



## **Upkeep and Maintenance of Your Limited Liability Company**

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You have started a new enterprise or invested in income producing property and discovered how simple it is to set up a Limited Liability Company (“LLC”). An LLC can offer significant limited liability protection by shielding you from personal liability with respect to the operation of your LLC’s business and personal asset protection by protecting your personal assets outside the LLC but lacks the strict formality of a corporation. What’s more, it is very easy to create an LLC – in most states you can create an LLC online in minutes by registering online with the state and applying for a taxpayer identification number on the IRS website.

Unfortunately, many LLC owners are busy running the day-to-day operations of their LLC’s business and neglect to attend to some easy but critical requirements to maintain the legal status and integrity of the LLC. These failures can result in the loss of the limited liability protection and personal asset protection features the LLC was set up to avoid and expose the owner to significant personal liability.

### **Failure to file annual report**

The mistake we see most often is failure to keep up with the state’s annual reporting or franchise tax payment rules. Each state has its own unique laws for reporting and/or fees. All domestic LLCs and all foreign LLCs registered in Massachusetts must file an annual report each year on the anniversary of the date the certificate of organization/certificate of foreign registration was filed, along with a fee of \$500 (and online filing fee of \$20). The annual report is a very short form confirming the purpose, management and contact information for the LLC. It may be filed online or by mail with the Secretary of the Commonwealth. Other states have their own reporting requirements and fees and LLCs registered in more than one state must pay close attention to each set of state specific rules.

States may or may not send out reminders to the LLC that the annual report or fee is due, so it is important that the manager of the LLC or other responsible person calendar the due date. Depending on the state, there may be late fees or penalties for late filing. The real danger in not complying with the state deadlines is that the LLC may no longer be “in good standing” and may eventually be terminated by the state or administratively dissolved by the state. A terminated or administratively dissolved LLC does not exist as an entity who can bring a lawsuit or defend itself against a lawsuit. The owners of the terminated LLC may be personally liable for the debts of the LLC and may lose their homes and personal financial accounts to any judgement arising out of LLC activities.

Additionally, contracts entered into with an LLC not in good standing at the time of the contract may be voidable by the other party.

An LLC can typically regain good standing by paying all back fees/taxes and filing all annual reports in order to be reinstated retroactive to the date it was terminated or administratively dissolved. However, the owners may not be protected from personal liability regarding events that arose during the time the LLC was not in good standing.

Another frequent complication of falling out of good standing is that a new LLC may register with the same name, forcing the revived LLC to change its original name. This can be devastating to a company that has built its reputation with an original and well-known name. For instance, Charlotte is an accomplished website designer and sets up her own LLC, filing with the Secretary of State as “Charlotte’s Web Designs, LLC”. While Charlotte is extremely successful over a decade and builds up an amazing reputation, she forgets to file her annual report. The LLC is terminated by the state, which Charlotte may not necessarily receive any notice of. Meanwhile, Emma is starting up her own website design company and thinks “Charlotte’s Web Designs, LLC” would be the perfect name, and her research shows no active LLC in the state is using that name. Emma can now file her LLC with the state as “Charlotte’s Web Designs, LLC”. Charlotte has lost the right to that unique name.

### **Failure to maintain a registered agent**

Because an LLC is an entity apart from its owner, it has to consent to be sued in its own capacity. A registered agent is a person or corporation in the LLC's home state who agrees to accept service on behalf of the LLC. A domestic LLC often uses the home or office address of one of its principals. There are many professional registered agent companies that will also serve as registered agent for an annual fee. Sometimes the LLC will neglect to pay the registered agent's annual fee, which leads to the resignation of the agent, which leads to the LLC falling out of good standing and/or termination as detailed above. As with the annual report, the registered agent's annual fee should receive prompt attention.

#### **Failure to observe formalities**

An LLC is its own entity and must be treated with formalities which set it apart from its owner or owners. It must have its own taxpayer identification number and bank account. The owner should be careful to not mingle his or her own funds with the operational account of the LLC. For instance, all LLC expenses should be paid from the LLC bank account or a credit card in the name of the LLC. Contracts should not be signed in an owner's individual capacity, but as a member or manager of the LLC. A failure to clearly distinguish LLC assets from assets of the LLC owners can lead to a claim that the LLC is a sham organization and that the owners should be personally liable for debts of the LLC.

#### **Failure to have an operating agreement**

We often receive anxious calls from clients who have had a falling out with, or the sudden death of, a business partner. A detailed operating agreement, signed when the LLC is first formed and reviewed over the years, can guide the LLC owners through the next steps when such a crisis occurs.

An operating agreement is not required in many states, including Massachusetts; however, even a member-managed LLC with one member should execute an operating agreement to formalize the creation of the entity and address governance, tax matters, financial terms, equity transfer restrictions, and management of the LLC. An LLC with two or more individuals involved should have an operating agreement to cover all

potential future disagreements, such as major financial transactions, transfer and/or sale of membership interest, what happens when an owner or manager dies, acceptance of new members, and procedures for termination or sale of the LLC or the assets of the LLC. Fortunately, an attorney familiar with LLCs will be able to draft a comprehensive operating agreement to cover a wide range of potential issues.

In addition, depending on the purpose and use of the LLC, the LLC should obtain and maintain customary business insurance policies and insurance coverage. The use of an LLC should not be a substitute or replacement for a business having and maintaining adequate levels of insurance coverage for its business operations, but rather the LLC should serve as a frontline defense to provide limited liability protection and personal asset protection in addition to insurance coverage for the operations of the LLC's business and assets.

The attorneys at Wilchins Cosentino & Novins LLP have a wide range of expertise in advising clients on LLC issues and general business law, including strategic business planning for commercial transactions, licensing, mergers and acquisitions, debt and equity financings and employment. We have also counseled our clients through challenging corporate governance issues such as generational transfers, corporate divorces and other changes of control to ensure compliance with the rights of shareholders and creditors. Please contact the Private Clients Group at Wilchins Cosentino & Novins LLP if you would like more information on the topics discussed in this article.

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