TEXAS LIMITED LIABILITY COMPANIES

The Houston CPA Society
a Chapter of the Texas Society of CPAs

February 18, 2014

Presented by:

Robert M. Mendell, J.D., C.P.A.*
Robert M. Mendell, Attorney at Law, P.C.
800 Town & Country Blvd.
Suite 300
Houston, Texas 77024
(713) 888-0700
Fax : (713) 888-0800
Email: rmendell@mendell.law
Website: www.mendell.law

* Board Certified - Tax Law
Texas Board of Legal Specialization

Disclaimer: Any statements or content contained in this handout (including any attachments) are not intended to be relied upon for any specific legal or tax matter and are for general consideration only. An appropriate professional should be consulted in connection with any actual situation. Further, any statements or content contained herein are not intended for use, and cannot be used, for purposes of (i) avoiding penalties imposed under the United States Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any tax-related matter.

THE TEXAS LIMITED LIABILITY COMPANY

I. THE TEXAS LIMITED LIABILITY COMPANY ACT.

A. Background and Introduction.

A limited liability company is a business entity that potentially combines the most attractive features of partnerships and corporations. For example, a limited liability company provides all of its owners (known as "members") with limited liability, as with any corporation, along with more flexible management control by the owners, similar to a partnership. It differs from a limited partnership since there is no one, such as a general partner, who is automatically personally liable for all the company's liabilities.

In addition, under "Check the Box" Regulations, unincorporated domestic entities, including Texas limited liability companies, may affirmatively elect to be taxed as S corporations for U.S. income tax purposes and achieve possible liability shielding advantages associated with the limited liability company structure and possible self-employment tax advantages associated with S corporations, while maintaining a single level of tax. Or, they may utilize the automatic default "partnership" classification if they have more than one member or the automatic default "disregarded entity" classification if they have one member, despite the limited liability features associated with the limited liability company structure. Furthermore, if accorded "partnership" or "disregard" tax treatment, a limited liability company is similar to an S Corporation in many respects, but is not burdened by many of the tax requirements that an S Corporation is subject to, such as number of shareholders and shareholder qualification requirements. As a result of these benefits, limited liability companies have continued to become a growing choice for entity selection of closely held businesses.

At the end of 1991, only six (6) states, including Texas, had adopted limited liability company statutes. As of June 15, 1996, all fifty (50) states and the District of Columbia had enacted limited liability company statutes, demonstrating the rapid and tremendous interest accorded such entity. While there are numerous technical and some substantive differences among the states' limited liability company statutes, such statutes show a tendency toward relative uniformity.

B. Legislative History and Effective Date in Texas.

The Texas Limited Liability Company Act (the "Old Act") is a combination of certain features of the Texas Business Corporation Act ("TBCA") and the Texas Revised Limited Partnership Act ("TRLPA"). The Old Act was part of H.B. 278 which was passed in May, 1991 and became effective on August 26, 1991. The Old Act is found at Article 1528n of Vernon's Civil Statutes. The Old Act was substantively amended by H.B. 1239 by the 1993 Texas Legislature and such amendments to the Old

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

Act become effective September 1, 1993 (the "1993 Amendments"). Effective January 1, 2006, all newly formed limited liability companies in Texas will be governed under the Texas Business Organizations Code ("TBOC"). The provisions relating specifically to limited liability companies are found in TBOC Chapter 101. Existing limited liability companies will continue to be governed under the Old Act, unless they affirmatively elect to be governed under the TBOC, until January 1, 2010, at which time all limited liability companies in Texas will be governed under the TBOC.

C. Formation of a Limited Liability Company.

Chapter Three of the TBOC and Part Three of the Old Act prescribe the technical requirements for the formation of a limited liability company. For limited liability companies formed on or after January 1, 2006, a Certificate of Formation is filed with the Texas Secretary of State. For limited liability companies formed prior to January 1, 2006, Articles of Organization were filed with the Texas Secretary of State pursuant to the Old Act. The filing fee was increased from $200.00 to $300.00 effective January 1, 2006.

D. Name of a Limited Liability Company.

TBOC §5.053 and Article 2.03 of the Old Act provide that a limited liability company's name may not be deceptively similar to any name used by another domestic or foreign filing entity either formed in or authorized to do business in Texas. Prior to the effective date of the 1993 Amendments, the name of a limited liability company had to contain the word "Limited" or the abbreviations "Ltd." or "L.C." After the effective date of the 1993 Amendments (September 1, 1993), the name of a limited liability company must contain one of the following: (i) the words "limited liability company", (ii) the words "limited company", (iii) the abbreviation "Ltd. Co.", (iv) the abbreviation "L.L.C." or (v) the abbreviation "L.C." (TBOC §5.056/Article 2.03 of the Old Act.) The failure to use any of the foregoing designations in the name could result in the loss of limited liability with respect to third parties who were unaware that they were dealing with a limited liability company. Reserved name and assumed name provisions are also applicable to limited liability companies.

E. Purpose and Powers of a Limited Liability Company.

Article 2.01 of the Old Act stated that "a limited liability company…may engage in any lawful business unless a more limited purpose is stated in its articles of organization or regulations." Comparable provisions under the TBOC for all filing entities are contained in Chapter 2 of the TBOC.

For limited liability companies governed by TBOC, the agreement governing the relationships of the members of the limited liability company is referred to as the Company Agreement and, for limited liability companies governed by the Old Act, such agreement is referred to as the Regulations (referred to herein as the "Company Agreement/Regulations", whichever is applicable). The Company Agreement/

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

Regulations are similar to the contents of a partnership agreement, but also have many of the same characteristics of Bylaws for a corporation formed in accordance with the TBOC or the TBCA. TBOC §101.052 generally provides that the provisions of the TBOC applicable to limited liability companies may be waived or modified by the Company Agreement (except for certain non-waivable provisions as provided in TBOC §101.054). Article 2.09 of the Old Act provided that the Regulations may contain any provisions for the regulation and management of the affairs of a limited liability company not inconsistent with law or the Articles of Organization.

F. Members of a Limited Liability Company.

Instead of having "shareholders" or "partners," the owners of a limited liability company are called "members." Unlike an S corporation, there is no limit on the number or type of members that a limited liability company may have, although it is necessary to have two (2) or more members to obtain partnership tax treatment for U.S. income tax purposes. (Note: Under the "Check the Box" Regulations, unless they elect otherwise, single member domestic limited liability companies will be treated as having the entity disregarded for U.S. income tax purposes and will, thus, have a single level of tax.) The TBOC (TBOC §101.102) and the Old Act generally contain no restrictions regarding who may become a member of a limited liability company.

G. Contributions by Members to a Limited Liability Company.

For limited liability companies governed by the Old Act, a person becomes a member of a limited liability company by making a "contribution," which may be in the form of cash, property or services rendered, or a note or other obligation to pay cash or transfer property to the company (Art. 5.01 of the Old Act), and receives a "membership interest" in exchange for such contribution. This provision in the Old Act was a departure from corporations which were not allowed to issue stock for a note or future consideration.

For these pre-TBOC limited liability companies, a member's obligation to make a contribution or otherwise pay cash is not enforceable unless in writing and signed by the member. (Art. 5.02A of the Old Act). A member who is obligated to make a contribution, or the legal representative of a member who is so obligated, must do so, even if the member has died, becomes disabled or there has been a change in circumstances, unless the Regulations say otherwise or all of the members consent to the non-payment. (Art. 5.02B and 5.02D of the Old Act). Even if a member or his legal representative has obtained the approval of the other members for non-payment, a creditor of the company who "acts in reasonable reliance" on the performance of such enforceable obligation before its cancellation may enforce the original obligation.

TBOC §101.102(b), following a modern trend in state law entity statutes, provides that no contributions are required of a member.

H. Distributions to Members From a Limited Liability Company.

Members of a limited liability company shall be entitled to share distributions of cash or other assets of the company as stated in its Company Agreement/Regulations. If the Company Agreement/Regulations is silent, distributions shall be made in accordance with the "agreed value" of the member's membership interest. (TBOC §101.203/Art. 5.03 of the Old Act). Therefore, if it is intended that the distributions be made disproportionately, then the Company Agreement/Regulations must so provide. This is in contrast with S corporations which do not allow for disproportional allocations under applicable U.S. income tax rules. Therefore, limited liability companies affirmatively electing S corporation status should make sure that the Company Agreement/Regulations do not allow disproportional allocations and otherwise follow S corporation rules. A limited liability company may not make any distributions to its members if, after the distribution, the company's liabilities would exceed the fair market value of its assets. (TBOC §101.206/Art. 5.09 of the Old Act).

I. Members' Voting Rights.

For limited liability companies governed by the TBOC: Unless the Company Agreement provides otherwise, all members and managers have equal voting rights. TBOC §101.354 – providing general rule of equal voting rights; TBOC §101.052 – Company Agreement can override general voting scheme.

For limited liability companies governed by the Old Act: Members have only such voting rights as are granted to them in the Regulations. (Art. 4.02A of the Old Act). The Regulations may provide for classes of members who have different voting rights. (Art. 4.02B of the Old Act). Article 8.12 of the Old Act specifically incorporates Article 5 of the TBCA regarding mergers and share exchanges, and therefore, membership voting on such transactions is likely required. The Old Act has no voting requirement concerning the amendment of the Articles of Organization, including requiring members' vote thereon, as in the TBCA; however, this voting right may be incorporated by virtue of the Old Act's incorporation of the nonconflicting provisions of the TBCA.

J. Management Structure of a Limited Liability Company.

A limited liability company may be managed by either its members or by "managers," or by a combination of the two. In a limited partnership, limited partners may not participate in the partnership's management or they risk losing their liability limitations. This is not true with limited liability companies, and, in fact, members may desire to participate since there is no managing general partner with personal liability to manage the company.

The managers need not be residents of Texas or members of the limited liability company, unless the company's Company Agreement/Regulations so provide. Whichever body manages the limited liability company, the company's Certificate of

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

Formation (post-TBOC) or Articles of Organization (pre-TBOC) must specify the managing party or parties and provide the names and addresses of all those who will initially manage the company.

If the limited liability company is managed by managers, there may be one or more managers who will be elected, as provided in the Company Agreement/Regulations. Additionally, the managers may be divided into any number of classes and managers may form committees. One or more persons, who may or may not be managers or members, may be designated as officers of the limited liability company by the manager or managers, if management is vested in one or more managers, or by the member or members, if management of the limited liability is reserved to the members.

TBOC §101.254 and Art. 2.21 of the Old Act state that *every* officer and manager of a limited liability company are agents of the company with unilateral authority to execute instruments in the name of the company or to otherwise act for and on behalf of and to unilaterally bind the limited liability company for the company's business purpose. This management provision calling for unilateral powers of managers differs from the powers of a corporation's directors who generally must act in accordance with a majority vote, and is, therefore, more similar to a partnership structure, which generally provides for the unilateral authority of each partner to bind the partnership.

K. Duration of Existence, Dissolution.

The period of duration of a limited liability company must be stated in its Certificate of Formation (post-TBOC) or its Articles of Organization (pre-TBOC). Prior to the effective date of the 1993 Amendments, the period of duration could not exceed thirty (30) years. After the effective date of the 1993 Amendments (September 1, 1993), the period of duration may be perpetual. (TBOC §3.003/Art. 3.02A(2) of the Old Act). Additionally, TBOC §11.051 and Article 6.01A of the Old Act provide that a limited liability company shall be dissolved upon the termination of the period fixed for its duration or upon the action of the members to dissolve the limited liability company.

Also, for limited liability companies governed by the Old Act, unless the Regulations provide otherwise, the limited liability company shall be dissolved upon "the death, retirement, resignation, expulsion, bankruptcy or dissolution of a member or the occurrence of any other event which terminates the continued membership of a member" in the company (Art.6.01A(5) of the Old Act); however, the consent of all remaining members, or a lesser number if so specified in its Articles of Organization or Regulations, may prevent the dissolution upon the termination of one or more members (Art. 6.01B of the Old Act). Thus, under the Old Act, the possible termination of a limited liability company upon the termination of the membership of any single member could have been a significant disadvantage over limited partnerships and corporations. It could have been argued that any assignment of a membership interest terminates the

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

continued existence of a limited liability company, necessitating the consent of the remaining members to continue the company.

Under the TBOC, the dissolution of a domestic legal entity, including limited liability companies, is called "winding up" and is governed by the provisions of Chapter 11 of the TBOC. Such provisions no longer provide that a limited liability company wind up and/or reconstitute due to a terminating event of one member if there are other members of the company at the time.

Like a corporation, a limited liability company must wind up its affairs and file a Certificate of Termination (post-TBOC) or Articles of Dissolution (pre-TBOC) to complete the winding up. (TBOC Chapter 11 Arts. 6.03, 6.05, 6.07 and 6.08 of the Old Act).

L. Applicability of Other Texas Statutes.

For limited liability companies governed by the Old Act: Article 8.12 of the Old Act specifies that the TBCA as well as the Texas Miscellaneous Corporation Law Act ("TMCLA") supplement the Old Act to the extent they are not inconsistent with the Old Act. In particular, Part 5 of the TBCA with respect to mergers and Article 7.06 of the TMCLA regarding director liability (for managers) are specifically incorporated into the Old Act. Despite the Old Act's definite reliance on the TRLPA, the TRLPA was not included with the reference to the TBCA and the TMCLA in Article 8.12 of the Old Act. As a result, future interpretation of large amounts of the Old Act which were drawn from the TRLPA may be difficult.

For limited liability companies governed by the TBOC, the TBOC is a comprehensive code embracing essentially all legal entities within its contents.

II. EFFECT OF LIMITED LIABILITY COMPANY STATUS.

A. Liability to Third Parties – Entity Creditors (Veil Piercing).

Effective September 1, 2011, §101.002 was added to the limited liability company provisions of the TBOC in order to level the "playing field" regarding owner (shareholder/member) liability to third parties with regard to entity level debts, whether the entity is organized as a corporation or a limited liability company. The leveling occurred by making limited liability companies subject to the same rules as corporations by reference to the corporate veil piercing provisions contained in the TBOC and making them applicable to limited liability companies. The amendment reads as follows:

> Sec. 101.002. APPLICABILITY OF OTHER LAWS. (a) Subject to Section 101.114, Sections 21.223, 21.224, 21.225, and 21.226 apply to a

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

limited liability company and the company's members, owners, assignees, affiliates, and subscribers. [Emphasis added]

(b) For purposes of the application of Subsection (a):

(1) a reference to "shares" includes "membership interests";

(2) a reference to "holder," "owner," or "shareholder" includes a "member" and an "assignee";

(3) a reference to "corporation" or "corporate" includes a "limited liability company";

(4) a reference to "directors" includes "managers" of a manager-managed limited liability company and "members" of a member-managed limited liability company;

(5) a reference to "bylaws" includes "company agreement"; and

(6) the reference to "Sections 21.157-21.162" in Section 21.223(a)(1) refers to the provisions of Subchapter D of this chapter.

Added by Acts 2011, 82nd Leg., R.S., Ch. 25, Sec. 1, eff. September 1, 2011.

Sec. 101.114. LIABILITY FOR OBLIGATIONS. Except as and to the extent the company agreement specifically provides otherwise, **a member or manager is not liable for a debt, obligation, or liability of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.** [Emphasis added]

Acts 2003, 78th Leg., ch. 182, Sec. 1, eff. Jan. 1, 2006.

The language making §101.002 expressly subject to §101.114 would seem to result in the continuing applicability of the above-emphasized language of §101.114 and, thus, the continuing protection of members and managers from entity level debts of the limited liability company. However, notwithstanding this “problematical” grammatical construction error possibly involved in the amendment, after August 31, 2011, this author would conclude that there is presumably no entity shielding advantages for entity liabilities by choosing the limited liability company structure over the corporate structure.

Thus, after August 31, 2011, limited liability companies would presumably be subject to the corresponding liability limiting provisions of the TBOC (particularly, TBOC §21.223), for corporations governed by the TBOC, and of the TBCA (particularly, TBCA Art. 2.21A), for corporations not governed by the TBOC. For example, TBOC §21.223(a)(2) and TBCA Art. 2.21A limit shareholders’ liability with

respect to *contractual* obligations of the corporation not involving actual or constructive fraud on the part of the shareholder, which leads to questions regarding shareholder liability for *tort* claims against the corporation. Additionally, there is some concern that the language excluding liability for corporate obligations on the basis of the failure of the corporation to observe a corporate formality could be construed to mean claims *solely* based on such failure, leaving open the potential liability exposure to the shareholder for claims asserting a failure to observe corporate formalities *coupled with* some other action or omission by the shareholder or the corporation.

It should also be noted that there are certain other exceptions to a member's limited liability to entity creditors that have existed prior to the amendment that became effective on September 1, 2012 and continue to apply. First, the company's Company Agreement/Regulations may provide exceptions to a members' otherwise limited liability. Second, a member will be liable for the written promise to make a contribution to the limited liability company, despite a change in circumstances. (Art. 5.02 of the Old Act). Third, if a member knowingly receives a distribution after which the limited liability company's liabilities exceed the fair market value of its assets, then the member is liable for the return of such distribution. (TBOC §101.206(d)/Art. 5.09B of the Old Act). Finally, an assignee of a members' membership interest will be liable to make the assignor's contributions to the company, unless such obligations were unknown to the assignee. (Art. 4.07B of the Old Act).

Also be cognizant of independent grounds for liability against a member or a manager for entity creditors. If liability against a member or manager is based upon the actions or inactions of the member or manager, rather than the actions or inactions of other members, managers, employees or other agents of the limited liability company, then the member or manager may be liable for his or her own actions or inactions, independent of possible recourse against the limited liability company.

B. Liability to Third Parties – Creditors of Members (Reverse Veil Piercing).

A significant provision in the Old Act, and in the TBOC provisions relating to limited liability companies, is the exclusive remedy provision regarding creditors of a member (but not of the limited liability company) with respect to collection against the membership interest of a debtor member ("external creditors"). This remedy is commonly referred to as a "charging order" remedy (as opposed to, for example, a "turnover order" remedy). TBOC §101.112/Art. 4.06 of the Old Act. A "charging order" gives the judgment creditor only a right to the cash distributions attributable to the member's interest (when and to the extent declared by the limited liability company). The judgment creditor who holds the charging order does not become the owner of the membership interest of the debtor member.

Both TBOC §101.112 and Art. 4.06 of the Old Act were amended effective as of September 1, 2007 to clarify that the "charging order" remedy is the exclusive remedy of a judgment creditor of a debtor member with respect to the debtor member's membership interest in the limited liability company. (Note: Such was probably already

the case, but the statutes were modified to delete some ambiguous wording to make this clearer.)

The 2010 *Olmstead* case in Florida has garnered significant interest in the reverse veil piercing arena, particularly when dealing with single member limited liability companies. *Olmstead v. Federal Trade Commission*, No. SC08-1009 (Florida Supreme Court 6-24-10). The Florida Supreme Court ruled in that case that, based on the wording of the applicable Florida remedy execution statutes, a court could enter a "turnover order" remedy against a limited liability company's assets relating to a judgment creditor of its single member. The holding was that the "charging order" provisions were permissive, not exclusive. Presumably, a Texas court would have to disallow the result determined by the Florida court because the Texas statute makes it clear that the "charging order" remedy is exclusive. Compare the statutes:

Florida Statute:

Section 608.433(4). On application to a court of competent jurisdiction by any judgment creditor of a member, *the court may charge the limited liability company membership interest of the member* with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of such interest. This chapter does not deprive any member of the benefit of any exemption laws applicable to the member's interest. [Emphasis added]

Texas Statute:

Sec. 101.112. MEMBER'S MEMBERSHIP INTEREST SUBJECT TO CHARGING ORDER. (a) On application by a judgment creditor of a member of a limited liability company or of any other owner of a membership interest in a limited liability company, *a court having jurisdiction may charge the membership interest of the judgment debtor to satisfy the judgment.* [Emphasis added]

(b) If a court charges a membership interest with payment of a judgment as provided by Subsection (a), the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise be entitled in respect of the membership interest.

(c) A charging order constitutes a lien on the judgment debtor's membership interest. The charging order lien may not be foreclosed on under this code or any other law.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

(d) The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of any other owner of a membership interest may satisfy a judgment out of the judgment debtor's membership interest. [Emphasis added]

(e) This section may not be construed to deprive a member of a limited liability company or any other owner of a membership interest in a limited liability company of the benefit of any exemption laws applicable to the membership interest of the member or owner.

(f) A creditor of a member or of any other owner of a membership interest does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company.

Acts 2003, 78th Leg., ch. 182, Sec. 1, eff. Jan. 1, 2006.
Amended by:
Acts 2007, 80th Leg., R.S., Ch. 688, Sec. 98, eff. September 1, 2007.
Acts 2009, 81st Leg., R.S., Ch. 84, Sec. 40, eff. September 1, 2009.

C. Nature of Ownership Interest.

A member's "membership interest" in a limited liability company is considered personal property. (TBOC §101.106/Art. 4.04 of the Old Act). A member has no interest in any specific property of a limited liability company. (TBOC §101.106/Art. 4.04 of the Old Act). A membership interest may be evidenced by a "certificate of membership interest" if the Company Agreement/Regulations so provide, or it may be uncertificated and represented on the company's books only. (TBOC §3.201/Art. 4.05B of the Old Act).

D. Restrictions on Transferability.

While a membership interest is assignable in whole or in part, the assignee of the interest has only the right to share in distributions and does not become a member of the limited liability company solely as a result of the assignment, unless the Company Agreement/Regulations state otherwise. In such cases and unless the Company Agreement/Regulations provides otherwise, the assignee will become a member only upon the consent of all the remaining members. (TBOC §101.109(c)/Art. 4.07 of the Old Act). An assignee who is not a member will still receive any distribution made in respect of the membership interest; however, the assignor will continue to be the member of the company and will have the power to exercise the rights and powers of a member. (TBOC §101.109/Art. 4.05(A)(3) and (4) of the Old Act). If the assignee becomes a member of a limited liability company, he will have all

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

assigned rights and powers relating to the membership interest that was assigned, and is liable for all enforceable obligations for contributions of the assignor to the company if the assignee knew of such obligations. (TBOC §101.110/Art. 4.07B of the Old Act).

E. Effect Outside Texas.

Due to the proliferation of limited liability company statute enactment which now includes all fifty (50) states and the District of Columbia, it appears likely that all or essentially all of the benefits a Texas limited liability company may enjoy in Texas will be recognized by other states, although attention should be directed toward the possible impact of technical, and even substantive, differences among the various states' statutes. Article 4.03B of the Old Act states that "it is the intention of the Legislature…that the legal existence of limited liability companies, formed under this Act may be recognized beyond the limits of [Texas]." When conducting business in other states, qualification of the Texas limited liability company as a foreign limited liability company should be obtained. With respect to foreign limited liability companies conducting business in Texas, Texas has included in the Old Act and the TBOC the requirements for the registration of foreign limited liability companies in Texas.

III. TAX EFFECT OF LIMITED LIABILITY COMPANIES

A. Tax Entity Classification Under the "Check the Box" Regulations..

Default Classification; Two or More Members. Effective January 1, 1997, a domestic non-corporate business entity, including a Texas limited liability company, with two (2) or more members will be classified as a partnership for U.S. income tax purposes, unless such entity makes an affirmative election to be classified as a corporation. (Reg. §§301.7701-3(a); 301.7701-3(b)(1)).

Default Classification; Single Member. A domestic non-corporate business entity, including a Texas limited liability company, with a single member shall be disregarded as an entity separate from its owner for U.S. income tax purposes, unless such entity makes an affirmative election to be classified as a corporation. (*Id*). If a domestic non-corporate business entity with a single member is disregarded for U.S. income tax purposes, its activities are treated in the same manner as a sole proprietorship, branch or division of the single member, depending on whether the single member is an individual or another non-disregarded entity. (Reg. §301.7701-2(a)). Note: In many cases, the default classification will be the desirable classification and will be achieved automatically with no need to file an election.

> Revenue Ruling 2004-77. Rev. Rul. 2004-77, 2004-31 I.R. B. 119 (8/2/2004) provides that, if a limited liability company has two members under local law, but one of the members is, for U.S. income tax purposes, disregarded as an entity separate from the other member, then the limited liability company cannot be classified as a partnership and is disregarded as an entity separate

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

from the other member. Thus, for example, a limited liability company ("Limited Liability Company No. 1") with two members, one member being a natural person ("Individual A") and the other member being another limited liability company owned wholly by Individual A ("Limited Liability Company No. 2"), will not be treated as a partnership for U.S. income tax purposes. Both, Limited Liability Company No. 1 and Limited Liability Company No. 2 will be disregarded entities of Individual A, unless an election is made to be taxed as a corporation by either or both limited liability companies.

Revenue Procedure 2002-69. Rev. Proc. 2002-69, 2002-45 I.R.B. 831 (11/12/2002) provides that the default classification of a limited liability company whose ownership interests are comprised solely of community property interests of a husband and wife shall be the classification chosen by the husband and wife by their tax filings, either disregarded like a single member limited liability company or partnership like a limited liability company with two members. If disregarded classification is desired, the Company Agreement should be signed by only one of the spouses, as ownership interests reflected as contractual interests would presumably create a partnership default classification.

Taxpayer Identification Number (TIN). A single member disregarded entity is required to obtain its own TIN for employment tax returns and certain excise tax returns. This includes disregarded limited liability companies that are qualified subchapter S subsidiaries. [See Instructions to Form SS-4 for a good discussion on this.]

Pierre v. Commissioner (8-24-09). Although the "Check the Box" Regulations indicate that the entity tax classification rules are applicable for federal tax purposes (as opposed to federal *income* tax purposes), the Tax Court, in a fully reviewed decision, ruled that a single member limited liability company, treated as a disregarded entity for federal income tax purposes, is nonetheless treated as a separate entity for federal gift tax purposes, thus, allowing valuation discounting. *Suzanne J. Pierre*, 133 T.C. No. 2 (8-24-09).

Election to be Taxed as a Corporation. A non-corporate entity, including a Texas limited liability company, may elect to be classified as other than its default classification described above or change its classification by filing Form 8832, Entity Classification Election, with the IRS service center designated on such form. (Reg. §301.7701-3(c)(1)(i)). Such election form should be attached to such entity's tax return for such year. The effective date of the election will be the date specified by the entity on Form 8832 or the date filed if no such date is specified on the election form. (Reg. §301.7701-3(c)(1)(iii)). The effective date specified on Form 8832 cannot be more than 75 days prior to the date on which the election is filed and cannot be more than 12 months after the date on which the election is filed. (*Id*). If a non-corporate entity, including a Texas limited liability company, makes an election to change its classification (other than an election made by an existing entity to change its

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

classification as of the effective date of these regulations), the entity cannot change its classification by election again during the 60 months succeeding the effective date of the election. (Reg. §301.7701-3(c)(1)(iv)).

Election to be Taxed as an S Corporation. Many practitioners who favor S corporation structuring, and who also believe that the limited liability company structure provides a better liability shield than the corporate structure in Texas (but note the enactment of the 2011 Texas state legislation discussed above which was designed to make comparable the liability shields of corporations and limited liability companies), often recommend forming a limited liability company, electing to be taxed as a corporation rather than a partnership (or disregarded entity) and electing S corporation status. The instructions to both Form 8832 (Entity Classification Election) and Form 2553 (S Election) provide that only the Form 2553 need be filed to make both elections, assuming that the same effective date is desired for both elections (which is usually the case). For example, the instructions to Form 8832 (Rev. March 2007) state on the top of the middle column on Page 4: "An eligible entity that timely files Form 2553 to elect classification as an S corporation and meets all other requirements to qualify as an S corporation is deemed to have made an election under Regulations section 301.7701-3(c)(v) to be classified as an association taxable as a corporation."

Pre-1997 Classifications. The claimed tax classification of a non-corporate entity, including a Texas limited liability company, that was in existence prior to January 1, 1997 will be respected for all periods prior to January 1, 1997, if the entity had a reasonable basis (within the meaning of IRC §6662) for its claimed classification, and neither the entity nor any of its members was notified in writing on or before May 8, 1996 that the classification of the entity was under examination (in which case, the entity's classification will be determined in the examination). (Reg. §301.7701-3(f)(2)). Note: This provision should provide substantial comfort that IRS conflicts over classification issues for even prior periods should be uncommon.

B. Comparison to Limited Partnerships.

1. **Flow Through of Tax Attributes.** Assuming tax status as a partnership, a limited liability company will not be a separate taxable entity and there will be a flow through to the members of all tax attributes associated with the company. The benefits to be achieved from this flow through is the avoidance of double taxation associated with C corporations and the availability to pass through losses and deductions to the member level.

2. **Passive Activity Loss Restrictions.** Only three of the seven material participation tests (under Reg. §1.469-5T(a)) apply to determine material participation by limited partners: (i) participating for more than 500 hours, (ii) materially participating in the activities for five of the last ten years or (iii) if the activity is a personal service activity, participating for three years preceding the current tax year. As a practical matter, this means a limited partner will materially participate only if he participates more than five hundred hours during the year or the requisite prior years.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

Although treated as a partnership for tax purposes, arguably members of a limited liability company should be treated as S corporation shareholders for purposes of determining material participation. Accordingly, all seven tests (under Reg. §1.469-5T(a)) relating to the determination of material participation should be open to them, including: (i) participation by the member constitutes substantially all of the participation in the activity by all members during the year, (ii) participation by the member is for more than one hundred hours, but not less than any other individual, (iii) the activity is a "significant participation activity" and the member's cumulative number of hours of participation in all significant participation activities exceeds five hundred hours or (iv) based on all of the facts and circumstances, participation by the member in the activity is on a regular, continuous and substantial basis. If it is ultimately determined that the "partnership" rule would apply, the limited liability company is still superior to a limited partnership due to the availability of the "500" test, without risk of losing limited partner status under state law due to too much management involvement. With respect to managers, who would normally be general partners in a limited partnership, the "partnership" rule could be disadvantageous because such managers would be limited to only three of the seven tests.

Garnett v. Comr., 132 T.C. No. 19 (6/30/09) held that interests in a limited liability company will be treated as general partnership interests for determining material participation of a member and that the presumption is that losses passing through to the members is not passive. See, similarly, *Thompson v. U.S.*, No. 06-211 (Fed. Cl. (7/20/09, *acq'd* by IRS as to result on 4-5-10) and *Newell v. Commissioner*, T.C. Memo 2010-23 (2/16/10).

3. **<u>3.8% Net Investment Tax</u>.** The tax on net investment income at a rate of 3.8% became in effect for tax years starting in 2013 (the "3.8% Net Investment Income Tax"). The following rules apply generally as to individuals: (i) the tax is imposed on the net investment income of the individual in excess of the designated threshold amounts ($250,000 for married couples, $125,000 for single taxpayers); (ii) essentially almost all "non-compensation" income (income other than wages, bonuses and earnings from self-employment) is treated as net investment income; (iii) an exception is allocable income from a trade or business which is not "passive" to the individual (in other words, "active") under the passive activity loss rules (IRC §469 and treasury regulations thereunder); and (iv) the material participation tests under Reg. §1.469-5T(a) will be generally used to determine whether an individual is materially participating in the trade or business and whether such individual is, thus, "active" with respect to such trade or business (making the allocable income not subject to the 3.8% Net Investment Tax). Again, it would appear, as discussed above regarding the passive activity rules, that a limited liability company would allow for all seven tests to apply, but the limited partnership only three. However, for both limited partnerships and limited liability companies, there may be exposure that qualification under a material participation test may cause the allocable share of income to be taxed as earnings from self-employment. Furthermore, particularly with limited partnerships, the activities associated with qualifying under a material participation test may cause the loss of the individual's entity liability shield for non-tax state law purposes.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

4. Tax Basis of Interest in Limited Liability Company. Assuming partnership tax status, a limited liability company member would be allowed to include certain liabilities of the company in his basis for purposes of computing the basis limitation on the use of losses and deductions allocated to him. While this is true with respect to limited partnerships, as well, an important distinction in a limited liability company context is that a non-guaranteed "recourse" debt of the limited liability company should be treated as "nonrecourse" to the members and thus, available for basis inclusion in each member's basis. This is contrary to the limited partnership scenario, where the general partners are by operation of state law responsible for "recourse" obligations of the partnership.

5. Special Allocations. If partnership status is achieved for tax purposes, the ability to make special allocations of tax losses and deductions could be achieved, but subject to the comprehensive regulations promulgated under IRC §704(b). An advantage a limited liability company may have over a limited partnership in this regard relates to the greater chance of not having to comply with the deficit capital account restoration requirement promulgated under these regulations. This is because allocations of tax losses and deductions attributable to nonrecourse debt need not have a deficit capital account restoration requirement, as with allocations of losses and deductions attributable to recourse debt. As discussed above, there may be a greater ability for a limited liability company debt to be nonrecourse, even if recourse to the company, since no owner is automatically liable for the company's debts by operation of law, as is the case with general partners of a limited partnership.

6. Limited Liability. The participation of a limited partner in the management of a limited partnership can in many circumstances result in that limited partner's loss of limited liability protection. Conversely, all limited liability company members may participate in the management of the limited liability company without loss of limited liability protection. Furthermore, this limited liability protection extends to all limited liability company members, while a limited partnership must have at least one general partner who is liable for the limited partnership's debts. Participation in management by the limited liability company member may even satisfy one of the passive activity "material participation" tests, allowing the utilization of tax deductions at the member level, without jeopardizing such member's limited liability status.

7. Texas Franchise Tax. Commencing in 2007, both limited liability companies and "active" limited partnerships will be subject to the Texas franchise tax.

8. Mergers and Conversions. TBOC Chapter 10 and Art. 8.12 of the Old Act specifically provide for the ability of limited liability companies to merge with other limited liability companies and with corporations or limited partnerships and vice-versa. Generally, a merger or conversion of a limited partnership to a limited liability company should not cause a termination of the limited partnership for tax purposes assuming there will be no transfer of fifty percent or more of the ownership interests in the conversion or merger under IRC §708. (*See* Rev. Rul. 95-37, 1995-1 C.B. 130.)

Even prior to the issuance of such ruling, the IRS ruled, in PLR 9029019, that a Florida general partnership that converted into a Florida limited liability company did not terminate for tax purposes. Similarly, PLR 9010027 held that a conversion of a Florida limited partnership into a Florida limited liability company did not cause a tax termination of the limited partnership. In these rulings, the IRS analogized these transactions to the conversion of a general partnership into a limited partnership as discussed in Rev. Rul. 84-52, 1984-1 CB 157. Furthermore, PLR 9210019, dealing with the merger of a Texas limited partnership into a newly created Texas limited liability company, held that such merger did not terminate the partnership for tax purposes. It would appear that in such a conversion, the partners would be deemed to contribute their old partnership interests in exchange for the new limited liability company interests, and thus no terminating event would occur for purposes of IRC §708. Because IRC §752 would apply in such circumstances, any limited partnership converting or merging into a limited liability company that contained significant debt must be carefully scrutinized, particularly where disproportionate ownership interests may result between pre- and post-conversion or merger.

C. Comparison to S Corporations.

1. **Qualification.** Limited liability companies, not electing to be taxed as a corporation, avoid the numerous restrictions imposed by the IRC on S corporations. Thus, such a limited liability company could involve one or more of the following, which would disallow S corporation treatment to a corporation: (i) a limited liability company may have more than one class of ownership interest (stock); (ii) a limited liability company may have more than one hundred owners (shareholders); and (iii) corporations, nonresident aliens, general or limited partnerships, all trusts, pension plans and charitable organizations can be owners (shareholders) of a limited liability company.

2. **Automatic Tax Status.** Limited liability companies are not required to file elections to obtain flow-through tax status, unlike an S corporation. In addition, a limited liability company is not subject to the inadvertent risk of losing tax status through changes in its stock ownership or classes of stock.

3. **Special Allocations.** Assuming partnership tax status, the limited liability company provides the ability to make special allocations of tax items if the requirements of IRC §704(b) are met. Due to the ability to treat "recourse" liabilities of a limited liability company (not guaranteed by one or more members of the limited liability company) as nonrecourse debts as to its members, the unattractive "deficit capital account restoration" requirement relating to special allocations can be avoided under certain circumstances. No special allocations are allowed for S corporations as all allocations must be made proportionate to stock ownership.

4. **3.8% Net Investment Tax.** The tax on net investment income at a rate of 3.8% became in effect for tax years starting in 2013 (the "3.8% Net Investment Income Tax"). The following rules apply generally as to individuals: (i) the tax is imposed on

the net investment income of the individual in excess of the designated threshold amounts ($250,000 for married couples, $125,000 for single taxpayers); (ii) essentially almost all "non-compensation" income (income other than wages, bonuses and earnings from self-employment) is treated as net investment income; (iii) an exception is allocable income from a trade or business which is not "passive" to the individual (in other words, "active") under the passive activity loss rules (IRC §469 and treasury regulations thereunder); and (iv) the material participation tests under Reg. §1.469-5T(a) will be generally used to determine whether an individual is materially participating in the trade or business and whether such individual is, thus, "active" with respect to such trade or business (making the allocable income not subject to the 3.8% Net Investment Tax).

Many practitioners are favoring the S corporation as the entity of choice (over the limited liability company) because it may be considered as the best vehicle for avoiding the 3.8% Net Investment Tax. This may be largely because it is convenient and customary to "W-2" an owner for compensation (in this case, possibly "low" compensation) and have the remaining allocation of income (possibly a substantial amount) constitute income from an "active" source with respect to the owner, so as to avoid both the payroll taxes (including the additional 0.9% Medicare tax) and the 3.8% Net Investment Income Tax on such income. This is contrasted to the situations where (i) it is not customary (and maybe not allowable) to "W-2" income from entities that are partnerships for U.S. income tax purposes, like a limited liability company with more than one member classified under its default tax classification status, or (ii) an entity that will be treated as a Schedule C sole proprietorship for U.S. income tax purposes, like a limited liability company with a single individual member classified under its default tax classification status.

However, to be also considered, are several potentially significant drawbacks to selecting the S corporation structure, particularly where the main advantage being sought is solely the avoidance of the often relatively low tax liabilities associated with payroll taxes and the 3.8% Net Investment Tax. Those disadvantages may often pale when compared to the potential for double taxation, accelerated taxation and other potentially costly circumstances that may occur under the S corporation scenario and not generally with the limited liability company structure (in its default tax status as a disregarded entity or a partnership). These potential drawbacks include: (i) possible increased IRS scrutiny of owner compensation with regard to possible underpayment of payroll taxes (including the additional 0.9% Medicare tax) and the 3.8% Net Investment Income Tax, (ii) inadvertent S corporation disqualification or termination due to stock ownership by disqualified shareholders, (iii) inadvertent S corporation disqualification or termination due to the existence of a second class of stock, (iii) rigid tax and distribution allocation scheme, (iv) non-formation contributions of appreciated property taxable to the owner contributor, (v) distributions of appreciated property taxable to the owners, (vi) no increase in shareholder basis due to guaranty of entity debt, (vii) more entity formalities and (viii) susceptibility to reverse veil piercing.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

5. Tax Basis of Interest. Assuming partnership treatment for tax purposes, the limited liability company provides the benefit of tax basis inclusion for entity level liabilities under IRC §752, particularly inclusion of (i) guaranteed entity level debt and (ii) "recourse" entity level debt (not guaranteed by one or more members). A shareholder in an S corporation may not include in the tax basis of his stock any share of the S corporation's debt. Consequently, a limited liability company may be preferable in order to avoid the basis limitation on a member's ability to deduct the entity's tax losses as they occur. Furthermore, a member of a limited liability company would have the availability of an adjustment in the tax basis of a limited liability company's assets upon the sale of a member's interest under IRC §754, which adjustment is not available for shareholders of an S corporation.

6. Mergers. TBOC Chapter 10 and Art. 8.12 of the Old Act specifically provide for the ability of limited liability companies to merge with other limited liability companies and with corporations or limited partnerships and vice-versa. However, the merger of an S corporation (or a C corporation) with a limited liability company may result in adverse tax consequences to the corporation and its shareholders. Presumably such a merger would be treated as a dissolution of the S corporation and a contribution by the shareholders of the corporate assets to the limited liability company in return for their limited liability company interests. In such case, the S corporation, as would a C corporation, should recognize gain or loss under IRC §336, and each of its shareholders, after adjusting his tax basis in his stock for his allocable share of the gain or loss recognized by the corporation on a liquidation, should recognize gain or loss under IRC §331.

D. Self-Employment Tax Treatment.

On January 13, 1997, the Service withdrew its controversial December 28, 1994 proposed regulations amending Code §1402 regarding self-employment tax treatment of members of certain limited liability companies and issued new proposed regulations under Regulation §1.1402(a)-2 dealing with limited partners, in general.

The new proposed regulations basically provide that an individual's net earnings from self-employment generally do not include a distributive share of income or loss as a limited partner. The definition of limited partner is presumably defined to include individual members of a limited liability company meeting certain criteria. Generally, under these new proposed regulations, an individual, presumably including members of a limited liability company, will be treated as a limited partner unless the individual (i) has personal liability for the debts of or claims against the partnership (presumably including a limited liability company) by reason of being a partner; (ii) has authority to contract on behalf of the partnership (presumably including a limited liability company) under the statute or law under which the partnership is organized; or (iii) participates in the partnership's (or presumably limited liability company's) trade or business for more than 500 hours during the tax year.

It is the second condition that is most troublesome. If the limited liability company is managed by its members, then all members may be subject to self-employment tax, whether active or not, since all members have the authority to contract on behalf of the limited liability company by statute. If the limited liability company is managed by managers, then all managers may be subject to self-employment tax, whether "working" or not, since all managers have the authority to contract on behalf of the limited liability company by statute.

Under an exception for holders of more than one class of interest, an individual who is not treated as a limited partner under the general rule as to a specific class of partnership interest owned by such individual shall, nonetheless, be treated as a limited partner as to that class if, immediately after acquisition of that class of interest, ***limited partners of the partnership*** own a substantial, continuing interest in that specific class of partnership interest and the individual's rights and obligations with respect to the specific class of interest are identical to those held by the limited partners.

Note: Members who are also managers of a limited liability company may want to bifurcate their interests in the company in order to create a "limited partner" interest in the company for self-employment tax purposes, since the manager member will not be treated as a limited partner because managers have authority to contract on behalf of limited liability companies under Texas law. However, due to the language indicating that the "limited partner" interest must be identical to those interests held by the "limited partners" may imply that ***there must be other, non-manager members*** holding such interests. Therefore, this technique may not work for limited liability companies owned by members who are all managers.

With the 3.8% Net Investment Tax becoming effective for 2013, and the likely increase in owners of limited partnerships and limited liability companies (taxed as partnerships) attempting to avoid this tax through application of the material participation rules, added tension between the material participation rules (which indicate the performance of services by the individual on behalf of the entity) and the self-employment tax rules, whose purpose is to tax income derived from the performance of services not classified as "W-2" services, is sure to lead to increased IRS scrutiny and attempts to have such income taxed either as earnings derived from self-employment (and, thus, subject to the 3.8% Medicare tax) or income subject to the 3.8% Net Investment Tax, to the extent the taxpayer meets the thresholds for applicability.

Another possibility is for the limited liability company to elect to be taxed both as a corporation and as an S corporation. Then, the limited liability company would be under the "S corporation" tax rules for self-employment tax purposes, rather than the "partnership" rules. However, with the enactment of the 2011 Texas state law legislation, discussed elsewhere above, which legislation makes the liability shields for corporations and limited liability companies comparable, there may be no significant advantage to forming a limited liability company over a corporation for purposes of forming an entity that will elect S corporation status.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

E. Texas Franchise Tax Considerations.

Effective generally for tax years commencing with 2007, the existing Texas franchise tax was replaced with a new tax (referred to as the "Texas Margins Tax") that applies to most business entities that have statutory liability protection, including, without limitation, corporations (C or S), limited liability companies and limited partnerships. The Texas Margins Tax is generally a 1% (0.5% for retailers and wholesalers) tax levied on "taxable margin" (though temporary rate reductions are available for tax years 2014 and 2015 under 2013 legislation enacted through HB 500). "Taxable margin" for this purpose is generally equal to total revenue of the entity, less deductions for either (1) cost of goods sold or (2) compensation, including benefits. Compensation (excluding benefits) is limited to $300,000 per person (inflation adjusted every two years). Under a 2007 legislative amendment (HB 3928), a 0.575% gross receipts tax may be used as an alternative tax for entities with $10 million or less in total revenue.

Limited partnerships, including family limited partnerships, that meet certain qualifications making them "passive entities" are exempt from this tax. Additionally, otherwise taxable entities with gross receipts of $300,000 or less (inflation adjusted every two years) are also exempt from this tax for tax years prior to 2010. Under a 2007 legislative amendment (HB 3928), entities with gross receipts from $300,001 to $900,000 will receive a discount on the tax based on a sliding scale for tax years prior to 2010. Starting with a 2009 legislative amendment (HB 4765), the small business exemption was again increased so that otherwise taxable entities with gross receipts of $1,000,000 or less would be exempt from this tax. HB 500 enacted in 2013 makes the $1,000,000 exemption (with adjustment for inflation) permanent. However, affiliated entities deemed to constitute a unitary business are required to do combined reporting, which, among other things, may disqualify various affiliated entities from use of the applicable small business exemption.

With essentially parity being created for Texas franchise tax applicability amongst liability shielding entities, including limited liability companies and "active" limited partnerships, the Texas franchise tax should no longer be a deterrent for choosing the limited liability company structure over the limited partnership structure for "active" business enterprises.

IV. FOREIGN LIMITED LIABILITY COMPANY.

TBOC Chapter 9 and Part VII of the Old Act provide specific rules pertaining to the qualification of foreign limited liability companies to do business in Texas. Pursuant to Chapter 9 of the TBOC, a foreign limited liability company wishing to qualify under the TBOC must file an Application for Registration with the Secretary of State's Office, along with a $750.00 filing fee. Pursuant to Art. 7.05 of the Old Act, a foreign limited liability company wishing to qualify under the Old Act had to file a Certificate of Authority with the Secretary of State's Office, along with a $500.00 filing fee.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law

V. APPLICABILITY TO PROFESSIONALS

A limited liability company may be formed by professionals including, among others, lawyers and accountants. With respect to accountants, on January 14, 1992, members of the AICPA voted to change the Code of Professional Conduct to allow CPA firms to organize themselves in any manner permitted by the state in which they practice. On April 21, 1992, the Texas State Board of Public Accountancy adopted specific rules indicating that CPA firms may organize themselves as limited liability companies. The 1993 Amendments added Part 11 to the Old Act providing rules relating to the organization of professional limited liability companies analogous to corresponding provisions found in the Texas Professional Corporation Act and the Texas Professional Association Act. As with a Texas professional corporation or a Texas professional association, a professional who is a member of a professional limited liability company will still have personal liability for his or her own professional negligence, but will be afforded liability protection against the acts or omissions of other member professionals. The name of a professional limited liability company must contain the words "Professional Limited Liability Company" or the abbreviation "P.L.L.C." or "PLLC".

Similar rules are applicable for professional entities governed by the TBOC. The provisions of the TBOC specifically applicable to professional limited liability companies are contained in TBOC Chapter 304.

ROBERT M. MENDELL, ATTORNEY AT LAW, P.C., 800 TOWN & COUNTRY BLVD., SUITE 300, HOUSTON, TEXAS 77024
PHONE: 713-888-0700. EMAIL: rmendell@mendell.law WEBSITE: www.mendell.law