The Limited Liability Company:  
A New Way to Do Business Internationally

By Anthony Cipiti, Jr.

The two basic forms of business organization in the United States are corporations and partnerships. Each form has certain advantages and disadvantages. One of the most important advantages of the corporate form is that liability for claims against the corporation is limited to the corporation’s own assets—the personal assets of its shareholders are not at risk. Partnerships, on the other hand, do not shield the personal assets of partners. They do, however, permit the avoidance of tax at the entity level, meaning that all tax consequences pass through to the partners individually. Various hybrid forms of business organization have been devised over the years to provide, subject to certain restrictions, both limited liability and the avoidance of “double taxation” (taxation of the entity as well as its owners). The most recent development in this regard, and the least restrictive form of hybrid business organization, is the “limited liability company,” or LLC.

LLCs first appeared in the United States in 1977, in Wyoming. Despite the attractive combination of limited liability and pass-through tax treatment, other states did not rush to adopt similar legislation. One reason for this was uncertainty about whether the Internal Revenue Service (IRS) would allow an LLC to be classified as a partnership for federal income tax purposes. In 1988, the IRS indicated that it would do just that. Since then, a growing number of states (19 at last count) have enacted LLC legislation, more than half in 1992 alone. LLC legislation is being considered in many other states as well.

Global Attraction

Although still in the developmental stage, LLCs are generating a great deal of interest in business and legal circles. They are expected to be particularly useful in joint ventures and real estate projects, and as investment holding companies. Moreover, they are ideally suited for transactions involving foreign investors. This is most readily apparent when LLCs are compared with other hybrid forms of doing business in the United States: S corporations and limited partnerships. S corporations, which are creatures of US tax laws, allow for both limited liability and the avoidance of double taxation, but foreign investors are prohibited from owning shares in them. Foreign investors can own interests in limited partnerships, which afford both limited liability and pass-through tax treatment for their limited, or passive, partners, but not for their general, or managing, partners. Thus a foreign investor can achieve limited liability and favorable tax treatment (as a limited partner) only by foregoing any role in the operation of the business. An LLC is the first and only business form available to foreign investors that provides for limited liability, pass-through tax treatment, and active participation in management.
As such, LLCs are likely to be used extensively in business transactions involving US and foreign participants.

**Principal Characteristics**

An LLC may engage in any lawful business, and may hold ownership interests in corporations, partnerships, and other LLCs. Strictly speaking, an LLC can have any number of owners (who are called “members”). As a practical matter, however LLCs are best suited for situations in which the number of members is fairly small, because the consent of each member is required in certain cases.

An LLC can be managed either like a partnership, with each owner having a role in management, or like a corporation, with management functions being delegated to one or more managers, who can be members or nonmembers.

Members typically will vote in proportion to the amount of their capital contributions, but this can be varied by agreement. Indeed, in some states it is possible to divide members into different groups or classes. Similarly, although an LLC will probably allocate profits and losses and make distributions in proportion to capital contributions in most cases, it is possible to provide for disproportionate allocation and distribution. The flexibility allowed in voting and in allocations and distributions is a key reason why LLCs are expected to be popular.

**Things to Keep in Mind**

It is critical that an LLC be structured in conformation with IRS guidelines, to ensure taxation as a partnership rather than as a corporation. Moreover, because LLCs are new, there are some unsettled issues attending their use. One example: since most states have not yet adopted LLC legislation, care must be taken to protect a member’s limited liability status if an LLC does business in a non-LLC state. (This can often be achieved contractually.) Another example is uncertainty concerning how LLC ownership interests will be treated under US securities laws. (The answer will probably depend on whether the LLC is managed like a partnership or a corporation.)

As more states adopt LLC statutes and the use of LLCs becomes more common, the unsettled issues will disappear. Even now, though, LLCs merit serious consideration in any transaction involving a foreign participant.

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