An Introduction to Limited Liability Companies and Limited Liability Partnerships

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COMPARISON OF BUSINESS ENTITIES

The Limited Liability Company and Limited Liability Partnership are only two of multiple available choices of business entities. The following chart briefly analyzes the advantages and disadvantages of many of the more common business entities:

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<th>Survey of Business Entities</th>
<th>Sole Proprietorship</th>
<th>General Partnership</th>
<th>LP</th>
<th>LLC</th>
<th>S-Corp</th>
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<td>Liability</td>
<td>Unlimited personal liability</td>
<td>Unlimited personal liability, but with rights of contribution</td>
<td>GP’s - Unlimited personal liability; LP’s - Limited to investment</td>
<td>Limited to equity</td>
<td>Limited to equity</td>
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<td>Control</td>
<td>Full authority</td>
<td>Each partner has full authority</td>
<td>GP’s have full authority; LP’s have no authority</td>
<td>Can be member-managed or manager-managed.</td>
<td>Shareholders have few management rights; management by Board and Officers</td>
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<td>Transfer of Ownership</td>
<td>Transfer of assets</td>
<td>Partnership interest is transferable; any partner can cause dissolution</td>
<td>Interest is transferable; any general partner can cause dissolution</td>
<td>Distribution rights transferrable; membership rights generally not transferable</td>
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Origins of Mississippi LLC’s

The Limited Liability Company came into existence in response to a demand for an organization that affords its owners limited liability, but is not subject to the double tax regime applicable to corporations.1 The first limited liability act was passed in Wyoming in 1977,2 followed by Florida in 1982.3 Due largely to uncertainty to tax treatment of entities organized as LLC’s, response to these two acts was underwhelming. It was not until 1990 that another state enacted an LLC statute.4 In 1988, the Internal Revenue Service clarified its position on tax treatment of the LLC entity, and declared that an LLC may be classified as a partnership for federal income tax purposes.5 This clarification resulted in a surge of interest in the LLC, and thereafter, acts authorizing the formation of the LLCs as alternative business entities were passed.

<table>
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<th>Taxes</th>
<th>Formed at individual level; self-employment tax applies</th>
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<th>Choice of taxation as (1) corporation; (2) partnership/sole proprietorship</th>
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<td>None</td>
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<td>Formation documents; complex agreement; annual informational return; accountings</td>
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1Ribstein & Keating on Limited Liability Companies, § 1.02.
throughout the nation. All fifty states and the District of Columbia now recognize limited liability companies as valid business entities.6

Mississippi adopted the Mississippi Limited Liability Act in 1994, thereafter permitting owners of unincorporated entities in Mississippi to enjoy the same benefits of liability protection previously enjoyed by shareholders, while simultaneously enjoying the flexibility and favorable tax treatment of a partnership.7 Unlike corporation acts or the uniform commercial code, there exists no uniform limited liability company act that is followed by all, or even a majority, of states. However, all states generally define an LLC as “an unincorporated entity that is formed or organized through a filing with the state under a state limited liability company statute, the members and managers of which do not have vicarious liability for the obligations of the entity, and the relationship of the members, managers, and the entity is largely governed by an agreement among them or, where the parties have not agreed to the contrary, by the default rules of the state statute.”

Mississippi’s Limited Liability Company Act borrowed from the Mississippi Limited Partnership Act and the Mississippi Business Corporation Act, with additional guidance drawn from the Prototype Limited Liability Company Act, as well as LLC statutes of other states.8

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6 Sargent & Schwidetzky, Limited Liability Company Handbook §§ 5.01, 5.02.


8 McCullough & Dillard, comment, n. 1.
ADVANTAGES OF LLC’S

Limited Liability Companies have several unique advantages over other types of business entities; among which are:

- limited liability enjoyed by members and managers;\(^9\)
- participation in the management of the entity by owners;
- management flexibility;
- distribution flexibility;
- tax flexibility.

LLC’s can either be “member managed” or “manager-managed.” Operation of the “member-managed” Limited Liability Company closely resembles the general partnership, with each member taking an action role in managing the affairs of the business, and possessing the authority to bind the company. The “manager-managed” LLC operates much like a corporation with management authority being vested in designated “managers,” much like shareholders’ selection of directors to manage the affairs of a corporation. The LLC provides very few limitations on voting rights and distributions, permitting voting power to be based on completely different criteria than the criteria used to determine distribution of profits.

Unlike the S-Corporation, there are no limitations on the number or type of “persons” who may be owners of an LLC.\(^10\) The limited liability company is not subject to the strict formalities of Mississippi Business Corporations.\(^11\) Likewise, unless the LLC members elect to receive corporate tax treatment, members may typically include their share of LLC debt in calculating their basis in their LLC ownership.

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\(^9\) WMCA § 79-29-305.

\(^10\) Unlike the S-Corporation, corporations, pension funds, foreign persons, and owners numbering greater that 75, may all be members of the LLC.

\(^11\) West’s Ann. Miss. Code § 79-4-1.01 et. seq.
DISADVANTAGES OF LLC’S

Limited Liability Companies also have distinct disadvantages which must likewise be considered, which include:

☐ default termination upon death, disability, bankruptcy, or withdrawal of a member;\(^\text{12}\)

☐ annual filing with the Secretary of State;\(^\text{13}\)

☐ registration in foreign states in which LLC conducts business;

☐ absence of much legal precedent interpreting the Act;

☐ potential uncertainty regarding issues of taxation;

☐ flexibility touted as most apparent advantage may also result in absence of sufficient certainty and predictability.

MECHANICS OF LLC FORMATION

Certificate of Formation

Mississippi LLC’s are formed upon the filing of a Certificate of Formation\(^\text{14}\) with the Mississippi Secretary of State. The Certificate must set forth: (a) the name\(^\text{15}\); (b) street and mailing address of the registered agent\(^\text{16}\); (c) date of dissolution (if any); and (c) disclosure of whether the entity will “member” managed or “manager” managed.\(^\text{17}\) The Certificate must be signed by the person forming the LLC, however, facsimile signatures are acceptable.\(^\text{18}\) The current fee for filing is $50.00.\(^\text{19}\)

The registered agent may be an individual, or a corporation. The only

\(^{12}\)This disadvantage can be overcome through careful drafting of a Limited Liability Company Agreement or Certificate of Formation.

\(^{13}\)General partnerships require no such filing.


\(^{15}\)Name must contain the words, “Limited Liability Company,” “L.L.C.” or “LLC.”

\(^{16}\)Every LLC must maintain a registered office and agent within the state of Mississippi.


requirement is that the registered agent must maintain an address for service of process within the state of Mississippi. An LLC may change its agent by an amendment to the Certificate. The agent may likewise resign upon 90 days notice to the Secretary of State, following 30 days prior notice to the LLC. In the event a Mississippi LLC has no agent, or its agent cannot otherwise be served with reasonable diligence, the Mississippi Secretary of State becomes its agent for service of process by default.

The Certificate of Formation must also set forth any limitations on the purpose, powers, or limitations placed upon the business. Absent any limitations contained in the Certificate, a Mississippi LLC may carry on any lawful business, purpose, or activity. Additionally, unless otherwise limited by its Certificate, a Mississippi LLC possesses the same powers as an individual to do all things necessary to carry out its business affairs, including, without limitation:

- the power to sue and defend lawsuits;
- lease, acquire, and improve real and personal property;
- sell, pledge, or lease real or personal property;
- enter into contracts; and
- to do any acts not inconsistent with law in furtherance of its business and affairs.

Amendment to the Certificate of Formation

A Certificate of Formation may be amended by filing an amendment with the Secretary of State, and payment of a $50.00 filing fee. The Amended Certificate of Formation may be effective upon filing, or have a future effective date no greater than 90
days from the date of filing. Unless otherwise provided by the Limited Liability Company Agreement (frequently called the Operating Agreement), or Certificate of Formation, all members must unanimously agree to an amendment of the Certificate of Formation.

SUBSTANTIAL COMPLIANCE

Despite placing some formalities on organization of Mississippi LLC’s, the Mississippi Act expressly incorporates and adopts the “substantial compliance doctrine.” Specifically, the Act provides that the typically applied common law rule regarding strict construction of statutory obligations does not apply to the limited liability company act.

“It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”

Accordingly, as long as third parties are on notice that they are dealing with an LLC, and no party suffers loss acting in reliance on an error, misstatement, or omission in the Certificate of Formation, the LLC should continue to be a valid entity, and in substantial compliance with the statute despite technical compliance errors or omissions. However, caution and vigilance are the most prudent practice, notwithstanding the substantial compliance doctrine, as there are no reported cases in Mississippi applying this doctrine.

THE OPERATING AGREEMENT

The Mississippi Act does not require an Operating Agreement, or in the Act’s vernacular, a Limited Liability Company Agreement, however as a practical matter such agreement’s are almost universal in the formation of an LLC, if not formally written, then

29 David Simon & Debra Lee, comment, the substantial compliance doctrine: preserving limited liability under the Uniform Limited Partnership Act, 13 U.C. Davis L. Rev. 924, 938-39 (1980); James A. McCullough, II and L. Bradley Dillard, comment, the Mississippi limited liability company: a new choice for Mississippi, 64 Miss. L.J. 117, 140 (1994).
certainly verbally. From a practical perspective, lending banks expect to see a written Operating Agreement, which is often reason enough to execute such a writing.

As the LLC Certificate of Formation is analogous to corporate articles of incorporation, so the Operating Agreement is analogous to a corporation’s bylaws. The Operating Agreement frequently contains such terms as: dissolution; methods and terms of distributions; recitation of capitalization; recitation of membership interests; voting interests; management obligations of members; and duties of members. Unlike the Certificate of Formation, the Limited Liability Company Agreement is not required to be filed with the Secretary of State, and therefore is often the document of choice in which to memorialize most agreements between the members. In fact, there is no specific requirement that Operating Agreement even be in writing, merely that it be agreed to, although clearly a written Operating Agreement is the more prudent practice. In the absence of a Limited Liability Company Agreement, or where such an agreement is silent on a particular issue, the Mississippi Limited Liability Company Act contains several default provisions governing the operation and management of the LLC.

The Operating Agreement must initially be unanimously agreed to by all members, however, the Certificate of Formation, or the Operating Agreement itself, can provide for less than unanimity in amendment of the Operating Agreement. It is unclear whether multiple or subsequently executed documents can comprise such an operating agreement under the Mississippi Act.

32 Miss. Code Ann. Code § 79 – 29 – 306; compared with Alaska Stat. § 10.50.990(15); Cal. Corp. Code § 17001(ab); Ky. Rev. Stat. Ann. § 3(13), all defining LLC agreements as the agreement “which is binding upon all members.”
33 Miss. Code Ann. Code § 79 – 29 – 306(2)(b);
34 Ribstein & Keating on Limited Liability Companies, § 4.16 (West 2001); Partnership cases have held multiple documents to comprise the partnership agreement; see Westminster I Apartments v. Bernard, 516 N. 2b 476 (Ill App. 1987).
Although most matters concerning the operation of an LLC can be controlled or modified by an Operating Agreement, the Act places certain limitations on indemnification of members and managers, inspection rights of members, minimum duties of care of management, and limitations on distributions. Likewise, certain governing provisions, such as management being vested in one or more managers, and limitations on its power to conduct business, must be contained in its public Certificate of Formation, and not in its private Limited Liability Company Agreement, due to 3rd party concerns.

OPERATION AND STRUCTURE

The ownership rights in an LLC are personal property, and are called a “membership interests.” Once the limited liability company is formed, a person may become a member upon receipt of membership shares from the LLC, upon compliance with any terms contained in the Certificate of Formation or Limited Liability Company Agreement, or if receiving the interest from an individual member, upon consent of all members of the LLC and acceptance of any outstanding Limited Liability Company Agreement.

Limited liability companies may be managed by their members, or by designated managers. If an LLC is manager-managed, it must be so designated by its Certificate of Formation. Unless the Certificate of Formation states otherwise, the LLC is member-managed. The Certificate of Formation may impose restrictions on the powers and

authority of managers. In member-managed limited liability companies, all members are agents of the company and can bind the LLC, much like in a general partnership, unless the members agree otherwise. The activities of a member outside the ordinary scope of the LLC’s business, however, will not bind the LLC unless the activity is expressly authorized.

Where a limited liability company has elected to be manager-managed, and provided such notice in its Certificate of Formation, no member acting alone has authority to bind the LLC. Managers are elected by majority vote of the members, unless otherwise provided. There is no residency requirement. Vacancies are filled by majority vote of the LLC members, unless otherwise agreed. They may be removed by a majority vote of the members.

**MEMBERSHIP RIGHTS**

The Mississippi Act draws a distinction between a “member” and his “membership interest.” “Limited Liability Company Interest” is defined as a member’s share of the profits and losses of a limited liability company and the right to receive distributions of company assets. Governance of LLC’s is, by default based upon per capita vote of members, whereas distributions are, by default, based upon membership interest. These are subject to alteration by the operating agreement or the Certificate. By default, membership interests computed based upon pro rata capital contributions, although the members are free to select alternate methods of computation. This one man/one vote approach provides a simple method of making management decisions.

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which is less prone to error than an approach based on capital contributions which can frequently fluctuate in some businesses and require re-calculation before the casting management decision votes. A membership interest is an economic interest, and unless otherwise provided by the Certificate of Formation or Limited Liability Company Agreement, is freely alienable and assignable as personal property.

LLC’s are permitted to have separate classes or groups of membership with independent rights for distribution, voting, or otherwise, if the members so desire. This flexibility accounts for a much of the recent popularity of LLC’s, when viewed in contrast to the rigid requirements of a corporation, in which shareholder decisions and distributions must both be based upon ownership of stock.

**CAPITAL CONTRIBUTIONS**

A member’s rights to distributions and other financial interests in the limited liability company is based upon the pro rata value of his contributions to the company, unless otherwise agreed. Capital contributions are not limited to cash, but may also include intangibles, such as property, services, or promises to contribute services or cash at a later date. The promise to perform future services or contribute future cash to the LLC in exchange for a present membership interest is unenforceable unless set out in writing and signed by the member. Unless there is a contrary provisions in the Certificate or operating agreement, profits, losses and distributions, must be allocated among the members on the basis of their respective contributions.

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57 While certain mechanisms are available to circumvent this general equality between shareholder voting and shareholder distributions, the results can be attained with greater simplicity through the LLC.
DISTRIBUTIONS

The Act does not provide members any right to distributions prior to withdrawal. Additionally, the only form of distribution to which a member is entitled is cash. There is no right to receive a distribution in any other form, regardless of the nature of the member’s contribution.

Mississippi LLC’s are prohibited from making any distribution which would render the company unable to pay its debts as they become due in the usual course of business, or would otherwise cause the company’s total assets to be less than the sum total of its liabilities plus the amount needed to satisfy any preferential members’ rights upon dissolution, if any. In the event that a distribution is made in violation of this prohibition, all members voting in favor of such a distribution become personally liable to the LLC in the amount that the distribution exceeds the amount which could lawfully have been distributed. This liability is joint and several, with a right of contribution from other members.

LIABILITIES

The hallmark of the Limited Liability Company is the shield of limited liability it provides to its members. Members cannot be held personally liable for acts of the LLC solely due to their membership. Likewise, a member is not a proper party to proceeding against an LLC simply by virtue of membership, except in certain derivative actions against the LLC. This feature of the LLC illustrates a significant difference between LLC’s and partnerships. In partnerships, general partners are personally jointly and severally liable for any and all debts or obligations of the partnership.

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PROFESSIONAL LIMITED LIABILITY COMPANIES

The Act contains special provisions for Limited Liability Companies engaged in providing professional services. A “Professional Limited Liability Company” or PLLC may be formed where all owner-members are authorized, by law, to render a professional service described in the LLC’s Certificate of Formation. In addition to the same rules applicable to LLC’s, PLLC’s must also meet the following additional restrictions:

- limited to rendering professionally licensed services;
- professional services business purpose must be stated in the Certificate of Formation;
- name of entity must designate it as a PLLC; and
- 100% of members must be licensed by a state licensing authority.

Membership transfers are likewise limited to persons licensed in the LLC’s service profession. PLLC’s are required to acquire a members’ membership interest upon the members’ death (unless the members’ successor is also professionally licensed), disqualification through loss of his professional license or otherwise, or if a membership interest is otherwise transferred by operation of law or judgment. In the event of such a compulsory acquisition of membership interest, the PLLC must purchase the interest at “fair value” as of the date of disqualification, as opposed to “fair market value,” thereby mandating valuation without discount for minority ownership or lack of liquidity.

While the liability shield of a PLLC will operate the same as an ordinary LLC for business debts and obligations of the PLLC, members cannot escape personal liability for

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their own professional negligence. However, unlike a general partnership, remaining members of a PLLC are not otherwise personally liable for the professional malpractice of their co-members.

FOREIGN LIMITED LIABILITY COMPANIES

Mississippi permits the registration of foreign limited liability companies to transact business in the state, although the operation of the foreign LLC remains governed by the law of its state of formation. A foreign LLC may register under any name of its choosing, so long as the name would is permissible for a domestic LLC. A registered foreign LLC must appoint an agent for service of process within the state of Mississippi, or otherwise may be served by process upon the Mississippi Secretary of State. Although foreign LLC’s must register with the Mississippi Secretary of State prior to transacting business here, the following acts do not constitute “doing business”: (a) maintaining, defending or settling any proceeding within the state; (b) holding meetings of members or carrying on other activities concerning internal affairs within the state; (c) maintaining bank accounts; (d) maintaining offices for transfer of membership interest; (e) selling membership interests through independent contractors; (f) soliciting and obtaining orders through mail or through employees; (g) creating or acquiring indebtedness for security interest in real or personal property; (h) securing or collecting debts; (i) owning real or personal property; (j) conducting an isolated transaction completed within a period of 30 days; or (k) transacting business in interstate commerce. While not constituting “doing business” for purposes of mandatory registration, this list is not necessarily dispositive of a “doing business” analysis for

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81 Miss. Code Ann. § 79-29-1008.
personal jurisdiction.82

LIMITED PARTNERSHIPS

A partnership, or general partnership, is an association of two or more persons to carry on a business as co-owners for profit. The partners may be individuals or entities. While frequently created as the result of a written agreement, no such agreement is required. Matters not covered by any agreement between the parties are governed by the default provisions under the Mississippi Code. In a general partnership, each partner is equally entitled to participate in managing the affairs of the partnership. Likewise, each partner is personally jointly and severally liable for the obligations and liabilities of the partnership. Unless agreed otherwise, profits and losses of the partnership are shared equally between partners, regardless of capital contribution.

Limited partnerships resemble a the general partnership in many ways. A limited partnership also requires participation by more than one partner. LP’s can engage in any business that a general partnership can engage in.83 However, unlike general partnerships, which require no statutory authority of origin, and no publicly filed formalities to create, LP’s are a statutory creation. Significant differences between general partnerships and LP’s include: (a) a limited partnership requires greater formalities; (b) only general partners have control and are personally liable for partnership obligations; (c) is not as easy to dissolve.

Mississippi law defines a limited partnership as “a partnership formed by two (2) or more persons under the laws of this state and having one or more general partners and one or more limited partners.”84 The general partner has unlimited liability, just as a partner in an ordinary partnership. The difference, and appeal, of the LP is the limited liability to the Limited Partners, which is limited to their investment in the venture.

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However, with this limitation on liability also comes limits in rights to management participation. Limited Partners have no right to participate in the management and operation of the business. A person’s role as General Partner and Limited Partner must be set out in the certificate of limited partnership.

Mississippi has enacted the Mississippi Limited Partnership Act, which substantially follows the Uniform Limited Partnership Act. Mississippi Courts should interpret the Act in such a way that the law is uniform with the law of other states who have adopted it. The provisions of the Act are severable, and therefore, invalidity of one section of the Act does not effect the other provisions. Furthermore, for any cases not provided for in the Act, the Mississippi Uniform Partnership Act will govern.

Like LLC’s, LP’s are formed with the filing a certificate with the Secretary of State’s office. They cannot be formed by implication or acts of the partners alone like general partnerships. The certificate must include:

(a) the name of the limited partnership;
(b) the street address and mailing address of the partnership’s office;
(c) the name, street, and mailing address of the registered agent for service of process;

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85 A “person” is broadly defined as “an individual, corporation, business trust, estate, trust, partnership, limited partnership, association, joint venture, government, governmental subdivision or agency, any other legal or commercial entity, nominee or any individual or entity in any representative capacity.” Miss. Code Ann. s 79-14-101(15) (West Supp. 2000).
87 See Miss. Code Ann. s 79-14-1102 (West Rev. 1996) for proper cite to Act.
(d) the name, street, and mailing address of each general partner;\(^{95}\) (e) the latest date upon which the limited partnership is to dissolve;\(^{96}\) and (f) any other matters the general partners wish to include.\(^{97}\)

A limited partner’s name cannot be included in the name of the partnership.\(^{98}\) Furthermore, the name of the LP must contain the words “Limited Liability Partnership” or the abbreviation “L.L.P.” or “LLP”.\(^{99}\)

While the LP must have an office in Mississippi, it does not have to carry on business here.\(^{100}\) The limited partnership is formed at the date and time that the certificate is filed,\(^{101}\) or when there has otherwise been substantial compliance with the Act.\(^{102}\) Amendments to the certificate must also be filed with the Secretary of State.\(^{103}\) Amendments can be made at any time, and for any purpose the general partners deem appropriate.\(^{104}\) The Certificate must be amended upon the occurrence of: (a) the admission of a new general partner;\(^{105}\) (b) the withdrawal of a general partner;\(^{106}\) (c) the continuation of the business after the withdrawal of a general partner;\(^{107}\) (d) name change;\(^{108}\) or (e) address change.\(^{109}\) If the certificate of amendment is delivered within thirty days for the foregoing events, no person is subject to liability because the

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\(^{96}\) Miss. Code Ann. s 79-14-201(a)(4) (West Supp. 2000)
\(^{101}\) Miss. Code Ann. s 79-14-201(b) (West Supp. 2000).
\(^{102}\) Miss. Code Ann. s 79-14-201(b) (West Supp. 2000).
amendment was not filed sooner.\textsuperscript{110}

\textsuperscript{110} Miss. Code Ann. s 79-14-202(e) (West Supp. 2000).