



South Carolina Bar

Continuing Legal Education Division

South Carolina Limited Liability Companies

20-35

Friday, September 18, 2020

presented by
The South Carolina Bar
Continuing Legal Education Division

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SC Supreme Court Commission on CLE Course No. 207561ADO

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LIVE WEBCAST

South Carolina Limited Liability Companies

September 18, 2020

This program qualifies for 5.0 MCLE Credit Hours, including up to 1.0 LEPR Credit Hour
SC Supreme Commission on CLE Course #:207561ADO

- 8:50 a.m. Welcome and Opening Remarks**
- 9:00 a.m. Overview of the S.C. Uniform Limited Liability Company Act**
David A. Merline, Jr., Merline & Meacham, PA
Scott Y. Barnes, Haynsworth Sinkler Boyd, PA
- 10:00 a.m. Choice of Entity**
Scott Y. Barnes, Haynsworth Sinkler Boyd, PA
- 10:20 a.m. Break**
- 10:35 a.m. Capital Accounts**
Scott Y. Barnes, Haynsworth Sinkler Boyd, PA
- 11:05 a.m. Securities**
Suzanne H. Clawson, Haynsworth Sinkler Boyd, PA
- 11:35 a.m. Single Members LLCs, LLCs taxed as S Corps, Professional LLCs, LLCs used in Estate Planning**
David A. Merline, Jr., Merline & Meacham, PA
- 12:15 p.m. Lunch Break**
- 1:15 p.m. Case Law Update**
Stafford J. McQuillin, III, Haynsworth Sinkler Boyd, PA
- 2:15 p.m. Current Events in Ethics and Discipline**
Barbara Seymour, Clawson & Staubes, LLC
- 3:15 p.m. Adjourn**

South Carolina Limited Liability Companies

SPEAKER BIOGRAPHIES

(by order of presentation)

David A. Merline, Jr.
Merline & Meacham, PA
(*course planner*)

Professional Qualifications

- South Carolina Supreme Court, Certified Specialist in Taxation Law
- South Carolina Supreme Court, Certified Specialist in Estate Planning and Probate Law
- AV Preeminent® rated by Martindale-Hubbell® Peer Review Ratings™

Professional Associations and Memberships

- American College of Trust and Estate Counsel (Fellow)
- American Bar Association – Business Law Section (Member)
- South Carolina Bar – Probate, Estate Planning and Trust Section (Member)
- South Carolina Bar – Tax Law Section (Member)
- Greenville County Bar Association (Member)
- Greenville Estate Planning Council (Member)
- Greenville County Estate Planning Study Group (Member)
- Rotary Club of Greenville – Paul Harris Fellow

Awards and Honors

- Ranked as a Leading Attorney in Private Wealth Law in South Carolina by Chambers Professional Advisers (2019 – 2020)
- Listed in The Best Lawyers in America for 2021 in the fields of:
 - Corporate Law (Lawyer of the Year 2021 in Greenville, SC)
 - Employee Benefits (ERISA) Law (Lawyer of the Year 2017 in Greenville, SC)
 - Litigation – ERISA (Lawyer of the Year 2019 in Greenville, SC)
 - Litigation – Trusts and Estates
 - Litigation and Controversy -Tax
 - Mergers & Acquisitions Law
 - Non-Profit/Charities Law
 - Tax Law (Lawyer of the Year 2010 in Greenville, SC)
 - Trusts and Estates (Lawyer of the Year 2018 in Greenville, SC)
- Best Lawyers in America previous Lawyer of the Year in the fields of:
 - Business Organizations (including LLCs and Partnerships) (Lawyer of the Year 2013, 2016 and 2020 in Greenville, SC)
 - Closely Held Companies and Family Businesses Law (Lawyer of the Year 2014 in Greenville, SC)
- Greenville Business Magazine Legal Elite (2012-Present)
- South Carolina Super Lawyers (2008-Present)

Education

- University of Miami, (LL.M) Taxation (1985)
- University of South Carolina School of Law, (J.D.) (1983)
- Furman University, (B.A.) Magna Cum Laude (1980)

Publications and Presentations

Scott Y. Barnes
Haynsworth Sinkler Boyd, PA

Scott Y. Barnes is Of Counsel to the law firm of Haynsworth Sinkler Boyd, PA in its Charleston, South Carolina office. His practice revolves around federal and state tax issues as they relate primarily to real estate transactions, partnership taxation, limited liability companies, conservation easements and corporate formation and operations. He is an adjunct professor at the Charleston School of Law where he teaches a class on Limited Liability Companies and was formerly an adjunct professor at the University of South Carolina School of Law. He has been listed for the last 27 years in The Best Lawyers in America by Woodward White, Inc. in the Corporate, Business Organizations (including LLC and Partnerships) and Tax Sections, and was named Charleston Lawyer of the Year for 2011 in Corporate Law and 2012 for Tax Law. He is currently and has been listed as a South Carolina Super Lawyer for tax since 2008.

Suzanne H. Clawson
Haynsworth Sinkler Boyd, PA

Suzi is a shareholder with Haynsworth Sinkler Boyd, P.A. She represents both public and private issuers with respect to securities registration and exemptions from registration and reporting compliance issues, while also advising public and private company clients on both sides of merger and acquisition transactions. Suzi has participated as counsel in numerous IPOs and other registered offerings. She routinely advises public companies on SEC annual and quarterly reporting requirements, proxy matters, and insider trading issues, as well as stock exchange listing and reporting requirements. She has also acted as counsel in going private transactions, tender offers and proxy contests.

Suzi also advises on corporate governance issues, including corporate structure, committee charters and governance principles, director and committee independence, related party transaction issues, and fiduciary duties of directors.

Stafford J. McQuillin, III
Haynsworth Sinkler Boyd, PA

A versatile litigation attorney with deep ties to his native Charleston, South Carolina, Mac McQuillin blends an established LLC and partnership litigation practice with an emerging practice as a certified Circuit Court Mediator. He frequently represents managers and members of LLCs in "business divorce" cases involving breach of fiduciary duty, oppression, buy out disputes, and misappropriation of company funds. He has participated in numerous mediations involving LLC and partnership disputes as both an advocate and as a mediator. He regularly advises LLC and partnership clients in complex matters, and has extensive experience with both jury and non-jury trials. As lead trial counsel, Mac recently tried to verdict an LLC derivative action, involving multi-million dollar claims.

Mac is listed in *The Best Lawyers in America*® Commercial Litigation (2020-2021) and *South Carolina Super Lawyers*® "Rising Stars" Business Litigation (2014-2020). In 2017, Mac was awarded the *South Carolina Lawyers Weekly* Leadership in Law Award and recognized by *Charleston Business Magazine* as one of the "Legal Elite of the Lowcountry."

Mac is a frequent speaker on LLC and litigation topics, including "Irreconcilable Differences - LLC Disputes - Business Divorce Cases," "Managing Your Liability When Clients Breach Their Fiduciary Duties," and "How to Get Your Social Media, Email and Text Evidence Admitted (and Keep Theirs Out)."

- University of South Carolina, J.D., cum laude, 2009 (Order of Coif)
- University of South Carolina, B.A., magna cum laude, 2005

Barbara Seymour
Clawson & Staubes, LLC

Barbara Seymour represents lawyers, law firms, judges, and law students in matters related to ethics, professional discipline, and Bar admissions at the law firm of Clawson and Staubes, LLC in Columbia, SC. She earned her Bachelor's Degree in Management and Marketing from the University of North Carolina at Greensboro in 1990 and her Juris Doctor from the University of Georgia in 1993. Barbara worked as a trial lawyer at Harris & Graves until 2000 when she joined the staff of the Office of Disciplinary Counsel. She served as the Deputy Disciplinary Counsel from 2007 until 2017. Barbara is a member of the South Carolina Bar, the Georgia State Bar, the Association of Professional Responsibility Lawyers, the South Carolina Association of Ethics Counsel, and the South Carolina Women Lawyers Association. She currently serves on the Law Related Education, Professional Responsibility, Unauthorized Practice of Law, Future of the Profession, and Diversity Committees at the South Carolina Bar. She was a 2006 and 2011 Fellow of the National Institute for the Teaching of Ethics and Professionalism. Barbara has served as an adjunct instructor in the Professional Legal Assistants Program at Converse College and the Paralegal Degree Program at Midlands Technical College. Her courses have included Civil Litigation, Legal Research & Writing, Business Law, Torts, Legal Ethics, and Law Office Management. www.linkedin.com/in/barbaraseymour



South Carolina Bar

Continuing Legal Education Division

Overview of the S.C. Uniform Limited Liability Company Act

David A. Merline, Jr.
Scott Y. Barnes

OVERVIEW OF THE 1996 UNIFORM LIMITED LIABILITY COMPANY ACT

South Carolina Bar | September 18, 2020

Scott Y. Barnes, Haynsworth Sinkler Boyd, P.A.

David Merline, Jr., Merline & Meacham, P.A.

OVERVIEW

- South Carolina remains under the 1996 Uniform Act and has not adopted the 2006 Uniform Limited Liability Company Act.

FORMING THE LLC

FORMING THE LLC

- At Will v. Term
 - At will – perpetual existence
 - Term – specific term

CHARGING ORDER TRAP

- Creditor of a member in an at will company can foreclose that member's membership interests.
- The creditor following foreclosure has the rights of a transferee.
- A transferee in an at will company can require the limited liability company to purchase the transferee creditors distributional interest for fair value.
- Term company transferee creditor can only be bought out at the end of the term.

WITHDRAWAL RIGHTS UNDER THE ACT

- At Will – Member may withdraw at any time.
- Term – Member may withdraw only at the end of the term.

"MANAGER MANAGED/MEMBER MANAGED"

- Manager Managed – only the manager has apparent authority to act on behalf of the LLC
- Member Managed – all members have apparent authority to act on behalf of the LLC

DESIGNATED OFFICE/DESIGNATED AGENT

- Designated office must be located in South Carolina.
- Registered Agent must be:
 - a resident of South Carolina, or
 - a domestic corporation or LLC, or
 - a foreign company authorized to do business in SC

NAME AND NUMBER OF MEMBERS

- Name
 - "Limited Liability Company", "Limited Company", "L.L.C.", "LLC", "L.C.", "LC" or "Ltd. Co."
- Number of Members
 - An LLC can have as few as one member
 - An LLC can have an unlimited number of members

CAPITAL CONTRIBUTIONS

- Members of an LLC have a capital account.
- Capital accounts go up by the amount of:
 - Cash or the fair market value of property contributed by a member
 - Profits allocated to a member
- Capital accounts go down by the amount of:
 - Cash or the fair market value of property distributed to a member
 - Losses allocated to a member

LLC IS A SEPARATE LEGAL ENTITY

- Once the Articles of Organization are filed, an LLC is an entity separate and distinct from its members.
- A membership interest in an LLC is an item of personal property.

KNOWLEDGE AND NOTICE

KNOWLEDGE AND NOTICE

- An LLC has knowledge and notice when an individual conducting the transaction for the LLC knows, has notice, or receives a notification of the fact or when the fact would have been brought to the individuals attention had the entity exercised reasonable diligence.

FINANCIAL STRUCTURE

FINANCIAL STRUCTURE

- The LLC Act has no provision for profit & loss sharing.
- The Operating Agreement must specify:
 - the arrangement, and
 - how distributions of cash and other property are made to members
- With certain exceptions, care must be taken that distributions track the allocation of profits.

FINANCIAL STRUCTURE

- Because members of an LLC are not employees but rather partners for tax purposes, they will receive a K-1 rather than a W-2 at the end of the year.
- Members who work for an LLC and receive a "salary" are not treated as employees for tax purposes. The "salary" is treated as a "guaranteed payment" and reported on the members K-1.

OPERATING AGREEMENT

OPERATING AGREEMENT

- Members of an LLC may enter into an Operating Agreement which can be written or oral. If there is no written Operating Agreement, the members "course or conduct" may raise to the level of an Operating Agreement.

OPERATING AGREEMENT

- The terms of the Operating Agreement will override the provisions of the Act, with one exception.
- S.C. Code Ann. §33-44-103 prohibits the operating agreement from changing the following items:
 - Limit a member's rights to inspect records
 - Reduce certain fiduciary duties
 - Vary the right to expel members
 - Vary the duty to wind up in certain circumstances
 - Restrict the rights of third parties

OPERATING AGREEMENT

- Section 33-44-404 of the Act lists those matters which, if not otherwise provided for in the Operating Agreement, require the unanimous consent of the members –
 - Amend the Operating Agreement
 - Amend the duty of loyalty
 - Amend the Articles of Organization
 - Compromise the obligation to make a capital contribution

OPERATING AGREEMENT

- Compromise the obligation of a member to return money or property wrongfully paid or distributed
- Make interim distributions
- Redeem a members interest
- Admit a new member
- Use company property to redeem an interest subject to a charging order
- Consent to dissolve the company

OPERATING AGREEMENT

- Waive the right to have the company's business wound up following dissolution
- Merge with another entity
- Sale of substantially all the assets of the company

MANAGEMENT

MEMBER MANAGED OR MANAGER MANAGED

- In a Member Managed Company:
 - Each member has equal rights in the management and conduct the company's business; and
 - Has apparent authority to act on behalf of the company.
- In a Manager Managed Company:
 - Each manager has equal rights in the management and conduct of the company's business.
 - Only a manager has apparent authority to act on behalf of the company.

VOTING

- Other than the provisions of S.C. Code Ann. §33-44-404(c) which requires unanimous consent of the members, the Act requires majority vote. The Operating Agreement can modify these voting requirements.

REAL ESTATE TRANSFERS – 33-44-301(C)

- For real estate transfers a manager of a manager managed LLC or any member of a member managed LLC may execute and deliver real estate transfer documents and a third party giving value without knowledge of lack of authority may rely upon the authority of the member/manager signing documents.
- The Articles of Organization may limit the authority of a member or manager and if the limitation is in place S.C. Code Ann. §33-44-301(c) will not apply.

INDEMNIFICATION

- S.C. Code Ann. §33-44-403(a) provides for the indemnification of a member or manager for liabilities incurred in the ordinary course of business of the company or preservation of the company's businesses or property. The Operating Agreement may expand or limit the indemnification obligation.

FIDUCIARY DUTIES

FIDUCIARY DUTIES

- Member Managed LLC
 - Members have the duty of care, duty of loyalty and the obligation of good faith and fair dealing
- Manager Managed LLC
 - Only the managers have the duty of care, duty of loyalty and the obligation of good faith and fair dealing
 - The members have no fiduciary duties

FIDUCIARY DUTIES

- The Operating Agreement may modify the duty of care and the duty of loyalty so long as the modification is not "manifestly unreasonable."
- A member of a member managed company will not violate his fiduciary duty or obligation merely because the members conduct furthers the members own interest.

FIDUCIARY DUTIES

- A member of a member managed company may lend money to and transact other business with the company and the rights and obligations of the lending members are the same as those of a person who is not a member.
- Upon a members dissociation his duty of loyalty to refrain from competing terminates and his duty of loyalty to account and refrain from dealing with the LLC on behalf of a competitor and his duty of care only applies to matters arising before the dissociation.

RECORDS

RECORDS

- The Act does not require the LLC to maintain records.
- The Act does require limited liability companies to provide members (and former members) and their agents access to the books and records.
- Operating Agreements may provide some restriction on access but may not "unreasonably restrict" a right to information or access to records.

TERM PARTNERSHIP INCLUDES LLCs

TERM PARTNERSHIP INCLUDES LLCs

- S.C. Code Ann. §33-44-1205 makes it clear that unless the context requires otherwise the term partnership includes and means limited liability company.

LIMITED LIABILITY OF MEMBERS

LIMITED LIABILITY OF MEMBERS

- S.C. Code Ann. §33-44-303(a) provides:
 - A member or manager is not personally liable for a debt, obligation, or liability of the limited liability company solely by being or acting as a member or manager.

LIMITED LIABILITY OF MEMBERS

- This language does not protect a member or manager for his own torts or contractual liabilities even if they were incurred in his capacity as a member or manager of the company.
- Examples:
 - The member or manager commits a tort when acting within the scope of the LLC business.
 - The member or manager personally makes a contract or guarantees an LLC obligation.

LIMITED LIABILITY OF MEMBERS, EXAMPLES CONTINUED

- The member or manager fails to disclose that he is acting on behalf of the LLC.
- The member or manager takes action prior to the formation of the LLC.
- The member or manager acts on behalf of the LLC but without authority to do so.
- The member fails to make a capital contribution when requested to do so.
- The member or manager makes or receives improper distribution or benefit from the LLC.

LIMITED LIABILITY OF MEMBERS, EXAMPLES CONTINUED

- The member or manager is subject to personal liability because a federal or state law provides for individual liability.
- The court pierces the veil of the LLC and holds the owners liable.

DISPUTES AMONG LLC MEMBERS

SUITS BETWEEN MEMBERS

- S.C. Code Ann. §33-44-410 specifically authorizes actions by members against other members or the company to enforce:
 - The members rights under the Operating Agreement
 - The members rights under the Act.
 - A members rights independent of the members relationship with the company.

DERIVATIVE ACTIONS

- S.C. Code Ann. §33-44-1101
 - A member may maintain an action in the right of the company if the members or managers having authority to do so have refused to commence the action or an effort to cause those members or managers to commence the action is not likely to succeed.
- The action is made in the name of the company and the recovery is for the benefit of the company.
- The court may award reasonable attorneys fees to the member bringing the action in the name of and for the benefit of the LLC.

ACCOUNTING ACTIONS

- Accounting actions are actions in equity seeking to have the plaintiff member made whole.
- Because it is an action in equity the doctrine of latches rather than the statute of limitations applies other than perhaps in dissolution where the statute of limitations may apply.

DIVERSITY

- An LLC is a citizen of all of the states in which each of its members is a resident.
- As a result of this rule it is almost impossible to pursue a derivative claim in federal court on a diversity basis.

TRANSFER AND SUBSTITUTION OF MEMBERSHIPS

TRANSFERS

- Under the Act a member may transfer all or a portion of his distributional interest (the right to receive distributions).
- The "transferee" (the person receiving the distributional interest) has only the right to receive distributions that the transferor member would be entitled to.
- If a member transfers all of his "distributional interests" to one or more transferees other than a transfer for security purposes or pursuant to a changing order, the transfer constitutes an "event of dissociation."

SUBSTITUTION

- Under the Act, a transferee of a distributional interest may become a member of the LLC if the transferor gives the transferee the right to become a member and all of the other members consent.
- A transferee who becomes a member will be liable for the transferors obligation to make contributions and obligations to return unlawful distributions but only if those obligations were known to the transferee at the time of transfer.
- Following the transfer, the transferor is not released from any liabilities he owes the LLC.

CHARGING ORDERS

CHARGING ORDERS

- A creditor of a member may "charge" a members membership interest in an LLC through the mechanism of a "Charging Order."
- A Charging Order is a judgment creditors exclusive remedy by which a judgment creditor may satisfy a judgment out of the debtors distributional interest.
- A Charging Order entitles the judgment creditor to distributions otherwise payable to the debtor from the LLC until the debt is paid off.

CHARGING ORDERS

- A judgement creditor can, following the issuance of a charging order, foreclose on the debtor members distributional interest.
- Following foreclosure the judgment creditor becomes a "transferee" of the members distributional interest.
- A transferee of a distributional interest has no right to vote, no right to company information, and will receive annually an K-1 from the LLC.

CHARGING ORDERS

- A transferee of an "at will" company has the right under S.C. Code Ann. §33-44-701(a)(1) to require the LLC to purchase the members "distributional interest" for "fair value."
- To avoid a creditor buyout all limited liability companies, with a few limited exceptions, should be Term Companies.

CHARGING ORDERS

- Finally, the Act provides that the charged debtors membership may be redeemed:
 - By the judgment debtor,
 - By one or more other members of the company, or
 - By the company but only if permitted by the Operating Agreement.

MEMBER DISSOCIATION

MEMBER DISSOCIATION

- The term "dissociation" refers to the change in the relationships among the dissociated member, the company and the remaining members caused by the dissociated member ceasing to be associated in the carrying on of the company's business.

EVENTS CAUSING "DISSOCIATION"

- Notice of a member's express will to withdraw
- Events set forth in the Operating Agreement causing dissociation
- Transfer of all of a members distributional interest (with exceptions)
- Members expulsion
- Member becomes a debtor in bankruptcy
- Member executes an assignment for the benefit of creditors

EVENTS CAUSING "DISSOCIATION"

- Appointment of a trustee, receiver or liquidator of the member on all or substantially all of the members property
- Members death
- Appointment of a guardian or general conservator
- Judicial determination that the member is unable to perform his duties under the Operating Agreement
- The distribution of a trusts entire rights to receive distributions from the company

EVENTS CAUSING "DISSOCIATION"

- Distribution of an estates entire rights to receive distribution from the company
- Termination of the existence of a member if the member is not an individual, estate or trust

MEMBER DISSOCIATION

- The Operating Agreement may negate some or all of these events of dissociation.
- Effect of Dissociation:
 - At will company
 - The company must cause the dissociated members distributional interest to be purchased for fair value

EFFECT OF DISASSOCIATION

- Term company
 - If the company does not dissolve and wind up at the end of its term it must purchase the dissociated members membership at that time for fair value.
 - Until the end of the term a dissociated member loses his right to vote and is treated as a transferee of a member.

DISSOLUTION

MECHANICS

- Dissolution begins the process of winding up the company's business.
- The Act provides the company is dissolved:
 - Upon an event of dissolution as specified in the Operating Agreement
 - If the members vote to dissolve
 - It is unlawful to continue the company's business
 - A court orders dissolution
 - The Secretary of State administratively dissolves the company

MECHANICS

- In the process of dissolution the company's creditors are paid and any remaining assets are distributed to the members, generally in accordance with positive capitol account balances.
- The Act establishes a notification procedure to known creditors with a deadline for filing claims and newspaper notice for claims of unknown creditors.
- An unknown creditors claim is banned if a proceeding to enforce the claim is not commenced within 5 years after publication of the claim.
- Claims brought by creditors during the 5 year period may be satisfied with company undistributed assets or by the members to the extent of assets distributed.

JUDICIAL DISSOLUTION

- A member may seek judicial dissolution if:
 - The economic purpose of the company is likely to be unreasonably frustrated.
 - Another member has engaged in conduct relating to the company's business that makes it not reasonably practical to carry on the company's business with that member.
 - It is not reasonably practical to carry on the company's business in conformity with the Articles of Organization and the company's Operating Agreement.

JUDICIAL DISSOLUTION

- The company failed to purchase a disassociated members distributional interest.
- The controlling member or manager have acted, are acting or will act in a manner that is unlawful, oppressive, fraudulent or unfairly prejudicial.
- At the end of the term or at any time in an at will company following a members dissociation, transfer or a foreclosure following a charging order.

TERMINATION

TERMINATION

- A company's existence is terminated upon the filing of Articles of Termination with the Secretary of State.

CONVERSIONS AND MERGERS

CONVERSIONS

- Limited liability company may convert to:
 - A corporation
 - A limited partnership
 - A general partnership
- A corporation may convert to:
 - A limited liability company
 - A limited partnership
 - A general partnership
- A partnership (general or limited) may convert to:
 - A limited liability company
 - A corporation

CONVERSIONS

- The conversion process requires an Agreement of Conversion and the filing of Articles of Conversion with the Secretary of State.
- If the converted entity owns real property in South Carolina, a notice of filing is required to be made in the ROD office in the county where the real estate is located.
- **The Act does not provide a mechanism for converting an out of state entity into a South Carolina entity. Cross border conversions are accomplished through a merger.**

MERGERS

- The Act provides that a limited liability company may be merged with or into one or more:
 - Limited liability companies
 - Foreign limited liability companies
 - Corporations
 - Foreign corporations
 - Partnerships
 - Foreign partnerships
 - Limited partnerships
 - Foreign limited partnerships
 - Other domestic or foreign entities

MERGERS

- Mergers are accomplished through a Plan of Merger and the filing of Articles of Merger with the Secretary of State (if a merger is with an out of state entity, a filing with the out of state entity's Secretary of State is required as well).

TAX AND OTHER IMPLICATIONS

- Mergers and conversions can trigger taxable income
- Mergers and conversions may require a new application for the Agriculture Use Exemption
- Merger and conversions may require a title endorsement from the title company
- Merger and conversions may trigger a default under bank loan documents
- Merger and conversions may trigger an assessable transfer for real property tax purposes

FOREIGN LIMITED LIABILITY COMPANIES

CERTIFICATE OF AUTHORITY

- Foreign corporations may apply for a Certificate of Authority to transact business in South Carolina
- Application for a Certificate of Authority is filed with the Secretary of State

FAILURE TO OBTAIN CERTIFICATE OF AUTHORITY

- Foreign LLC may not maintain an action or proceeding in South Carolina
- Secretary of State is foreign LLC agent for service of process
- Failure to file does not impair the validity of contracts or prevent the foreign LLC from defending an action or proceeding in South Carolina

FOREIGN LLC ACTIVITY

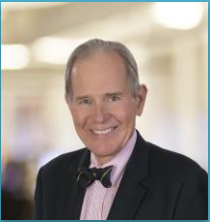
- Activities by foreign LLC which do not constitute transacting business:
 - Maintaining, defending or settling an action or proceeding
 - Holding meetings of its members or managers or carrying on other activities concerning its internal affairs
 - Maintaining bank accounts
 - Maintaining offers for transfer of its own securities
 - Selling through independent contractors
 - Soliciting or obtaining orders by mail or through employees or agents or otherwise if LLC order require acceptance outside the state before they become contracts

FOREIGN LLC ACTIVITY

- Creating or acquiring indebtedness, mortgages or security interests in real or personal property
- Securing or collecting debts, enforcing mortgages or other security interests in property and maintaining property acquired through foreclosure
- Conducting an isolated transaction that is completed within 30 days
- Transacting business in interstate commerce
- Obtaining an interest in a limited liability company organized or transacting business in South Carolina

INCOME PRODUCING PROPERTY

- The ownership of income producing real or personal property in South Carolina constitutes transacting business in South Carolina



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South Carolina Bar

Continuing Legal Education Division

Choice of Entity

Scott Y. Barnes

CHOICE OF ENTITY

South Carolina Bar | September 18, 2020

Scott Y. Barnes, Haynsworth Sinkler Boyd, P.A.

PROFESSIONAL ENTITIES

- Professional Corporation; 33-19-101 et seq.
- General Partnership; See former Rule 417(d), Rule 1.0(e) + (i)
- Registered Limited Liability Partnership; See former Rule 417(d), Rule 1.0(e) + (i)
- Limited Liability Company; See former Rule 417(d), Rule 1.0(e) + (i)

LIABILITY LIMITATIONS

- 33-19-340(a)
 - Each individual who renders professional services as an employee of a domestic or foreign professional corporation is liable for a negligent or wrongful act or omission in which he personally participates to the same extent as if he rendered the services as a sole practitioner. An employee of a domestic or foreign professional corporation is not liable, however, for the conduct of other employees of the corporation unless he is at fault in appointing, supervising, or cooperating with them.
- 33-19-340(b)
 - A domestic or foreign professional corporation whose employees perform professional services within the scope of their employment or of their apparent authority to act for the corporation is liable to the same extent as its employees.

15 FACTORS

1. Limited Liability
2. Pass-Through Taxation
3. Taxation on Formation
4. Taxation on Distribution/Liquidation
5. Restrictions on Ownership
6. Preferred Returns
7. Special Allocations
8. Distributions
9. Inclusion of Debt in Basis
10. Inside Basis Step Up
11. Health Insurance Premiums
12. Creditor Protection
13. Self Employment Taxes
14. Tax Brackets (2017)
15. Tax Cut and Jobs Act of 2017

TYPES OF ENTITIES

- Sole Proprietorship
- Partnership
 - General Partnership
 - Limited Partnership
 - Registered Limited Liability Partnership
- Limited Liability Company
 - Single Member
 - Multi Member
- Corporations
 - S Corporation
 - C Corporation

LIMITED LIABILITY

- Sole Proprietorship
 - Personal Liability
- Partnership
 - General Partnerships
 - Joint and several liability
 - Limited Partnerships
 - General Partner has personal liability
 - Limited Partner may have personal liability if he participates in the control of the business

LIMITED LIABILITY

- Registered Limited Liability Partnerships
 - No liability for partnership torts
 - Joint and several contract liability
 - \$100,000 general liability insurance policy requirement
 - Addition or withdrawal of a partner creates a new partnership with no liability shield until election filed with the Secretary of State
- Limited Liability Company
 - Single member LLC
 - No personal liability
 - Tax nothing (disregarded entity)

LIMITED LIABILITY

- Multi member LLC
 - No personal liability
- Corporation
 - S Corporation
 - No personal liability
 - C Corporation
 - No personal liability

LIMITED LIABILITY

- Exception

- Piercing the Corporate Veil

- Hunting v. Elders, 359 S.C. 217, 597 S.E.2d 802
 - John E. Hartfield, et al. v. The Getaway Lounge & Grill, Inc., Shou Mei Morris, individually and as President of the Getaway Lounge & Grill, Inc., Supreme Court, Opinion No. 26836, Filed July 26, 2010
 - NVR, Inc. v. West Georgia Road Ventures, LLC, 2012 WL 1902267 (SC D. Ct. May 25, 2012)

PASS-THROUGH TAXATION

- Sole Proprietorship
 - Schedule C income
 - Single Member LLC
- Partnership
 - Income flows through to the Partners
 - Single level of tax
 - §701
 - K-1 income

PASS-THROUGH TAXATION

- Limited Liability Company
 - Single Member LLC
 - Disregarded entity
 - Schedule C income
 - Multi Member LLC
 - Taxed as a Partnership unless elect to be taxed as a Corporation
- Corporation
 - S Corporation
 - Pass through entity K-1 income

PASS-THROUGH TAXATION

– C Corporation

- Two levels of taxation
- Example: X, the sole shareholder of Corporation Y, wants to sell his business for \$1,000,000. The buyer only wants to buy the assets, not the stock. Zero basis in stock and assets.

	<u>Corporate Tax</u>	<u>LLC Tax</u>
	\$1,000,000	\$1,000,000
	x 21%	x 23.8%*
Corporate Tax	<u>\$210,000</u>	<u>\$238,000</u>
	\$790,000	
Tax on Distribution	x 23.8%*	
	<u>\$188,020</u>	
Net	\$601,980	\$762,000

*20% Fed. Capital Gains Tax 3.8% Obama Care Tax

TAXATION ON FORMATION

- Sole Proprietorship
 - No tax
- Partnership
 - Contribution of cash or appreciated property is not taxable. 721
 - Contributions of real property is not an assessable transfer under the South Carolina Real Property Valuation Reform Act
 - Exception under 721(b) for investment company contributions
 - 80% of the value of the LLC assets consist of marketable securities and the contribution of property results in a diversification of interests

TAXATION ON FORMATION

- Limited Liability Company
 - Same rule as Partnerships
- Corporation
 - Generally tax exempt, particularly on formation
 - Control Group requirements - §351
 - Contributing shareholders must possess at least 80% of the total combined voting power of stock and 80% of the nonvoting shares of the corporation immediately after the transfer
 - An assessable transfer if the control test is not met

TAXATION ON DISTRIBUTION/LIQUIDATION

- Distributions
 - Sole Proprietor/Single Member LLC
 - No tax on distributions
 - Should not be an assessable transfer
 - Partnership/LLC
 - General rule
 - Distribution of appreciated property tax free 731

TAXATION ON DISTRIBUTION/LIQUIDATION

- Exception
 - Distribution triggers a change in the members' interest in unrealized receivables (accounts receivables) and inventory items (real property held for sale to customers). 751(b)
 - Distribution results in the distributee in the distribution being relieved of debt in excess of basis. 731(a)
 - Example:
 - Partner "A" in ABC Partnership has an outside basis of \$10 and his share of partnership debt is \$12, and the partnership debt is assumed by partner "B". "A" is deemed to have received a cash distribution of 12 and has \$2 of income.

TAXATION ON DISTRIBUTION/LIQUIDATION

- Distribution of marketable securities to the extent the securities exceed the partners' basis in his partnership interest. 731(c)
 - Generally an “assessable transfer” for South Carolina ad valorem tax purposes
- Corporation
 - Gain recognized at corporate level on the distribution of appreciated property to a shareholder (S Corporation and C Corporation)
 - Gain recognized at the shareholder level on C Corporation distributions (dividend)
 - Generally an “assessable transfer”

TAXATION ON DISTRIBUTION/LIQUIDATION

- Liquidations
 - Sole proprietorship/Single member LLC
 - Not taxable
 - Deed of distribution out of a Single member LLC should not be an assessable transfer, but rumor has it that the DOR treats it as an assessable transfer.
 - Partnership
 - Generally tax free with a carry over outside basis toll charge
 - Assessable transfer triggered
 - Limited Liability Company
 - Same as partnerships

TAXATION ON DISTRIBUTION/LIQUIDATION

– Corporation

- S Corporation – taxable at corporate level
- C Corporation – taxable at corporate level and shareholder level
- Assessable transfer – distributions on liquidations are assessable transfers

RESTRICTIONS ON OWNERSHIP

- Sole Proprietorship/Single Member LLC
 - Limited to one owner
- Partnerships and LLC
 - No restriction on number and type of owner
- S Corporation
 - 100 shareholders
 - Limited to individuals and certain trusts
 - No foreign owners
- C Corporation
 - No restriction on number or type of owner

PREFERRED RETURNS

- Sole Proprietor/Single Member LLC
 - N/A
- Partnership
 - Preferred returns on investments permitted
 - Example:
 - A & B form a partnership. A puts in \$10,000 and B puts in services. Partnership Agreement provides that A gets a 10% preferred return on his adjusted invested capital before distributions are made to B.

PREFERRED RETURNS

- Limited Liability Company
 - Preferred returns permitted
- Corporation
 - C Corporation
 - preferred returns in the form of preferred stock permitted
 - S Corporation
 - Single class of stock
 - All shares must have identical rights to distributions and liquidation proceeds
 - Debt may constitute a second class of stock

SPECIAL ALLOCATIONS: PROFITS, LOSSES AND DISTRIBUTIONS

- Sole Proprietorship/Single Member LLC
 - N/A
- Partnership
 - Partnerships have until the due date of their return to specially allocate tax items among the partners. 704(a), 761(c)
 - Example:
 - A & B form a partnership. A puts in \$10,000. B puts in service. The Partnership Agreement provides that profits are split 50/50, but all losses are allocated to A until A's adjusted investment capital is "0".

SPECIAL ALLOCATIONS: PROFITS, LOSSES AND DISTRIBUTIONS

- Special allocation respected by the IRS as long as the allocations have substantial economic effect. 704(b)
- Disproportionate distributions of property or cash may be made to partners

SPECIAL ALLOCATIONS: PROFITS, LOSSES AND DISTRIBUTIONS

- Limited Liability Company
 - Same as partnerships
- Corporations
 - S Corporations – No special allocations of tax items. Allocated in accordance with proportionate stock ownership
 - C Corporations – Tax items are held at the corporate level. No special allocation

DISTRIBUTIONS

- Sole Proprietorship/Single Member LLC
 - N/A
- Partnership
 - Disproportionate distributions permitted, generally tax free
 - Example:
 - Partnership AB has \$100 of income in 2008. A + B who are equal partners agree to distribute 2008 income, \$80 to A, and \$20 to B.

DISTRIBUTIONS

- Limited Liability Company
 - Same as partnerships
- Corporations
 - Distributions are in the form of dividends and must be based on stock ownership

INCLUSION OF DEBT IN BASIS

- Sole Proprietorship/Single Member LLC
 - N/A
- Partnership
 - A partner can only deduct losses allocated to him to the extent of his basis in his partnership interest. 704(d)
 - Under 752(a), a partner can include in his outside basis his share of partnership debt
 - Example:
 - A&B each contribute \$10 to partnership AB. Each has an outside basis of \$10. Partnership A&B borrows \$40. A&B's outside basis each increase to \$30.

INCLUSION OF DEBT IN BASIS

- Limited Liability Company
 - Same as partnerships
- Corporations
 - C Corporation
 - Debt retained at corporate level, no effect on shareholder basis

INCLUSION OF DEBT IN BASIS

– S Corporation

- S Corporation shareholders can only deduct pass through losses to the extent of his basis in his S Corporation stock plus amounts he loaned to the corporation. 1366(d)
- S Corporation shareholders cannot include entity level debt in his outside basis
- S Corporation shareholders may include shareholder debt in his basis if he is the lender

INSIDE BASIS – STEP UP

- Sole Proprietorship/Single Member LLC
 - N/A
- Partnership
 - 754 election on purchase of a membership interest
 - Example:
 - Partnership ABC owns land FMV \$300, Basis \$90
 - D buys C's 1/3 interest for \$100
 - If partnership sold the land the following day without a 754 election, D would have \$70 of gain

INSIDE BASIS – STEP UP

- By making the 754 election, D's inside basis in the land is \$100 and D would have no gain on sale §743(b)(1)
- A 754 election also results in an inside basis step up on the death of a member 743(b)
 - Example:
 - If C dies before selling his interest to D, C's estate gets a step up in basis of the Partnership interest inherited from C, as well as a step up in the Partnership's basis in the land.
- Limited Liability Company
 - Same as Partnership

INSIDE BASIS – STEP UP

- Corporation
 - Step up basis in the stock, but no basis step up in assets held by the Corporation

HEALTH INSURANCE PREMIUMS

- Fully deductible in all cases

CREDITOR PROTECTION (VOTING)

- Sole Proprietorship
 - None – Creditor acquires the assets and in effect, voting control
 - Single Member LLC – Bankruptcy courts have ruled that creditors can obtain voting rights, but that right may not apply outside of bankruptcy
- Partnership
 - A creditor may “charge” a partnership interest. The creditor, once the interest is charged, has the rights of an assignee and is entitled to receive partnership distributions, but has no right to vote. §33-41-750 (General Partnership) - §33-42-1230 (Limited Partnership)

CREDITOR PROTECTION (VOTING)

- Limited Liability Company
 - Creditor granted a charging order and is entitled to the rights of an “assignee” – rights to distribution (if made), no right to vote
- Corporation
 - Creditors may foreclose on the stock, and once received the creditors can vote the stock

SELF-EMPLOYMENT TAXES

- Sole Proprietor/Single Member LLC
 - Subject to self-employment taxes on earnings
- Partnership
 - General Partner
 - IRC 1402(a) – “Net earnings from self-employment” include a partner’s distributive share of income or loss described in §704(a)(8) from any trade or business carried on by a partnership of which he is a member
 - See, *Renkemeyer, Campbell & Weaver, LLP, et al. v. Commissioner*, 136 TC No. 7

SELF-EMPLOYMENT TAXES

- Limited Partner
 - IRC §1402(a)(13) – “Net earnings from self-employment” does not include any income or loss of a limited partner
- Limited Liability Company
 - Proposed Reg. §1.1402(a)-2(h)(2) issued January 1, 1997.
 - An LLC member treated as a limited partner unless:
 - he has personal liability for debts or claims against the entity by reason of being a partner
 - he has authority to contract on behalf of the LLC

SELF-EMPLOYMENT TAXES

- or – he participates in the LLC's trade or business for more than 500 hours per year
 - or – he is a member of a service LLC
- All members of a member managed LLC have the legal ability to contract so members subject to self-employment tax
- Manager managed LLC
 - only the manager has the authority to contract

SELF-EMPLOYMENT TAXES

- Two Classes of Membership Interest
 - A manager can have a membership interest which grants him management authority and income from that interest which is subject to tax
 - He can also have a second passive membership interest which is not subject to tax
 - Congress mandated that the Proposed Regs. withdrawn in the Taxpayers Relief Act of 1997
- Corporations
 - C Corporation
 - Shareholders are treated as employees and not subject to self-employment tax. Tax paid at corporate level.

SELF-EMPLOYMENT TAXES

– S Corporation

- Rev. Rule 59-221, 1959-1 C.B. 225
- S corporation shareholder's distributive share of pass-through income is not to be included in determining net earnings from self-employment.
- Treasury Inspector General for Tax Administration Audit Report 2002-30-125 (205-02) instructed IRS Service Centers to pursue S Corporations for failure to pay reasonable compensation subject to employment taxes
- Veterinary Surgical Consultants P.C. v. Commissioner, 117 T.C. 141 (2001) aff. 90 Fed Appx. 669 (3rd Cir, 2004)

TAX BRACKETS – PRE JANUARY 1, 2018

- Sole Proprietor/Single Member LLC
 - Individual Bracket
 - 15% - up to \$17,850
 - 39.6% - over \$450,000
- Partnership
 - Tax at individual's rate
- Limited Liability Company
 - Tax at individual's rate

TAX BRACKETS – PRE JANUARY 1, 2018

- Corporation
 - S Corporation
 - Tax at individual's rate
 - C Corporation
 - 15% - up to \$50,000
 - 35% - over \$10,000,000

TAX BRACKETS COMPARISON

- Corporate
 - 15% - up to \$50,000
 - 25% - \$50,000 to \$75,000
 - 34% - \$75,000 to \$10,000,000
 - 35% - over \$10,000,000
- Individual-Married
 - 15% - up to \$17,850
 - 25% - \$17,850 to \$72,500
 - 28% - \$72,500 to \$146,400
 - 33% - \$146,400 to \$223,050
 - 35% - \$223,050 to \$398,350
 - 39.6% - over \$450,000

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

- Tax Brackets
 - Sole Proprietor/Single Member LLC
 - Individual Bracket
 - 10% - up to \$19,050
 - 37% - over \$600,000
 - Partnership
 - Tax at individual's rate
 - Limited Liability Company
 - Tax at individual's rate

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

– Corporations:

- S Corporation
 - Taxed at individual's rate
- C Corporation
 - 21%

– Tax Bracket Comparison

<u>Corporate</u>	<u>Individual – Married</u>
21%	10% up to \$19,050
	12% 19,050 - \$77,400
	22% \$77,400 - \$165,000
	24% \$165,000 - \$315,000
	32% \$315,000 - \$400,000
	35% \$400,000 - \$600,000
	37% over \$600,000

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

- Business Income from Pass-Through Entities: 20% Deduction.
 - To provide some parity between C Corporations now taxed at a 21% rate and pass through entities a deduction of 20% of an entities “qualified business income” is available to owners of a pass-through entity.
 - Only income from a “qualified trade or business” will qualify
 - Income from investments doesn’t qualify.
 - Income from a service business does not qualify (with an exception)
 - Calculation of “Qualified Business Income”
 - Generally net income (Gross income less deductions)

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

- Wage limitation
 - The 20% deduction is limited by wages paid and the unadjusted basis of qualified depreciable property of each qualified trade or business (The 20% deduction can be no more than 50% of the business's wages or alternatively the sum of 25% of the business wages plus 2.5% of the tangible personal property subject to depreciation used by the trade or business.
- Exceptions.
 - Wage limitation
 - Taxable Income below \$315,000 for Joint filers (\$157,500 for all others)
 - wage limitation does not apply full 20% deduction

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

- Taxable Income above \$415,000 for Joint filers and (\$207,500 for all others).
 - Wage limitation applies
- Taxable Income above \$315,000 for Joint filers (\$157,500 for all others) and below \$415,000 for Joint filers and (\$207,500 for all others).
 - Phase in of wage limitation
- Service Providers (exception to the Qualified Trade or Business Rule)
- Taxable income below \$315,000 for Joint filers (\$157,500 for all others) 20% deduction available.
- Taxable income above \$415,000 for Joint filers (\$207,500 for all others) service provider limitation applies. No 20% deduction.

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

- Taxable income above \$315,000 for Joint Files (\$157,500 for all others) and below \$415,000 for Joint filers (\$207,500 for all others) phase out of the Credit.
- Example
 - Husband and wife have a \$200,000 of K-1 income from a law firm and \$150,000 in wages. After taking the standard deduction (\$24,000) their taxable income is \$326,000 which exceeds \$315,000 by \$11,000.
 - Calculation:
 - Step 1.
 - 20% of \$200,000 = \$40,000 (available deduction)
 - Step 2.
 - $\$11,000 / \$100,000 = 11\%$

TAX CUT AND JOBS ACT OF 2017 – EFFECTIVE JANUARY 1, 2018

- Step 3.
 - $\$40,000 \times 11\% = 4,400$ disallowed.
- Step 4.
 - $\$40,000 - \$4,400 = \$35,600$ Credit allowed.

SUMMARY

- A Sole Proprietorship is:
 - Simple
 - Major drawback –no limited liability
 - Solution – Single Member LLC
 - Pass-through taxation
 - No tax on formation
 - No tax on distribution or termination
 - No restrictions on ownership
 - Preferred returns not an issue

SUMMARY

- Special allocation of profits not an issue
- Debt is included in basis
- Basis step up on death
- Health insurance fully deductible
- Creditor protection unlikely in bankruptcy
- No relief from self-employment tax
- Solution – S Corporation
- No shelter from personal tax bracket
- If income above \$315,000 for Joint Filers (\$157,500 for all others) the 20% deduction may not be available.

SUMMARY

- Partnerships:
 - With the advent of LLC's, partnerships as a general rule have become obsolete
 - One exception – limited partnerships are still used for estate planning purposes for valuation discount purposes

SUMMARY

- Limited Liability Companies:
 - Entity of choice
 - Limited liability
 - Pass-through taxation
 - No tax on formation
 - Generally no tax on distribution or liquidation
 - No restriction on ownership
 - Preferred returns allowable
 - Special allocations of profits, losses and distributions allowable
 - Debt included in basis

SUMMARY

- Inside basis step up available
- Health insurance premiums deductible
- Creditor protection available
- Self-employment taxes can be managed and planned for
- Tax bracket protection is not available

SUMMARY

- S Corporation:
 - Limited liability
 - Pass-through taxation
 - Entity level tax on distribution of appreciated property
 - Severe restrictions on ownership
 - No preferred returns
 - No special allocations
 - No inclusion of debt in basis
 - No inside basis step up
 - Health insurance premiums deductible

SUMMARY

- No creditor protection-voting
- Some self-employment tax benefit
- No tax bracket protection
- C Corporation:
 - Significant Tax bracket protection available
 - Qualified Small Business Stock

QUALIFIED SMALL BUSINESS STOCK

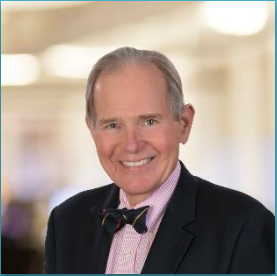
- Gain on the Sale of Qualified Small Business Stock is exempt from tax if the stock is held for more than five (5) years.
- Qualified Small Business Stock:
 - Stock originally issued after August 10, 1993
 - Issued by a "C" Corporation
 - Acquired at original issuance for money, property, or services
 - The Corporation is a "Qualifying small business"
 - The Corporation is an "active business"

QUALIFIED SMALL BUSINESS STOCK

- "Qualifying Small Business"
 - Corporation uses 80% of its assets in the active conduct of one or more qualified trades or businesses
 - Gross assets less than \$50,000,000
- Qualified Trade or Business
 - Businesses other than:
 - Service business
 - Banking, insurance, financial services
 - Farming
 - Oil & gas
 - Hotels, restaurants

QUALIFIED SMALL BUSINESS STOCK

- Active Business
 - 80% of its assets used in the active conduct of a trade or business
- Cap on Deferred Gain
 - Greater of \$10,000,000, or
 - 10 x the aggregate adjusted basis of the Qualified Small Business stock



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South Carolina Bar

Continuing Legal Education Division

Capital Accounts

Scott Y. Barnes

CAPITAL ACCOUNTS

South Carolina Bar | September 18, 2020

Scott Y. Barnes, Haynsworth Sinkler Boyd, P.A.

OVERVIEW

- Capital account maintenance rules
- Substantial Economic Effect
- 704 C (imbedded gain and bookup)

WHAT ARE CAPITAL ACCOUNTS?

- Capital Accounts measure a partner's equity in a partnership
- Balance sheet
 - Assets = Liability + Capital

CAPITAL ACCOUNT MAINTENANCE RULES

- Capital Accounts go up by:
 - Cash contributed to the partnership
 - The fair market value of property contributed by the partner to the partnership (less liabilities assumed)
 - Income or gain allocated to the partner
- Capital Accounts go down by:
 - Cash distributed to the partner
 - The fair market value of property distributed to the partner (less liabilities assumed)
 - Loss allocated to the partner

EXAMPLE

- A + B form a 50-50 partnership and each make an initial capital contribution of \$1,000 cash

Assets	=	Liabilities	+	Capital
Cash \$2,000		0		A \$1,000
				B \$1,000
\$2,000				\$2,000

EXAMPLE – YEAR TWO

- In year two, A + B borrow \$5,000 and buy a city lot for \$7,000 which they lease for parking at \$1,000 per year

Assets		=	Liabilities		+	Capital	
Lot	\$7,000		\$5,000			A	\$1,500
Cash	\$1,000					B	\$1,500
	\$8,000		\$5,000				\$3,000

EXAMPLE – YEAR THREE

- At the end of year three, A + B distribute the cash from years 2 and 3 to themselves

Pre-Distribution

Assets			=	Liabilities		+	Capital
Lot	\$7,000			\$5,000			A \$2,000
Cash	\$2,000						B \$2,000
	\$9,000			\$5,000			\$4,000

Post-Distribution

Assets			=	Liabilities		+	Capital
Lot	\$7,000			\$5,000			A \$1,000
							B \$1,000
	\$7,000			\$5,000			\$2,000

EXAMPLE – YEAR THREE PAY DOWN DEBT

- If in year 3, A + B paid down \$2,000 of debt instead of making a distribution their Capital Account would be reflected as shown below:

Assets	=	Liabilities	+	Capital
Lot \$7,000		\$3,000		A \$2,000
				B \$2,000
\$7,000		\$3,000		\$4,000

TRANSFER OF A PARTNERSHIP INTEREST

- When a partner transfers his partnership interest the buyer takes the selling partners capital account.
- Operating agreements often contain the following provision:
 - **SALE OR EXCHANGE OF INTEREST**

In the event of a sale or exchange of some or all of a member's interest in the company, the Capital Account of the transferring member shall become the Capital Account of the assignee, to the extent it relates to the portion of the interest transferred.

EXAMPLE

- Rather than paying down debt in year 3, A convinces B to let him draw the \$2,000 cash from the partnership to pay for his divorce.

Assets	=	Liabilities	+	Capital
Lot \$7,000		\$5,000		A \$0
				B \$2,000
\$7,000		\$5,000		\$2,000

EXAMPLE

- What if A needs more cash and sells his partnership interest to C for \$1,000. C thinks this is fair because the lot is worth \$7,000, there is \$5,000 of debt and \$2,000 in equity ($\$7,000 - \$5,000 = \$2,000$) and he is buying a 50% partnership interest.
- When the lot is sold 2 years later, C will discover that on dissolution and liquidation of the partnership B will get \$2,000 and C will get \$0. C will only have a \$1,000 long-term capital loss.

Post Sale and Debt Repayment

Assets	=	Liabilities	+	Capital
Cash \$2,000		\$0		C \$0
				B \$2,000
\$2,000		\$0		\$2,000

SUBSTANTIAL ECONOMIC EFFECT

- In addition to the Capital Account maintenance rules the IRS also requires that allocations of income, gain, loss or deduction have Substantial Economic Effect. Allocations must have economic consequence to partners.
- To have Substantial Economic Effect (and economic consequences)
 - Capital Accounts must be maintained in accordance with the Capital Account Maintenance Rules
 - In liquidation distributions are required to be made in accordance with positive Capital Account balances
 - A partner with a negative capital account following all liquidating distributions must, by the end of the taxable year, restore the deficit balance

SUBSTANTIAL ECONOMIC EFFECT

- If a partnership agreement has a "Qualified Income Offset" provision, the partner is not required to restore the deficit balance.

QUALIFIED INCOME OFFSET

- Most limited liability company operating agreements have a Qualified Income Offset Provision.
- **Qualified Income Offset**

In the event any member, in such capacity, unexpectedly receives an Offsettable Decrease, such member will be allocated items of income and gain (consisting of a pro rata portion of each item or partnership income and gain for such year) in an amount and manner sufficient to offset such offsettable decrease as quickly as possible.

HOW DO THE SUBSTANTIAL ECONOMIC EFFECT RULES EFFECT C?

- Because distributions in liquidation must be made on the basis of positive capital accounts, C will get nothing on the sale of the lot.

			Sale/Date Paid		
Assets	=	Liabilities + Capital	Assets	=	Liabilities + Capital
Lot \$7,000		\$5,000	Cash \$2,000		\$0
		C \$0			C \$0
		B \$2,000			B \$2,000
\$7,000		\$5,000	\$2,000		\$0
		\$2,000			\$2,000

- As shown in the next example, C's capital account had been negative, a qualified income offset provision would allocate any gain from the sale of the property to bring his capital account up to zero.
- If the operating agreement has no qualified income offset provision, the operating agreement should require a restoration of that deficit.

EXAMPLE

- Instead of selling the lot, the partnership borrows \$1,000 and distributes it to C.

Assets	=	Liabilities	+	Capital
Lot \$7,000		\$6,000		C (\$1,000)
				B \$2,000
\$7,000		\$6,000		\$1,000

EXAMPLE – TWO YEARS LATER

- Two years later, the lot is sold for \$8,000, the debt is repaid and the partnership is liquidated.
- The \$1,000 of gain (the lot was purchased for \$7,000) is allocated to C pursuant to the qualified income offset provision to bring C's capital account up to zero. B is distributed the \$2,000 in cash.

Before Debt Paid Off

Assets	=	Liabilities	+	Capital
Cash \$8,000		\$6,000		C \$0
				B \$2,000
\$8,000		\$6,000		\$2,000

After Debt Paid Off

Assets	=	Liabilities	+	Capital
Cash \$2,000		\$0		C \$0
				B \$2,000
\$2,000		\$0		\$2,000

704(C)

- 704(c) requires that when appreciated property is contributed to a partnership, the built in gain or loss is allocated to the contributing partner.

EXAMPLE

- Partner A contributes property with a basis of zero and a fair market value of \$5,000. Partner B contributes cash in the amount of \$5,000. Three years later the land is sold for \$7,000.
 - The built in gain \$5,000 is allocated to A (and is already reflected in his capital account)
 - \$1,000 of post contribution gain is allocated to A
 - \$1,000 of post contribution gain is allocated to B

Assets	=	Liabilities	+	Capital
Cash \$12,000		\$0		A \$5,000
				Post contribution gain \$1,000
				B \$5,000
				Post contribution gain \$1,000
\$12,000				\$12,000

- A has \$6,000 of taxable gain
- B has \$1,000 of taxable gain

HOW DO THE 704C RULES APPLY TO AN INCOMING PARTNER?

- A + B form a partnership and each contributes \$1,000. The partnership purchases a lot for \$2,000. A year later when the lot is worth \$4,000, C joins the partnership and contributes \$2,000 cash.

Initial Balance Sheet

Assets = Liabilities + Capital			
Lot	\$2,000	\$0	A \$1,000
			B \$1,000
	\$2,000	\$0	\$2,000

Balance Sheet on Admission of C

Assets = Liabilities + Capital			
Lot	\$4,000	\$0	A \$2,000
Cash	\$2,000		B \$2,000
			C \$2,000
	\$6,000	\$0	\$6,000

- Upon the admission of C, a new member, the lot is booked up to fair value and A + B's capital accounts are booked up to fair value.
- On liquidation of the partnership, C gets no benefit in the lot appreciation prior to his admission to the partnership.

Balance Sheet Following Book Up

Assets		=	Liabilities	+	Capital
Lot	\$4,000		\$0		A \$2,000
Cash	\$2,000				B \$2,000
					C \$2,000
	\$6,000		\$0		\$6,000

Balance Sheet Following Sale of the Lot

Assets		=	Liabilities	+	Capital
Cash	\$6,000		\$0		A \$2,000
					B \$2,000
					C \$2,000
	\$6,000		\$0		\$6,000

- If no bookup had taken place, C would have received a windfall on the sale of the property.

Balance Sheet on Admission of C – No Book Up

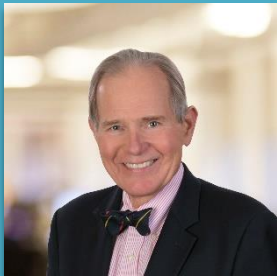
Assets		=	Liabilities	+	Capital
Lot	\$2,000		\$0		A \$1,000
Cash	\$2,000				B \$1,000
					C \$2,000
	\$4,000		\$0		\$4,000

- On the sale of the lot, the \$2,000 gain (\$4,000 sales price - \$2,000 basis) will be split in one-thirds.

Balance Sheet Following Sale – No Book Up

Assets	=	Liabilities	+	Capital
Cash \$6,000		\$0		A \$1,000
				1/3 of Gain \$666.66
				B \$1,000
				1/3 of Gain \$666.66
				C \$2,000
				1/3 of Gain \$666.66
\$6,000		\$0		\$6,000

- Cash distributed on liquidation
 - A \$1,666.66
 - B \$1,666.66
 - C \$2,666.66
- If A + B had not admitted C then cash following sale would have been:
 - A \$2,000 (\$1,000 initial capital and \$1,000 allocated gain)
 - B \$2,000 (\$1,000 initial capital and \$1,000 allocated gain)
- With no book up, C receives a \$666.66 windfall



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South Carolina Bar

Continuing Legal Education Division

Securities

Suzanne H. Clawson

SECURITIES LAW IMPLICATIONS OF SALES OF LLC INTERESTS

South Carolina Bar | September 18, 2020

Suzanne Hulst Clawson, Haynsworth Sinkler Boyd, P.A.

ARE LLC MEMBERSHIPS SECURITIES?

- Member-managed: Generally presumed NO
- Manager-managed: Generally presumed YES under *Howey* “investment contract” test. Case-by-case focus on economic realities of the investment.
 - *Howey* test: “Investment contract” defined as a contract, transaction or scheme whereby a person invests money in a common enterprise and is led to expect profits based solely on the efforts of the promoter or a third party.
- Either presumption can be overcome on the basis of members’ right to control.
- South Carolina courts also look to the *Howey* test.

IF AN LLC INTEREST IS A SECURITY, SALE MUST BE REGISTERED OR EXEMPT

- Sales of securities must be registered under federal and state law, or qualify for an exemption from registration under federal and state law.
- Registration of securities under federal and state law is expensive and time-consuming, and offering documents are subject to review and comment by the Securities and Exchange Commission and state securities regulators.
- Most smaller issuers seek exemptions from registration.
- Failure to fully comply with requirements of exemption may result in purchaser's right of rescission, interest, and attorney's fees.

FEDERAL EXEMPTIONS UNDER SECTIONS 3 AND 4 OF THE SECURITIES ACT OF 1933

- Section 4(a)(2) private placement exemption – sales by issuers in transactions that do not constitute “public offerings”
 - No practical need for the protections of the 1933 Act because the purchasers are sophisticated and have access to necessary information.
 - Permissible number of investors not specified, but large number would suggest offering is not “private.”
 - Securities sold are “restricted securities” – limitations on resale.

REGULATION D

- *Rule 506* – safe harbor for establishing compliance with Section 4(a)(2) of the 1933 Act
 - Unlimited dollar amount
 - Unlimited number of “accredited investors”
 - Up to 35 non-accredited investors, but must be capable of evaluating merits and risks of investment
 - Information delivery requirements for non-accredited investors
 - Prohibitions on general solicitation or advertising

REGULATION D – RULE 506 CONTINUED

- Must electronically file Form D with SEC
- “Bad actor” disqualification
- Exempt from state registration or exemption requirements, but may be required to make notice filing with states
- Securities sold are “restricted securities”

REGULATION D

- *Rule 504* – private offering exemption under Section 3(b)(1) of the 1933 Act
 - Offering limited to \$5 million in 12-month period
 - Unlimited number of investors
 - No required investor qualifications
 - No disclosure document delivery requirement, but still must comply with anti-fraud requirements

REGULATION D – RULE 504 CONTINUED

- No public solicitation and restrictions on resale
- Must electronically file Form D with SEC
- “Bad actor” disqualification
- With limited exceptions, securities sold are “restricted securities”

SECTION 3(a)(11) OF THE 1933 ACT – INTRASTATE EXEMPTION

- Securities offered and sold only to persons resident within a single state where issuer is resident and doing business
- 1933 Act Rules 144 and 144A provide safe harbors for assuring compliance with Section 3(a)(11)
- Complex and technical – narrowly construed

REGULATION CROWDFUNDING UNDER SECTION 4(a)(6) OF THE 1933 ACT

- Allows internet sales of securities to larger groups of investors without registration
- Allows sales to unaccredited investors
- Must sell through on-line intermediaries registered with the SEC or “funding portal” registered with the SEC
- Offering limited to \$1.07 million in a 12-month period (subject to adjustment by SEC every five years)

REGULATION CROWDFUNDING UNDER SECTION 4(a)(6) OF THE 1933 ACT

- Limitation on individual investments ranging between \$2,200 and \$107,000, depending on annual income or net worth, in any 12-month period
- Issuers must electronically file Form C: Offering Statement with the SEC containing information similar to that required in a registration statement and furnish to investors and intermediary

REGULATION CROWDFUNDING UNDER SECTION 4(a)(6) OF THE 1933 ACT (CON'T)

- Issuers must file annual reports with the SEC and post copy on website
- Issuers must keep SEC posted about progress of the offering
- Limitations on advertising and restrictions on resale
- “Bad actor” disqualification

REGULATION A UNDER SECTION 3(b) OF THE 1933 ACT – "SHORT-FORM REGISTRATION"

- Requires filing with SEC electronically of offering statement on Form 1-A and delivery of offering circular to investors. SEC has opportunity to review and comment and require revisions.
- Tier 1 and Tier 2 offerings

REGULATION A UNDER SECTION 3(b) OF THE 1933 ACT – "SHORT-FORM REGISTRATION"

- Tier 1 Offering
 - Offering limited to \$20 million in a 12-month period
 - No qualification requirements for investors
 - No limitation on amounts an individual may invest
 - Subject to state registration or exemption requirements

REGULATION A UNDER SECTION 3(b) OF THE 1933 ACT – "SHORT-FORM REGISTRATION"

- Tier 2 Offering
 - Offering limited to \$50 million in a 12-month period
 - Generally, purchasers must be accredited investors
 - Required to file annual, semi-annual and current reports with the SEC for at least a year
 - Not subject to state registration or exemption requirements, but may be required to file offering documents with state regulators and pay filing fees
 - Regulation A almost as difficult as registration, so not very useful

SOUTH CAROLINA EXEMPTIONS

- Limited Offerings
 - No more than 25 purchasers in South Carolina in a 12-month period
 - Generally no public solicitation and no advertising
- Little Reg. D
 - State version of federal Reg. D, but not exactly the same
 - Rule 504 exemption only permitted for up to \$250,000 in a 12-month period and all investors must be “sophisticated”
 - Rule 506 sales do not require a South Carolina exemption, but a notice filing must be made with the Securities Commissioner

SOUTH CAROLINA EXEMPTIONS

- Intrastate exemption
 - Offering limited to \$1 million
 - No more than \$5,000 may be sold to a non-accredited investor
 - “Bad actor” disqualification
 - Must comply with Section 3(a)(11) of the 1933 Act and 1933 Act Rule 147, or with Rule 147A
- Offers to accredited investors
 - No limitation on dollar amount or number of investors

SOUTH CAROLINA EXEMPTIONS

- Offerings under Tier 2 of 1933 Act Regulation A
 - Notice filing and filing fee
- Sales to institutional investors

EXEMPTIONS FOR REALES OF SECURITIES

- Requirement of registration or exemption applies not only to initial sales of securities, but also to resales.

FEDERAL EXEMPTIONS – SECTION 4(a)(1) OF THE 1933 ACT

- Permits unregistered sales of securities by persons who are not issuers, underwriters or dealers.
- Key to this exemption is definition of the term “underwriter” – broadly defined and may include individual investors not affiliated with the securities industry – person who purchases from an issuer with a “view to distribution” of the securities.
- Rule 144 provides a safe harbor for establishing that an individual is not an underwriter.

FEDERAL EXEMPTIONS – SECTION 4(a)(1) OF THE 1933 ACT

- If conditions of the rule are met, person who sells restricted securities or affiliate securities will be deemed not to be engaged in a distribution, and therefore, not an underwriter.
- Conditions include: holding periods for restricted securities, availability of current information about the issuer, limitation on amount of securities that can be sold, requirement of sale in a brokers' transaction, with a market maker, or in a riskless principal transaction, filing of a notice of sale with the SEC.
- South Carolina exemption – isolated non-issuer transaction

ANTIFRAUD REQUIREMENTS

- Whether a transaction in securities is registered or exempt, the seller must comply with the antifraud requirements of the federal and state securities laws.
- Unlawful to make an untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.
- Important to make full disclosure of all information that would be material to an investor's decision to invest.

KEY TAKEAWAYS

- Compliance with federal and state securities laws is generally time-consuming and expensive, even if an exemption is available.
- Easiest way to avoid having to deal with securities laws is to use the member-managed LLC, and ensure that all members are kept fully informed and are actively involved in decision-making.
- If because of the nature of the LLC's business or for some other reason a manager-managed LLC is the preferable course of action, seek advice from securities counsel at the outset to determine what steps need to be taken to comply.

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South Carolina Bar

Continuing Legal Education Division

Single Members LLCs, LLCs taxed as S Corps,
Professional LLCs, LLCs used in Estate Planning

David A. Merline, Jr.

Single Members LLCs, LLCs taxed
as S Corps, Professional LLCs,
LLCs used in Estate Planning

Presented by:

David A. Merline, Jr., Esq.



MERLINE & MEACHAM, PA
ATTORNEYS AT LAW

Main Topics

- I. Single Member LLCs
- II. LLCs Taxed as S Corporations
- III. Professional LLCs
- IV. LLCs used in Estate Planning



Single Member LLCs



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Key Items

- When to Use
 - *Operating Business*
 - Good for entry level business
 - Generally cheaper than forming a corporation, especially if no employees
 - *Corporation needs articles, minutes, bylaws, stock certificates and EIN*
 - *LLC needs articles, OA and maybe EIN*
 - *Real Estate*
 - Rental Property (both commercial and residential)
 - TIC
 - *Acquire Assets of Another Business*



- Manager Managed vs. Member Managed
 - *Member Incapacity*
 - *Signing Contracts*
 - If member managed, all members have apparent authority

- Need EIN for Payroll Purposes
 - *Normally use SSN*

- How Taxed
 - *C Corporation*
 - *S Corporation*
 - *Sole Proprietorship*

- Term vs. At Will
 - *Creditor of member of an at will LLC can foreclose on member's interest and force buyout at FV*

- Operating Agreement
 - *Veil Piercing*
 - One of the first things a plaintiff's attorney will request
 - *Authority*
 - Lenders and parties to contracts will likely want to see
 - *Creditor Protection*
 - Bankruptcy trustee could assert causes of action or rights derivatively against member or on behalf of LLC
 - See operating agreement sections 3.6, 3.7, 4.3, 5.9, 5.10 and 6.2

■ 3.6 Certain Assignees shall become Members.

Notwithstanding the provisions of Section 3.5, if the Member's entire Distributional Interest is assigned voluntarily by the Member by sale, exchange, gift, or involuntarily by reason of the Member's death, insolvency or bankruptcy, (but not by reason of a charging order obtained by a creditor under the Act), then the assignee of the Member's Distributional Interest shall automatically become a member of the Company, bound by this Agreement, and shall be entitled to all of the rights of the Member hereunder and at law.

■ 3.7 Right to distribution.

From time to time the Management Committee may cause the Company to make distributions, including distributions of Capital Contributions, to the Member. Subject to the Act, at the time that the Member becomes entitled to receive a distribution, the Member has the status of and is entitled to all remedies available to a creditor of the Company with respect to the distribution.

■ 4.3 Advances by Member.

If the Company does not have sufficient cash to pay its obligations, the Member may advance all or part of the needed funds to or on behalf of the Company. An advance described in this section constitutes a loan from the Member to the Company, bears interest at the General Interest Rate from the date of the advance until the date of payment and is not a Capital Contribution.

■ 5.9 Personal Services.

Neither the Member nor any Manager shall be required to perform any services for the Company by virtue of being the Member or a Manager of the Company. Neither the Member nor any Manager shall be required to devote his full time and efforts to the Company.

■ 5.10 **Compensation for Services.**

Those Managers who provide services to the Company shall be entitled to reasonable compensation from the Company in an amount to be determined by the Member. Also, the Managers shall be entitled to reimbursement for all expenses reasonably incurred by them on behalf of the Company.

■ 6.2 Indemnification.

To the fullest extent allowed by law, the Member and the Managers shall be indemnified and held harmless by the Company for any liability resulting from any act performed or omission made by them in good faith on behalf of the Company, except for acts or omissions of gross negligence, reckless conduct, intentional misconduct, or knowing violation of the law.

LLCs Taxed as S Corporations



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Qualifications

- This is a source of error and confusion for clients and their advisors
- Domestic Corporation
 - *A U.S. C Corporation or LLC*
 - *Certain Corporations (such as insurance companies and financial institutions) are Ineligible*
- No Disallowed Shareholders
 - *May be individuals, certain trusts and estates*
 - Individuals must be U.S. citizens or resident aliens
 - Most trusts disallowed – RT, ESBT or QSST permitted
 - *May **not** be partnerships, corporations or non-resident aliens*
- No More than 100 Shareholders
- Only 1 Class of Stock
 - *Can have voting and non-voting*
 - *Cannot have preferred and common*
- Calendar Year-End
- Examples of problems
 - *Member is corporation*
 - *Member is partnership*
 - *Multiple classes*
 - *Preferred/common*



Making an S Election

- File IRS Form 2553
 - *Must be Signed by all Shareholders*
- Must be filed:
 - *No more than 2 months and 15 days after the beginning of the tax year the election is to take effect; or*
 - *At any time during the tax year preceding the tax year it is to take effect.*



S Corporation Benefits

- Same Liability Protection as C Corporation
- Avoids Double Taxation of C Corporation
- Ability to Pass Through Losses
- Employment Tax Savings
 - *Required “Reasonable Compensation” subject to FICA*
 - *Distributions to Shareholder are not subject to FICA*



Professional LLCs



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Use of LLCs by Professionals

- Lack of guidance from SC Supreme Court and from ABA
- Position of relevant licensing agency
 - *Attorney - LLP ok per ABA*
 - *CPA*
 - *Doctor*
 - *Dentist*
 - *Engineer – LLP ok in NC*



Overview of Liability Protection for Owners

- Professional Association (PA)
 - *Limited Liability in Contract*
 - *Personal Liability in Tort*
 - For your own tort
 - For those you supervise
 - Not for other shareholders

- General Partnership (GP)
 - *Joint and Several Liability in Contract and Tort*

- Limited Liability Partnership (LLP)
 - *Joint and Several Liability in Contract*
 - *Limited Liability in Tort (maybe not for Professionals)*

- Limited Liability Company (LLC)
 - *Limited Liability in Contract*
 - *Limited Liability in Tort (maybe not for Professionals)*



Overview of Taxation

- Professional Association (PA)
 - *C Corporation or S Corporation*

- General Partnership (GP)
 - *Partnership*

- Limited Liability Partnership (LLP)
 - *Partnership*

- Limited Liability Company (LLC)
 - *Single Member – Corporation (C or S) or Disregarded Entity*
 - *Multi-Member – Corporation (C or S) or Partnership*



Observation of Formalities

- Professional Association (PA)
 - *Must Observe Formalities*
 - *Election to be Statutory Close Corporation*
 - Helps with lack of corporate minutes

- General Partnership (GP)
 - *Should Observe Formalities*
 - *Should have Partnership Agreement*

- Limited Liability Partnership (LLP)
 - *Should Observe Formalities*
 - *Should have Partnership Agreement*

- Limited Liability Company (LLC)
 - *Not Required to but Should Observe Formalities*
 - *Should have an Operating Agreement whether Single or Multi-Member*



LLCs used in Estate Planning



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A Primer on Transfer Taxes

- Three Categories
 - *Gift*
 - *Estate*
 - *Generation Skipping Transfer*
- Unified Credit
 - *Current Exemption Amount - \$11.58 Million per taxpayer*
 - *Set to revert to \$5 Million (indexed for inflation) in 2026*
 - *2020 Election*
- Stepped-Up Basis at Death
 - *IRC Sec. 1014*
 - *2020 Election*
- Annual Exclusion
 - *Current Annual Exclusion - \$15,000*



Family Limited Liability Company

- Family Limited Liability Company ("FLLC")
- Allows for many of the benefits associated with Family Limited Partnerships (FLPs)
 - *Manager Controlled*
 - Plan for succession of management
 - *Limited Liability*
 - *Gift of FLLC Membership Interests*
 - Valuation discounts
 - Leverage use of annual exclusion and lifetime exemption
 - Can shift equity/value but retain control
 - Can gift interest in portfolio of assets without breaking up the assets
 - *Fractional interest in real estate*
 - *Other liquid asset*



Family Limited Liability Company vs. Family Limited Partnership

■ Advantages of FLLC

- *One entity vs. two*
- *Easier to Form*
- *Less Expensive to Operate*
- *Better Liability Shield because no General Partner*

■ Advantages of FLP

- *Discounts Probably a Little Higher*
- *Sec. 2704(b)*
- *Settled Law*





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Case Law Update

Stafford J. McQuillin, III



South Carolina Bar

Continuing Legal Education Division

Current Events in Ethics and Discipline

Barbara Seymour

SC Ethics and Discipline Update
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(09/03/2020)

Part I –Summaries of Disciplinary Opinions
Part II – Non-Disciplinary Cases of Interest
Part III – SC Bar Ethics Advisory Opinions
Part IV – Recent Rule Revisions and Proposals

I. Summaries of Disciplinary Opinions

Criminal Conduct

- (1) Matter of Odom. Lawyer was convicted of criminal solicitation of a minor. He was sentenced to seven years, suspended on five years' probation. Disbarred, by agreement, applied retroactively to May 17, 2006, the date of Lawyer's interim suspension. (Op.#27918, September 25, 2019)
- (2) Matter of Drose. Lawyer was arrested for possession of a controlled substance. He completed PTI and the charge was dismissed. Lawyer also misappropriated a client's portion of a \$25,000.00 settlement in a personal injury case. Three year suspension, retroactive to May 2014 interim suspension, plus restitution to the Lawyers' Fund for Client Protection, by agreement. (Op.#27956, March 18, 2020)
- (3) Matter of Walker. Lawyer is licensed in NY and SC. He pled guilty to third degree reckless assault after becoming intoxicating and severely injuring a woman at his home. Lawyer's license was suspended NY for four months. The Court imposed reciprocal discipline on his SC law licensed. Four month suspension. (Op.#27962, April 8, 2020)
- (4) Matter of Parrott. Lawyer entered an Alford plea to charges of indecent exposure. His three year prison sentence was suspended on service of twelve months' probation. Lawyer's disciplinary history included a four-month suspension in 1997 (for assaulting a person on a beach by removing her bathing suit from behind) and a nine-month suspension in 2017 (for voyeurism by using his mobile phone to video up the skit of a customer in front of him in a grocery store). Disbarred, retroactive to June 2018, by agreement. (Op.#27989, August 12, 2020)

Neglect, Incompetence, and Failure to Adequately Communicate with Clients

- (5) Matter of Dotson. ODC received a complaint that Lawyer had neglected a workers' compensation case. During the investigation, Lawyer revealed that he suffered from an untreated mental health issue that impaired his ability to practice law. Lawyer entered into a deferred discipline agreement with the Commission on Lawyer Conduct. Lawyer failed to comply with the terms of that agreement and it was revoked. In the meantime, additional complaints were filed. One involved a divorce case neglected by Lawyer, including failing to comply with the client's request for the file, which was in storage rendered inaccessible to Lawyer because of failure to pay rent. The other involved a personal injury case that was so neglected it was dismissed. Lawyer did not adequately cooperate with the

disciplinary investigation. The Court also noted that Lawyer had received three prior letters of caution for related misconduct. One year suspension, retroactive to October 2016 interim suspension, plus restitution to the Lawyers' Fund for Client Protection, by agreement. (Op.#27922, October 23, 2019)

- (6) Matter of Gaines. Lawyer severely neglected three client matters, including failing to timely file pleadings, missing court dates, failing to communicate with clients or response to requests for return of client files, and failing to refund unearned fees. Lawyer also failed to cooperate in the disciplinary investigation. Two year suspension, retroactive to July 2018 interim suspension, plus restitution to clients and the Lawyers' Fund, by agreement. (Op.#27931, November 27, 2019)
- (7) Matter of Dickey. Lawyer neglected four client matters. Lawyer failed to cooperate in the disciplinary investigation. One year suspension, retroactive to February 2015 interim suspension, plus Ethics School and two years' LHL monitoring, by agreement. (Op.#27979, June 3, 2020)

Trust Account Violations and Other Financial Misconduct

- (8) Matter of Moody. Lawyer was disbarred in 2014 for misappropriation and has not been readmitted. Two disciplinary matters were subsequently resolved with restitution orders. One involved Lawyer's misappropriation of funds received from a client for the purpose of paying a civil judgment on his behalf. The other one involved Lawyer taking more fees from a settlement than he was entitled to. In that same case, Lawyer also diverted funds from the client's settlement to pay a third party on behalf of another client. Lawyer had been unable to pay the third party because he misappropriated that client's money as well. Restitution ordered. (Op.# 27960 and 27961, April 8, 2020)
- (9) Matter of Anonymous Member of the Bar. Lawyer was employed as President of South Carolina Operations of a large law firm headquartered in Georgia. In that role, Lawyer oversaw communications, business development, and HR for the firm's two offices in SC. However, Lawyer was not involved in operations. As a result of the misappropriation of nearly \$30 million in trust account funds firm-wide, the SC trust accounts incurred several overdrafts. A title company investigation revealed nearly \$650,000 shortfall in four of the firm's SC trust accounts. The misappropriation of funds was part of a fraudulent scheme orchestrated by the firm's CEO and majority owner and the nonlawyer head of the accounting department, both of whom have been convicted of criminal charges related to the theft. The title insurance company covered the losses to the clients. Lawyer admitted that she failed to make reasonable efforts to ensure the firm's SC trust accounts were in compliance with the record-keeping and reconciliation requirements of Rule 417, Lawyer also permitted a number of people to access those accounts without the supervision of a SC licensed attorney. The Court found that Lawyer's "misconduct enabled those with impermissible and unfettered access to misappropriate almost \$30 million." Because of Lawyer's lack of disciplinary history and cooperation in the investigation, the Court elected to impose an anonymous admonition in order to publish the order for the education of the Bar. Admonishment, plus costs, Ethics School and Trust Account School, by agreement. (Op.#27973, May 27, 2020)
- (10) Matter of Anonymous Member of the Bar. Lawyer was employed as Senior Managing Attorney in a SC office of a large law firm headquartered in Georgia. Lawyer was also the sole attorney employed in the firm's Columbia office. As a result of the misappropriation of

nearly \$30 million in trust account funds firm-wide, the SC trust accounts incurred several overdrafts. A title company investigation revealed nearly \$650,000 shortfall in four of the firm's SC trust accounts. The misappropriation of funds was part of a fraudulent scheme orchestrated by the firm's CEO and majority owner and the nonlawyer head of the accounting department, both of whom have been convicted of criminal charges related to the theft. The title insurance company covered the losses to the clients. Although Lawyer properly handled the processing of funds for her client's closings, she admitted that she did not have access to the account statements or reconciliations. During the course of the investigation, Lawyer submitted statements and documents to ODC that were prepared or orchestrated by the head of the accounting department, designed to cover up her theft. Lawyer was unaware of the falsity of those submissions. Lawyer admitted that "numerous people forbidden by Rule 417 from having access to South Carolina trust accounts had such access." The Court found that Lawyer's failure to control the accounts and records allowed the misappropriation of client funds. The Court determined that an admonition was warranted, but elected to publish an anonymous opinion "to warn members of the Bar against allowing law firm leadership or staff located outside of South Carolina to have unfettered access and control over South Carolina client funds." Admonishment, plus costs, Ethics School and Trust Account School, by agreement. (Op.#27974, May 27, 2020)

- (11) Matter of Collins. Lawyer misappropriated approximately \$440,000 from funds received to settle civil litigation involving his clients. Lawyer pled guilty to related criminal charges. He was sentenced to ten years in prison, suspended to five years on probation, community service, and restitution of \$500 per month. In connection with another case, Lawyer stole about \$72,000 and lied to a judge that the funds remained in trust. Lawyer used misappropriated money for personal debts, cash withdrawals, purchase of office supplies, payroll, phone bills, CLEs, and a political donation. Also, Lawyer agreed to a sanctions order in a civil case without consulting his client. Lawyer paid the sanctions directly. Lawyer's neglect of the case led to summary judgment, about which he failed to inform his client. Disbarment, retroactive to July 2016, by agreement. (Op.#27984, June 24, 2020)

Conflicts of Interest

- (12) Matter of Bannon. Complainant had two cases, one in which his parental rights were terminated and one in which he was charged with CSC. Complainant was represented by the same attorney in both cases. Lawyer represented the adoptive couple who was adverse to Complainant in the TPR action. Lawyer was also involved in the CSC matter, as an appointed special prosecutor. Sometime later, Lawyer hired Complainant's attorney to work in his law firm. Lawyer engaged in a conflict of interest when he became involved in a related matter for the adoptive couple adverse to Complainant. Public reprimand, by agreement. In an unrelated PCR matter, Lawyer failed to timely file his client's action. He had advised his client that he would not file the PCR action until he was paid in full. The client's family member paid the fee, but due to a clerical error in Lawyer's office, the payment was not reflected in the file. In imposing discipline, the Court cited Comment 5 to Rule 1.5, which states that a fee agreement "may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client's interest." The Court held that "[o]nce a lawyer accepts employment, the lawyer may, with reasonable warning, withdraw from representation due to the client's substantial failure to fulfill an obligation to pay for the lawyer's services. However, a lawyer may not

condition the duties of representation on the payment of fees.” Public Reprimand, plus Ethics School and costs, by agreement. (Op.#27933, December 18, 2019)

Dishonesty and False Witnessing

- (13) **Matter of McCarty**. While Lawyer was a partner in a law firm, he represented clients without the knowledge of the firm and accepted \$100,000 in legal fees that he did not pay over to the firm. Lawyer used law firm resources to represent the clients. Although Lawyer initially screened the clients for conflicts with the law firm, he did not enter most of the cases into the firm’s case management system. Lawyer claimed that the firm did not prohibit “moonlighting” but the firm disagreed, claiming that there was a policy against it that was not in writing. In any event, Lawyer admitted wrongdoing and settled with the firm by paying the portion of the fees he earned from the moonlighting cases that it would have been owed if they were firm clients. Public Reprimand, plus Ethics School, Trust Account School, and costs, by Agreement. (Op.#27916, August 21, 2019)
- (14) **Matter of Sloan**. Lawyer altered and falsified records related to billable hours and client expenses, including time entries and receipts. Lawyer misled clients about the status of cases he neglected. Three year suspension, retroactive to January 2017, by agreement. (Op.#27936, January 22, 2020)
- (15) **Matter of Brooks**. In February 2019, Lawyer was admitted to the SC Bar on her Wyoming Uniform Bar Exam score. She provided false and misleading information to the Office of Bar Admissions in connection with her application to be admitted in SC. In that application, Lawyer failed to disclose one of two arrests for DUI. She also failed to identify all of the states where she had sought admission or to be truthful about her reasons for withdrawing her application filed in Wyoming. The truth was that Wyoming’s Character and Fitness Committee was investigating her submission of a falsified document. Lawyer also provided false information in connection with her applications for admission to North Carolina and Idaho. Finally, although Lawyer did disclose a second DUI arrest, she failed to disclose other charges related to that arrest or her failure to comply with the terms of her release pending resolution of those charges. Disbarment, retroactive to October 2019 interim suspension. (Op.#27984, June 24, 2020)

Unauthorized Practice of Law

- (16) **Matter of Rawlinson**. Lawyer was administratively suspended for failure to comply with MCLE requirements. While on suspension, Lawyer represented a client in a conference call with the solicitor and the judge. The judge advised Lawyer that he would not be heard because of his suspension. Subsequently, the solicitor contacted Lawyer to advise that a court date had been set. Lawyer falsely stated that he had “clearance” to resume practice. Lawyer then failed to appear at the hearing. He later sent an email to the solicitor stating that he was just “waiting on approval,” suggesting that he had petitioned for reinstatement, which he had not done. Also while on suspension, Lawyer collected advance payments for legal services from clients, signed up new clients, communicated with opposing counsel, and even appeared on behalf of a client at a mediation. In other matters, Lawyer failed to communicate with clients regarding his suspension and allowed their legal matters to languish. Lawyer revealed that he was suffering from depression. Lawyer charged “non-refundable” flat fees in several cases, which he did not hold in trust. He did not have the proper language in a written fee agreements that would allow him to use those fees prior

to earning them. Lawyer did not adequately respond to disciplinary authorities. He failed to refund those fees when he was suspended. 18 month suspension, retroactive to July 2018 interim suspension, plus restitution to clients, payment of costs, and up to three years of mental health treatment monitoring, by agreement. (Op.# 27926, November 6, 2019)

Failure to Cooperate with Disciplinary Investigation

(17) **Matter of Crews**. Lawyer's law license in NC was suspended for thirty days for failure to cooperate in a disciplinary investigation in that state. The SC Court imposed reciprocal discipline. Thirty day suspension. (Op.#27987, July 15, 2020)

II. Nondisciplinary Cases of Interest

(18) **Unauthorized Practice of Law in Federal Workers' Compensation Cases**. Respondent was disbarred in Washington State in 2009. He was never licensed to practice in South Carolina. Respondent operated a business in SC known as Chartmans, Inc. and advertised as a "legal consultant" offering "compassionate problem-solving, pragmatic negotiations and unwavering litigation" in "US administrative hearings, before international tribunals, foreign courts, or in mediations and arbitrations abroad." He held himself out as a "litigator" and touted his experience as an "American lawyer, cleric and foreign legal and business consultant." Although federal regulations permit non-lawyers to represent parties in Longshoremen's and Harbor Workers' Compensation Act claims brought before the Department of Labor's Office of Administrative Law Judges, Respondent had been disqualified by two federal ALJs because, as a disbarred lawyer, he was not a "non-attorney" as defined in the regulation. This declaratory judgment action was brought by the Solicitor in the original jurisdiction of the SC Supreme Court. Ordinarily, a state court has no jurisdiction to regulate practice before the federal courts under the Sperry Doctrine, but in this case, Supreme Court was able to take action because Respondent was not authorized by federal law to practice in SC. The Court enjoined Respondent from giving advice to clients, negotiating settlements, and management of SC state workers comp cases without attorney supervision. He was also enjoined from drafting settlement agreements and contracts involving real estate, negotiating legal rights and responsibilities of others, or giving advice about settlement offers or contract terms under SC law. In re Marshall, Op.#27919 (September 25, 2019)

(19) **Unauthorized Practice of Law by Debt Collection Company**. Restaurant discontinued contracted services of its linen provider based on unsatisfactory performance. The linen provider hired The Murkin Group, LLC, a nonlawyer debt collector, to collect liquidated damages set forth in the contract. Restaurant hired a lawyer to help resolve the dispute. When settlement negotiations broke down, Restaurant's lawyer filed a declaratory judgment action in the original jurisdiction of the Supreme Court to determine whether some of Murkin's activities constituted the unauthorized practice of law. The Court held that Murkin's activities exceeded mere debt collection, including negotiation of the dispute over terms of the contract, advising the linen company regarding legal strategy, controlling when an attorney would be brought in on behalf of the linen company and claiming it would control the actions of such an attorney, threatening to file suit and bring certain claims, giving legal opinions and interpreting the contract. The Court held that this was not merely collecting a debt, but rather a contract dispute. A nonlawyer debt collector engages in the unauthorized practice of law by advising a client on what legal action to take, whether to hire a lawyer,

whether to accept a settlement offer, and what damages are available. A nonlawyer is not authorized to negotiate resolution of a dispute beyond the value of the claim. In re The Murkin Group, LLC, Op#27957 (March 18, 2020)

III. SC Bar Ethics Advisory Opinions*

- (20) SC Bar Opines that Attorney Hired by Insurance Carrier May Appear on Behalf of Missing Client.** “Attorney may appear for and defend an Insured who cannot be located at the request of the Insurance Carrier if Insurance Carrier’s insurance contract with the Insured gives it the right to retain counsel to defend claims made against the Insured. Where a person has, by contract, including insurance contract, delegated authority to another to choose counsel, conduct the defense of a claim, and perhaps even settle a matter within certain boundaries, an attorney may reasonably rely upon the instruction of the person’s agent, in this situation Insurance Carrier, to appear and conduct the defense of the case in the absence of any direction from the missing Insured to the contrary.” (EAO#19-04)
- (21) SC Bar Clarifies Obligations of Successor Counsel to Honor Fee Lien.** Contingency fee Client fired Firm A and hired Firm B. Firm A asserted charging lien for 15% of settlement and costs advanced. Firm B paid over the costs, but does not want to honor the lien. The Advisory Committee advises that under Rule 1.15(e) Firm B must first determine if Firm A’s claim is frivolous (the Committee did not give an opinion on that). If Firm B determines that Firm A’s claim is not frivolous, Firm B must hold 15% of the fee in trust until the dispute between the firms is resolved. Firm B is free to disburse the remaining portion of the fee. EDITOR’S NOTE: While not mentioned in the opinion, it is important to remember that this scenario represents a dispute between the predecessor and successor firms, not a dispute between the predecessor firm and the client. Comment [8] to Rule 1.5 specifically states that client consent is not required in this scenario: “[W]hen a client has hired two or more lawyers in succession on a matter and later refuses to consent to a discharged lawyer receiving an earned share of the legal fee, [Rule 1.5’s fee sharing provision] should not be applied to prevent a lawyer who has received a fee from sharing that fee with the discharged lawyer to the extent that the discharged lawyer has earned the fee for work performed on the matter and is entitled to payment.”
- (22) SC Bar Offers Guidelines for Insurance Defense Attorneys to Reduce Fees to Facilitate Settlement.** In response to an inquiry from an attorney hired to defend a client by an insurance company, the Ethics Advisory Committee stated that the attorney was not permitted to contribute his own money to facilitate a settlement that favored his client. However, the attorney is permitted to reduce his flat fee to give the insurance company more money to put towards the settlement offer. According to the Committee, this arrangement (similar to a plaintiff’s attorney agreeing to reduce the contingency fee to afford the client more money) the attorney must only do so if it is in the interest of the client and must ensure that the client and the insurance company consent. (EAO #20-01)

*NOTE: Ethics Advisory Opinions (EAOs) are issued by a committee of the South Carolina Bar. They are not approved by the Commission on Lawyer Conduct or the Supreme Court of South Carolina and have no binding effect. Practitioners are advised to read the full text of EAOs to ensure applicability and to consult with experienced ethics counsel or the SC Bar before proceeding with a questionable course of conduct.

(23) SC Bar Authorizes Use of Competitive Keyword Advertising. The Ethics Advisory Committee has determined that “a lawyer may purchase an internet competitive advertising keyword that is the name of another lawyer or law firm, in order to display a ‘sponsored’ website advertisement.” The Committee warned that all of the advertising provisions in the Rules of Professional Conduct apply to internet advertising and that lawyers must “ensure that no derogatory or uncivil message is conveyed.” Also, the Committee confirmed that “surreptitious redirection from a competitor’s website to a lawyer’s own web page via a hyperlink is prohibited under our Rules.” (EAO #20-02)

IV. Recent Rule Revisions and Proposals

(24) ABA Revamps Model Lawyer Advertising and Solicitation Rules. At its meeting in August 2018, the ABA House of Delegates adopted changes to the Model Rules of Professional Conduct that regulate lawyer advertising (Rule 7.1 – 7.5). The changes include elimination of several content and format restrictions, address issues related to technology and social media, permit nominal hospitality gifts to referral sources, and permit direct solicitation of potential clients in most business and transactional matters. The SC Bar House of Delegates in 2020 sent a proposal to adopt some, but not all, of the ABA changes. Non-ABA changes would include permitting advertising accolades and awards (such as Super Lawyers), eliminating the 30-day waiting period to solicit personal injury clients (except in cases of wrongful death), and

(25) Supreme Court Reminds Lawyers that Informed Consent is Required to Reference Client Matters in Advertising; No “Generally Known” Exception. The SC Bar petitioned the Supreme Court for an amendment to Rule 1.6 that would allow lawyers to reveal citations to published opinions without being required to obtain client consent. The Court declined to amend the rule as proposed by the Bar. Instead, the Court amended Rule 1.6 to add a new comment reminding lawyers that Rule 1.6 requires them to obtain informed consent from clients before revealing information about the representation to advertise the lawyers’ services. The comment further clarifies this obligation applies regardless of whether any information revealed is contained in court filings or has become generally known.

(26) Supreme Court Amends RPC to Address Digital Competence. The Court has adopted new language in Rule 1.1 that reminds lawyers that ethical competence includes “a reasonable understanding of the benefits and risks associated with technology the lawyer uses to provide services to clients or to store or transmit information related to the representation of a client.” Along the same lines, the Court added a new paragraph to Rule 1.6 that a “reasonable effort to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client” is part of the lawyer’s confidentiality obligation. The new Comment [20] provides extensive guidance on securing clients’ digital data.