



What CPAs Need to Know About the New LLC Law

BY MARK ASTLING

On April 1, 2013, Governor Gary R. Herbert signed into law a new limited liability company (LLC) statute (the “New Act”) to replace the existing LLC statute (the “Old Act”). The New Act will automatically apply to all Utah LLCs formed after January 1, 2014, and, after January 1, 2016, the New Act will apply to all Utah LLCs (regardless of the date of their formation). This article reviews several significant differences between the Old Act and the New Act to highlight issues that CPAs should be aware of when advising clients who own or operate their businesses through a Utah LLC.

An Operating Agreement is Vital Under the New Act.

The New Act provides a set of default rules that will govern the LLC if the members do not adopt an operating agreement. For example, if an LLC does not adopt an operating agreement, the New Act provides that each member has “equal rights” in the management and affairs of the LLC and that distributions be divided in “equal

shares among members.” See Utah Code Ann. Sections 48-30-407(2)(b) and 48-3a-404(1). These default rules work well for a two-member LLC where the members each own 50% of the LLC and the members intend that each member has equal rights to management (i.e., one member = one vote) and that distributions be made in equal shares. The default rule may have unintended consequences, however, in a two-member LLC where the parties intend that ownership not be equal. For example, if the parties intend for ownership (i.e., voting and economic rights) to be divided 90% for one member and 10% for the other member, the default rules of “equal rights” in management and “equal shares” in distributions give the 10% member too much voting power and distributions and takes away the voting power and distributions from the 90% member. Utah LLCs and their CPAs should be familiar with the impact the default rules under the New Act will have on their LLC and ensure that the LLC owners adopt an operating agreement to avoid any unintended negative consequences. A robust and detailed operating agreement is the only way an LLC

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can modify the New Act's default rules and ensure that the members' agreement is protected and upheld in the future.

In an area of particular concern for accountants, the New Act does not have a default rule for allocations of profits and losses. In contrast, the Old Act contains a default rule that allocates profits and losses in accordance with the members' capital contributions. In eliminating this default rule, the New Act recognizes that members may contribute services to the LLC in exchange for their interests in the LLC, and that applicable tax, accounting and other regulatory requirements should provide the basis for the allocation of profits and losses. Utah LLCs and their CPAs should be aware of the absence of a default rule with respect to profits and losses and take appropriate steps to clearly delineate their agreement with respect to such allocations in the LLC's operating agreement.

Adopting a Written Operating Agreement Can Prevent it from Being Inadvertently Modified

The Old Act required an operating agreement to be in writing. See Utah Code Ann. Section 48-2c-102(16)(a). The New Act allows any agreement whether "...oral, in a record, implied or in any combination thereof..." to be considered an operating agreement. See Utah Code Ann. Section 48-3a-102(16). Without a written operating agreement, a court will consider a wide range of evidence in determining what constitutes the agreement among the members, including the conduct of the members, their course of dealings, and oral statements. Any activity involving unanimous consent of the members may become part of the "operating agreement." The best way to provide certainty with respect to the rights of the members is to: (1) adopt a written operating agreement that clearly sets forth the rights and obligations of the members and management, (2) include an integration clause in the written operating agreement to make it clear that the written operating agreement constitutes the whole agreement among the parties and that the written agreement supersedes and preempts any prior (or contemporaneous) agreements, and (3) require all amendments to the operating agreement to be in writing.

Given the possibility of oral and implied-in-fact components to an operating agreement, a person becoming a member of an existing LLC should take precautions to ascertain the full contents of the operating agreement whether written, oral or is implied in fact.

GIVEN THE COMPLEX ISSUES SURROUNDING THE FORMATION OF AN LLC, THE CHOICES OF LAW AVAILABLE TO ITS MEMBERS, THE IMPACT AND OPERATION OF THE NEW ACT'S DEFAULT RULES AND RELATED TOPICS, IT IS ADVISABLE TO SEEK QUALIFIED LEGAL ADVICE FROM AN ATTORNEY WHO IS FAMILIAR WITH UTAH'S NEW ACT AND THE LAWS OF OTHER JURISDICTIONS IN ORDER TO ENSURE THAT THE NEEDS OF THE LLC AND ITS OWNERS ARE MET.

Limited Public Disclosure of Ownership and Management.

The New Act limits public disclosure of ownership and management of the LLC. Under the New Act, an LLC is formed by filing a certificate of organization with the Utah Division of Corporations and Commercial Code. The New Act requires that the certificate of organization contain only the name of the entity, the name and address of its registered agent and the street and mailing address of the LLCs principal office. See Utah Code Ann Section 48-3a-201(2). Under the Old Act, an LLC's articles of organization were required to contain the names of all managers (if the LLC was manager-managed) or the names of all members (if the LLC was member-managed). The New Act does not require the certificate of organization to designate whether the LLC is member-managed or manager-managed. Under the New Act, the operating agreement of an LLC contains those and other governing provisions. Since the operating agreement is not a publicly-filed document, Utah LLCs may keep certain information about its ownership and management out of the public eye.

Existing LLCs May Opt-in To the New Act before January 1, 2016

Until January 1, 2016, the New Act will not apply to Utah LLCs formed before January 1, 2014. On January 1, 2016, the New Act will apply to all Utah LLCs. If members of an existing LLC desire to have the New Act — rather than the Old Act — apply to their LLC before January 1, 2016, they may elect to opt in to the New Act when the New Act becomes effective on January 1, 2014. This process (known as “opting-in”) is accomplished by including an affirmative statement in the LLC’s operating agreement that the members elect to have the New Act govern the LLC and affairs. See Utah Code Ann. Section 48-3a-1405(1)(b). If an operating agreement already exists, it will need to be reviewed in order to comply with any provisions it may have relative to having the members amend its provisions. If the operating agreement is silent as to amendments, then the Old Act requires that all of the members agree to an amendment of the operating agreement. See Utah Code Ann. Section 48-2c-506.

Conclusion

This article reviews several key issues that Utah LLCs and their CPAs should consider in light of the adoption of the New Act. Given the complex issues surrounding the formation of an LLC, the choices of law available to its members, the impact and operation of the New Act’s default rules and related topics, it is advisable to seek qualified legal advice from an attorney who is familiar with Utah’s New Act and the laws of other jurisdictions in order to ensure that the needs of the LLC and its owners are met. ■



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