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The Limited Liability Company (“LLC”) Traps and Pitfalls

The limited liability company (“LLC”) entity continues to grow as a preferred option for many new businesses in Washington. Unfortunately, the relative ease of establishing an LLC and common misperceptions about this entity choice may result in a business structure that fails to meet the desired objectives

Many **incorrectly** assume that an LLC provides **absolute protection** from personal liability. An LLC member may be held personally liable for his/her tortious conduct if done in the course of the business. *(For example, causing an accident while driving under the influence of alcohol.)* In this case, the other members of the LLC should be protected against personal liability; however the assets of the LLC itself would be attachable if a judgment is obtained. *(Along with the personal assets of the member who committed the tort.)* LLC members are also personally liable if they personally guarantee a business debt or other obligation.

Additionally, the personal assets of LLC members may be at risk if someone successfully “pierces the corporate veil,” Where a business fails to follow certain formalities and/or misuses the entity to harm an innocent party, a court may rule that an injured party can recover from the personal assets of LLC members.

Some factors that may be considered by a court considering whether or not the corporate structure can be pierced include: (1) failing to identify the business as an LLC, (2) commingling of business and personal assets, (3) poor accounting and (4) undercapitalization (i.e., not having enough capital based on the type of business.)

Also, many fail to create an effective Operating Agreement (“OA”). A properly drafted OA can address key issues such as: decision making authority, membership rights, LLC termination, succession planning, and intellectual property rights. Unfortunately many forgo creating an OA or “cut and paste” one from a generic source without really evaluating the specific business needs which can lead to costly litigation and/or other complications down the road.

It may be prudent to consult with an accountant and/or an attorney before deciding on a business structure. (For example, LLCs can choose: pass-thru taxation or corporate taxation.) In some cases, an S-corporation or other business structure may be a better option for a small/medium sized business.

GBL3 Law provides legal counsel to businesses and individuals; for specific advice contact GBL3 Law or your attorney.

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