CUMMINGS & LOCKWOOD LLC

WHAT IS THE PRIMARY "TRAP FOR THE UNWARY" RELATED TO THE MANAGEMENT OF A FAMILY LIMITED LIABILITY COMPANY OR LIMITED PARTNERSHIP?

Family limited liability companies and limited partnerships (referred to herein as “family companies”) are ordinarily formed in order to take advantage of a number of tax and asset protection opportunities. However, those opportunities are jeopardized if the family company fails to adhere to a number of legal formalities. In sum, these formalities revolve around a single concept, which is the importance of respecting the family company as an operating business. Once a family company is in place, it is critically important to convey to the family members that the failure to respect the formalities associated with the operations of the company as a business imperil the very objectives that led to the family company’s formation.

Family members must understand at the outset that the family company cannot operate as a “piggy bank” for members of the family. Assets which will be needed in order to satisfy family expenses unrelated to the business of the family company should not be contributed to the company. Once the company is in place, the owners must continue to adhere to this principal and avoid the temptation to commingle personal funds with the family company or add assets unrelated to the business to the family company. Most importantly, family company funds should only be used to pay company expenses; company funds must not be used to pay personal expenses of family members, or be tied to a pattern of distributions which correlates with the expenses of individual family members. Distributions to owners should be made following a pattern consistent with other for-profit businesses.

The family business must be identified as a business when interacting with the public. Accounts for the business must use the tax identification number and name of the family company, and not the name or Social Security number of an individual family member. Correspondence related to the business of the family company should appear on company letterhead, to clearly distinguish the business of the company from the business of individual family members.

A family company should keep scrupulous records of its activities. In addition to formation documents, the company should retain copies of bank statements and regular expense and income activity, including receipts. Experienced professional advisors should be in place to ensure that this recordkeeping function is satisfied. An experienced accountant should prepare tax returns, issue Schedule K-1s to the owners on a timely basis, track capital account changes and maintain books and records. An attorney should supervise the retitling of assets in the name of the family company, review the corporate records to confirm that they are in good order, attend to annual state filings and prepare annual written consents to memorialize decisions made in periodic meetings.