

## **Alberty.com - Winter 2002 Newsletter**

We're sending this newsletter to you, as a customer of Alberty Publishing LLC, to bring you news about the law of limited liability companies and what's new at Alberty.com.

### **Adding a New Member to an LLC**

LLCs have now been around long enough that practitioners seeing increasing numbers of LLCs that want to admit new members in order to obtain additional capital or human resources. Adding a new member to an LLC raises a number of issues.

- Are the existing members of the LLC willing to consent to the admission? Most LLC statutes and operating agreement require unanimous consent for the admission of a new member, meaning that any dissenting member has veto power.
- Is amendment of the LLC's articles of organization required? In most cases, the answer will be "no," but an amendment will be needed if the admission of the new member will involve conversion of a member managed LLC to a manager managed LLC, or vice versa.
- Is amendment of the LLC's operating agreement required? Some amendments to the operating agreement are almost always required unless a new member is admitted early in the life of the LLC and on the same terms as the existing members. If a new member is admitted to a single member LLC, the operating agreement will probably need to be rewritten because single member LLC operating agreements typically do not deal with issues like voting rights, transfer restrictions, and withdrawal rights.
- What will the new member's interest be in LLC profits, losses, and distributions? The new member and the LLC have often resolved this issue before the lawyer is asked to draft documents for the admission. But it is important to clarify how the interests of the new member will affect those of the existing members.
- What will the members' interests in capital be after the admission? The new member and the LLC may have decided what the new member will be contributing to the capital of the LLC and what its value is. But the capital interests of the existing members may also need to be revalued and restated at the time of the new member is added in order to credit or charge them with unrealized appreciation or depreciation of the LLC's assets.
- Will the admission of the new member be a taxable event? If the new member contributes property, the admission will likely be nontaxable under IRC §721(a), but a tax may be imposed at the time of admission or a later date if the contribution is considered to be a disguised sale or if a significant portion of the LLC's assets are marketable securities. If the new member contributes services, the admission will generally be nontaxable so long as the new member receives only a profits interest and no interest in capital.
- How will the income or loss of the LLC for the year of admission be allocated between the new member and the existing members? The regulations under IRC §706(d) allow the allocation to be

made in a couple of different ways, and advance consideration should be given to the availability and possible effect of these alternatives.

- Are interests in the LLC securities for either federal or state law purposes? If they are, compliance with applicable securities laws may be required, or the documents admitting the new member may need to address the availability of exemptions from compliance requirements.

## **Form**

The Alberty Publishing Form 5.5, which is an agreement for adding a new member to an LLC, was prepared after one of our customers requested such a form. If you have thoughts about other forms that would be useful in your practice, we'd love to hear from you.

## **Subscription Info**

As a customer of Alberty.com, we'd like to continue sending you updates on the law of LLCs and about useful forms that can enhance your practice. But if you'd rather not receive our newsletters, just let us know by replying to this e-mail. A human being will be reading your e-mail, so just ask us to take you off our mailing list – no magic words are needed in the subject line.

We welcome your input or feedback about this newsletter. Please feel free to reply with any thoughts or requests. Thank you.

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