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LIMITED LIABILITY COMPANIES

House Bill 4023 as enrolled
Second Analysis (5-26-93)

Sponsor: Rep. Kirk A. Profit
House Committee: Business & Finance
Senate Committee: Corporations & Economic Development

THE APPARENT PROBLEM:

Individuals interested in organizing a company for business purposes may choose from among various business forms in Michigan, including general partnerships, limited partnerships, corporations or other for-profit or non-profit business entities. In choosing how to organize, participants and other investors must consider a number of things, such as whether the company is to be managed by a few partners or many investors, to what extent will partners or other investors be personally liable for the company, how will the earnings of the company and its investors be taxed under federal, state and local laws, and similar considerations. Each of the different business forms has advantages and disadvantages, and organizers must determine which one could best help them to achieve their specific business goals. For instance, the general partnership offers flexibility in the way a company may be managed, but puts the participants' personal assets at risk for business liabilities. Under a limited partnership, however, those who invest as "limited" partners have their personal assets shielded, but, in turn, may not participate in managing the enterprise; this falls to one or more "persons" (individuals or entities) who serve as general partners having personal liability for the partnership obligations.

On the other hand, an investor in a company that incorporates is not personally liable, beyond the amount invested, for business debts and may participate as a shareholder in managing the business, but the company itself is subject to fairly complex laws that require regular filings with the state, regulate how it is to be structured, and govern various internal procedures such as meetings and voting. Shareholders in a corporation also face the prospect of double taxation, where corporate income is taxed at the corporate level and then taxed again at the investor level if distributed to shareholders. Although some corporations may elect to be treated as so-called "S-corporations" to significantly reduce this tax burden, the federal tax code limits the qualification for this special treatment to corporations with fewer than 35 shareholders, and imposes various other limitations on this business form.

In recent years, individuals wishing to organize a business or those already in business have looked to a new form of business entity, the limited liability company, that combines the best features of the partnership and corporation. The limited liability company form provides its "members" (those with an interest in the company) protection against personal liability for the debts of the business, and offers them flexibility in structuring a company's internal organization, management and procedures. But more importantly, a limited liability company--assuming its operating agreement is drafted properly--should be able to secure the same federal tax treatment as a partnership if, as many tax law experts expect, the Internal Revenue Service (IRS) confirms the status of limited liability companies for tax purposes. A number of states have authorized the formation and operation of limited liability companies within their borders and some people believe Michigan should, too.

THE CONTENT OF THE BILL:

The bill would create the Michigan Limited Liability Company Act to allow a limited liability company, defined under the bill as "an entity that is an unincorporated association having 2 or more members" and was formed under the bill, to be formed in Michigan. The bill would take effect June 1, 1993.

Article 1 - General Provisions. Article one of the bill defines the terms used throughout the proposed act and contains provisions regarding the filing of the articles of organization and other documents that would be needed to form a limited liability company. Among other things, its provisions would:

* require any documents that had to be filed under the bill or by law to be delivered to and filed with the Department of Commerce (the "administrator" under the bill), accompanied by the appropriate fees;
* require files and records of limited liability companies formed under the bill to be open for public inspection;
* provide that a document would be effective when it was indorsed unless a subsequent effective time was set forth in the document that was not later than 90 days after the date when it was delivered to the administrator;
* pursuant to the Administrative Procedures Act, allow a person to seek judicial review of a decision by the administrator to refuse filing by a person wishing to form a "domestic limited liability company" (a company formed under the bill's provisions), or of a decision refusing to authorize a "foreign limited liability company" (a company formed under laws other than Michigan's) to transact business in the state;
* permit the filing of a certificate of correction document to correct a previously filed document containing inaccurate information or that was defectively executed.

Article 2 - Formation of Limited Liability Companies. Two or more persons who were to be "members" (defined as persons with interest in the company having certain rights and obligations) could form a limited liability company for any lawful purpose for which a domestic corporation or a foreign limited partnership could be formed by filing executed articles of organization. A company's existence would begin on the effective date of the articles of organization, which would have to contain all of the following:

* the name of the limited liability company and why it was formed;
* the street address, and mailing address if different, of the company's initial registered office and name of its initial resident agent at that address;
* if the business of the company was to be managed by "managers" (defined in the bill as persons designated by members to manage the company as provided in an operating agreement), a statement that it was to be so managed; and
* the maximum duration of the company.

The articles of organization would not have to describe the powers of a limited liability company but could, at the discretion of its organizers, contain any provision not inconsistent with the bill or other state law, such as how the company was to be managed, the limits of its powers or of members' or managers' powers, or the extent of monetary liability of a member or manager to the company for a breach of duty. A provision within the articles of organization could not, however, eliminate or limit the liability of a manager for 1) receiving a financial benefit to which he or she was not entitled, 2) agreeing with a decision to make an improper distribution, 3) knowingly violating the law, or 4) an act or omission that occurred prior to when the provision became effective.

The name of a domestic limited liability company would have to contain the words "limited liability company" or contain the abbreviation "L.L.C." or "L.C.," and the name of a foreign or domestic company would have to conform to various other requirements as set forth in the bill. The bill, however, would allow a foreign limited liability company to transact business in the state under an assumed name if its current name did not meet the bill's requirements. Assumed names could be used by foreign or domestic companies in certain other situations, too. The bill would establish a process for reserving the right to use a specific name by a company for five years, allow the period for the use of such rights to be extended by the administrator, and permit such rights to be transferred to another person.

Each domestic or foreign limited liability company authorized to do business in the state would have to continuously maintain in the state a registered office that could, but would not have to, be the same as its place of business, and a registered agent. The registered agent could be either an individual resident in the state whose business office or residence was identical with the registered office, a domestic corporation, or a foreign corporation that was authorized to do business here and which had a business office identical with the registered office. The resident agent would receive any process, notice or demand required or permitted to be served upon the company and, upon accepting service of process, would have to promptly forward it to the member or manager of the company that appointed him or her. Each company authorized to transact business in the state would have to file with the administrator (no later than February 15 of each year) an annual statement executed as specified in the bill that contained its resident agent's name and the company's registered office in the state. In addition, the bill would permit an appointed resident agent to resign and allow another person to be appointed in his or her place.

A company would have to keep at its registered office all of the following:
* a current list of the full name and last known address of each member and manager;
* a copy of the articles or restated articles of organization, together with amendments added to them;
* copies of the company's federal, state and local income tax returns and reports, if any, for the three most recent years;
* copies of any of its financial statements for the three most recent years;
* copies of operating agreements; and
* copies of records that would allow a member to determine the members' relative shares of the company's distributions and members' relative voting rights.

Subject to the limitations set forth in the bill, another act or in a company's articles of organization, a limited liability company would have all powers necessary or convenient to accomplish any purpose for which it was formed, including all powers granted to corporations under the "Corporate Powers" section of the Business Corporation Act. An act of a limited liability company and a transfer of real or personal property to or by one, if otherwise lawful, would not be invalid because the company was without capacity or power to perform the act or make or receive the transfer, except that the lack of capacity or power could be asserted:
* in an action by a member against the company to enjoin the act or the transfer of real or personal property by or to the company;
* in an action by or in the right of the company to procure a judgment in its favor against an incumbent or former member or manager for loss or damage due to his or her unauthorized act; or
* in an action or special proceeding by the attorney general to dissolve the company or to enjoin it from the transaction of unauthorized business.

A limited liability company, whether or not it was formed at the request of a "lender," could agree in writing to pay any rate of interest as long as the rate of interest did not exceed the criminal usury rate, i.e., 25 percent at simple interest per year.

Article 3 - Member Contributions, Distributions. A limited liability company member could contribute any tangible or intangible property or benefit to the company, including cash, property, services performed, promissory notes, contracts for services to be performed, or other binding obligations to contribute cash or property or to perform services. A promise by a member to contribute would be enforceable only if it was made in a writing that was signed by him or her, and a member would be obligated to contribute assets or perform services promised in writing even if he or she was unable to do so due to death, disability or another reason. In lieu of promised obligations that could not be performed, the member would be obligated--at the company's option--to contribute cash equal to the value of that portion of the enforceable contribution that could not be made. Unless an operating agreement provided otherwise, a member's obligation to contribute or return money or other property paid or distributed in violation of the bill could be compromised only with the unanimous consent of the company's members; if a compromise was made, though, a creditor of the company who extended credit or otherwise acted based on the member's original written obligation before a written compromise was made that could enforce the original obligation.

Distributions of a company's assets would be allocated among the members and classes of members in the manner provided in a written operating agreement, or, if no allocation was stated in the operating agreement, distributions would have to be allocated based on the value of recorded member contributions to the company that had not yet been returned. The bill provides for distributions to be made to a member for amounts (generally, in the form of cash) to which he or she was entitled upon his or her withdrawal from the company, and provides that a member could not be forced to accept a distribution of an asset in kind to the extent that the percentage of the asset distributed exceeded a percentage of that asset which was equal to the percentage in which the member shared in distributions from the company.

Before distributions could be made, however, it would have to be determined that the company's other debts could be paid or, if the company were dissolved, that the preferential rights of other members that were superior to those of the member(s) receiving the distribution could be satisfied. A determination by a company that a distribution was not prohibited could be based either on financial statements prepared according to accounting practices that were reasonable under the circumstances or on a fair valuation or other method considered reasonable for the situation. If a distribution was made, its effect would be measured based on certain factors (e.g., when debt was incurred or money or property transferred by the company relative to when the member ceased to be a member, or when the payment was made). When the member was entitled to receive a distribution, he or she also would be entitled to all remedies available to a creditor of the company with respect to the distribution, and the indebtedness to the member incurred by the company for such distributions would be equal to its general, unsecured debt to other creditors. If a company distributed an obligation to make future payments as payment of the fair value of a withdrawing member's interests, even though distribution of the obligation otherwise would be prohibited under the bill at the time it was made, the obligation could be issued with certain stipulations as set forth in the bill.

A member or manager who voted to make a distribution in violation of an operating agreement or the bill's provisions would be personally liable, jointly and severally, to the company for the excess amount of the distribution if it was established that the member/manager acted contrary to the conduct required of him or her in the bill. A member who accepted or received a distribution with knowledge that it violated an operating agreement or provisions in the bill would be liable to the company for the amount he or she accepted or received. Each member or manager held liable under the bill for an illegal distribution would be entitled to contribution from each member or manager who could be held liable for the distribution and from each member who could be held liable for the amount he or she received knowing that the distribution violated the bill's provisions or the operating agreement. A member or manager entitled to participate in a decision to make a distribution would be presumed to have assented to a distribution unless he or she filed a written dissent with the company at a company meeting that he or she attended where the decision to distribute was made, or "within a reasonable time" after he or she learned of the decision. A proceeding on a decision would be barred unless it was commenced within two years after the date on which the effect of the distribution was measured.

Article 4 - Operation and Management. Unless the articles of organization stated that the business of a limited liability company was to be managed by managers, its business would be managed by members subject to provisions in the operating agreement that restricted or enlarged the management rights and duties of any members or group of members. If management was vested in the members, they would be deemed to be managers for purposes of applying the act's provisions (unless the act clearly required otherwise), and would have and be subject to all duties and liabilities and all limitations on liability and indemnification rights of managers.

The articles of organization could provide for a limited liability company's business to be managed by or put under the authority of one or more managers, who could be members but would not have to be. Unless the operating agreement stated otherwise, if a company had more than one manager, all decisions of the managers would have to be made by majority vote of the managers. An operating agreement could prescribe qualifications for managers and would have to state the number of managers that would manage the company. Generally, managers would be elected to positions by a majority vote of members voting in proportion to their shares of the company's distributions, and could be removed by the members with or without cause unless the operating agreement required that a cause exist for removal.

The bill would hold a manager to the so-called "prudent person" principle regarding his or her discharge of duties, and provides that a manager could rely on information from various sources prepared or presented by the company's members or employees, legal counsel, public accountants or other professionals that he or she reasonably believed were competent or expert on specific matters. A manager could also rely on information provided by a committee of managers of which the manager was not a member if he or she felt the committee deserved his or her confidence. Unless otherwise provided in an operating agreement, a manager would have to account to the company and hold as trustee for it any profit or benefit derived without the members' informed consent by him or her from any transaction connected with the company's activities or from any personal use by the manager of its property. A manager would not be liable for any action taken or not taken as a manager if his or her duties were performed in compliance with the bill, and the bill provides that any action taken against a manager would have to be commenced either within three years after the action's cause had accrued, or within two years after the time the act or omission was discovered or reasonably should have been, whichever occurred first.

Every manager of a company would be an agent for that company for business purposes and his or her acts would be binding on the company unless they were contrary to the company's articles of organization, operating agreement or the bill's provisions, or the agent otherwise lacked authority to act on behalf of the company. A company could indemnify and hold harmless a manager from and against all losses, expenses, claims and demands sustained due to acts or omissions or alleged acts or omissions by the manager--except for conduct prohibited under the bill or by law--as allowed in an operating agreement or contract with the manager, or as otherwise permitted by law. A company could purchase and maintain insurance on behalf of a manager against any liability asserted against or expense incurred by him or her in any capacity or that arose out of his or her status as a manager, whether or not the company would indemnify him or her against liability.

Article 5 - Rights of Members, Managers. A person could become a member of a limited liability company by making a contribution accepted by the company or by unanimous consent of the company's other members, or as otherwise allowed in the company's operating agreement. Except as provided in the bill or under an operating agreement, someone who was a member or manager, or both, of a limited liability company would not be liable for the company's acts, debts or obligations.

Generally, members of a company would vote in proportion to their shares of the company's distributions, and would be entitled to vote on the company's dissolution, merger with another limited liability company, a transaction involving actual or potential conflict of interest between a manager of the company and the company, or on amendments to the company's articles of organization. Members also could vote on selling, exchanging, leasing or transferring all or substantially all of the company's assets other than in the ordinary course of business. A majority vote would be required to approve any matter submitted to the members, and the articles of organization or an operating agreement could provide for any other voting rights of members. If a member requested in writing the company's most recent annual financial statement or its most recent federal, state or local tax returns and other financial reports, these would have to be mailed to him or her by the company. A member also could inspect or obtain other information about the company or its business affairs upon written request. A membership interest would be personal property, and a member would have no interest in specific company property.

The bill would allow a member to assign his or her interest in the company in whole or in part to another person. Once interest had been assigned, the member would cease to be a member, although he or she would not be released from liability to the company, if any, even if the assignee became a member. An assignee of a membership interest in a company could become a member only if the other members unanimously consented to this, or as otherwise allowed in an operating agreement. An assignee who became a member would have those rights and powers assigned, and would be subject to restrictions and liabilities of a member under the company's articles of organization, any operating agreement or as provided in the bill. Upon becoming a member, an assignee also would be liable for any obligations of his or her assignor to make contributions and to return distributions. However, an assignee would not be obligated for liabilities unknown to him or her when he or she became a member unless the liabilities were shown on the company's financial records.

On application to a court of competent jurisdiction by any judgment creditor of a member, the court could charge the member's membership interest with payment of the unsatisfied amount of judgment with interest. If the membership interest was so charged, the judgment creditor would have only the rights of an assignee of membership interest. The bill would not deprive any member of the benefit of any exemption laws applicable to his or her membership interest, and, except as provided in an operating agreement, the member would remain a member and retain all rights and powers of membership except the right to receive distributors to the extent charged. The granting or pledge of a security interest, lien or other encumbrance in or against any or all of a member's membership interest would not cause the member to cease to be a member or to lose power to exercise his or her rights or powers. The bill would allow a member to withdraw from a company and provides a procedure for this, but specifies that if the withdrawal violated an operating agreement, the withdrawing member would not be entitled to distributions and the company could recover from him or her damages for breach of the agreement in excess of the amount that otherwise would be distributable to him or her.

A member could commence and maintain a civil suit in the right of a limited liability company if all of the following conditions were met:
* Either the company's management was vested in a manager or managers who had the sole authority to cause the company to sue in its own right, or management was reserved to the members but the plaintiff did not have the authority to cause the company to sue in its own right under the operating agreement's provisions;
* The plaintiff had made written demand on the authorized managers or members asking that they cause the company to take suitable action;
* Ninety days had expired from when the demand had been made unless the member had earlier been notified that the demand had been rejected or unless irreparable injury to the company would result by waiting this long;
* The plaintiff was a member of the company when the act or omission of which he or she complained had occurred, or he or she was granted membership by operation of law or pursuant to the operating agreement's terms from someone who had been a member at that time;
* The plaintiff fairly and adequately represented the company's interests in enforcing its right;
* The plaintiff continued to be a member until judgment was made, unless the failure to continue as a member was due to action by the company in which the former member had not acquiesced and the derivative proceeding was commenced prior to the termination of the former member's status as a member.

If the company commenced an investigation into allegations made in demand or complaint, the court could stay any derivative proceeding for as long as it felt was appropriate. The court would have to dismiss a derivative proceeding if, on motion by the company, the court found that one of the groups making a determination had done so in good faith after conducting a reasonable investigation upon which it concluded that maintaining the derivative proceeding was not in the company's best interests. The bill would authorize determinations to be made by majority vote of groups composed of "disinterested" members or managers (those who were not a party to the proceeding, or those who were a party if the company showed that the claim asserted against the person was frivolous or insubstantial), or by a panel of one or more disinterested persons appointed by the court upon motion by the company. For determinations made by groups of disinterested members or managers, the company would have the burden of proving the good faith of the group making the determination and whether the investigation was reasonable, whereas the burden of proving these would fall to the plaintiff in a determination made by a court-appointed panel. A proceeding could not be discontinued or settled without court approval. If the court determined that a proposed discontinuance or settlement would substantially affect the interests of the company's members, it would have to require notice to be given to affected members. If notice was ordered, the court could determine whether one or more of the parties to the action would have to pay for giving the notice and how much would have to be paid. Upon the proceeding's termination, the court could order various court costs to be paid by one party for the other, or vice-versa.

Article 6 - Amending the Articles of Organization. A limited liability company could amend its articles of organization if the amendment contained only provisions that might be allowed in original articles filed when the amendment was made. A company would have to amend its articles if it changed its name or purposes, if it changed to or from being operated by managers, if its maximum duration had been changed or if a statement in its articles had become false or erroneous.

To amend the articles a certificate of amendment would have to be filed and executed that contained certain pertinent information about the company, described the articles or sections of articles being amended, and stated that the amendment(s) had been approved by majority vote of the members or as otherwise required. A company could file restated articles to accomplish the purposes of an amendment or amendments, and the bill provides guidelines for amending the articles in this way. Once they took effect, restated articles would supersede the company's original articles and would become its articles of organization.

Article 7 - Plan for Merger. Two or more limited liability companies could become one company if a plan for merger set forth all of the following:
* the name of each constituent company and the surviving company's name;
* the terms and conditions of the proposed merger, including the manner and basis of converting each company's membership interests into those of the surviving company, into cash or other property or into a combination of them;
* a statement of any amendment to or restatement of the surviving company's articles of organization that would result from the merger, or that no such changes were to be made;
* other provisions of the proposed merger that the merging companies felt were necessary or desirable.

The bill would require approval of a merger by unanimous consent of the members of each company, unless the operating agreement of one of the companies provided otherwise. If the operating agreement of one of the merging companies allowed for approval of the merger with less than unanimous consent and a merger was approved, a dissenting member could withdraw from the company and receive distributions he or she was entitled to. After a plan of merger was approved, a certificate of merger would have to be executed and filed on behalf of each constituent company that contained pertinent information about the merging companies and the newly-formed company. The bill would allow one or more domestic limited liability companies to merge with one or more foreign limited liability companies, and specifies how this would have to be done. Unless a plan for merging provided otherwise, at any time before the effective date of a certificate of merger the merger could be abandoned as set forth in the plan of merger or by unanimous consent of the members from each company involved, unless a company's operating agreement provided otherwise. If a certificate of merger already had been filed by a constituent company that then decided to abandon the merger, the company would have to file a certificate of abandonment within ten days after the abandonment but no later than the certificate of merger's effective date.

Article 8 - Dissolution. A limited liability company would be dissolved and its affairs would come to an end when any of the following occurred:
* at the time specified in the articles of organization or an operating agreement;
* when certain events occurred, as stated in the articles of organization or an operating agreement;
* by unanimous consent of all members;
* upon the death, withdrawal, expulsion, bankruptcy or dissolution of a member, or the occurrence of any other event that ended the member's continued membership in the company, unless 1) within 90 days after the membership's termination, a majority of the remaining members agreed to continue the business of the company and to admit one or more members as necessary, or 2) management of the company had not been delegated to managers, an operating agreement did not allow an assignee to become a member other than by unanimous consent by the other members, and the company's business was continued as provided in an operating agreement; or
* upon the entry of a decree of judicial dissolution.

A circuit court in the county where a company was registered, upon application by or for a member, could decree the company's dissolution if it was unable to continue operating according to its articles of organization or operating agreements. The attorney general also could bring an action in the circuit court to have the company dissolved upon the grounds that it had obtained its organization through fraud, or repeatedly and willfully exceeded its legal authority or conducted its business in an unlawful manner.

Upon a company's dissolution and the winding up of its affairs, an authorized representative for the company would have to execute and file with the administrator a certificate of dissolution that would have to state the company's name, why it was dissolving and the dissolution's effective date if it was later than when the dissolution certificate was filed. Generally, the company's members or managers who had not wrongfully dissolved the company could bring its affairs to an end, but the circuit court could do this at the request of, and for good cause shown by, any member, his or her legal representative or assignee. The company could sue and be sued in its name, and process could issue by and against it just as if dissolution had not occurred. Any action brought by or against a company before its dissolution would not abate because of the dissolution.

A dissolved company could notify its existing claimants in writing of the dissolution at any time after its effective date, although the giving of notice would not mean that the person to whom it was given had a valid claim against the company. A written notice would have to include:

* a description of the information that would have to be included in a claim. The company could demand sufficient information to allow it to reasonably judge whether to accept or reject the claim;
* a mailing address where a claim could be sent; and
* the deadline--which could not be less than six months after the written notice's effective date--by which the dissolved company would have to receive the claim, and that the claim would be barred if not received by then.

A claim against a dissolved company would be barred if it was not delivered to the dissolved company by the deadline, or if a claimant whose claim was rejected by a written notice of rejection by the dissolved company did not commence a proceeding to enforce the claim within 90 days after the rejection notice's effective date. The bill would provide for the assets of a dissolved company to be distributed to creditors, members and former members to the extent permitted by law or as otherwise provided in an operating agreement. However, before assets could be distributed as specified, the limited liability company would have to file tax returns and pay tax obligations as required under the state revenue act (Public Act 122 of 1941).

Article 9 - Professional Services. A limited liability company could be formed under the bill for the purpose of rendering one or more "professional services," which the bill would define as "a type of personal service to the public that requires as a condition precedent to the rendering of the service the obtaining of a license or other legal authorization." Such a company and its members and managers would be subject both to the specific provisions of this article and to the act's; however, the article's provisions would take precedence over the act's if they were in conflict. Also, the bill could not be construed to abolish, repeal, modify, restrict, or limit the law now in effect applicable to the professional relationship and liabilities between the person furnishing the professional services and the person receiving them, and to the standards for professional conduct.

The articles of organization of such a company would have to state, as its purpose, that the company was formed to render specific professional services. Except as specified in the bill or otherwise prohibited by law, a professional limited liability company (PLLC) could render one or more professional services, and each member or manager would have to be licensed in one or more of the services rendered by the company. If the PLLC rendered a professional service that was included within the Public Health Code, all members or managers of the company would have to be licensed or legally authorized in the state to render the same professional service. Someone who was licensed from another jurisdiction could become a member, manager, employee or agent of the PLLC but could not render any professional services here until he or she was licensed or legally authorized to do so in Michigan.

A PLLC could not render professional services in the state except through its members, managers, employees and agents who were licensed or legally authorized to perform those services in the state. Each member, manager, employee or agent would be personally and fully liable and accountable to the person for whom services were performed on behalf of the company for any negligent or wrongful acts or misconduct committed by him or her, or by someone else under his or her direct supervision and control. A PLLC could not engage in any business other than the rendering of the professional services for which it was specifically organized. A membership interest in a PLLC could not be sold or transferred except to a person who was eligible to be a member of the company or to the personal representative or estate of a deceased or legally incompetent member. The articles of organization or operating agreement could provide specifically for additional restrictions on the transfer of membership interests.

A PLLC would have to file with the administrator an annual report, together with a $50 filing fee, listing the names and addresses of all members and managers and certifying that they all were duly licensed or otherwise legally authorized to render in the state the same professional services as those for which the company was formed. The report would have to be filed no later than February 15 of each year, and a penalty of $50 would be added to the fee if the report had not been filed nor the fee paid by this date. Such a company could merge only with another limited liability company whose members and managers were licensed persons permitted to be members or managers, as specified under this article.

Article 10 - Foreign Limited Liability Companies. Subject to the state constitution, the laws of the jurisdiction under which a foreign limited liability company was organized would govern its organization and internal affairs, and such a company and its managers and members could not be denied a certificate of authority to operate in the state due to any difference between those laws and this state's laws. A foreign limited liability company would have to obtain a certificate of authority before operating here, and would have to file an application with the administrator that included pertinent information similar to that required of domestic companies (the company's name, the state in which it was organized, its address, the name and address of its agent, and the like). The administrator would have to file a company's application to operate here and issue it a certificate of authority to operate in Michigan if its application conformed to the bill's requirements. Foreign limited liability companies generally would be granted the same authority to transact business in the state and have the same rights and privileges as domestic limited liability companies would have. The bill would also permit a foreign company that had been authorized to operate in this state to withdraw from operating here, and specifies how this would be done and the obligations and liabilities for which the company could still be responsible.

A foreign limited liability company operating in the state without a certificate of authority could not maintain an action, suit or proceeding in a court of this state until it had obtained a certificate of authority. An action commenced by a foreign company without a certificate, however, could not be dismissed if a certificate was obtained before the order of dismissal was made. Any dismissal order would have to be without prejudice to the recommencement of the action, suit or proceeding by the foreign company after it obtained a certificate of authority. This prohibition would also apply to a successor in interest of a foreign company (except receivers, trustees in bankruptcy, or other representatives of creditors of the company) and an assignee of the foreign company, except an assignee of value who accepted an assignment without knowing that the foreign company should have but did not obtain a certificate of authority here. The bill would establish various penalties and fines (up to $10,000) that could be imposed on a foreign company that operated in the state without a certificate of authority. A foreign company found by a court to have operated in the state in violation of the bill could be restrained by the court from operating any longer in the state, and would be enjoined from continuing to operate here until all civil penalties, plus any interest and court costs, had been paid and a certificate obtained by the foreign company. A member of a foreign company would not be liable for the debts and obligations of it solely because the company had transacted business in the state without a valid certificate of authority.

Specifically, a foreign limited liability company would not be considered to be transacting business in the state if it carried on any of the following activities here:
* maintained, defended or settled any proceeding;
* held meetings of its members or carried on any other activities concerning its internal affairs;
* maintained bank accounts;
* maintained offices or agencies for the transfer, exchange and registration of its own securities, or maintained trustees or depositaries with respect to those securities;
* sold through independent contractors;
* solicited or obtained orders, whether by mail or through employees or agents or otherwise, if the orders required acceptance outside the state before they became contracts;
* created or acquired indebtedness, mortgages and security interests in real or personal property;
* secured or collected debts or enforced mortgages and security interests in property securing the debts;
* owned real or personal property;
* conducted an isolated transaction that was completed within 30 days and that was not one of many transactions of a similar nature; or
* transacted business in interstate commerce.

Article 11 - Fees, Other Provisions. Any document required to be filed with the administrator under the bill would have to be accompanied by the appropriate fee, as follows:
* certificate of correction, $25;
* articles of organization, $50;
* amendment to the articles of organization, $25;
* restated articles of organization, $50;
* application to reserve a company name, $25;
* certificate of assumed name or a certificate of termination of an assumed name, $25;

* annual statement of resident agent and registered office, $5;
* notice or resignation of resident agent, or statement of change of registered office or resident agent, $5;
* certificate of merger, $100;
* certificate of abandonment, $10;
* certificate of dissolution, $10;
* application of a foreign limited liability company for issuance of a certificate of authority to transact business, $50;
* certificate correcting a statement contained in an application for a certificate of authority to transact business, $25;
* certificate attesting to the occurrence of a merger of a foreign limited liability company, $10; and
* application for withdrawal and issuance of a certificate of withdrawal of a foreign limited liability company, $10.

In addition to these fees, the administrator could charge a fee of $50 if a document was filed by facsimile transmission, or the administrator was asked to transmit a document in this manner. The fees would be nonrefundable and, when collected, would have to be paid to the state treasury and credited to the administrator for sole use of the Corporations and Securities Bureau (within the Department of Commerce) in carrying out its duties under the bill. A minimum charge of $1 for each certificate and 50 cents per folio would have to be paid to the administrator for certifying a part of a file or record related to a limited liability company for which provision for payment was not set forth under the bill. An interest in a limited liability company to which the bill's provisions would apply would be a security to the same extent as an interest in a corporation, partnership or limited partnership was a security.

FISCAL IMPLICATIONS:

The Department of Treasury estimates that the bill will result in a loss of $6 - $7 million annually in tax revenue to the state as limited liability companies are expected to pay lower intangibles taxes and single-business taxes compared to what they would if organized as another type of business entity. This estimate depends entirely on the number of limited liability companies that are formed under the bill. (5-26-93)

The Corporations and Securities Bureau (of the Department of Commerce) also reports that the bill's fiscal impact to the department would depend on the number of limited liability company partnerships that are formed under the bill's provisions and the amount of additional work that will have to be performed relative to them. According to a bureau spokesman, the bureau does not yet know what its costs will be under the bill, but revenues from the $50 filing fee and other fees proposed in the bill should be enough to cover its administrative costs under the bill. (5-19-93)

ARGUMENTS:

For:

The bill would make Michigan a more attractive place to do business, especially for smaller businesses, by allowing persons either to organize a new business as a limited liability company, or to convert an existing enterprise that qualified into this business form. The limited liability company form offers the tax advantages of the partnership--LLC members pay federal taxes on company profits only at the personal level, and may deduct certain business losses that otherwise do not "pass through" to individual shareholders in a corporation--and the "limited liability" advantage of the corporate structure--LLC members may actively manage the company without undertaking risk of personal liability for its debts. Although a Michigan business currently may elect to be treated as an S-corporation for federal tax purposes, this business form is limited by the IRS to companies with 35 shareholders or less and faces a number of other restrictions.

Essentially, an unincorporated organization cannot, according to IRS regulations, have more than two of the corporate characteristics of 1) limited liability, 2) centralized management, 3) continuity of life or 4) free transferability of interest, if it is to avoid being considered a corporation. A company formed under the bill's provisions would have to have the characteristic of limited liability, but could choose any one of the other three distinguishing features. Moreover, a company formed under the bill could be formed for any purpose that a business organized under the Business Corporation Act or the Professional Services Corporation Act may be formed. Over fifteen states now permit the limited liability company form, and many others are considering legislation that would permit their organization and operation.

Against:
According to a spokeswoman with the Department of Treasury, the bill could result in up to $7 million annually in reduced tax revenue to the state, as any limited liability companies created under the bill would pay less intangibles taxes and single-business taxes to the state than they otherwise would as a limited partnership, corporation or other business form. The state, at a time when the budget is tight, cannot afford to lose this revenue.

Response:
Although the state could in the early years after the bill's implementation receive less revenue that it otherwise would via the intangibles tax and the SBT, it is expected that authorizing limited liability companies to operate here will ultimately attract more business to the state in the long run, and thereby provide an overall boost to the state's economy and its tax coffers. In fact, with more states moving toward legalizing the creation and operation of LLCs, the state could one day find itself at a competitive disadvantage in attracting businesses if it fails to act now to allow LLCs to operate here.

Against:
Some states that now allow limited liability companies to be organized specifically prohibit them from engaging in certain regulated businesses, such as banking, insurance and professional services.

Response:
Limited liability companies would automatically be barred from engaging in banking and insurance activities in Michigan as these require licensing under separate state statutes. As for professional services, there is no valid reason to deny limited liability companies from offering these as all members of an LLC would have to be qualified to provide the particular professional service in question. (For instance, all the members or managers of an LLC that wished to offer legal services would have to be licensed attorneys.) And members of a professional service LLC would be liable for personal negligence or other unlawful conduct as are partners in professional service firms now operating in Michigan.

Against:
The IRS has not yet ruled on a number of issues concerning limited liability companies and could begin to reconsider the way it treats them for tax purposes as more states (especially those that have a larger corporate tax base) begin to allow them. In addition, because limited liability companies are still relatively new, federal bankruptcy laws do not specify how they should be treated. These and other issues should be addressed at the federal level before limited liability companies are allowed to be organized and operated here.

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LIMITED LIABILITY COMPANIES

House Bill 4023 (Substitute H-1)
First Analysis (2-16-93)

Sponsor: Rep. Kirk A. Profit
Committee: Business & Finance

THE APPARENT PROBLEM:

Individuals interested in organizing a company for business purposes may choose from among various business forms in Michigan, including general partnerships, limited partnerships, corporations or other for-profit or non-profit business entities. In choosing how to organize, participants and other investors must consider a number of things, such as whether the company is to be managed by a few partners or many investors, to what extent will partners or other investors be personally liable for the company, how will the earnings of the company and its investors be taxed under federal, state and local laws, and similar considerations. Each of the different business forms has advantages and disadvantages, and organizers must determine which one could best help them to achieve their specific business goals. For instance, the general partnership offers flexibility in the way a company may be managed, but puts the participants' personal assets at risk for business liabilities. Under a limited partnership, however, those who invest as "limited" partners have their personal assets shielded, but, in turn, may not participate in managing the enterprise; this falls to one or more "persons" (individuals or entities) who serve as general partners having personal liability for the partnership obligations. On the other hand, an investor in a company that incorporates is not personally liable, beyond the amount invested, for business debts and may participate as a shareholder in managing the business, but the company itself is subject to fairly complex laws that require regular filings with the state, regulate how it is to be structured, and govern various internal procedures such as meetings and voting. Shareholders in a corporation also face the prospect of double taxation, where corporate income is taxed at the corporate level and then taxed again at the investor level if distributed to shareholders. Although some corporations may elect to be treated as so-called "S-corporations" to significantly reduce this tax burden, the federal tax code limits the qualification for this special treatment to corporations with fewer than 35 shareholders, and imposes various other limitations on this business form.

In recent years, individuals looking to organize a business or those already in business have looked to a new form of business entity, the limited liability company, that combines the best features of the partnership and corporation. The limited liability company form provides its "members" (those with an interest in the company) protection against personal liability for the debts of the business, and offers them flexibility in structuring a company's internal organization, management and procedures. But more importantly, a limited liability company--assuming its operating agreement is drafted properly--should be able to secure the same federal tax treatment as a partnership if, as many tax law experts expect, the Internal Revenue Service (IRS) confirms the status of limited liability companies for tax purposes. A number of states have authorized the formation and operation of limited liability companies within their borders and some people believe Michigan should, too.

THE CONTENT OF THE BILL:

The bill would create the Michigan Limited Liability Company Act to allow a limited liability company, defined under the bill as "an entity that is an unincorporated association having 2 or more members" and was formed under the bill, to be formed in Michigan.

Article 1 - General Provisions. Article one of the bill defines the terms used throughout the proposed act and contains provisions regarding the filing of the articles of organization and other documents that would be needed to form a limited liability company. Among other things, its provisions would:
* require any documents that had to be filed under the bill or by law to be delivered to and filed with the Department of Commerce (the "administrator"