

Overview of Limitations for a Limited Liability Company

There are certain disadvantages that may exclude the LLC from consideration as the best organizational entity:

1. The LLC is not always available to the sole proprietor

Several states require two or more members to form a limited liability company. So, on occasion, a sole proprietor may not be able to form an LLC. A carefully drafted grantor trust could therefore serve as a second member for the LLC. An additional benefit to this arrangement is that having a second member would also reinforce the limited liability aspect of the LLC, as we've discussed earlier. Its income would be reported on the owner's 1040 Schedule C income tax return.

2. The LLC is not always available for the professional practice

Many states prohibit an LLC for such professionals as physicians and attorneys. Don't form a limited liability company to operate your professional practice before you check with your state licensing agency or an attorney familiar with your state's professional regulations.

3. Questionable estate tax benefits

The limited liability company may not save you estate taxes. If you have a taxable estate, then it may be safer to use the family limited partnership if you want a discounted valuation of your estate. Your limited partnership may, however, own one or more LLCs, which would enable you to capture the estate tax discounted valuation.

4. The dissolution dilemma

You may also require the unanimous vote by all LLC members to continue the LLC after the death, bankruptcy, retirement, etc. of one member. One member can then possibly become a holdout and make unreasonable demands on the remaining members to vote to continue the LLC. You can avoid this holdout problem if your LLC operating agreement requires only a majority vote to continue the company.