive evidence of conversion of LLC. 17540.4(b).

E. Compliance with Other Laws.

Conversion of LLC into foreign entity shall be required in order to comply with conditions of conversion. 17540.5(a).

If LLC converting into a foreign business entity, conversion shall be in accordance with laws of state or place of organization of foreign entity. 17540.5(b).

To enforce obligation of converting LLC, Secretary of State shall only be agent for service of process of converted entity if no agent shown by affidavit to satisfaction of court. Personal delivery of service to Secretary of State of two copies shall be deemed complete on 10th day after delivery. Upon receipt of process and fee, Secretary of State shall give notice by forwarding by certified mail. Secretary of State shall keep a record of all process served. 17540.5(b).

F. Statement of Conversion.

Upon conversion of an LLC:

- If converting into a domestic limited partnership, statement of conversion shall be on certificate of limited partnership.
- If converting into domestic partnership, statement of conversion completed on statement of partnership authority, or if none, a statement of conversion shall be filed separately.
- If converting into domestic corporation, statement of conversion shall be on articles.
- If converting into foreign LLC or foreign other entity, certificate of conversion filed with Secretary of State.

17540.6(a).

Any certificate or statement of conversion executed and acknowledged by all managers, unless a lesser number is provided in articles or operating agreement, and shall set forth:

- Name and file number of converting LLC;
- Statement that principal terms of conversion approved by vote of members, which equaled or exceeded required vote, specifying each class entitled to vote and percentage vote of each class; and
- Form of organization of converted entity.

17540.6(b).

E. Compliance with Other Laws.

If Secretary of State served, procedures of 18-911(c) applicable, except plaintiff may give address or any other address and Secretary of State shall notify LLC at all such addresses. 18-216(e)(7).

F. Statement of Conversion.

If LLC converts to foreign other entity, certificate of conversion shall be filed in Secretary of State, containing:

- Name of LLC and original name;
- Date of filing original certificate of formation;
- Jurisdiction in which LLC shall be converted;
- Future effective date and time, if any;
- That conversion has been properly approved;
- Agreement that LLC may be served with process in Delaware; and
- Address.

18-216(e).

LLC ceases to exist when conversion becomes effective. 18-216(f).

Filing of certificate of conversion or document with statement of conversion has the effect of filing certificate of cancellation by converting LLC and converting LLC not required to file certificate of dissolution or certificate of cancellation. 17540.6(c).

G. Real Property.

When converting entity owns California real property, then can record the certificate of conversion or other organizing document to evince record ownership in converted entity, if laws provide that converted entity succeeds to ownership of converting entity real property. 17540.7(a).

Filed and recorded certificate of conversion or other organizing document for foreign other entity, containing statement of conversion, stating name of converting LLC, but not any other information required by 17540.6, is sufficient for real property recording. 17540.7(b).

Recording certificate of conversion or other organizing document containing a statement of conversion shall create in favor of bona fide purchasers or encumbrances for value a conclusive presumption that conversion valid. 17540.7(c).

H. Conversion to Domestic LLC.

Other entity or foreign entity may be converted to domestic LLC only if authorized under entity's organizing laws. 17540.8(a).

Other entity or foreign entity shall approve plan of conversion or other instrument according to laws of other entity. 17540.8(b).

Conversion of other entity or foreign entity into domestic LLC approved by percentage required by laws of other entity, or percentage set forth in governing documents. 17540.8(c).

Conversion by other entity into domestic LLC effective at time conversion is effective under laws of other entity as long as articles of organization containing a statement of conversion have been filed with Secretary of State. If converting entity's law is silent, conversion effective upon completion of all acts required to form a domestic LLC in California. 17540.8(d).

Filing with Secretary of State of certificate of conversion or articles with statement of conversion has effect of filing certificate of cancellation of converting entity in California, and not required to file any further document. If converting entity is foreign corporation, filing conversion document surrenders corporation's right to transact business in California. 17540.8(e).

G. Real Property.

H. Conversion to Domestic LLC.

Other entity may be converted to domestic LLC by complying with requisite approval and filing certificate of conversion. 18-214(b).

Prior to filing certificate of conversion, must be approved in manner provided by law or instrument governing other entity. 18-214(h).

Conversion done by filing certificate of conversion and certificate of formation. 18-214(b). Certificate of conversion shall state:

- Date and jurisdiction of converting entity upon formation and jurisdiction immediately prior to conversion;
- Name of other entity;
- Name in certificate of formation; and
- Future effective date and time, if any.

18-214(c).

Conversion effective upon filing or future date. 18-214(d).

Converting other entity not required to wind up and is not dissolved. 18-214(g).

Rights of converting entity may be exchanged for rights of converted entity, other entity, or cancelled. 18-214(i).

No limitation of accomplishment of a change in law governing or domicile of another entity to Delaware by

any other means provided by LLC agreement or otherwise permitted by law. 18-214(j).

I. Effect of Conversion.

Entity that converts is for all purposes same entity that existed before the conversion. 17540.9(a).

Upon conversion all of following apply:

- All rights and property of converting entity are vested in converted entity.
- All debts and obligations of converting entity continue in converted entity.
- All rights of creditors and liens of converting entity are preserved and remain enforceable against converted entity.
- Any action or proceeding pending by or against the converting entity may be continued against converted entity.

17540.9(b).

Member of converting LLC liable for:

- All obligations that member was personally liable for before conversion; and
- All obligations of converted entity unless member is a limited partner or shareholder in a corporation or member of LLC, provided no liability under law of converted entity.

17540.9(c).

Member of converted LLC remains liable for all obligations of converting entity for which member personally liable before conversion. 17540.9(d).

If other party reasonably believes that LLC member is a general partner, such member is liable for obligation incurred by LLC within 90 days after conversion takes effect. For all other obligations, member liability is same as all members. 17540.9(e).

I. Effect of Conversion.

No transfer to new entity shall be deemed to have occurred by conversion. 18-214(f).

Converting entity is the same as converted entity. 18-214(g).

LLC is same entity for purposes of conversion to other entity and not required to dissolve. 18-216(c).

Conversion does not affect any obligations or liabilities of other entity or personal liability therewith. 18-214(e).

All rights and property of converting entity and debts and obligations vested in converted entity. 18-214(f).

All rights and property and liabilities of converting LLC vest in other entity, but no transfer shall be deemed to have occurred. 18-216(h).

Member of converting LLC still liable if was personally liable before conversion. 18-216(g).

J. Domestication.

J. Domestication.

Non-United States entity means foreign LLC or foreign corporation, statutory trust, business trust, association, REIT, common-law trust or any other unincorporated business or entity, including a general or limited partnership created under laws of foreign country or foreign jurisdiction (other than any state). 18-212(a).

Any non-U.S. entity may become domesticated in Delaware by complying with internal approval and filing with Secretary of State:

- Certificate of domestication; and
- Certificate of formation.

18-212(b).

Certificate of domestication shall state:

- Date on which and jurisdiction where non-U.S. entity first formed;
- Name of non-U.S. entity immediately prior to filing;
- Name of LLC in certificate of formation;
- Future effective date or time, if any;
- Jurisdiction of principal place of business of non-U.S. entity or equivalent thereto; and
- That domestication approved by instrument governing non-U.S. entity or by applicable non-Delaware law.

18-212(c).

Domesticated upon filing or future effective date, but existence shall be deemed to have commenced on date non-U.S. entity formed in non-U.S. jurisdiction. 18-212(d).

Domestication of non-U.S. entity shall not be deemed to affect any obligations or liabilities incurred prior to domestication in Delaware or personal liability of any person therefor. 18-212(e).

Filing of certificate of domestication shall not affect choice of law applicable to non-U.S. entity prior to effective date of domestication. After such effective date, Delaware law applies to entity. 18-212(f).

Prior to filing certificate of domestication, shall be approved in manner provided for by instrument governing internal affairs of non-U.S. entity or by applicable non-Delaware law, and LLC agreement shall be approved by same authorization. 18-212(g).

All rights and, *e.g.,* obligations and property shall be vested in the domesticated entity (and the non-U.S. entity if and for so long as it continues in existence in the foreign jurisdiction). Rights, privileges, powers and interests in property, as well as debts, liabilities and duties of non-US entity shall not be deemed to have been transferred to the domestic LLC to which non-U.S. entity has domesticated for any purpose of the laws of the state of Delaware. 18-212(h).

When non-U.S. entity has become domesticated, LLC shall be deemed to be same entity as the domesticating entity and domestication shall constitute continuation. Domesticating non-U.S. entity shall not be required to wind up affairs and domestication shall not constitute dissolution of non-U.S. entity. If continues existence in foreign country, the two entities shall constitute a single entity for Delaware law. 18-212(i).

Interests in non-U.S. entity may be exchanged for cash, property, rights or securities of, or interests in, the domesticated LLC or any other entity or may be cancelled. 18-212(j).

K. Transfer or Continuance.

Transfer or Continuance.

Any domestic LLC may transfer to or domesticate or continue in any jurisdiction other than any state, and may elect to continue existence as an LLC in Delaware. 18-213(a).

LLC agreement may specify how transfer or domestication or continuance is authorized. If LLC agreement does not authorize but does not prohibit, transfer authorized in same manner as LLC agreement provides for authorization of merger or consolidation. If that is also not in LLC agreement, then authorized by approval of more than 50 percent members or each class of members as applicable. If transfer is authorized, shall file with Secretary of State a certificate of transfer if Delaware existence is to cease, or certificate of transfer and domestic continuance if LLC will continue in Delaware. 18-213(b).

Certificate of transfer or certificate of transfer and domestic continuance shall state:

- Name and original name under certificate of formation;
- Date of filing of original certificate of formation with Secretary of State;
- Jurisdiction to which LLC shall be transferred, domesticated or continued and the name of entity coming into being thereby;
- Future effective date or time, if any;
- Transfer or domestication or continuance has been approved in accordance with this section;
- If certificate of transfer, that existence in Delaware shall cease and agreement of LLC that it may be served in Delaware by serving Secretary of State;
- Address to which process shall be mailed by Secretary of State, which shall follow 18-911(c) except that plaintiff shall furnish Secretary of State with addresses and Secretary of State shall notify at all such addresses; and
- If certificate of transfer and domestic continuance, that LLC will continue to exist.

18-213(b).

Upon filing or future effective date of certificate of transfer, Secretary of State shall certify that the filing is complete and LLC shall cease to exist in Delaware. 18-213(c).

Transfer or domestication or continuance shall not affect obligations or liabilities or personal liabilities prior to transfer or choice of law prior thereto. Transfer or domestication or continuance shall not require LLC to wind up affairs and shall not be deemed dissolution. 18-213(d).

If LLC files certificate transfer and domestic continuance, upon effectiveness LLC shall continue in Delaware, and shall be the same entity as the foreign transferred and continued entity. 18-213(e).

Rights or securities of or interests in LLC may be exchanged for new entity interests or any other entity or may be cancelled. 18-213(f).

When LLC has transferred or domesticated or continued out of Delaware, it shall constitute a continuation of LLC. All rights and liabilities vest in new entity (and LLC if it continues in Delaware). Transfer shall not be deemed to have occurred. 18-213(g).

LLC agreement may provide that domestic LLC shall not have the power to transfer, domesticate or continue. 18-213(h).

XIII. Merger
A. Eligible Entities.

Eligible:

- Two or more LLCs into one LLC;
- One or more LLCs and one or more other business entities into another business entity; and
- One or more LLCs and one or more other business entities into one LLC.

17550(a).

Merger of any number of LLCs with any number of other entities may be effected only if other business entities organized in California are authorized by laws under which organized to effect the merger, if LLC is surviving LLC, foreign entities not prohibited by their laws from effecting merger, and if foreign business entity survives, laws of that jurisdiction authorize the merger. No matter what, if one or more domestic corporations is a party, the merger may be effected only if, with respect to any foreign other corporation, foreign corporation is authorized by its laws to effect the merger. 17550(b).

A. Eligible Entities.

Eligible: one or more LLCs and one or more other business entities or LLCs. 18-209(a).

LLC agreement may provide that merger or consolidation not allowed. 18-209(h).

B. Agreement of Merger.

Must have approved agreement of merger. Each LLC must approve by majority of members or greater percentage specified in articles or written operating agreement. Unanimous if possibility of members becoming personally liable, unless agreement of merger provides dissenters' rights. Other business entities approve merger by their laws' requirements.

B. Agreement of Merger.

Must have approved agreement of merger. Each domestic LLC must approve by more than 50 percent of members or each class of members, unless otherwise provided in LLC agreement. Interests in domestic LLC may be exchanged for cash, property, rights, or interests in another business entity, even if not surviving entity, or may be cancelled. 18-209(b).

Agreement of merger shall state:

- Terms and conditions of merger;
- Name and place of organization of surviving entity, and of each disappearing entity, may change name if authorized;
- Manner of converting interests or cash or property received;
- Amendments to articles of surviving LLC to be effected by the merger;
- Any other details required by the laws under which the other entity is organized, including if a domestic corporation is a party, terms of agreement required by Corp C §1113; and
- Any other provisions desired, including treatment of fractional interests.

17551(a).

Each member of a class treated equally with respect to distributions when class being cancelled and held by a constituent LLC or its parent or child. Except in a merger of an LLC with a 90-percent controlled LLC, nonredeemable interests of constituent LLC may be converted only into nonredeemable interests of the surviving entity if a constituent LLC or its parent or child if it owns more than 50 percent of the vote of the other constituent entity or domestic corporation unless all members of the class consent. 17551(b).

Agreement of merger may be amended prior to filing certificate of merger or agreement of merger if amendment approved by members of each constituent LLC in same manner as needed for original approval and if amendment changes principal terms, amendment approved by each constituent entity in same manner required for approval of original agreement of merger. 17551(c).

Merger may be abandoned by members in same manner as required for approval subject to rights of their parties any time prior to effectiveness of merger. 17551(d).

Agreement of merger may effect any amendment to operating agreement or adoption of new operating agreement for surviving LLC. Amendment effective at date of merger. If greater than majority is required to approve amendment, then that number needs to approve merger. 17551(e).

Surviving business entity shall keep agreement of merger. Upon request of a member, shareholder, or other securities holder, any member or person with authority shall deliver to requesting member a copy of the agreement of merger. Waiver is unenforceable. 17551(f).

Agreement of merger may be amended pursuant to provision in agreement of merger. 18-209(b).

Merger may be terminated pursuant to provision in agreement of merger. 18-209(b).

Certificate of merger with amendment shall be deemed amendment to certificate of formation of LLC. 18-209(e).

Agreement of merger may effect any amendment to LLC or adopt new LLC agreement for surviving LLC. Amendment effective at date of merger. Amendment effective even if original LLC agreement discusses amendment, unless it references amendment in connection with a merger or consolidation. May also provide for merger in LLC agreement or other agreement or by law, including that LLC formed for purpose of consummating merger shall be LLC agreement of surviving entity. 18-209(f).

C. Certificate of Merger.

If surviving entity is anything but a corporation in a merger involving a domestic corporation, after approval of merger, must file a certificate of merger on Secretary of State form, executed and acknowledged by all managers of domestic constituent LLC (unless lesser number specified in articles or operating agreement) and by each constituent other business entity by number required by law. Certificate of merger shall set forth:

- Names and file numbers of each entity, separately identifying surviving and disappearing entities;
- If vote of members required, statement setting total number of outstanding interests and that vote to approve merger equaled or exceeded vote required, by class;
- If surviving entity is LLC, change to articles, including change to name, and filing of certificate of merger changing articles operates as amendment to articles by surviving LLC;
- Future effective date or time (not more than 90 days subsequent to filing);
- If surviving entity is another entity or foreign LLC, full name, type of entity, legal jurisdiction, and address of principal place of business; and
- Any other information required by other laws, including information for domestic corporation under Corp C §1113.

17552(a).

If surviving entity is domestic corporation or foreign corporation in merger in which domestic corporation was a party, then after approval, surviving corporation shall file copy of agreement of merger and attachments required by Corp C §1113(g)(1). Certificate of merger executed and acknowledged by all managers of domestic constituent LLC unless lesser number specified in articles or operating agreement. 17552(b).

Certificate of merger or agreement of merger has effect of filing certificate of cancellation of articles for each disappearing LLC. 17552(c).

If disappearing other business entity is foreign corporation, filing automatically cancels right to do business in California. 17552(d).

D. Effective Date.

Unless future effective date specified, merger effective upon filing certificate of merger or agreement of merger with Secretary of State. 17553(a).

C. Certificate of Merger or Consolidation.

If domestic LLC involved, it or surviving business entity must file certificate of merger or consolidation executed by 1 or more authorized persons. Certificate of merger shall state:

- Names and jurisdiction of formation of each domestic LLC and other business entity involved;
- Agreement of merger or consolidation approved and executed by each of the domestic LLCs and other business entities;
- Name of surviving entity;
- If domestic LLC is surviving entity, changes to certificate of formation name, registered office or registered agent;
- Future effective date or time;
- That agreement of merger on file at place of business of surviving entity, including address thereof;
- Copy of agreement of merger or consolidation will be furnished by surviving entity, on request and without cost, to any member of a constituent party to the merger; and
- If surviving entity not domestic entity, statement that surviving entity may be served with process in Delaware, appointing Secretary of State as agent to accept service.

18-209(c).

Can file agreement of merger or consolidation containing information required to be in certificate, even if domestic corporation not involved. 18-209(e).

Certificate of merger or consolidation has effect of filing cancellation for disappearing domestic LLC. 18-209(e).

D. Effective Date.

Unless future effective date specified, merger effective upon filing certificate of merger or consolidation. 18-209(d).

Copy of certificate of merger is conclusive evidence of merger. If surviving entity is a corporation in which a domestic corporation and a domestic LLC are parties, copy of agreement of merger has same force as original. 17553(b).

E. Succession of Survivors.

Upon merger of LLCs with each other or other entities, separate existence of disappearing LLCs and disappearing other entities ceases and survivors shall succeed to all rights and property of all disappearing entities and shall be subject to all debts and liabilities of disappearing entities. 17554(a).

All creditor rights and liens shall be preserved against surviving entities, provided that such liens upon disappearing entity property shall be limited to property affected immediately prior to merger. 17554(b).

Any action or proceeding by or against disappearing entity shall bind surviving entity. 17554(c).

If partnership is party to merger nothing affects liability of a general partner of a disappearing partnership existing prior to the merger. 17554(d).

F. Assumption of Tax Liability.

Upon merger, surviving entity shall be deemed to have assumed franchise tax liabilities of disappearing entities to:

- Prepare and file tax and information returns; and
- Pay any tax liability determined to be due.

17554.5(a).

If surviving entity is domestic LLC, domestic corporation, or registered LLP or foreign LLC, foreign LLP, or foreign corporation, Secretary of State shall notify franchise tax board of merger. 17554.5(b).

G. Merger with Foreign.

Merger of domestic LLCs with foreign LLCs must comply with Corp C §17550. 17555(a).

If surviving entity is domestic LLC or domestic other entity, merger proceedings shall conform to provisions of chapter governing merger of domestic LLCs, but if foreign entity survives, then subject to dissenters' rights with respect to domestic entities, merger proceedings may be in accordance with laws of surviving entity. 17555(b).

If surviving entity is domestic entity other than a domestic corporation, certificate of merger shall be filed and then merger is effective. If domestic corporation, then agreement of merger filed and it will be effective. 17555(c).

E. Succession of Survivors.

Upon merger, separate existence of disappearing entities ceases and survivors shall succeed to all rights and property of all disappearing entities and shall be subject to all debts and liabilities of disappearing entities. 18-209(g).

All creditor rights and liens shall be preserved against surviving entities. 18-209(g).

Any action or proceeding by or against disappearing entity shall bind surviving entity. 18-209(g).

F. Assumption of Tax Liability.

G. Merger with Foreign.

If surviving entity is foreign entity, certificate of merger shall include statement that Secretary of State may be served, and procedures under 18-911(c) shall be applicable, except that plaintiff shall furnish Secretary of State with address in certificate of merger or consolidation, and Secretary of State shall notify surviving entity at all addresses furnished by plaintiff. 18-209(c)(8).

If surviving entity is foreign entity, merger effective in accordance with laws of surviving entity, but merger effective as to domestic disappearing LLC at time of effectiveness in foreign jurisdiction or upon filing certificate of merger or agreement of merger. 17555(d).

If merger includes registered foreign disappearing LLC, filing of certificate cancels it without need for further filings. 17555(e).

Voting and dissenters rights apply to any members of domestic constituent LLCs and of any domestic LLCs that are parent of foreign constituent LLC. 17555(f).

If surviving entity is foreign entity, it shall file with Secretary of State an agreement that it may be served in California to enforce an obligation of any constituent entity and to enforce dissenters' rights, irrevocable appointment of Secretary of State as agent for service of process; and an agreement that it will promptly pay holder of dissenting interest the amount to which the person is entitled. 17555(g).

H. Real Property.

H. Real Property.

If surviving entity succeeds to California real property of disappearing entity, may record certificate of merger or agreement of merger certified by Secretary of State or an authorized public official of another state in which merger is effected. 17556.

XIV. Dissenting Members' Rights

A. Reorganization.

A. Reorganization.

Reorganization refers to:

- Conversion;
- Merger;
- Acquisition by one LLC in exchange for its membership interests of securities in another business entity if immediately after, the acquiring LLC has control of the other entity; or
- Acquisition of one LLC in exchange for membership interests or debt securities not adequately secured and have a maturity date in excess of five years after consummation of acquisition of all or substantially all of the assets of another business entity.

17600(a).

Control means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a business entity. 17600(b).

B. Purchase of Interests.

B. Purchase of Interests.

If approval of outstanding membership interests is required for LLC to participate in reorganization, then

LLC agreement or agreement of merger or consolidation may provide contractual appraisal rights in connection

each member may require LLC to purchase for cash at fair market value, interest owned by member if the interest is a dissenting interest, determined as of the day before the first announcement of the terms of the proposed reorganization, excluding any appreciation or depreciation in consequence of the proposed reorganization unless inequitable. 17601(a).

Dissenting interest means a membership interest that satisfies all of:

- Outstanding on date for determination of members entitled to vote on reorganization;
- Membership interest not voted in favor of reorganization or was voted against reorganization;
- Member demanded that LLC purchase interest at fair market value under 17602; and
- Member submits for endorsement a certificate under 17603.

17601(b).

Dissenting member means the record holder of a dissenting interest, including an assignee of that interest. 17601(c).

C. Notice of Approval.

If members have dissenters' rights, LLC shall mail to each member notice of approval of reorganization within 10 days after date of approval, accompanied by copy of 17601, 17602, 17603, 17604 and 17605, statement of price determined to represent fair market value, statement of method of valuation, latest available balance sheet, latest available income statement, and a brief description of the procedure to be followed if the member decides to exercise its rights. Statement of price constitutes an offer by LLC to purchase at price stated unless dissenting interests lose such status. 17602(a).

Any member with dissenters' rights shall make written demand upon LLC for purchase and payment in cash of fair market value. Not effective unless received by LLC or any transfer agent within 30 days after date on which notice of approval of reorganization is mailed by LLC to members. 17602(b).

Demand shall state number or amount of dissenting member's interest and shall contain statement of what member claims to be fair market value of interest. This constitutes offer to sell interest at that price. 17602(c).

D. Dissenting Members.

Within 30 days after notice of approval of outstanding interests mailed to dissenting member, member shall submit certificate if they have none, to be stamped or endorsed with a statement that interest is dissenting. If no certificate, written notice of interest that dissenting

with any amendment of an LLC agreement, any merger or consolidation, any conversion, any transfer to or domestication or continuance in any jurisdiction, or sale of all or substantially all of LLC assets. Court of Chancery may hear and determine any matter relating to such rights. 18-210.

C. Notice of Approval.

D. Dissenting Members.

member demands purchase. Upon subsequent transfers, new certificates or other written statements shall bear statement. 17603.

E. Agreement on Value.

E. Agreement on Value.

If LLC and dissenting member agree that interest is a dissenting interest and agree on price, dissenting member entitled to price with legal rate of interest on judgments from date of reorganization. Agreements on value must be in writing and filed with LLC. 17604(a).

Payment shall be made within 30 days of agreement or within 30 days after statutory or contractual conditions are satisfied, whichever is later. Payment subject to surrender of certificates unless agreed otherwise. 17604(b).

F. Denial.

F. Denial.

If LLC denies that interest is dissenting or fail to agree on fair market value, then within 6 months of mailing of notice of approval, member or LLC may file complaint to determine whether interest is dissenting or fair market value or both. 17605(a).

Two or more dissenting members may join as defendants in any action and two or more actions may be consolidated. 17605(b).

On trial, court shall determine the issues. Court shall first determine whether interest is dissenting. If fair market value is at issue, court shall determine or shall appoint one or more impartial appraisers to determine fair market value. 17605(c).

G. Appraisers.

G. Appraisers.

If court appoints appraiser(s), they shall determine fair market value per interest, by class if necessary. Within time fixed by court, appraisers or a majority of them shall make and file report with court. On motion of any party, report shall be submitted and considered along with any other relevant evidence. Court may confirm the report. 17606(a).

If majority fail to make and file report within 30 days after appointment or further time allowed by the court, or report not confirmed by the court, court shall determine fair market value. 17606(b).

Judgment shall be rendered against LLC for fair market value determined by the court if dissenting members entitled to require, with interest. 17606(c).

Any judgment payable forthwith, but only upon endorsement and delivery of certificates of interest. Any party may appeal from judgment. 17606(d).

Costs of action shall be assessed or apportioned as the court considers equitable, but if appraisal exceeds price offered by LLC, the LLC shall pay the costs, including, in the discretion of the court, if value awarded is more than 125 percent of price offered by LLC, attorney fees and fees of expert witnesses. 17606(e).

H. Payments.

H. Payments.

If payment is required to be returned as an unlawful distribution or the Uniform Fraudulent Transfer Act, then payment shall not be made and dissenting members shall become creditors of LLC for amount of funds, together with interest. Dissenting members subordinate to all other creditors in any proceeding relating to winding up and dissolution. 17607.

I. Cash Distributions.

I. Cash Distributions.

Cash distributions to dissenting member after date of reorganization but prior to payment shall be credited against total amount to be paid for dissenting interest. 17608.

J. Rights and Privileges.

J. Rights and Privileges.

Dissenting members shall continue to have all rights and privileges they had immediately prior to reorganization until payment by LLC for interests. A dissenting member may not withdraw a demand for payment unless LLC consents. 17609.

K. Loss of Status.

K. Loss of Status.

Dissenting interest loses its status if LLC abandons reorganization. Upon abandonment, LLC shall pay, on demand, to any dissenting member who initiated proceedings in good faith, all reasonable expenses and reasonable attorneys fees. 17610(a).

Dissenting interest loses its status if interest is transferred prior to its submission for endorsement. 17610(b).

Dissenting interest loses its status if dissenting member and LLC do not agree and neither files a complaint nor intervenes in a pending action within 6 months after notice of reorganization mailed to the member. 17610(c).

Dissenting interest loses its status if dissenting member withdraws demand for purchase with LLC's consent. 17610(d).

L. Litigation.

L. Litigation.

If litigation instituted to test sufficiency or regularity of vote of members in authorizing reorganization, any proceedings under this chapter suspended until final determination of that litigation. 17611.

M. Application to LLCs.

M. Application to LLCs.

Chapter applies to domestic LLC and foreign LLC if members holding more than 50 percent of voting interests reside in California. 17612(a).

Chapter does not apply to membership interests whose operating agreements specifically set forth the amount to be paid in the event of reorganization. 17612(b).

Chapter shall not apply to any LLC with 35 or fewer members if all members have waived application of chapter in writing and at time of reorganization, LLC

actually had more than 35 members. 17612(c).

N. Validity of Reorganization.

No possible dissenting member has any right at law or equity to attack the validity of the reorganization or to have the reorganization set aside or rescinded except in action to test sufficiency of vote or when LLC action is fraudulent with respect to member or LLC. 17613(a).

If one of the parties to reorganization is directly or indirectly controlled by or under common control with another party to the reorganization, controlled party who has not demanded payment can bring action to attack validity of reorganization, but if so, then the member shall not have dissenter's rights. 17613(b).

Controlling party shall have burden of proving that transaction is just and reasonable as to members of controlled party and a person who controls two or more parties to reorganization shall have the burden of proving that transaction is just and reasonable to members of controlled party. 17613(c).

Controlling/controlled party restrictions do not apply if a majority in interest of members other than controlled party members approve or consent to reorganization. 17613(d).

This section does not prevent member of LLC from bringing action against LLC, manager, officer, employee, or agent as to any matters other than reorganization. 17613(e).

XV. Miscellaneous Provisions

A. Failure to Execute or File.

If manager or member required by title to execute or file any document fails after demand to do so within a reasonable time or refuses, any other manager or member or any person appointed by a court of competent jurisdiction may prepare, execute, and file that document with the Secretary of State. 17650(a).

If there is any dispute concerning filing or failure to file, any manager or member may petition to direct execution. 17650(b).

If court finds it is proper for document to be executed and any person so designated has failed or refuses to execute, it shall order a party to file the document on a Secretary of State form. 17650(c).

In any action under this section, if court finds failure of manager or member to comply without justification, court may award amount sufficient to reimburse manager or members bringing action for reasonable expenses, including attorney fees. 17650(d).

Any member who is not a manager shall state the statutory authority after the signature on the appropriate document. 17650(e).

B. Failure to Maintain Books.

N. Validity of Reorganization.

A. Failure to Execute or File.

If person required to execute any certificate fails or refuses, any other person adversely affected may petition Court of Chancery to direct execution. If proper, court shall order Secretary of State to record an appropriate certificate. 18-205(a).

If person required to execute any LLC agreement or amendment fails or refuses, any other person adversely affected may petition Court of Chancery to direct execution. If proper, court shall grant appropriate relief. 18-205(b).

B. Failure to Maintain Books.

Every LLC that neglects, fails, or refuses to keep required books and records subject to penalty of $25 for each day failure or refusal continues, beginning 30 days after receipt of written request by member that duty be performed, up to maximum of $1500. Penalty paid to member or members making request for performance, if suit commenced within 90 days after written request made. Maximum daily penalty because of failure to comply with any number of separate requests made on any one day or for the same act shall be $250. 17651(a).

Upon failure of LLC or registered foreign LLC to file statement of information, Secretary of State shall mail notice of delinquency. Notice shall contain information about this section, advise of penalty, right to request relief for reasonable cause or unusual circumstances. If, within 60 days after mailing notice of delinquency, Statement of Information still has not been filed, subject to $250 penalty. 17651(b).

C. Penalties.

Any penalty assessed by 17651 shall be in addition to remedy by injunction or action for damages or by writ of mandate for nonperformance of acts and duties enjoined by law upon LLC or its managers. Court may reduce, remit, or suspend penalty as it deems reasonable when it appears neglect, failure, or refusal was inadvertent or excusable.

D. Failure to File Statement.

Upon failure to file Statement of Information, Secretary of State shall mail notice of delinquency, containing information concerning application of this section, penalty imposed by Rev & T C §19141 for failure to timely file, and advise of right to request relief. If within 60 days after mailing of notice of delinquency, Secretary of State shall certify the name of such LLC to the Franchise Tax Board. 17653(a).

Upon certification, Franchise Tax Board shall assess penalty under Rev & T C §19141. 17653(b).

Penalty under Rev & T C §19141 shall not apply to an LLC that on or prior to date of certification has dissolved or has been merged out. 17653(c).

Penalty shall not apply and Secretary of State need not mail notice of delinquency to LLC that has been suspended by Franchise Tax Board on or prior to and remains suspended on last day of filing period. Secretary of State need not mail to LLC to suspended LLC. 17653(d).

If after certification Secretary of State finds statement was filed and fee paid before 60-day period expired or failure to provide notice of delinquency was due to an error of the Secretary of State, then Secretary of State shall decertify name of LLC to FTB. FTB shall then promptly abate any penalty assessed against the LLC. 17653(e).

C. Penalties.

D. Failure to File Statement.

If Secretary of State determines that failure to file is excusable because of reasonable cause or unusual circumstances, Secretary of State may waive penalty imposed by this section and Rev & T C §19141, in which case Secretary of State shall either not certify or shall decertify as appropriate. 17653(f).

E. Failure to File Statement of Information.

E. Failure to File Statement of Information.

An LLC that fails to file Statement of Information and has not filed such a statement during the preceding 24 months and was certified for penalty shall be subject to suspension instead of penalty. 17654(a).

Secretary of State shall mail notice informing LLC that powers, rights, and privileges will be suspended after 60 days if it fails to file its Statement of Information. 17654(b).

After expiration of 60-day period Secretary of State shall notify FTB of suspension and mail notice to LLC and, except for amending articles to set forth a new name, all powers, rights, and privileges of LLC are suspended. 17654(c).

Statement of Information may be filed even by suspended LLC. Upon suspended LLC filing statement, Secretary of State shall certify that fact to FTB and LLC may be relieved from suspension unless suspended for failure to pay taxes. 17654(d).

F. Forfeiture of Powers.

F. Forfeiture of Powers.

FTB penalty and suspension apply to registered foreign LLCs. Suspension of powers means forfeiture of powers, rights and privileges of foreign LLC in this state. 17655(a).

Forfeiture of exercise of powers, rights and privileges of foreign LLC in California does not prohibit transaction of business if business would not require certificate of registration. 17655(b).

G. Liability for Failure to Notify Attorney General.

G. Liability for Failure to Notify Attorney General.

An LLC liable for civil penalty not to exceed $1,000,000 if:

- It has actual knowledge that a member, officer, manager or agent makes a material statement or omission that is false and intended to materially change the value of membership interests or a member, officer, manager or agent refuses or has refused to make any book entry or post any notice required by law, misstates or conceals from a regulatory body a material fact in order to deceive a regulatory body to avoid a statutory or regulatory duty; AND
- Within 30 days after actual knowledge is acquired, the LLC knowingly fails to notify the Attorney General and its members and investors in writing, unless the LLC has actual knowledge that they have been notified; AND

- Notify members and investors in writing, unless the LLC has actual knowledge that the members and investors have been satisfied.

17656(a).

Requirement for notification is not applicable if action is abated within the time prescribed for reporting, unless appropriate government agency requires disclosure. 17656(b).

If action reported to Attorney General pursuant to this section implicates government authority of another agency, then Attorney General shall forward notice to that agency. 17656(c).

If Attorney General not notified but LLC reasonably and in good faith believed that it had complied with the notification requirements by notifying government agency, no penalties shall apply. 17656(d).

This section only applies to LLCs that are issuers under §2 of the Sarbanes-Oxley Act. 17656(f).

An action to enforce section may only be brought by Attorney General or a district attorney or city attorney in the name of the people of the State of California. 17656(g).

H. Definitions.

Manager

Agent

Member

Notify its members

Appropriate government agency

Actual knowledge of the limited liability company

Refuse to make a book entry

Refuse to post any notice required by law

Misstate or conceal material facts from a regulatory body

Material false statement or omission

Officer.

17656(e).

I. Severability.

J. Cases Not Provided for in This Chapter.

H. Definitions.

I. Severability.

If any provision of chapter held invalid, invalidity does not affect other provisions or applications of the chapter. 18-1103.

J. Cases Not Provided for in This Chapter.

In any case not provided for in this chapter, the rules of law and equity, including the law merchant, shall

govern. 18-1104.

K. Fees.

K. Fees.

No filed document is effective until applicable fee paid. 18-1105(a).

$75—Application for reservation of name, application for renewal of reservation or notice of transfer or cancellation of reservation of name. 18-1105(a)(1).

$200—Change of registered agent information, and $2 for certificate of resignation without designating successor agent. 18-1105(a)(2).

$70—Initial certificate of formation.

$180—Domestication, transfer, transfer and domestic continuance, conversion, amendment, cancellation, merger or consolidation, restated certificate of formation, certificate of amendment of a certificate with a future effective date or time, termination of a certificate with a future time, correction, or revival. 18-1105(a)(3).

$50—Certification of copies on file for each copy certified. 18-1105(a)(4).

$10—First page of photocopy, $2 each additional page.

$2—Each microfiche copy. 18-1105(a)(5).

$200—Application for registration of foreign LLC, amendments thereto, cancellation thereto. 18-1105(a)(6).

$200—Certificate to change registered agent information of foreign LLC, and $2 for each certificate of resignation without designating successor agent. 18-1105(a)(7).

$250—Preclearance of any document for filing. 18-1105(a)(8).

$50—Preparing and providing a written report of a record search. 18-1105(a)(9).

$50—Certificate of good standing.

$175—Certificate reciting all of an LLCs filings with the Secretary of State. 18-1105(a)(10).

$200—Any other filing for which no fee is prescribed.

$50—Change only of registered office or registered agent. 18-1105(a)(11).

$60—In discretion of Secretary of State for any check returned for insufficient funds. 18-1105(a)(12).

Additional Fees:

$7500 or less—Any filing expedited to be completed within 30 minutes on the same day as the day of the request.

$1000 or less—Expedited within 1 hour on same day of

request.

$500 or less—Expedited within 2 hours on same day of request. 18-1105(b)(1).

$300 or less—Completed same day as request. 18-1105(b)(2).

$150 or less—Completed within 24 hours of request. 18-1105(b)(3).

Secretary of State may establish and maintain schedule of specific expedite fees. 18-1105(b).

Secretary of State may in discretion permit extension of credit for fees. 18-1105(c).

Secretary of State shall retain from revenue collected a sum sufficient to maintain a fund of at least $500 but not more than $1500 from which the secretary may refund overpayments, deposited with a Delaware legal depository. 18-1105(d).

Fees of Secretary of State other than in this section shall be as provided in 29 Del C Ann §2315. 18-1105(e).

L. Power to Alter or Repeal.

L. Power to Alter or Repeal.

All provisions of this chapter may be altered from time to time or repealed and all rights of members and managers are subject to this reservation. All amendments shall apply to LLCs and members and managers whether or not existing at the time of such amendment. 18-1106.

M. Taxation.

M. Taxation.

LLCs classified as partnership for tax purposes, unless classified otherwise for federal income tax purposes. Member or assignee of a Delaware LLC or registered foreign LLC treated either as resident or nonresident partner unless classified otherwise for federal income tax purposes. 18-1107(a).

$250—Annual tax for domestic LLC and registered foreign LLC. 18-1107(b).

Annual tax due and payable June 1 following close of calendar year or upon cancellation of certificate of formation. Secretary of State shall pay all taxes to Department of Finance of State of Delaware. Unpaid taxes bear interest at 1-1/2 percent for each month until fully paid. 18-1107(c).

Secretary of State shall mail notice of taxation to registered agent at least 60 days prior to June 1 each year. 18-1107(d).

If fail to pay tax by June 1 each year, additional $200 will be due. 18-1107(e).

If fail to pay tax and agent dies, resigns, or refuses to act, service may be made on Secretary of State. 18-1107(f).

Annual tax is debt due to State of Delaware, action at law may be maintained if in arrears for period of 1

month. Tax shall be a preferred debt in the case of insolvency. 18-1107(g).

Fail to pay tax, LLC or registered foreign LLC shall cease to be in good standing or registered. 18-1107(h).

Restoration to good standing or registration upon payment of annual tax and all penalties or interest due. 18-1107(i).

If annual tax in arrears for 3 months after tax is payable, Attorney General may apply to Court of Chancery upon 5 days' notice for an injunction to restrain the LLC from doing business in Delaware until payment of tax, interest, and penalties, and court may grant injunction. 18-1107(j).

Domestic LLC that ceases to be in good standing remains domestic LLC, but Secretary of State shall not accept any certificate for filing of either domestic or registered foreign LLC until restored. 18-1107(k).

Entity not in good standing or registered may not maintain action, suit, or proceeding until restored. Successor may not maintain any action until original entity has been restored. 18-1107(*l*).

Failure to pay tax does not impact validity of contract, deed, mortgage, interest, lien, or act of LLC or prevent LLC from defending any action, suit, or proceeding. 18-1107(m).

Member or manager of entity that fails to pay tax is not liable for debts, obligations, or liabilities of LLC solely by failure to pay or be in good standing or duly registered. 18-1107(n).

N. Cancellation of Certificate for Failure to Pay Taxes.

N. Cancellation of Certificate for Failure to Pay Taxes.

Certificate of formation shall be cancelled if domestic LLC fails to pay tax for a period of 3 years from the date it is due. 18-1108(a).

List of domestic LLCs with cancelled certificates shall be filed in Secretary of State office. On or before October 31 of each calendar year, Secretary of State shall publish such list on the Internet for a period of 1 week and shall advertise the website in at least 1 newspaper of general circulation in Delaware. 18-1108(b).

O. Revival.

O. Revival.

Domestic LLC whose certificate has been cancelled may be revived by filing certificate of revival with Secretary of State and payment of fee and payment of annual tax, penalties, and interest due at time of cancellation. Certificate of revival shall set forth:

- Name at date of cancellation, and if not available, new name to be revived;
- Date of filing of original certificate of formation;

- Address of registered office in Delaware and name and address of registered agent;
- Statement that certificate is filed by one or more authorized persons; and
- Any other matters.

18-1109(a).

Certificate of revival shall be deemed to be an amendment to certificate of formation. 18-1109(b).

Upon filing certificate of revival, LLC shall be revived with same force and effect as if certificate of formation had not been cancelled. Such revival validates all contracts, acts, matter and things made, done and performed by the LLC, its members, managers, employees and agents during period of cancellation. 18-1109(c).

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Directory

§5.4C

The URL for the Franchise Tax Board website: http://www.ftb.ca.gov/

The URL within that website relating to the refund claim procedure:

http://www.ftb.ca.gov/professionals/taxnews/article/llcfees.html

Fax:

(916) 845-9796

Mail:

Franchise Tax Board

P.O. Box 942867

Sacramento, CA 94267-8888

§7.1

The website maintained by the Secretary of State:

http://www.sos.ca.gov/business/forms.htm

§7.4

The URL for the Name Availability Inquiry Letter is: http://www.sos.ca.gov/business/corp/pdf/naavinquiryform.pdf

Address:

Secretary of State

Name Availability Unit

1500 11th Street, 3rd Floor

Sacramento, CA 95814

For information about establishing a prepaid account, contact the Accounting Office at (916) 653-1233.

§7.14

All Secretary of State LLC forms are available on the Secretary of State's website: http://www.sos.ca.gov/business/forms.htm

§7.25

For current information on both services, see the Secretary of State's website: http://www.sos.ca.gov/business/be/preclearance-expedited-services.htm

§§7.26-7.27

The preclearance service provides a filer the opportunity to submit a document in person at the public counter of the Secretary of State's Sacramento office before filing.

Address:

1500 11th Street, Room 390

Sacramento, CA

Hours of service:

8:00 a.m. to 5:00 p.m.

Monday through Friday, excluding state holidays.

§§7.35, 7.37

All Secretary of State LLC forms are available on the Secretary of State's website: http://www.sos.ca.gov/business/bpd_forms.htm

§11.32

The Secretary of State's website also makes available sample articles of incorporation containing a statement of conversion when entities convert to a domestic corporation:

http://www.sos.ca.gov/business/be/forms.htm

§11.56

Mail:

Secretary of State

Document Filing Support Unit

1500 11th Street, 3rd Floor

Sacramento, CA 95814

Walk in:

Business Entities Section

1500 11th Street, 3rd Floor

Sacramento, CA 95814

Telephone:

916 657-5448

§13.3B

See the entry for §§7.35 and 7.37 above.

For mailing the LLC's Statement of Information, use the following address:

Secretary of State

Statement of Information Unit

P.O. Box 944230

Sacramento, CA 94244-2300

To hand deliver the LLC's Statement of Information, use the following address:

Secretary of State

1500 11th Street, 3rd Floor

Sacramento, CA 95814

§13.8

Franchise Tax Board

Attn.: Change of Accounting Period

P.O. Box 1998

Rancho Cordova, CA 95741-1998

§15.3

For Delaware Series LLC fee information, see:

http://www.state.de.us/corp/newfee.pdf

§15.4

For Nevada Series LLC fee information, see:

http://www.sos.state.nv.us/business/forms/pdf/FeeScheduleLLC.pdf

§15.17

For the Franchise Tax Board's position on Delaware Series LLCs, see: http://ftb.ca.gov/professionals/taxnews/tn_06/03_04.html (click on "Ask the Advocate").

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Internet Resources for California Businesses

A. Government Sites—Federal

Americans with Disabilities Act	http://www.ada.gov Information and technical assistance on the ADA by the U.S. Department of Justice.
Board of Governors of the Federal Reserve System	http://www.federalreserve.gov/ Home page with informational links about the "Fed," monetary policy, banking regulation, economic data, and other topics.
Bureau of Industry and Security (BIS), U.S. Department of Commerce	http://www.bis.doc.gov/about/index.htm Federal agency that administers the U.S. export control and treaty compliance system, including the Export Administration Regulations (EAR).
Business.gov	http://www.business.gov/ Home page, operated by the U.S. Small Business Administration, with links to legal and regulatory information, and plain-English guides for starting a business, handling finances, managing employees, and other topics.
CIA, The World Factbook	https://www.cia.gov/library/publications/the-world-factbook/ U.S. government profiles of countries and territories around the world.
Equal Employment Opportunity Commission (EEOC)	http://www.eeoc.gov/ EEOC site with basic introduction to employers' rights and responsibilities under the federal equal employment opportunity laws.
Federal agencies (through Library of Congress site)	http://www.loc.gov/rr/news/fedgov.html A Library of Congress resource page with links to most federal agencies.
Federal Citizen Information Center (FCIC)	http://www.pueblo.gsa.gov/ Part of the U.S. General Services Administration, the FCIC's Small Business Links offer information for persons planning or owning small businesses, including information on procurement, taxes, woman- and minority-owned businesses, human resources, and financial and legal issues.
Federal Deposit Insurance Corporation (FDIC)	http://www.fdic.gov/ Home page with links to statistical data, pertinent regulations, and FAQs.
Federal Register	http://www.gpoaccess.gov/fr/index.html Main page, with search functions, for the Federal Register—the official daily publication for federal agency rules, proposed rules, and notices as well as executive orders. Specific Federal Register pages can be retrieved at http://www.gpoaccess.gov/fr/retrieve.html
Federal Reserve Bank of San Francisco	http://www.frbsf.org/ Home page. The current FRBSF discount rate, used to determine the usury ceiling in California, is posted at http://www.frbsf.org/banking/data/discount/index.html
Federal Trade Commission	http://www.ftc.gov/ftc/business.shtm Home page for businesses, with links to business publications, advertising guidance, fair packaging and labeling, antitrust law guide, and other topics. Information concerning the Hart-Scott-Rodino premerger notification requirements is at http://www.ftc.gov/bc/hsr/introguides/introguides.htm

USA.gov	http://www.usa.gov/Business/Business_Gateway.shtml The official web portal of the U.S. government, with links to information on contracting with the U.S. government, export licenses, business financial assistance, and many other topics.
Internal Revenue Service	http://www.irs.gov/ Home page; access to downloadable IRS forms and publications.
Occupational Safety and Health Administration (OSHA)	http://www.osha.gov/ Home page.
Office of the Comptroller of the Currency (OCC)	http://www.occ.treas.gov/ Home page with links to reports and other resources for banking industry professionals, as well as public information about the national banking system.
Office of Federal Contract Compliance Programs (OFCCP)	http://www.dol.gov/ofccp/index.htm Home page with statutory, regulatory, and compliance information regarding nondiscrimination requirements for federal contractors.
Office of the U.S. Trade Representative	http://www.ustr.gov/index.html Home page.
Securities and Exchange Commission (SEC)	http://www.sec.gov/ Home page with links to information for small businesses; online access to proposed and final rules, SEC releases, policy statements, and other commission notices and information; searchable database of all electronic company filings since 1994.
SEC Edgar	http://www.sec.gov/edgar.shtml SEC Edgar main page, with access to electronic filings and forms.
Small Business Administration	http://www.sba.gov/ Home page with extensive links to federal and other resources for small businesses.
Social Security Administration	http://www.ssa.gov/ Home page. SSA forms are available online at http://www.ssa.gov/online/forms.html
THOMAS	http://thomas.loc.gov/home/thomas.html Website of the Library of Congress providing federal legislative information.
U.S. Citizenship and Immigration Services	http://www.uscis.gov/portal/site/uscis Home page with links to immigration laws and forms.
U.S. Copyright Office	http://www.copyright.gov/ Home page with links to copyright registration and other information. The agency's new Electronic Copyright Office (eCO) is at http://www.copyright.gov/eco/index.html
U.S. Department of Commerce	http://www.commerce.gov/ Home page.
U.S. Department of Justice, Antitrust Division	http://www.usdoj.gov/atr/public/guidelines/guidelin.htm Link to Antitrust Division Guidelines and Policy Statements.
U.S. Department of Labor	http://www.dol.gov/ Home page with links to statutory and regulatory information, labor statistics, small-business regulatory-compliance assistance, and other information.

U.S. Department of Labor, Dictionary of Occupational Titles (DOT)	http://www.oalj.dol.gov/libdot.htm Dictionary of job titles and standardized job descriptions; useful for job placement, occupational research, career guidance, labor-market information, curriculum development, and long-range job planning. Last updated in 1991, the DOT has now been replaced by O*NET Online, http://online.onetcenter.org/
U.S. Department of State	http://www.state.gov/ Home page with links to international commercial laws and guides.
U.S. Environmental Protection Agency	http://www.epa.gov/ Home page.
U.S. Government Printing Office	http://www.gpo.gov/ Home page with links to products and services, including online searchable copies of the United States Code and the Code of Federal Regulations.
U.S. International Trade Commission	http://www.usitc.gov/ Home page with rules, regulations, reports, and other information, including an extensive list of links to international trade resources.
U.S. Patent and Trademark Office	http://www.uspto.gov/ Home page with downloadable forms and information on patent applications and trademark registrations.

B. International Sites

Private International Law Database: Trade/Business Transactions Law, U.S. Department of State	http://www.state.gov/www/global/legal_affairs/transaction_law.html Access to treaties in force for the United States, other international instruments, and information on current negotiations and projects concerning private international law. Updated through January 1, 2001. For treaty actions since January 1, 2001, see http://www.state.gov/s/l/treaty/c3428.htm
CURIA	http://curia.europa.eu/jcms/jcms/j_6/ Home page of the courts of the European Communities, with searchable case law and other information.
Electronic Embassy Website	http://www.embassy.org/ Information on all foreign embassies in Washington, D.C.
EUR-Lex	http://eur-lex.europa.eu/en/index.htm Website providing direct free access to European Union law. Among other things, it includes the Official Journal of the European Union, treaties, legislation, case law, and legislative proposals.
European Franchise Federation (EFF)	http://www.eff-franchise.com/ Nonprofit international organization that promotes the interests and development of franchising in Europe.
Hague Conference on Private International Law (HCCH)	http://hcch.e-vision.nl/index_en.php?act=text.display&tid=1 Home page.
International Trademark Association (INTA)	http://www.inta.org INTA is an international nonprofit membership association dedicated to the support and advancement of trademarks and related intellectual property.
NAICS Association	http://www.naics.com/index.html Agency that administers the North American Industry Classification System (NAICS), which replaced the old Standard Industrial Classification (SIC) system in 1997. NAICS codes are used by statistical agencies in the U.S.,

	Canada, and Mexico to classify businesses for the collection, analysis, and publication of statistical data related to the economy.
North American Free Trade Agreement (NAFTA) Secretariat	http://www.nafta-sec-alena.org/en/view.aspx Home page with link to text of NAFTA.
Canadian System for Electronic Document Analysis and Retrieval (SEDAR)	http://www.sedar.com/ Home page of the Canadian equivalent to the SEC's EDGAR. Provides access to corporate filings of Canadian companies with Canada's securities regulatory authorities.
United Nations Commission on International Trade Law (UNCITRAL)	http://www.uncitral.org/ Home page with links to UNICITRAL texts, including conventions, model laws, guides to enactment, legislative guides, legislative recommendations, and model contract rules. In particular, this website includes the text of the U.N. Convention on Contracts for the International Sale of Goods (CISG).
CISG Database at Pace University School of Law, Pace Law Library, Institute of International Commercial Law	http://cisgw3.law.pace.edu/ Site dedicated to U.N. Convention on Contracts for the International Sale of Goods (CISG), with annotated text of CISG, CISG in different languages, cases organized by countries, and related CISG material.
International Institute for the Unification of Private Law (UNIDROIT)	http://www.unidroit.org/dynasite.cfm Home page.
World Intellectual Property Organization (WIPO)	http://www.wipo.int/portal/index.html.en A specialized agency of the United Nations, dedicated to developing a balanced and accessible international intellectual property system.
World Trade Organization (WTO)	http://www.wto.org/ Global international organization dealing with the rules of trade between nations.

C. Government Sites—California

California Department of Corporations (DOC), Franchise Regulation	http://www.corp.ca.gov/SRD/franchise.asp Access to information and forms concerning franchise registration.
California Department of Corporations (DOC), Securities Regulation Division	http://www.corp.ca.gov/SRD/default.asp Access to forms, departmental publications, Commissioner's releases, opinions, and notices concerning the California blue sky laws.
Cal-EASI	http://www.corp.ca.gov/CalEASI/caleasi.asp California Department of Corporations website providing access to securities and franchise filings.
California Department of Fair Employment and Housing	http://www.dfeh.ca.gov/ Home page.
California Department of	http://www.dir.ca.gov/workers'_comp.html

Insurance, Workers' Compensation Information	Access to information on workers' compensation insurance.
California Department of Real Estate (DRE)	http://www.dre.ca.gov/ Home page with information for consumers as well as real estate licensees and examinees.
California Division of Occupational Safety and Health (DOSH)	http://www.dir.ca.gov/dosh Access to information concerning the Cal-OSHA program.
California Employment Development Department (EDD)	http://www.edd.ca.gov Home page; information concerning job placement and referrals, unemployment insurance, disability insurance, employment and training, the labor market, payroll taxes, and other topics.
California Franchise Tax Board (FTB)	http://www.ftb.ca.gov/ Home page with links to downloadable state tax forms and publications.
California Law Revision Commission	http://www.clrc.ca.gov/ Home page.
Official California Legislative Information	http://www.leginfo.ca.gov/index.html Full text of bills, resolutions, and constitutional amendments, as well as their status, history, votes, analyses, and veto messages.
California Legislative Resource	http://calbar.ca.gov/state/calbar/calbar_generic.jsp?cid=10137&id=10452 Webpage maintained by the State Bar of California with many helpful links regarding California's legislative process, pending bills, legislative calendar, committees, and other topics.
State Bar of California Bill Tracking Service	http://www.calbar.ca.gov/calbar/legislation/State%20Bar%20Bill%20Tracking-Sections.html Centralized legislative monitoring and tracking service listing bills of potential interest to members of the State Bar's sections and their committees.
CalGOLD	http://www.calgold.ca.gov/ The CalGOLD website provides links and contact information for California businesses concerning business permits, licenses, and registrations required by federal, regional, state, and local agencies. Information is searchable according to type of business.
California Office of Privacy Protection	http://www.oispp.ca.gov/consumer_privacy/default.asp State agency dedicated to promoting and protecting the privacy rights of consumers.
California State Agencies	http://www.ca.gov/ State of California site with links to California agencies, departments, and commissions.
California State Association of Counties	http://www.csac.counties.org/ Home page with links to all California counties.
California State Board of Equalization	http://www.boe.ca.gov/ Home page with access to information about sales and use taxes, sellers' permits, forms, and publications.
California Secretary of State— California Business Portal:	http://www.sos.ca.gov/business/ Home page.

Forms and Fees:	http://www.sos.ca.gov/business/forms.htm Directory of forms, sample forms, and fees for different business filings, including UCC forms, some in fill-in format.
Business Filings:	
Business Entities	http://www.sos.ca.gov/business/be/ Business Entities main page with links to services offered for corporations, limited liability companies, limited partnerships, and other business entities; filing tips to meet statutory minimum requirements; name availability; FAQs; and more.
Trademarks and Service Marks	http://www.sos.ca.gov/business/ts/ Trademarks and service marks main page with links to forms and fees, name availability, FAQs, private service companies, and more.
California Business Search	http://kepler.sos.ca.gov Fill-in boxes to check records online for corporations, limited partnerships, and limited liability companies.
Starting a Business	http://www.sos.ca.gov/business/be/starting-a-business.htm A step-by-step guide for starting a business in California.
e-file Statement of Information	https://businessfilings.sos.ca.gov/ Fill-in boxes to file a Statement of Information for a corporation online.
Notary Public	http://www.sos.ca.gov/business/notary/ Notary public main page, with links to topics such as obtaining a notary public commission, handbook, authentications, apostille or certification, forms, and fees.
Uniform Commercial Code	http://www.sos.ca.gov/business/ucc/ UCC main page with links to UCC Connect (the Secretary of State's online service for UCC inquiries, filings, requests for copies and debtor search certificates, and more), financing statement forms and filing fees, administrative rules, FAQs, and other resources.
International Business Relations Program	http://www.sos.ca.gov/business/ibrp/ Main page with links to chambers of commerce, foreign consulates, trade associations, and other agencies, and to other resources to assist foreign business entities with various California filing procedures.
Business Program Division, Legislation	http://www.sos.ca.gov/business/bpd_newleg.htm Summaries and links to new state laws affecting businesses.
Victims of Corporate Fraud Compensation Fund	http://www.sos.ca.gov/vcfcf/ Main page with information, including application requirements, instructions, and forms, concerning the fraud compensation fund administered by the Secretary of State's office.

D. Private Agency Sites

ABA Section of Business Law	http://www.abanet.org/buslaw/home.html Home page with links to publications and other resources for business lawyers.
Active Capital	http://activecapital.org/ Site dedicated to helping individual accredited investors, SBICs, and institutional venture capitalists find small, growing companies through a secure Internet database, and providing ongoing training and research for entrepreneurs and small investors.
AllBusiness	http://www.allbusiness.com

	Small business portal, with links to forms, directories, and resources on many topics.
American Arbitration Association	http://www.adr.org/ Home page with links to rules and procedures.
American Intellectual Property Law Association (AIPLA)	http://www.aipla.org Home page with links to practice areas, professional development, educational materials, meetings, and events.
Annual Reports.com	http://www.annualreports.com/ Free service offering links to annual reports of public companies.
BenefitsLink	http://www.benefitslink.com Compliance information and tools for employee benefit plan sponsors, service providers, and participants.
Better Business Bureau	http://www.bbb.org/ National home page. There are separate regional Better Business Bureaus covering different geographical areas of California, each with its own website.
The Biz-Tech Network by Brint Institute, LLC	http://www.brint.com/ Portal with a meta-index of business, management, and information technology topics; it also provides search capabilities and full text articles on related issues.
Business.com	http://www.business.com/ Business search engine and directory intended to help users find companies, products, services, and other business-related information; some features are fee-based.
Business Law Section of the State Bar of California	http://www.calbar.ca.gov/state/calbar/calbar_sections_generic.jsp?sCategoryPath=/Home/Attorney%20Resources/Sections/Business%20Law Home page with links to standing committees, programs, and publications.
Business Week Online	http://www.businessweek.com/ Articles, links, and opportunity to subscribe to free newsletter.
CNBC	http://www.cnbc.com/ Home page of business and financial news cable network.
CNN Money	http://money.cnn.com/?cnn=yes General business news website offered by CNN and *Fortune* and *Money* magazines.
Corporate Finance Sourcebook	http://www.financesourcebook.com/ Link for ordering popular guidebook published by National Register Publishing. The guidebook features over 1500 top investment sources and 1700 service firms for business entrepreneurs.
Corporate Information	http://www.corporateinformation.com/ Subscription-based website offering research reports on public, private, domestic, and foreign corporations.
The Corporate Library	http://www.thecorporatelibrary.com/ The Corporate Library is an independent research firm providing corporate governance data, analysis, and risk assessment tools.
Creative Commons	http://creativecommons.org A nonprofit organization founded by Prof. Lawrence Lessig of Stanford University that provides special copyright license forms and other free tools to

	enable authors, scientists, artists, and educators to share intellectual property.
Dun & Bradstreet	http://www.dnb.com/us/ Home page of Dun & Bradstreet. Subscribers can request reports and run online queries in proprietary databases.
Edgar Online, Inc.	http://www.edgar-online.com/ Edgar Online, Inc. is a private company, not affiliated with the SEC, specializing in the extraction, packaging, and distribution of public-company information contained in SEC filings.
Entrepreneur.com	http://www.entrepreneur.com/mag Free access to *Entrepreneur* magazine articles back to 1998.
Financial Accounting Standards Board (FASB)	http://www.fasb.org/ Access to FASB Statements of Financial Accounting Standards and other resources.
Findlaw Business Center	http://smallbusiness.findlaw.com/ Portal with links to articles and guides on starting a business, taxes and accounting, small business legal concerns, and more. Part of West Group.
Garage Technology Ventures	http://www.garage.com/ Venture capital fund for emerging technology companies.
GNU	http://www.gnu.org/ Organization promulgating the development and use of free software and the use of open-source software licenses.
Google Business News	http://news.google.com/nwshp?tab=wn&ned=us&topic=b Business news headlines with links to full stories from news organizations around the world.
Google Small Business Directory	http://directory.google.com/Top/Business/Small_Business/ A directory of small business resources.
Hieros Gamos Small Business Center	http://www.hg.org/sbcenter.html Portal with links to topics such as starting a business, choosing a legal structure, and financing.
Hoover's Online	http://www.hoovers.com/ Subscription-based site with industry snapshots, company profiles, earnings, and other information.
Intellectual Property Law Section of the State Bar of California	http://www.calbar.ca.gov/state/calbar/calbar_sections_generic.jsp?cid=10707 Home page with links to standing committees, programs, and publications.
International Franchise Association (IFA)	http://www.franchise.org/ Trade association promoting responsible franchise development worldwide.
Internet Corporation for Assigned Names and Numbers (ICANN)	http://www.icann.org/ Private agency responsible for global coordination of the Internet's system of unique identifiers, including domain names (such as.com,.org, and country codes such as.fr), as well as addresses used in a variety of Internet protocols.
IP Mall	http://ipmall.info/ Website sponsored by Franklin Pierce Law Center, with links to intellectual property resources around the world (including patents, copyrights, trademarks, trade secrets, licensing, and technology transfers).
JAMS	http://www.jamsadr.com

	Home page with information about JAMS mediation and arbitration services and a search engine to assist in locating qualified mediators and arbitrators. The website also offers sample dispute resolution clauses for commercial contracts.
Jefren Publishing Co.	http://www.jefren.com Subscription service offering proxy statement forms and strategies.
MarketResearch.com	http://www.marketresearch.com/ Free database of market research reports representing all market and industry sectors.
NASDAQ	http://www.nasdaq.com/ Comprehensive current information on market performance and investments.
National Association of Attorneys General	http://www.naag.org/ Association of the attorneys general of all 50 states, with contact information and links to enforcement initiatives.
National Association of Seed and Venture Funds	http://www.nasvf.org/ Network of private, public, and nonprofit organizations investing and facilitating investment in entrepreneurs.
National Business Association	http://www.nationalbusiness.org/ Nonprofit association's site for the self-employed and small business community.
National Venture Capital Association (NVCA)	http://www.nvca.org/ Home page with links to members and other resources.
New York Stock Exchange (now NYSE Euronext)	http://www.nyse.com/ Comprehensive, current information on market performance and investments.
PayChex	http://www.paychex.com/index.aspx Company offering payroll processing, human resources administration and compliance, and employee benefit administration services for small and mid-sized businesses.
PayPal Merchant Services	https://merchant.paypal.com/cgi-bin/marketingweb?cmd=_render-content&content_ID=merchant/home Commercial service enabling businesses to accept credit card and other payments securely on websites, by e-mail, or over the telephone.
The Public Register Online	http://www.annualreportservice.com/ Free access to annual reports of over 2200 companies. Site also has links to the SEC's Edgar database for filings.
Reuters	http://www.reuters.com/finance Business and finance news database with reports on business transactions, markets, small businesses, industries, the economy, and other topics.
Safeselling.org	http://www.safeselling.org/ ABA-sponsored resource for business people launching e-commerce enterprises and for businesses venturing into online sales.
The Small Business Portal	http://www.thesmallbusinessportal.com/ Links to topics such as starting a business, franchise advice, financing, and home-based businesses.
Standard & Poor's	http://www.standardandpoors.com/ Home page with search engine for public company credit ratings and other

	features.
Tripod by Lycos	http://www.tripod.lycos.com/smallbiz/index.html Portal with tips on starting an online business, yellow pages, and some free and some fee-based services.
U.S. GAAP Information	http://cpaclass.com/gaap/ Comprehensive source of information on generally accepted accounting principles in the U.S.
Wall Street Journal Online Edition	http://online.wsj.com/home-page General business and financial news.
Washburn University School of Law Small Business Portal	http://www.washlaw.edu/subject/small.business.html Portal with links to a forms library and business and economic data.
Yahoo! Finance	http://biz.yahoo.com/i/ Free company profiles and stock charts for over 9000 public companies.
Yahoo! Small Business	http://smallbusiness.yahoo.com/index.html? Portal with links to topics such as creating a website, promoting a business, and selling online.

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