

Since 1995 over 390,000 new LLCs have been formed in Arizona; wonder why?

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Arizona Limited Liability Company Basics

Introduction

The LLC has become one of the most popular forms of business entities because an LLC is:

- Easy to form and maintain;
- Provides limited liability to its members; and
- Avoids double taxation with the IRS.

An LLC provides the best characteristics of both a corporation and a partnership. Specifically, corporations provide limited liability to its shareholders and directors, but are subject to double taxation. Conversely, sole proprietorships and partnerships avoid double taxation but do not provide its members with limited liability. Thus, the LLC was created to provide the limited liability benefits of a corporation with the double taxation avoidance benefits of a partnership or sole proprietorship!

LLC 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.

LLC Purpose and Personal liability

In Arizona, 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 clearly set forth the purpose for which the LLC was created.

Articles of Organization

The articles of organization are the documents which must be filed with and approved by the Arizona Corporation Commission in order to establish an Arizona limited liability company.

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

- The name of the LLC;
- The name and Arizona street 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.

Operating Agreement

An operating agreement allows you to structure how you and your member/managers want to conduct business. These financial and working relationships can be wide and varied and it is important that the following topics are clearly addressed within an LLC's operating agreement:

- Membership rights;
- Membership interests in the LLC;
- Voting rights for member/managers;
- 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 a well drafted operating agreement, default state laws will be used to address issues that would have been otherwise addressed within the LLC's operating agreement. Unfortunately, in many cases, the way in which the state would manage your LLC is different than how the LLC members / managers might conduct the business.

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".

In addition, the name of an LLC must generally not include the following words: "bank," "deposit," "credit union," "trust" or "trust company."

For example: The valid name of an LLC could 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 actually form the LLC at the time the name is reserved.

"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?

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Management Structures

The management structure of an LLC can either be vested in the manager(s) or reserved to the member(s) of the LLC.

A management structure that is vested in the managers means that only those persons who are elected as managers of the LLC can partake in management decisions. Conversely, if management of the LLC is reserved to its members, then all the members of the LLC can partake in LLC management decisions.

Management Structure Pros vs. Cons:

Careful consideration needs to be given when considering the type of management structure to implement.

For example: An LLC with a large number of members may elect to have management decisions vested in the managers. Conversely, an LLC with only a few members may elect to have management decisions reserved to the members.

Profits and Losses

Profits and losses are split between LLC members depending on the basis of their contributions to the LLC.

Thus, if one LLC member contributes 80% of the capital to the LLC, that member will be entitled to 80% of the profits as well as be responsible for 80% of the losses. However, the members of an LLC can choose to enter into an agreement on how they want to share profits and losses. Generally, this agreement is contained in the terms of the LLC's operating agreement.

Membership Transfer Rights

Unless contrary in the LLC's operating agreement, if a member transfers their interest in an LLC to another person or entity, the member can only transfer their right to receive their share of the LLC's profits and losses. However, upon the consent of all the members, management rights can be transferred from a member to another party.

About the Author

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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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