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## Doing Business as an LLC: New Disadvantages

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The emergence of the limited liability company (LLC) as a preferred form of doing business has been remarkable. While the prevalent traditional business form, the corporation, has existed for hundreds of years, the LLC has been created in the U.S. less than 30 years ago and has gained immense popularity during the past decade. Recent changes to the New York LLC law have introduced new burdensome requirements for LLCs, requiring us to reevaluate whether the LLC still remains the form of choice for businesses in New York.

### The Corporation

For hundreds of years, the corporation has been the ultimate form of doing business. According to several sources, the oldest corporation in the United States and North America is the President and Fellows of Harvard College, also known as the Harvard Corporation, chartered in 1650. Offering limited liability, unlimited growth potential, and legal life independent of that of its owners, the corporation has been synonymous with success and potential, and perceived as a necessary vehicle towards the realization of one's commercial dreams. The prevalent tax concern associated with the corporation has been the so-called "double taxation", where the same corporate profits are being taxed initially at the corporate level and then once again at the individual shareholder's level as dividends.

### Close, But Not Close Enough

The growing need for evolution and reform of the corporate form resulted in the legislative creation of the "closely-held" corporation, also known as the "Sub-Chapter S" or "S-Corporation", which was introduced to ameliorate double-taxation vis-à-vis small businesses traditionally owned by families or by a small group of people. "Subchapter S" of the U.S. tax code (hence the name) allowed a corporation, which met several stringent requirements, to choose to be taxed as a partnership, effectively dis-

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pensing with 'double-taxation'. The primary requirements mandate that the number of owners not exceed 75 persons (increased from 35 several years ago) and that all of those owners be citizens or permanent residents of the U.S. While being widely utilized, the S-Corporation is still not a viable option for those who, by the very nature of their business cannot meet such legal requirements.

### The LLC

Enter the LLC. Following worldwide trend of limited liability reform, the U.S. introduced state-based LLC legislation in the late 1970s. The most notable advantage of the LLC is its hybrid nature, affording its owners (called 'members') limited liability similar to the type enjoyed by shareholders of a corporation,

while also avoiding 'double taxation' in the same manner an S-Corporation would, but without restricting the number or residency status of its owners. Coupled with additional tax advantages and viewed from the two all-important aspects of forming a business, namely, limited liability and taxation, the LLC form has created a 'best of both worlds' entity. Some disadvantages of the LLC, while noteworthy, seem to have remained secondary in importance. Among those are certain difficulties in raising capital due to investors' preference for investing in the better-understood corporate form with a hopeful view toward a future initial public offering (IPO). Also, the relative young age of the LLC form has yielded little case law to be relied upon in forecasting legal consequences of business operations. LLC legislation, evolving in a different pace in each U.S. state, has resulted in lack of uniformity and has necessitated monitoring of the law in multiple states to constantly remain aware of those states offering the most LLC-friendly laws.

Traditional actions to be taken upon formation of an LLC have been largely similar to those of a corporation. The LLC would obtain a tax identification number; open a commercial bank account; execute initial business resolutions and an operating agreement between its members (the equivalent of a shareholders agreement in a corporation); elect officers; etc. One current and hotly debated issue in New York is

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the added requirement that the formation of a new LLC be published. New York and Arizona have been the only states in the U.S. requiring new LLCs to publish their formation. Recent amendments to the New York LLC Law with respect to this requirement has brought this issue even closer to the debate forefront.

### The New Rules

Governor George Pataki has recently signed into law an amendment to the New York LLC Law, providing, among other, that effective June 1, 2006,

**"THE LLC FORM OF DOING BUSINESS SHALL... REMAIN THE FORM OF POPULAR CHOICE"**

- a new LLC will have to publish, within 120 days after formation, once a week for 4 consecutive weeks, a notification of its new existence in one daily newspaper and one weekly newspaper (both to be determined by the clerk of the county in which the LLC intends to operate). LLCs formed between January 1, 1999 and June 1, 2006 will have 18 months to accomplish the same.
- the publication is to disclose the names of the LLC's 10 largest active owners;
- failure to comply with the new publication requirement will result in the suspension of the LLC status (it is noted that previously, failure to provide proof of publication meant only that an LLC could not institute a lawsuit in New York).

Proposed amendments to this law increase the publication duration to 6 consecutive weeks (still once a week), eliminate listing of the LLC's largest owners, but also modify the sanction for failure to comply from 'suspension of status' to the imposition of personal liability for the actions of the LLC upon its individual owners until the publication requirement is complied with. Essentially, failure to comply will effectively mean the removal, albeit temporary and curable, of the LLC's limited liability shield.

### Non-NY LLCs

An LLC is governed by the laws of the state in which it was formed. If the LLC intends, or is deemed, to be 'doing business' in another state, such LLC needs to become authorized to do so. 'Doing business' in a state is itself a term of art which requires legal analysis. Traditional factors considered are the existence of an office, local telephone number; and meaningful sales or orders activity.

Once an LLC becomes authorized to do business in New

York, it becomes subject to the publication requirements as any other New York domestic LLC.

### In Sum

Prior to the recent changes to the New York LLC law, the legal requirement to publish LLCs in New York did not impose a significant burden as many New York LLCs have opted to wait until their failure to publish had actually barred them from instituting a lawsuit in a New York court. The new amendment, providing for harsher consequences for noncompliance, has effectively increased the overall LLC formation costs, thus requiring more advance planning and analysis of the desired business form and formation locale. If, as expected, the wording adopted and enacted by the NY Senate excludes the need to publish names of the top-10 members, the only additional burden imposed is monetary and we believe that the LLC form of doing business shall continue, in most circumstances, to offer invaluable advantages over corporations and remain the form of popular choice.

**"FAILURE TO COMPLY WITH THE NEW PUBLICATION REQUIREMENT WILL RESULT IN THE SUSPENSION OF THE LLC STATUS"**