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Center for Community Economic Development

# Limited Liability Companies As Tax-Exempt Organizations

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June 2013

# Introduction

Limited liability companies (LLCs) have gained wide-spread popularity over the last 20 years for businesses of many types and sizes. Like a corporation it provides limited liability for its owners, but with the flexibility and flow-through tax attributes of a partnership. The default tax classification of an LLC is a partnership, however, founding members may elect to be taxed as a corporation by simply “checking the box” on IRS Form 8832, Entity Classification Election. Single member LLCs (SMLLCs) are automatically considered disregarded entities (DREs), are not taxed at the entity level, and possess no tax existence separate from their owner. However, a SMLLC may choose to not be disregarded and instead seek its own tax exemption. It follows that an LLC with two or more members cannot be treated as a disregarded entity.

Almost 15 years ago, the IRS issued an announcement that the financial operations of a SMLLC owned by an organization exempt under Section 501(a) of the Internal Revenue Code should be included in the parent’s annual information return. At the time no statement was made in regards to how charitable contributions made to the SMLLC should be treated by the donor. Now finally, after years of speculation, the IRS issued Notice 2012-52 indicating taxpayers may deduct charitable contributions made to SMLLCs wholly owned by U.S. charities.[1] This pronouncement clears up many years of uncertainty around the deductibility of donations made by an individual donor and the charitable status of the LLCs.

Also recently, in September 2012, the California legislature passed Senate Bill No. 323, the California Revised Uniform Limited Liability Company Act (CRULLCA). This legislation, to go into effect January 1, 2014, will invoke many changes to the formation and operation of California Limited Liability Companies. In light of the recent IRS focus on nonprofit LLCs, this paper makes an effort to highlight both the changes in California law and the changes in Federal tax law that affect nonprofit LLCs.

[1] IRS Notice 2012-52, *Charitable Contributions to Domestic Disregarded Entities*, Internal Revenue Bulletin 2012-35 (August 27, 2012).

# The Rise of Nonprofit LLCs

The number of LLCs being formed has increased exponentially in recent years, and increasingly for-profit businesses are choosing LLCs more often than corporations.[2] The primary benefits of this form that draw these businesses, including flexibility and limited liability, are the same attributes that have begun to draw nonprofit organizations to the structure. For many charities the ability to use LLCs as either the primary organizational structure or an alternate structure for special ventures, meets their desire for an entity with more mission-focused activities and fewer regulatory formalities.

In 1998 the IRS addressed the issue of nonprofit organizations forming LLCs with for-profit businesses in Revenue Ruling 98-15. It stated that "a § 501(c)(3) organization may form and participate in a partnership, including an LLC treated as a partnership for federal income tax purposes, and meet the operational test if participation in the partnership furthers a charitable purpose, and the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose, and only incidentally for the benefit of the for-profit partners."[3] Issues in these arrangements arise when the for-profit member of the LLC is "allowed to control or use the nonprofit organization's activities or assets for the benefit of the private party"[4] in direct contradiction to the requirement that no part of an exempt organization's net earnings inures to the benefit of any private shareholder or individual.[5]

Nonprofits may also use LLCs to accept and/or hold donated property that may carry special environmental or other risks. While the charity could receive the donation then fund an LLC to carry the asset, to avoid entering the chain of title the organization may want to have the LLC receive the contribution directly.[6] As long as it is a SMLLC, the entity would be considered disregarded for federal information reporting purposes, but would maintain its own separate liability, shielding the parent nonprofit from potential risk.[7] Similarly, nonprofits may utilize LLCs to isolate especially risky activities.

If an LLC wishes, it may seek recognition for federal purposes as a tax-exempt entity in its own right. It should be noted, however, that an exempt LLC cannot have private shareholders or individuals as members,[8] and an eligible entity that is seeking to be exempt from taxation under section 501(a) will be treated as having made an election to be classified as an association.[9] SMLLCs may also elect separate entity treatment by filing Form 8832 or by filing a separate Form 1023, Application for Recognition of Exemption, or Form 990.[10] IRS guidance issued in 2001 detailed 12 conditions designed to ensure the LLC is organized and operated exclusively for exempt purposes, and to preclude inurement of net

[2] Walker, David S., *A Consideration of an LLC for a 501(c)(3) Nonprofit Organization*, 38 Will. Mitch. L. Rev. 627, 634 (2011).
[3] Rev. Rul. 98-15; 1998-1 C.B. 718 .
[4] *Id*. at 15.
[5] 26 C.F.R. § 1.501(c)(3)-1(c)(2) (2013).
[6] Richard R. Upton and Carl Merino, *IRS Allows Charitable Contributions to Disregarded Entities*, Tax Practice Tax Notes, December 17, 2012, at 1328.
[7] Ann 99-102.
[8] R.A. McCray and W.L. Thomas, *Limited Liability Companies as Exempt Organizations*, *Continuing Professional Education, Exempt Organizations – Technical Instruction Program for FY 2000 (1999), available online at*: http://www.irs.gov/pub/irs-utl/topich00.pdf. [hereinafter McCray and Thomas].
[9] 26 C.F.R. 301.7701-3(c)(1)(v)(A) (2013).
[10] McCray and Thomas, *supra* 8 at 27.

earnings to private shareholders. To qualify for exempt status separate and apart from its 501(c)(3) parents, an LLC must meet 12 conditions outlined by the IRS as follows: [11]

1. The organizational documents must include a specific statement limiting the LLC's activities to one or more exempt purposes.

2. The organizational language must specify that the LLC is operated exclusively to further the charitable purposes of its members.

3. The organizational language must require that the LLC's members be section 501(c)(3) organizations or governmental units or wholly owned instrumentalities of a state or political subdivision thereof ("governmental units or instrumentalities").

4. The organizational language must prohibit any direct or indirect transfer of any membership interest in the LLC to a transferee other than a section 501(c)(3) organization or governmental unit or instrumentality.

5. The organizational language must state that the LLC, interests in the LLC (other than a membership interest), or its assets may only be availed of or transferred to (whether directly or indirectly) any nonmember other than a section 501(c)(3) organization or governmental unit or instrumentality in exchange for fair market value.

6. The organizational language must guarantee that upon dissolution of the LLC, the assets devoted to the LLC's charitable purposes will continue to be devoted to charitable purposes.

7. The organizational language must require that any amendments to the LLC's articles of organization and operating agreement be consistent with section 501(c)(3).

8. The organizational language must prohibit the LLC from merging with, or converting into, a for-profit entity.

9. The organizational language must require that the LLC not distribute any assets to members who cease to be organizations described in section 501(c)(3) or governmental units or instrumentalities.

10. The organizational language must contain an acceptable contingency plan in the event one or more members ceases at any time to be an organization described in section 501(c)(3) or a governmental unit or instrumentality.

11. The organizational language must state that the LLC's exempt members will expeditiously and vigorously enforce all of their rights in the LLC and will pursue all legal and equitable remedies to protect their interests in the LLC.

12. The LLC must represent that all its organizing document provisions are consistent with state LLC laws, and are enforceable at law and in equity.

Because of state-by-state inconsistencies, the IRS requires that both the articles of organization and operating agreement separately comply with the first 11 conditions.[12] The final condition should be met using a separate written statement.

[11] McCray and Thomas, *supra* 8, at 29.

# IRS & California Treatment of Charitable Disregarded Entities

## Federal Financial Reporting Responsibilities of Charitable Disregarded Entities

On October 25, 1999 Announcement 99-102 indicated that the operations of an entity wholly owned by an organization exempt from federal taxation under Section 501(a) of the Internal Revenue Code should be included in the annual information return of the parent.[13] These disregarded entities are generally also exempt from federal income taxes, federal unemployment taxes, and other federal taxes where applicable. However, since 2008 an entity that is otherwise disregarded as a SMLLC cannot combine its reporting for employment taxes and excise taxes with the parent organization.[14] There may also be other areas of law in which the DRE will be regarded despite its status for federal income tax reporting. Exempt organizations should consult their tax advisor for further advice.

For entities disregarded pursuant to Code of Federal Regulations Sections 301.7701-1 through 301.7701-3, unless they elect to be treated separately on Form 8832, the instructions to Form 990, Return of Organization Exempt from Income Tax, instructs the parent nonprofit to include in Parts VIII through X all of the DREs revenues, expenses, assets, liabilities, and net assets or funds.[15] Entities disregarded under these regulations include SMLLCs whose sole member is a 501(c)(3) organization, and which have not sought separate recognition as an exempt entity.

In regards to donor reporting, only contributions "to or for the use of" a domestic charity are deductible under Section 170(c). Notice 2012-52 issued in August 2012 clarified that contributions to domestic SMLLCs owned and controlled by a U.S. charity are deductible as a donation to a branch or division of the U.S. charity. The relevant 501(c)(3) is the donee organization for substantiation and disclosure purposes.[16]

## CA Franchise Tax Filing Requirements of Disregarded Entities

California treats an LLC and its single owner for income tax purposes in the same manner both are treated for federal tax purposes.[17] All California LLCs must file Form LLC-1, Articles of Organization of a Limited Liability Company, along with a $70 filing fee upon formation. While disregarded and generally not required to report income separately from its owner, an SMLLC **is required** to complete Form 568 (sides 1, 2 and 6) and pay an annual tax of $800 and an LLC fee on total income greater than $250,000, any required estimated tax payments and calculate credit limitations (if applicable).[18] California LLCs not

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[12] McCray and Thomas *supra* 8, at 32.
[13] *Id*.
[14] 26 C.F.R. § 301.7701-2T(c)(iv)(C) and 26 C.F.R. § 301.7701-2(c)(2)(v).
[15] *See* Instructions to IRS Form 990, Appendix F.
[16] Notice 2012-52; 2012-2 C.B. 317 .
[17] *See* https://www.ftb.ca.gov/businesses/bus_structures/LLCompany.shtml?WT.mc_id=Business_Popular_LLCstructure
[18] *See* Limited Liability Company Filing Information, available at https://www.ftb.ca.gov/forms/misc/3556.pdf; *see also* Form 568 Booklet Item S for detailed filing information, available at https://www.ftb.ca.gov/forms/2012/12_568bk.pdf

taxed as corporations are subject to an $800 tax, regardless of whether they are disregarded or not, because California does not allow SMLLCs tax exempt status under Revenue and Taxation Code 23701.

Disregarded SMLLCs compute total income using the LLC Income Worksheet ("Schedule IW") found in Form 568 (Side 6) by entering the amounts from the single owner's federal tax return attributable to the SMLLC. If either of the following requirements are met, the SMLLC must also complete Schedule K:

- The income or loss amount reported on Schedule B, line 1 or line 3 through line 11, is $3,000,000 or more; or
- The "Total distributive income/payment items," Schedule K, line 21a, is greater than or equal to $3,000,000 OR less than or equal to $-3,000,000.

**Even if an SMLLC does not meet the preceding requirements to file Schedule K, they must still complete Schedule IW.** If they must file Schedule K, it should be completed by entering the amount of the single owner's share of income, deductions, credits, etc. attributable to the activities of the disregarded entity from the tax-exempt member's federal Form 990.[19] SMLLCs are not required to complete Schedule K-1, as the single owner should include in its tax return the various reportable items.

## Formation Document Requirements of Charitable Disregarded Entities

The IRS has not required that the articles of a SMLLC independently satisfy the organizational test "because the entity is treated as an activity of the owner, it is the owner's articles that matter."[20] Nevertheless, it is important that nothing in the articles prohibit the entity from operating exclusively for an exempt purpose.[21]

It should also be noted that the tax exempt parent of the SMLLC will not jeopardize its own federal tax exempt status simply because the SMLLCs organizational documents do not contain specific language limiting its activities to the exempt purposes of the owner.[22] However, the SMLLCs organizational documents should not provide for activities that are opposed to the exempt purpose of the parent.[23]

On the contrary, California does not allow a franchise tax exemption for SMLLCs under Revenue &Tax Code Section 23701, except certain title holding organizations.[24] The State does, however, allow for exemption from property taxes if an entity meets the qualifications for a Welfare Exemption. More information related to seeking a Franchise Tax exemption for all other LLCs or a Property Tax exemption follows.

[19] Form 568, Item S
[20] McCray and Thomas *supra* 8 at 2.
[21] PLR 200150027 (Aug. 7, 2001).
[22] Info 2010-0052 (Jun 25, 2010). See also section on Franchise Taxes below for specific language required by the California Franchise Tax Board.
[23] Id.
[24] State of California Franchise Tax Board - The Tax Exemption Process, https://www.ftb.ca.gov/businesses/Exempt_organizations/The_Process.shtml#LLC (last visited Apr. 30, 2013).

# Opportunities for California Charitable LLCs

If an LLC chooses to seek its own tax exempt status, separate and apart from its single owner, it may be able to do so. California law allows the creation of an LLC for "any lawful purpose, whether or not for-profit" with a few limited exceptions.[25] Senate Bill 323, also the California Revised Uniform Limited Liability Act ("CRULLCA"), passed in September 2012 is based on the Revised Uniform Limited Liability Company Act (the "Uniform Act") adopted by the National Conference of Commissioners on Uniform State Laws in 2006. It recasts and reorganizes the existing Beverly-Killea Limited Liability Act with the exception of certain California-specific provisions that have been preserved.[26]

The changes in law apply to all domestic LLCs existing on or after January 1, 2014 and foreign LLCs registered with the Secretary of State whose registrations have not been cancelled as of that same date.[27] According to the Senate analysis of SB 323, the bill is intended to bring California LLC law in line with the LLC laws of other states and to make it easier for LLCs to operate at a multi-state level.[28]

## Franchise Tax Exemption

CRULLCA does not invoke any changes to the existing California state franchise tax structure. LLCs not taxed as a corporation are still subject to the Franchise Tax Board (FTB) minimum tax of $800.00 plus a fee based on the annual total income of the entity.29 As a general rule, a domestic nonprofit LLC is a taxable entity unless and until the LLC applies for tax-exempt status using form FTB 3500. However, as noted above, California does not allow disregarded entities tax-exempt status under Revenue &Tax Code Section 23701, except certain title holding organizations under § 23701h and 23701x.30 Therefore, only LLCs with two or members, or SMLLCs that have elected to be treated as corporations, may be eligible for a franchise and income tax exemption under California law. Similar to the Federal requirement, California LLCs seeking tax-exempt status must elect to be treated as a corporation and must provide a copy of federal Form 8832, Entity Classification Election, submitted to the IRS.

As previously stated all California LLCs must file Form LLC-1, Articles of Organization of a Limited Liability Company, along with a $70 filing fee upon formation. To apply for tax exempt status, an organization must submit with form FTB 3500, Exemption Application, a $25 application fee, copies of the Articles of Organization and the Operating Agreement including any amendments, and all other information requested in the application packet. Similar to Federal requirements, for California exemption purposes the Articles of Organization must contain specific language. Sample organizing documents are available in the FTB 3500 Instruction Booklet. For those California LLCs eligible for tax exemption, Form LLC-1 must contain a statement that its activities will be limited to those permitted under whichever section of the Revenue and Taxation Code the exemption is being sought. In addition to the specific and primary nonprofit purpose of the organization, the organizing documents must also contain the following:

- A statement that the individual members will not derive profit from the organization;

[25] Cal. Corp. Code § 17701.04(b) (Deering 2013).
[26] Senate Rules Committee Analysis of SB 323 at 4, "the Revised Uniform Limited Liability Company Act has been enacted in five states (Idaho, Iowa, Nebraska, Utah, and Wyoming) and the District of Colombia."
[27] S.B. 323, Ch. 419, 2012 Statutes at 3.
[28] *Id*. at 5.
[29] California Secretary of State- Business Programs Division, "Limited Liability Companies," California Tax Information (2013), *available online at*: http://www.sos.ca.gov/business/llc/forms/llcconv.pdf.
[30] State of California Franchise Tax Board - The Tax Exemption Process, https://www.ftb.ca.gov/businesses/Exempt_organizations/The_Process.shtml#LLC (last visited Apr. 30, 2013).

- A political limitation clause stating no substantial part of the activities will attempt to influence legislation or intervene in any political campaign;
- A dedication clause irrevocably dedicating its property to charitable purposes; and
- A dissolution clause stating that upon dissolution remaining assets after the payment of debts and liabilities will be distributed to a nonprofit fund, foundation or corporation organized exclusively for charitable purposes and that has tax-exempt status under IRC Section 501(c)(3).[31]

In addition to Form LLC-1, entities must also file with the California Secretary of State Form LLC-12, Statement of Information. This form may be filed online for a $20 fee, and must be completed within 90 days of filing Form LLC-1, and biennially thereafter during the applicable filing period.[32] This form simply includes identifying and descriptive information for the LLC, as well as information about officers and managers.[33]

## Property Tax Exemption

The California Constitution provides for various full and partial property tax exemptions. An LLC may be a qualifying entity for Welfare Exemption purposes, if (1) it is wholly owned by a qualifying organization or organizations, and (2) if it meets specific organizational and operating requirements.[34] A qualifying organization includes one that is exempt under IRC § 501(c)(3) or § 23701d of the California Revenue and Taxation Code, and that qualifies for exemption under Revenue and Taxation Code § 214.[35] A limited liability company is a qualifying organization if all its owner organization(s) (referred to as members) are exempt under section 501(c)(3) of the Internal Revenue Code or under section 23701d of the Revenue and Taxation Code and qualify for exemption under section 214 of the Revenue and Taxation Code.

"A limited liability company wholly owned by a qualifying organization(s) (e.g. DRE) may satisfy the organizational requirements for purposes of the exemption, if its articles of organization, or the equivalent legally recognized formative document under the laws of the jurisdiction where the entity is formed, meets all of the following requirements:

1. A specific statement shall be included which limits the activities of the limited liability company to one or more exempt purposes, as specified in section 214. This requirement may be satisfied by a clause stating that the limited liability company is organized and operated exclusively for one or more exempt purpose(s) as specified in section 214 (religious, hospital, scientific or charitable).
2. The organizational language shall specify that the limited liability company is operated exclusively to further the exempt purpose(s) as specified in section 214, of its member(s).

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[31] 2012 Exemption Application Booklet FTB 3500, 2012 at 38.
[32] See LLC filing tips on the California Secretary of State website at http://www.sos.ca.gov/business/be/filing-tips-llc.htm#llc1.
[33] Available online at http://www.sos.ca.gov/business/llc/forms/llc-12.pdf
[34] Cal. Code Regs. Tit. 18, Div. 1, Rule 136 (2013), *available online at*: http://www.boe.ca.gov/lawguides/property/current/ptlg/rule/136.html.
[35] Qualifying organizations also include government entities that are exempt from property taxes under the California Constitution. Section 214 of the Revenue and Taxation Code provides for an exemption from taxation under California law if the property is used exclusively for religious, hospital, scientific, or charitable purposes owned and operated by community chests, funds, foundations, limited liability companies, or corporations organized and operated for religious, hospital, scientific, or charitable purposes. Cal. Rev. & Tax Code § 214 (Deering 2013).

3. The organizational language shall require that each member of the limited liability company be a qualifying organization, as specified in subsections (b)(1) or (b)(2) of this rule.

4. The organizational language shall prohibit any direct or indirect transfer of any membership interest in the limited liability company to any nonqualified person or entity.

5. The organizational language shall provide an acceptable dedication clause. This requirement may be satisfied by a clause that irrevocably dedicates the property to one or more of the exempt purposes, as specified in sections 214 and 214.01.

6. The organizational language shall provide an acceptable dissolution clause. This requirement may be satisfied by a clause, which specifies that upon dissolution, all assets shall be distributed to an organization(s) organized and operated exclusively for exempt purposes, as specified in section 214, and which has established its tax exempt status under section 501(c)(3) of the Internal Revenue Code, or under section 23701d of the Revenue and Taxation Code.

7. The organizational language shall require that any amendments to the limited liability company's articles of organization or the equivalent legally recognized formative document under the laws of the jurisdiction where the entity is formed and to the operating agreement, be consistent with section 214.

8. The organizational language shall prohibit the limited liability company from merging with, or converting into, a for-profit entity.

9. The organizational language shall require that the limited liability company not distribute any assets to members who cease to be organizations described in section 214."[36]

The limited liability company seeking exemption should file with the Board of Equalization a copy of their certified Articles of Organization or the equivalent legally recognized formative document required under the laws of the jurisdiction where the entity is formed, and any certified amendments and restatements.

# The California Revised Uniform Limited Liability Company Act (CRULLCA)

While there were no changes to the state taxation of LLCs, recent LLC legislation passed in California is a sweeping repeal of the Beverly-Killea Limited Liability Company Act, the current law governing LLCs in California. In its place beginning January 1, 2014 will be CRULLCA which affects the formation, operation and dissolution of California LLCs.

Some of the changes affecting all LLCs include the following: [37]

- *Includes a more thorough set of default rules which apply when an LLC operating agreement is silent and adds detailed provisions indicating which of the CRULLCA sections cannot be overridden in the operating agreement.*

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[36] Rule 136, *supra* 34.
[37] Continuing Education of the Bar, State Bar of California, http://ceb.com/lawalerts/rullca.asp?utm_source=on&utm_medium=la&utm_content=bk&utm_campaign=BU33670_rgam_5 (last visited April 30, 2013).

Section 17701.10(b) of the California Corporations Code states "to the extent the operating agreement does not otherwise provide for a matter described in subdivision (a), this title governs the matter." Section 17701.10(c) goes on to enumerate what functions the operating agreement <u>may not</u> change. Notably among them are the following:

1. The LLC's ability to sue and be sued in its own name.
2. The law governing the internal affairs of the LLC, the liability of a member or manager as such for the debts, obligations or other liabilities of the LLC, or the authority of the members and agents of the LLC as prescribed under Section 17701.06.
3. Vary the power of a court to decree dissolution pursuant to an action filed by any manager or by any member of the LLC, or the provisions allowing for avoidance of dissolution through purchase of the interest of moving parties as outlined in subdivision (c) of Section 17707.03
4. Any provision under Article 10 (commencing with Section 17710.01), Merger and Conversion.
5. Any provision under Article 12 (commencing with Section 17712.01), Class Provisions.

With the exception of these and a few other provisions in § 17701.10(c), § 17701.10(d) allows the provisions of the operating agreement to be varied but requires that certain provisions varying from the default be in writing including: § 17701.13 which includes the requirement for an office and agent for service of process, among other things; § 17703.01 requiring the company to state if it is a manager-managed limited liability company in contrast to the presumption under § 17704.07 that an LLC is member-managed; and § 17704.08 allowing for indemnification of members and managers and the provision of insurance.

- *Clarifies the extent to which the operating agreement can define, alter, or eliminate aspects of fiduciary duty of members and managers.*

CRULLCA establishes the fiduciary duties a member owes to a member-managed LLC and the other members are the duties of loyalty and care.[38] Unlike in the expiring statute that simply stated, "The fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of the partnership," the duty of loyalty is defined in this statute to include the following: to account for and hold as trustee any property, profit or benefit the member derives from use of the LLC's property or in the conduct of its business; to refrain from dealing with the LLC on behalf of a party having an adverse interest to the LLC; and to refrain from competing with the LLC in its activities.[39]

Similarly, the duty of care is defined in the statute as limited to "refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."[40] Additionally, the obligations of good faith and fair dealing also apply.[41] In enumerating these duties, the statute specifically states that in a manager-managed LLC, the duties of loyalty and care apply to the managers and not the members.[42]

CRULLCA goes further in § 17701.10(c)(4) to prohibit the operating agreement from eliminating the duty of loyalty, the duty of care, or any other fiduciary duties, except to the extent it is done in writing and to

[38] Cal. Corp. 17704.09(a) (Deering 2013).
[39] Cal. Corp. 17704.09(b) (Deering 2013).
[40] Cal. Corp. 17704.09(c) (Deering 2013).
[41] Cal. Corp. 17704.09(d) (Deering 2013).
[42] Cal. Corp. 17704.09(f) (Deering 2013).

"expressly relieve a member of a responsibility and any fiduciary duty the member would otherwise have and imposes the responsibility on one or more other members, to the benefit of the member the operating agreement relieves of the responsibility."[43] Furthermore, § 17701.10(c)(5) restricts the ability to eliminate the contractual obligation of good faith and fair dealing in the operating agreement; however, under § 17701.10(c)(16) the operating agreement may "prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable."[44] The operating agreement may also identify specific types or categories of activities that do not violate the duty of loyalty and may specify the number or percentage of members that may authorize or ratify a specific act or transaction that otherwise would violate the duty of loyalty.[45]

· *Makes clearer when a member of an LLC may dissociate from the LLC, and the consequences of dissociation.*

The Beverly-Killea Limited Liability Act simply allowed withdrawal of a member as specified in the operating agreement and addressed their rights as a holder of an economic interest post-withdrawal. Contrary to this approach, CRULLCA § 17706.02 specifically defines situations in which a person is dissociated as a member from an LLC. It states a member can withdraw from the LLC or be expelled pursuant to the operating agreement, by unanimous consent of the other members or by judicial order.[46] The grounds for expulsion by unanimous consent as described in the Statute include situations in which it becomes unlawful to carry on the LLC's activities with the person as a member, where a transfer occurs of the person's transferable interest in the LLC (with the exception of transfers for security purposes or charging orders under § 17705.03), or when the member is a corporation or partnership that is being dissolved or the business is being wound up.[47]

Additionally, the LLC may apply to the court for a judicial order expelling a member that is engaging or has engaged in wrongful conduct that adversely and materially affects the LLC, willfully or persistently committed or is committing a material breach of the operating agreement or is engaged or engaging in conduct that makes it not practicable to carry on the activities of the LLC with the person as a member.[48]

The effects of dissociation are stated in § 17706.03. Notably, when a person is dissociated as a member, all of the following apply: the person's right to participate as a member in management terminates, in a member-managed LLC the person's fiduciary duties end for events occurring after dissociation, and any transferable interest owned by the member immediately before dissociation is owned by the person solely as a transferee.[49] In the case of a transfer of a member's transferable interest, the transferor/member retains all the rights, duties and obligations of a member, with the exception of the interest in distributions transferred, unless the transferee becomes a member with respect to the transferred interest.[50]

· *Unless stated otherwise in the operating agreement, the CRULLCA states that LLCs will be presumed to be member-managed, as well as authorizes classes of members.*

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[43] Cal. Corp. Code 17701.10(f) (Deering 2013).
[44] Cal. Corp. Code 17701.10(c)(16) (Deering 2013).
[45] Cal. Corp. 17701.10(c)(14) (Deering 2013).
[46] Cal. Corp. 17706.02(a)-(e) (Deering 2013).
[47] Cal. Corp. 17706.02(d) (Deering 2013).
[48] Cal. Corp. 17706.02(e) (Deering 2013).
[49] Cal. Corp.17706.03(a)(1)-(3) (Deering 2013).
[50] Cal. Corp.17705.02(g)-(h) (Deering 2013).

CRULLCA establishes a presumption that LLCs are member-managed as opposed to manager-managed.[51] To elect otherwise the operating agreement and the articles of organization must expressly provide, using these phrases or similar ones, that the LLC will be "manager-managed," "managed by managers," or that management will be "vested in managers."[52] Furthermore, in a member-managed LLC certain rules apply. Specifically, providing among other things for equal voting rights for all members (except as it relates to varying rights for classes of members as written in the operating agreement), majority approval for acts outside the ordinary course of business, and requiring the operating agreement be amended only with the approval of all members.[53]

Finally, identical to § 17102 in the Beverly-Killea Act, § 17712.01 allows for the creation of classes of members.

- *CRULLCA establishes limitations and restrictions with regard to the indemnification procedure.*

Contrary to the previous statute that allowed for indemnification of any person (including officers and employees), CRULLCA mandates indemnification, but only of members in member-managed LLCs and managers in manager-managed LLCs for any payment made or debt, obligation or liability incurred in the course of doing business for the LLC, if they complied with the duties of care and loyalty as defined in § 17704.09.[54] The statute also allows the LLC to purchase insurance on behalf of members or managers for liabilities asserted against them in their capacity with the LLC.[55] There is no mention in the new statute of officers or employees.

Further, the statute allows for the operating agreement to alter, limit, or eliminate indemnification for a member's or manager's liability to the LLC and its members for money damages, with the exception of the following situations:

1. A breach of the duty of loyalty.
2. A financial benefit received by the member or manager to which the member or manager is not entitled.
3. A member's liability for excess distributions under § 17704.06.
4. Intentional infliction of harm on the limited liability company or a member.
5. An intentional violation of criminal law.[56]

- Allows LLCs to be subject to the nonexclusive jurisdiction of courts in another state, or exclusive jurisdiction of CA courts.

CRULLCA allows members to consent in the operating agreement to be subject to the nonexclusive jurisdiction of courts in a specified state, not limited to California, or to the exclusive jurisdiction of

[51] Cal. Corp.17704.07 (Deering 2013).
[52] Cal. Corp.17704.07(a)(1)(A)-(C) (Deering 2013).
[53] Cal. Corp.17704.07(b) (Deering 2013).
[54] Cal. Corp. 17704.08(a) (Deering 2013).
[55] Cal. Corp. 17704.08(b) (Deering 2013).
[56] Cal. Corp. 17701.10(g) (Deering 2013).

California.[57] In addition, it allows members to consent to be subject to arbitration, either nonexclusively in other states and California, or exclusively in California.[58]

## Conclusion

LLCs can be an effective business form for charitable entities. Now, with recent IRS announcements and clarifications in California law, there is more guidance for organizations considering the LLC structure for their new joint venture or charitable organization.

[57] Cal. Corp. 17701.17(a) (Deering 2013).
[58] Cal. Corp. 17701.17(b) (Deering 2013).