

Limited Liability Company FAQ

Answers to common questions about starting and running an LLC.

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What is a limited liability company?

A limited liability company, commonly called an "LLC," is a business structure that fits somewhere between the partnership or sole proprietorship and the corporation. Like owners of partnerships or sole proprietorships, LLC owners report business profits or losses on their personal income tax returns; the LLC itself is not a separate taxable entity.

Like a corporation, however, all LLC owners are protected from personal liability for business debts and claims -- a feature known as "limited liability." This means that if the business owes money or faces a lawsuit for some other reason, only the assets of the business itself are at risk. Creditors normally can't reach the personal assets of the LLC owners, such as a house or car. (Both LLC owners and corporate shareholders can lose this protection by acting illegally, unethically, or irresponsibly.)

For these reasons, many people say the LLC combines the best features of both the partnership and corporate business structures. To learn more about limited liability companies and limited liability, see [LLC Basics](#).

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How many people do I need to form an LLC?

You can be the sole owner of your LLC (limited liability company) in all states. For more information on forming an LLC, see [How to Form an LLC](#).

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Who should form an LLC?

You should consider forming an LLC (limited liability company) if you are concerned about personal exposure to lawsuits arising from your business. For example, if you decide to open a store-front business that deals directly with the public, you may worry that your commercial liability insurance won't fully protect your personal assets from potential slip-and-fall lawsuits or claims by your suppliers for unpaid bills. Running your business as an LLC may help you sleep better, because it instantly gives you personal protection against these and other potential claims against your business.

Not all businesses can operate as LLCs, however. Businesses in the banking, trust, and insurance industry, for example, are typically prohibited from forming LLCs. In addition, some states, including California, prohibit professionals such as architects, accountants, doctors, and licensed healthcare workers from forming LLCs.

For more information on forming an LLC, read [How to Form an LLC](#).

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How do I form an LLC?

In most states, the only legal requirement is that you file "articles of organization" with your state's LLC filing office, which is usually part of the secretary of state's office. (A few states refer to this organizational document as a "certificate of organization" or a "certificate of formation.") Most states provide a fill-in-the-blank form that takes just a few minutes to prepare. You can obtain the form by mail or download it from your state's website (check your state's secretary of state or corporations division home page).

A few states require an additional step: Prior to filing your articles of organization, you must publish your intention to form an LLC in a local newspaper.

You'll also want to prepare an LLC operating agreement, though it isn't legally required in most states. Your operating agreement explicitly states the rights and responsibilities of the LLC owners. The main reasons to do this are to clarify your business arrangements, and to vary from the requirements of your state's LLC laws. If you don't create a written operating agreement, the LLC laws of your state will govern your LLC.

You can use self-help books or software to guide you through the process of creating personalized articles of organization and writing an LLC operating agreement. For more information, see [How to Form an LLC](#).

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Do I need a lawyer to form an LLC?

No. All states allow business owners to form their own LLC by filing articles of organization. In most states, the information required for the articles of organization is non-technical -- it typically includes the name of the LLC, the location of its principal office, the names and addresses of the LLC's owners, and the name and address of the LLC's registered agent (a person or company that agrees to accept legal papers on behalf of the LLC).

Now that most states provide downloadable fill-in-the-blank forms and instructions, the process is even easier. And LLC filing offices are becoming more accustomed to dealing directly with business owners; they often allow business owners to email questions to them directly.

Of course, if you're trying to decide whether the LLC is the right structure for your business, you may want to consult an expert. You may also want an expert to review your operating agreement or set up your bookkeeping and accounting systems.

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Does my LLC need an operating agreement?

Although most states' LLC laws don't require a written operating agreement, you shouldn't consider starting business without one. Here's why an operating agreement is necessary:

- It helps to ensure that courts will respect your personal liability protection by showing that you have been conscientious about organizing your LLC.
- It sets out rules that govern how profits will be split up, how major business decisions will be made, and the procedures for handling the departure and addition of members.
- It helps to avert misunderstandings between the owners over finances and management.
- It keeps your LLC from being governed by the default rules in your state's LLC laws, which might not be to your benefit.

For more information, see [Creating an LLC Operating Agreement](#).

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How are LLCs taxed?

Like sole proprietorships (one-owner businesses) and partnerships, an LLC is not considered a separate entity from its owners for tax purposes. This means that the LLC does not generally pay any income taxes itself; instead, the LLC owners pay taxes on their allocated share of profits (or deduct their share of business losses) on their personal tax returns.

LLC owners can elect to have their LLC taxed like a corporation. This may reduce taxes for LLC owners who will regularly need to retain a significant amount of profits in the company. For more on reporting and paying taxes as an LLC owner, see [How LLCs Are Taxed](#).

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What are the differences between a limited liability company and a partnership?

The main difference between an LLC and a partnership is that LLC owners are not personally liable for the company's debts and liabilities. This means that creditors of the LLC usually cannot go after the owners' personal assets to pay off LLC debts. Partners, on the other hand, do not receive this limited liability protection unless they are designated "limited" partners in their partnership agreement.

Also, owners of limited liability companies must file formal articles of organization with their state's LLC filing office, pay a filing fee, and comply with certain other state filing requirements before they open for business. By contrast, people who form a partnership don't need to file any formal paperwork and don't have to pay any special fees.

LLCs and partnerships are almost identical when it comes to taxation, however. In both types of businesses, the owners report business income or losses on their personal tax returns; the business itself does not pay tax on this money. In fact, LLC and partnerships file the same informational tax return with the IRS (Form 1065) and distribute the same schedules to the business's owners (Schedule K-1, which lists each owner's share of income).

For more information on LLCs, see the [Limited Liability Companies](#) section of Nolo's website. To learn more about partnerships, see the [Partnerships](#) section. Finally, for guidance on deciding which ownership structure is most suitable for your business, read [Choosing the Best Ownership Structure for Your Business](#).

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Can I convert my existing business to an LLC?

Yes. Converting a sole proprietorship or a partnership to an LLC is an easy way for sole proprietors and partners to protect their personal assets without changing the way their business income is taxed.

Some states provide a simple form for converting a partnership to an LLC (often called a "certificate of conversion"). Sole proprietors and partners in states that don't provide a conversion form must file regular articles of organization to create an LLC.

In some states, before a partnership can officially convert to an LLC, it must publish a notice in a local newspaper that the partnership is being terminated. And in all states, you'll have to transfer all identification numbers, licenses, and permits to the name of your new LLC, including:

- your federal employer identification number
- your state employer identification number
- your sales tax permit
- your business license (or tax registration), and
- any professional licenses or permits.

For general information on forming an LLC, read [How to Form an LLC](#).

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Do I need to know about securities laws to set up an LLC?

If you'll be the sole owner of your LLC and you don't plan to take investments from outsiders, your ownership interest in the LLC will not be considered a "security" and you don't have to concern yourself with these laws. For co-owned LLCs, however, the answer to this question is not so clear.

First, let's consider the definition of a "security." A security is an investment in a profit-making enterprise that is not run by the investor. Here's another way to think about it: If a person invests in a business with the expectation of making money from the efforts of *others*, that person's investment is generally considered a "security" under federal and state law. Conversely, when a person will rely on his or her own efforts to make a profit (that is, he or she will be an active owner of an LLC), that person's ownership interest in the company will not usually be treated as a security.

How does this apply to you? Generally, if all of the owners will actively manage the LLC -- the situation for most small start-up LLCs -- the LLC ownership interests will not be considered securities. But if one or more of your co-owners will not work for the company or play an active role in managing the company -- as may be true for LLCs that accept investments from friends and family or that are run by a special management group -- your LLC's ownership interests may be treated as securities by your state and by the federal Securities and Exchange Commission (SEC).

If your ownership interests are considered securities, you must get an exemption from the state and federal securities laws before the initial owners of your LLC invest their money. If you don't qualify for an exemption to the securities laws, you must register the sale of your LLC's ownership interests with the SEC and your state.

Fortunately, smaller LLCs, even those that plan to sell memberships to passive investors, usually qualify for securities law exemptions. For example, SEC rules exempt the private sale of securities if all owners reside in one state and all sales are made within the state; this is called the "intrastate offering" exemption. Another federal exemption covers "private offerings." A private offering is an unadvertised sale that is limited to a small number of people (35 or fewer) or to those who, because of their net worth or income earning capacity, can reasonably be expected to be able to take care of themselves in the investment process. Most states have enacted their own versions of these popular federal exemptions.

For more information about SEC exemptions, visit the SEC website at <http://www.sec.gov/smbus/qasbsec.htm#eod6>. A quick way to research your state's exemption rules is to go to the home page of your state's securities agency, which typically posts the state's exemptions rules and procedures. To find your state securities agency, go to your secretary of state's website. The Wyoming Secretary of State's office provides a list of state websites at <http://soswy.state.wy.us/sos/sos2.htm>.