

Limited Liability Companies

Chris Riser
Mayer & Riser, PLLC
Attorneys at Law
Post Office Box 750
Highlands, North Carolina 28741
USA
Tel. (828) 526-3731
Fax (828) 526-3734
criser@mayer-riser.com
<http://www.mayer-riser.com>
<http://www.riserreport.com>

4/24/2001

Overview

- LLCs are truly revolutionary
- A well-informed client and his or her well-informed advisors can use LLCs to greatly improve and enhance a client's personal and financial situation

4/24/2001

Introduction

- What's so special about LLCs?
 - Unrestricted Passthrough Taxation
 - Limited Liability for Business Debts
 - Personal Asset Protection for Owners
- A Working Knowledge of LLCs is Important for Sophisticated Investors, Businesspeople and their Advisors

4/24/2001

Corporations

- Separate legal identity from its owners
- Tripartite structure
 - Owners (shareholders)
 - Directors ("big picture" management)
 - Officers (day-to-day operations)
- Transfers of stock not restricted by statute
- Death of shareholder doesn't affect corporation's existence
- Limited liability

4/24/2001

Agenda

- Basic Legal and Tax Characteristics of Business Entities
- LLC Taxation
- LLCs and Asset Protection
- Basic Offshore LLC Structure
- Beware Old Information

4/24/2001

Limited Liability

- Liability limited to investment
- Liability for individual actions not limited
- Liability not limited if corporation is a sham
- Protects owners from contractual liability
- Protects owners from misdeeds of co-owners and employees
- Examples

4/24/2001

Taxation of C Corporations

- Corporation is a separate taxable entity
- Income taxed to corporation
- Dividends taxed to shareholders
- Exchange of property for stock may be taxable if Sec. 351 requirements not met

4/24/2001

Partnerships

- General partnership interests not freely transferable
- Death, etc. of general partner dissolves partnership
- Assignees receive only economic rights unless other partners agree otherwise

4/24/2001

Taxation of S Corporations

- Passthrough taxation
- Ability to re-deploy assets is limited by gain recognition when distributing appreciated assets
- Limited eligibility to elect S status
- Restrictions on ownership structure

4/24/2001

Taxation of Partnerships

- Passthrough taxation
- Generally no recognition of gain on contribution of property
 - Exceptions
 - Liabilities in excess of basis
 - Investment company rules

4/24/2001

Partnerships

- General and limited
- Management vested in general partners
- Limited partners cannot participate in management
- General partners have unlimited liability
- Limited partners have limited liability, but only so long as they do not participate in management

4/24/2001

Limited Liability Companies

- “Hybrid” with corporate and partnership features
- Flexible and understandable
- Management - one level of decision-making
 - Collectively by members (member-managed)
 - By one or more managers (manager-managed)

4/24/2001

Limited Liability Companies

- Concept has existed for over 100 years
- Wyoming LLC was the first in the U.S.
- Tax uncertainty kept things slow until 1988

4/24/2001

Taxation of U.S. LLCs

- Check-the-Box
 - 2 or more owners
 - Partnership (default)
 - Corporation (by election)
 - Can elect S
 - Single-owner entities
 - Disregarded entity (default)
 - Corporation (by election)
 - Can elect S
- Examples

4/24/2001

Limited Liability Companies: Check the Box

- Treasury Regulations 301.7701-3 issued in December 1996
- Form 8832
- Allows “eligible entities” (including LLCs and many foreign corporations) to choose tax treatment
- “Don’t check the box” for partnership tax treatment for U.S. LLCs
- Has made LLCs the entity of choice in most situations in most jurisdictions for progressive and sophisticated clients and their advisors

4/24/2001

Taxation of Offshore LLCs

- Per se corporations list
- Check-the-Box for everything else
 - 2 or more owners
 - Corporation (default)
 - Partnership (by election)
 - Single-owner entities
 - Corporation (default)
 - Disregarded entity (by election)

4/24/2001

Offshore LLCs

- European & Latin American-style
- U.S.-style
 - Anguilla
 - Isle of Man
 - Nevis

4/24/2001

Taxation of Foreign Corporations

- Forgotten or faulty 8832 causes Offshore LLC to be taxed as a foreign corporation
- Tax deferral via use of foreign corporation not available for typical U.S. investor
- Controlled Foreign Corporation
 - Undistributed Subpart F income taxed to U.S. shareholders
 - Gain on sale taxed as dividend (ordinary income)
 - Gain on contribution of appreciated property

4/24/2001

Taxation of Foreign Corporations

- Foreign Personal Holding Company (FPHC)
- Passive Foreign Investment Company (PFIC)
- Foreign Corporation Information Reporting

4/24/2001

LLCs & Estate Planning

- LLCs in many jurisdictions can be used as estate planning tools like FLPs
- Discounted gifts of LLC interests
- Nevis LLC works well

4/24/2001

Taxation of Foreign Partnerships

- Basically the same as U.S. partnerships
- No more 35% excise tax on contributions
- Foreign Partnership Information Reporting (Form 8865)

4/24/2001

LLCs & Asset Protection

- Corporate shares reachable by creditor
- LLC membership interests subject to charging order
 - Gives creditor economic rights to distributions
 - Does NOT give creditor management or voting rights
 - Creditor is at mercy of LLC manager
- Example
- Delaware Series LLC
 - cutting edge alternative to multiple entities
 - See article in Sep/Oct 2000 issue of The Riser Report available online at www.risereport.com

4/24/2001

Taxation of Foreign Disregarded Entities

- Income taxed directly to owner
- No reporting requirements
- No worries about gain on contribution
- No worries about failure to file information reports

4/24/2001

Charging Order History

- Derives from English partnership law
- Prevents disruption of business
- Long history in American law
- LLC charging order
 - Gives creditor economic rights to distributions
 - Does NOT give creditor management or voting rights
 - Creditor is at mercy of LLC manager
- Example

4/24/2001

Charging Order History

- Derives from English partnership law
- Prevents disruption of business
- Long history in American law

4/24/2001

Foreclosure

- Few cases
- May not be an attractive remedy for a creditor
 - Long wait
 - Tax consequences
 - Forced to deal with a foreign LLC manager
- Exclusivity
 - No foreclosure? or simply
 - No writs of execution?

4/24/2001

Charging Order & Single Member LLCs

- Policy reason doesn't exist
- U.S. court would probably have little patience
- Alter-ego/sham "end run" around the issue
- Caution advised

4/24/2001

Fraudulent Transfer Issues and LLCs

- Transfers in exchange for membership interests should be considered to be "for value"
- Transfers for value are usually more difficult to challenge
- May allow LLC structures to be used in "hotter" situations
- Tax law changes and offshore LLC legislation may make LLC-based planning superior to trust-based planning

4/24/2001

Offshore Charging Order Protection

- Nevis provides strong protection
- Possible lower-key alternative or complement to offshore asset protection trusts

4/24/2001

Offshore LLC Advantages

- Avoids forced distributions
- Avoids forced dissolution and liquidation
- Conducting an active business
 - Superior limited liability protection if assets (working capital, etc.) held offshore
- Offshore jurisdictions generally unfavorable to U.S. plaintiffs

4/24/2001

Basic Offshore LLC Structure

- Nevis LLC holds assets
- Client is 99% owner of LLC
- Offshore IBC is 1% owner & manager of LLC
- Foreign Trust holds IBC stock
- Other entities can be “plugged in”
- Disregarded entity or partnership for U.S. tax purposes

4/24/2001

LLC Agreement Provisions

- Manager-managed
- Restrictions on liquidation
- Distributions entirely in the discretion of managers
- Transfer restrictions
- Manager salary not a “distribution” to extent possible under the LLC Act
- Ability to redomicile LLC
- Excluded persons provisions
- Protector provisions
- Creditor-deterrent buy-sell provisions

4/24/2001

Beware Old Information

- Laws are changing rapidly for the better
- Check the Box
- Self-employment tax consequences
- Conversions
- Offshore LLCs for asset protection
- Offshore LLCs - tax consequences (or lack thereof)
- Estate Planning

4/24/2001