

CLIENT ALERTS

Operating Agreements: A Four Part Client Alert Series

Client Alert

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Limited liability companies (LLCs) have become a ubiquitous form of business enterprise since their universal adoption by all states in the 1990's. The funding, management and operation of an LLC is governed by an operating agreement, signed by all the LLC's members. Unfortunately, it is commonplace to see such agreements inadequately address the litany of tax and business issues relevant to the LLC's members.[1]

This series of Client Alerts will shed additional light on the variety of issues present in operating agreements and provide a roadmap to appropriately address them. We will breakdown the discussion into the following three (3) topics:

- [Capitalizing an LLC and Incentivize Employees/Service Providers in a Tax Efficient Manner](#)
 - Assuring that initial capitalization does not create an unintended "capital shift" for tax purposes – causing certain members to recognize "phantom income"
 - Documenting additional capital requirements for members and providing a mechanism for treatment of defaulting members
 - Structuring "profits interests" for service providers who do not contribute capital but provide "sweat equity" in exchange for a membership interest
- [Using Allocation and Distribution Provisions to Accomplish your Business Objectives Without Triggering Unintended Tax Effects](#)
 - Understanding the key differences between distributions and tax allocations; concepts which are often conflated
 - Providing a mechanism to match tax allocations with cash distributions (assuming this is the members' desire)

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- Creatively drafting distribution waterfall provisions
- Ensuring that Governance and Succession Planning are Appropriately Addressed
 - Determination and discussion regarding member-managed versus manager-managed entities
 - Establishing member voting rights/minority protections
 - On what items must members vote?
 - Common negotiations with investors/minority members over a list of “major decisions” that must require investor/minority member approval
 - Discussing management “deadlock” and potential remedies for resolving
 - How to most appropriately address a member’s death, disability, bankruptcy or divorce

Part Two Coming October 26: Capitalizing an LLC and Incentivizing Employees/Service Providers in a Tax Efficient Manner

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[1] For purposes of these Client Alerts, we will assume LLCs retain their default classification as partnerships for federal income tax purposes.