

THE LIMITED LIABILITY COMPANY (LLC)

The limited liability company has become the preferred choice of entity for new businesses in Wisconsin. In 2008, 24,882 new limited liability companies were formed in Wisconsin, compared to 3,732 new corporations. In this article, I will attempt to explain the differences between a limited liability company (LLC) and a corporation, and why the LLC is now the preferred choice of entity for many business organizations.

All 50 states and the District of Columbia now allow for the formation of LLCs. That wasn't always the case. Wisconsin first allowed for the creation of LLCs on January 1, 1994.

An LLC is essentially an unincorporated association of investors, called "members," whose personal liability for obligations of the venture is normally limited to the amount the member has invested (unless the operating agreement or other agreement entered into by the member provides otherwise). An LLC is designed to combine the features of a general partnership with the limited liability of a corporation.

In 1977, Wyoming became the first state to allow for the creation of LLCs, followed by Florida in 1982. Since then, all states have adopted legislation allowing for the creation of LLCs.

In 1988, the IRS ruled that an LLC would be taxed as a partnership rather than as a corporation. Since partnership (passthrough) tax treatment was considered favorable for many businesses, the interest in LLCs took off.

LLCs are generally more flexible in nature and do not require the legal formalities associated with corporations. For example, officers and directors, and shareholder and director meetings, are not required.

In 1996, the IRS adopted regulations that allowed greater flexibility in the tax treatment of LLCs. Now, an LLC can elect to be taxed as a sole proprietorship (if it has only one member), a general partnership (if it has more than one member), a C corporation, or as an S corporation. The ability to select the manner in which the LLC will be taxed provides more flexibility than is available with other types of entities.

Initially, the conversion from one type of entity to another was not permitted in Wisconsin. However, on October 1, 2002, Wisconsin's LLC law was amended to permit the conversion of an LLC to a corporation, and vice versa. Although the mechanism for converting from one type of entity to another is not complicated, significant tax implications may be involved, and tax liability can be triggered upon the conversion. Consideration of the tax consequences and tax planning is highly advisable before a conversion is adopted.

Some types of businesses are not appropriate for the LLC form of ownership. For example, incorporation rather than use of an LLC may be more appropriate for a company that is expected to "go public."

When selecting the type of entity, both legal and tax issues are involved. Therefore, it is advisable to consult with both your attorney and CPA before making a final decision.