

Memorandum

To: Lisa Thompson
Supervising Property Appraiser

Date: July 12, 2005

Ladeena Ford
Senior Specialist, Property Auditor Appraiser

From: Mary Ann Alonzo
Senior Legal Counsel

Subject: *Exemption Qualification of Limited Liability Companies*

This memo is in response to questions you raised last week concerning the requirements of Rule 136, "Limited Liability Companies As Qualifying Organizations For the Welfare Exemption." Rule 136 and the statutory amendments to section 214 authorizing the exemption to qualified limited liability companies (as defined by Rule 136) became effective only as of January 1, 2005.¹ The Exemptions Unit has received several exemption claims on behalf of limited liability companies requesting an organizational clearance certificate. An initial review of the exemption claims and supporting documentation indicates that the LLC claimants have not submitted their articles of organization with the provisions required by Rule 136. You have requested information that you can use to assist these claimants to meet the requirements for exemption.

As you are aware, a Limited liability company (LLC) has two basic organizational documents, an operating agreement² and the statutorily-prescribed Secretary of State form, "Limited Liability Company, Articles of Organization" (LLC-1). The LLC-1 may consist of one page or additional optional pages without limitation. An LLC comes into existence when its articles of organization are filed with the Secretary of State. (Corporation Code, section 17050, subd. (c)).

The Corporation Code allows LLCs to include optional matters in the articles. (Corp. Code section 17051, subd. (c); see no. 6 on form LLC-1) In that regard, section 17051, subd. (c) is written broadly to provide that "the articles of organization may contain any other provision not inconsistent with law, including, but not limited to:

- (1) A provision limited or restricting the business in which the limited liability company may engage or the powers that the limited liability company may exercise or both.

¹ A.B. 3073 (Ch. 354, Stats. 2004)

² Members may enter into an operating agreement either before or after filing of its articles (Corp. Code section 17050(a)). The operating agreement prescribes the structural details of the LLC, and members may enter into either an oral or written operating agreement. (Corp. Code section 17050(a)). The articles control if there is a conflict between any provision of the LLC's articles and its written operating agreement. The operating agreement is not to be filed with the Secretary of State.

- (2) Provisions governing the admission of members into the limited liability company.
- (3) The time at which the limited liability company is to dissolve.
- (4) Any events that will cause dissolution of the limited liability company.
- (5) A statement of whether there are limitations on the authority of managers or members to bind the limited liability company, and, if so, what the limitations are.
- (6) The names of the managers of the limited liability company."

The language of Corporation Code section 17051, subd. (c), "any other provision not inconsistent with law, including, but not limited to," allows for the inclusion of any lawful matter not specifically identified in items (1) through (6). However, the specific subdivisions of Corporation Code section 17051, subd. (c) authorize the inclusion of optional matters in the articles that directly relate to Rule 136 requirements. As noted above, section 17051, subd. (c)(1) specifies provisions may be included in the articles to limit or restrict the business in which the LLC may engage.

- Section 17051, subd. (c) relates to subsections (c)(1) and (c)(2) of Rule 136, which require specific statements that the LLC is to limit its activities to one or more exempt purposes of section 214, and operate exclusively to further the exempt purpose(s).
- Section 17051, subd. (c)(1) also specifies certain provisions that may be included in the articles to limit the powers the LLC may exercise, which relate directly to the following rule subsections:
 - subsection (c)(1)(5), restricting the LLC's use of its property by requiring irrevocable dedication to exempt purposes specified in sections 214 and 214.01;
 - subsection (c)(1)(6), restricting the LLC's future transfer of its property by requiring distribution to a qualified nonprofit organization upon dissolution of the LLC;
 - subsection (c)(1)(7), restricting amendments to the LLC's articles to those consistent with section 214;
 - subsection (c)(1)(8), barring the LLC from merging into or converting into a for-profit entity; and,
 - subsection (c)(1)(9), barring the LLC from distributing any assets to members who cease to be qualifying welfare organizations.

Optional matters can also include special requirements as to who may be or become members (Corp. Code section 17051(c)(2)), which relate to subsections (a), (b)(1) and (b)(2) of Rule 136. Those provisions define members of an LLC qualified for exemption as limited to organizations qualified for the welfare exemption, or as members comprised of both welfare organizations and government entities.

Claimants that have previously filed form LLC-1 with the Secretary of State and did not include the requirements of Rule 136 in their articles, will need to amend their articles. The

articles can be changed only by formal amendment filed with the Secretary of State and require the unanimous vote of all members (owners) unless otherwise provided by the LLC's articles of organization or operating agreement. (Corp. Code section 17103(a)(2)) Corporation Code section 17054 requires an LLC to amend its articles on a form prescribed by the Secretary of State, "Limited Liability Company, Certificate of Amendment" (LLC-2). Thus, LLC claimants amending their articles should be required to file copies of forms LLC-1 and LLC-2 certified by the Secretary of State with their exemption claim.

If you have further questions regarding Rule 136 requirements, please do not hesitate to contact me at 324-1392.

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