

Start your business off on the right foot!

When to Form a Limited Liability Company (LLC)

When to Form an LLC

An LLC can generally be formed to conduct any lawful business. However, an LLC should likely be formed upon the occurrence of any of the following:

- Starting a business;
- Upon the purchase/ownership of rental property;
- Becoming a residential real estate licensee;
- Becoming a commercial real estate licensee; or
- Segregating multiple real estate assets to avoid overlapping liability from one property to another.

Steps to Forming an Arizona LLC

Step 1 –Defining a Purpose

In Arizona, a limited liability company may be created to conduct or promote almost any lawful business so long as its actions do not exceed the scope of Arizona law or the purpose for which it was created, as set forth in its articles of organization or operating agreement.

For example: If an LLC was formed to accomplish a single purpose, (i.e. operating a clothing store) any action by a member or manager of the LLC to promote another purpose not in furtherance of the stated LLC purpose may expose that person to personal liability. Thus, to help members and

managers of an LLC avoid personal liability for their actions, the LLC's articles of organization and/or operating agreement should set forth the purpose for which the LLC was created.

Step 2 – Naming an LLC

The name of an LLC must include one of the following designations in order to be valid. These designations include the words "limited liability company" or "limited company" or the abbreviations "L.L.C.", "L.C."; "LLC" or "LC". The name of an LLC must generally not include the following words: "bank", "deposit", "credit union", "trust" or "trust company".

For example: A valid name of an LLC would be "ABC Real Estate, LLC". However, the name "ABC Trust, LLC" would be an invalid name because it includes the word "trust." A valid name can be reserved for 120 days with the Arizona Corporation Commission for a fee without having to form the LLC at that time.

“What’s in a good name?” When choosing an LLC name, consider the following:

- Is the name easy to remember?
- Does the name describe the LLC’s product or service?
- Is the name available as a web address as either a .com, .net, or .biz address?
- What websites pull up under popular search engines when the name is searched?
- Will the name infringe on an existing trade name or trade mark?

Step 3 – Prepare Articles of Organization

The articles of organization are the state required documents required by the Arizona Corporation Commission that must be filed in order to establish an Arizona limited liability company.

Once the LLC’s name has been selected and is available, the next step is to submit to the Arizona Corporation Commission the LLC’s articles of organization.

In order to be valid, the articles of organization must include the following information:

- The name of the LLC;
- The name and Arizona address for the LLC’s statutory agent for service of process;
- The Arizona business address for the LLC, if different than the address for the statutory agent for service of process;
- The latest date, if any, on which the LLC must dissolve, if the duration is less than perpetual;
- Whether management of the LLC is vested in the managers or reserved to the members; and

- The names and addresses of the managers and members with a 20% or greater share of ownership, if the management of the LLC is vested in the managers or all the members, if management is reserved to the members.

Articles of Organization are Approved

After determining that all filing requirements and fees have been satisfied, the Arizona Corporation Commission will provide notice to the individual who filed the documents or to the LLC’s statutory agent that the LLC’s articles of organization have been filed and provide the LLC with an entity number.

Once filed, the LLC can begin conducting business, unless the documents have a start date in the future. However, waiting till receipt of the notice stating the filing requirements have been satisfied before conducting business in the name of LLC is appropriate in the event there is an error in the filing. Further, most business transactions in the name of the LLC will require proof that the LLC has been validly formed.

For example: In order to open a bank account in the name of an LLC, the bank will generally require proof of the LLC’s formation evidenced by a copy of the “filed” articles of organization.

Articles of Organization Not Approved

If the articles of organization are not approved when received by the Arizona Corporation Commission, a Notification of the Nonconformance will be issued to the individual who filed the documents or to the statutory agent.

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The Arizona Corporation Commission will give thirty days from the date of notification to correct the nonconformance issues. If the nonconformance issues are not corrected within the thirty day time period, the articles of organization will not be approved and the LLC will be terminated.

Formation Liability Scenario

When a member incurs debt in the name of the LLC, but the LLC was not properly formed because the articles of organization were not accepted by the Arizona Corporation Commission and the member knew or should have known that the LLC was not properly formed, a creditor can hold the member personally liable for the obligations of the LLC.

However, if the member did not know or should not have known that the LLC was not properly formed and had reasonable belief that it was properly formed, then the unknowing member will generally not be personally liable for the debts of the LLC.

Liability for False Statements in the Articles of Organization

In addition to the LLC being responsible, the person who executes the articles of organization, articles of merger, articles of termination or causes another person to execute the articles on their behalf and knows or should have know that a statement within the articles were false when the articles were executed or any person who reasonably should have known the statements to be false will be exposed to personal liability.

Further, any individual who knows or should have known that an arrangement or other facts described in

the articles have changed (making the statement in the articles inaccurate in any respect) and a sufficient amount of time has passed to enable the individual to amend the articles, but they have failed to do so, they may be held personally liable.

Liability will also be imposed for the losses suffered by an individual or entity that relied on the false statements contained in the articles of organization.

Step 4 – Filing Requirement

The articles of organization must be filed with the Arizona Corporation Commission.

Step 5 – Publication Requirement

Once the articles of organization have been approved by the Arizona Corporation Commission, the publication requirement must next be satisfied. Within sixty (60) days of the articles of organization approval by the Arizona Corporation Commission, such articles must be published in a newspaper of general circulation in the county of the LLC's known place of business for three (3) consecutive publications.

Step 6 – Operating Agreement

An operating agreement allows you to structure how you and your partners want to conduct your business. These financial and working relationships can vary so it is important that these topics are clearly addressed within the LLC's operating agreement.

Some of these issues or topics that should be addressed in the operating agreement are as follows:

- Membership rights;
- Membership interests in the LLC;
- Voting rights for member / managers;

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- Diversification of operational duties and obligations;
- Meeting requirements;
- Capital contributions – cash, property or services;
- Percentage of ownership;
- Distributions;
- Profit and losses allocation;
- Liabilities;
- Creditor issues;
- Taxes;
- Termination issues;
- Community property issues;
- Buyout, buy-sell or death provisions; and
- Dissolution requirements.

Without an operating agreement, state default laws will be used by the court to address issues that would have been otherwise addressed within the LLC's operating agreement. Since the members or managers or an LLC may have different views than the state on how to operate their LLC, an LLC should enact their own operating agreement.

Conclusion

If you are desirous of forming your own LLC, the law firm of BURNS AND BURNS P.C. is skilled to handle all of your LLC formation and governance questions. Further, in the event you would like to start forming your LLC now, please see our Online Forms to start the online process right now.

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Scott F. Burns, Esq. is an Arizona attorney whose clientele include professional athletes, business owners, and families desirous of protecting their personal and professional legacies through the use of asset protection strategies, estate planning and business consulting.

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