

Corporation or LLC? Comparing Nontax Differences

Although tax considerations are a critical factor in selecting a business entity, nontax differences impact the day-to-day operations, and possibly even the long-term success, of a closely held business. Below are some questions and considerations that highlight key nontax differences between the corporation and LLC. (This comparison is tailored to the concerns of a closely held entity.)
Caution: State law varies widely. This chart features high-level differences, but there is no substitute for individual state law research.

<p>MANAGEMENT CONTROL</p> <p><i>Number of owners: Short- and long-term, how many owners are anticipated? How many will be able to control business decisions?</i></p> <p><i>Deadlock resolution: How will deadlocks be resolved?</i></p> <p><i>Change of control or ouster: What ability will other owners have to "oust" those in control?</i></p>	<p>Corporation</p> <ul style="list-style-type: none"> ▪ Most management issues determined by statute ▪ Management vested in board of directors by statute ▪ Can override statutory defaults only in very limited circumstances ▪ Shareholder management functions are indirect and limited—voting to elect/remove directors and on major structural changes ▪ Day-to-day affairs are managed by officers chosen by board of directors <p>LLC</p> <ul style="list-style-type: none"> ▪ Most management issues determined by operating agreement ▪ Management vested in members as statutory default ▪ Operating agreement overrides statute and can provide for manager-managed LLC ▪ Members, as well as non-members, can serve as managers ▪ Members and/or managers may manage day-to-day affairs or appoint officers to do so
<p>SALES OF INTERESTS</p> <p><i>IPO expectations: Are there plans to go public? Is it important to be able to do so more easily in the future?</i></p> <p><i>Merger or acquisition expectations: Within the industry, what is the "market" for LLC interests versus corporate shares?</i></p> <p><i>Retirement: Do any of the owners plan to eventually sell their interests?</i></p>	<p>Corporation</p> <ul style="list-style-type: none"> ▪ Shareholders can freely sell shares without approval, unless limited by buy-sell agreement ▪ Sale of shares includes financial & ownership rights ▪ Multi-step, statutory procedures must be followed when shareholders assert their right to dissent to merger and have their shares appraised and purchased by the corporation <p>LLC</p> <ul style="list-style-type: none"> ▪ Sale of financial right is without restriction ▪ Sale of ownership right requires approval of other members ▪ Dissenters' rights are specifically granted by some LLC acts; others allow LLC to grant this right and specify the procedure in the operating agreement

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FORMATION DOCUMENTS		Privacy concerns: How much information does formation state require to be included in formation documents? Does this state require any other information to be made publicly available, and if so, what?
Corporation	<ul style="list-style-type: none"> Corporation is created by filing articles of incorporation with state Usually required to provide more information than LLC More information required than needed for mere notice of corporation's existence Decision to opt-out of some statutory defaults (when possible) must be made in articles of incorporation (others may be made in bylaws) Requires shareholder approval to amend articles of incorporation 	LLC
Corporation	<ul style="list-style-type: none"> LLC is created by filing articles of organization with state Usually required to provide less information than corporation Only information sufficient to provide public with notice of entity's existence usually suffices Operating agreement (generally not a public document) can contain opt-out language for statutory defaults Operating agreement sets terms by which it can be amended 	LLC
MANAGEMENT DOCUMENTS		Investment terms: What kind of terms does the business expect to be able to obtain from investors? Flexibility in allocating profits and losses: How much flexibility is desired in allocating profits and losses among the owners?
Corporation	<ul style="list-style-type: none"> Bylaws are required by most states Bylaws are often perfunctory and seldom go beyond rights, duties, powers of shareholder, directors and officers 	LLC
Corporation	<ul style="list-style-type: none"> Operating agreement is optional in many states (without an operating agreement, the LLC will be governed by the default provisions of the statutes) Operating agreement is generally comprehensive, establishes the way the LLC conducts business, defines duties of members and sets financial rights/obligations 	LLC

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MEETING REQUIREMENTS		Compliance with formalities: Are the owners comfortable with having to comply with formal meeting requirements?	
Corporation	<ul style="list-style-type: none"> Organizational meeting is required Annual shareholder meeting statutorily required Board of directors must make decisions at valid meeting Statutory notice required for meeting to be valid Statutory quorum must be met for actions to be valid 	LLC	<ul style="list-style-type: none"> No statutory organizational meeting required No annual member meeting statutorily required Operating agreement determines who makes decisions and whether meeting is required No statutory notice required for meeting to be valid No statutory quorum necessary for actions to be valid
JUDGMENT CREDITORS		Rights of potential creditors: How important is protection from a judgment creditor attaching an owner's management interest? Bankruptcy of one or more owners: What happens to the business interest if an owner becomes insolvent or files bankruptcy?	
Corporation	<ul style="list-style-type: none"> Judgment creditor can attach shareholder's stock obtaining both economic rights and right to vote If shareholder holds majority interest, creditor can force liquidation 	LLC	<ul style="list-style-type: none"> Judgment creditors' rights limited to charging order giving only economic, not management, rights (exceptions may apply for single-member and husband/wife LLCs)

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FIDUCIARY DUTIES	
Alteration of traditional duties: Should directors or managers be bound by traditional duties of loyalty and care, or is it important to be able to alter or to specifically define the boundaries of the duties?	
Corporation	LLC
<ul style="list-style-type: none"> ▪ Statutes constrain ability to eliminate fiduciary duties ▪ Only monetary liability for breach of duty of care can be eliminated ▪ Duty of loyalty cannot be eliminated ▪ Statutes usually require corporations to indemnify directors or officers who were wholly successful in defending themselves for actions they took during the course of their employment 	<ul style="list-style-type: none"> ▪ Several states provide that duties of care and loyalty can be restricted or eliminated by operating agreements ▪ States vary on required indemnification of members and managers for liabilities incurred in ordinary course of business
DIVIDENDS	
Ability to force distributions: How important is it for minority interests to be able to require distributions? Flexibility: How important is flexibility in allocation of distributions among owners?	
Corporation	LLC
<ul style="list-style-type: none"> ▪ Board of directors decides when dividend will be paid ▪ Dividends are allocated on per-share basis based upon class of stock 	<ul style="list-style-type: none"> ▪ Operating agreement determines who decides when distribution will be paid ▪ Operating agreement determines how distributions are allocated

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NONPROFIT ENTITIES		Certainty: How important is it to have clear statutory authority and substantial precedent?
Corporation	<ul style="list-style-type: none"> Nonprofit corporations governed by well-settled law Most states have separate nonprofit corporation statutes 	LLC
		<ul style="list-style-type: none"> Nonprofit LLC law is not well-settled Many states do not have separate non-profit LLC statutes: The non-profit purpose is set forth in the articles of organization filed with the state

SOCIAL ENTERPRISE ENTITIES (BENEFIT CORPORATIONS AND LOW-PROFIT LLCs)		State of formation: Does the state of formation have a benefit corporation or L3C statute?
Corporation	<ul style="list-style-type: none"> Benefit corporation is most common corporate social enterprise entity Only a minority of states have benefit corporation statutes Directors are required to consider non-shareholder stakeholders Directors must report on corporation's progress in achieving goals 	LLC
		<ul style="list-style-type: none"> Low-profit limited liability company (L3C) is most common LLC social enterprise Only a few states permit organizing as L3C Obligations are governed by operating agreement