

# TABLE OF CONTENTS

---

Introduction ..... i  
 Acknowledgement..... ii  
 About the Editor/Authors ..... iii

## CHAPTER 1: INTRODUCTION

---

I. Formation and Organization ..... 1-2  
 II. Taxation..... 1-2  
 III. Limited Liability Company Statutes..... 1-3  
 IV. Choice of Entity ..... 1-3  
     A. C Corporations ..... 1-4  
     B. S Corporations ..... 1-4  
     C. General Partnerships ..... 1-5  
     D. Limited Liability Partnership ..... 1-6  
     E. Limited Partnership ..... 1-6  
     F. Limited Liability Limited Partnership..... 1-7

### APPENDIX

## CHAPTER 2: FORMATION AND ORGANIZATION

---

I. Preformation..... 2-1  
     A. Attorney Client Relationship..... 2-1  
     B. Preformation Agreement ..... 2-2  
         1. Confidentiality ..... 2-2  
         2. Stand Still Agreement..... 2-2  
         3. Non-Competition..... 2-3  
     C. Subscription ..... 2-4  
         1. Consideration for Membership Interest..... 2-4

2. Subscription Agreement .....2-4

II. General Operative Law and Documentation..... 2-4

    A. General ..... 2-4

    B. Knowledge and Notice ..... 2-5

III. Articles of Organization .....2-6

    A. General ..... 2-6

    B. Contents of the Articles of Organization..... 2-6

IV. DCCA Paper and Electronic Forms for Articles of Organization ..... 2-7

APPENDIX

**CHAPTER 3: OPERATING AGREEMENTS**

---

I. Introduction..... 3-1

II. Default Rules ..... 3-1

III. Non-Waivable Provisions ..... 3-3

    A. Access to Information..... 3-3

        1. Former Member.....3-3

        2. Information Provided to Members Without Demand.....3-3

        3. Information Provided to Members Upon Demand.....3-4

    B. Duty of Loyalty ..... 3-4

        1. A Member’s Duty of Loyalty.....3-4

        2. A Manager’s Duty of Loyalty.....3-6

    C. Duty of Care ..... 3-6

    D. Good Faith and Fair Dealing ..... 3-7

    E. Expulsion of a Member ..... 3-7

    F. Winding Up ..... 3-8

    G. Rights of Third Parties..... 3-9

APPENDIX

## CHAPTER 4: MANAGEMENT

---

I.	Overview: The Manager-Managed/Member-Managed Dichotomy .....	4-1
II.	Member-Managed LLC's .....	4-2
	A. Management .....	4-2
	B. Fiduciary Duties of Members .....	4-4
III.	Manager-Managed LLC's .....	4-5
	A. Management .....	4-5
	B. Appointment of Managers .....	4-7
	C. Fiduciary Duties of Managers .....	4-7
IV.	Liability of Members and Managers .....	4-8
V.	Books and Records .....	4-8

## CHAPTER 5: DISTRIBUTIONS

---

I.	Default Rule – Equal Shares .....	5-1
	A. Sharing Ratios and Other Alternatives.....	5-2
	B. Allocations and Tax Issues .....	5-3
	1. Substantial Economic Substance.....	5-3
	2. Minimum Gain Chargeback.....	5-3
	C. Distributions of Property (Other Than Cash).....	5-4
II.	Limitations .....	5-4
	A. Limitations on Distributions .....	5-4
	B. Liability for Unlawful Distributions .....	5-5
	1. General Rule .....	5-5
	2. Liability of Member with Knowledge .....	5-6
	C. Limitation Period .....	5-6
	D. Contribution/Indemnity .....	5-6
III.	Member's Rights as Creditor .....	5-6

### APPENDIX

## CHAPTER 6: ADMISSION, DISSOCIATION, and EXPULSION of MEMBERS, TRANSFERS of INTEREST

---

I.	Admission of Members .....	6-1
A.	Default Rule and Operating Agreement Provisions .....	6-1
II.	Transfer of Membership Interests.....	6-2
A.	Transfers of Distributional Interest.....	6-2
B.	Transferee Does Not Automatically Become a Member .....	6-2
C.	Transferee May Become a Member .....	6-3
III.	Creditors of Members; Charging Orders.....	6-5
IV.	Dissociation and Expulsion of Members.....	6-5
A.	Dissociation Generally .....	6-5
B.	Events Leading to Dissociation .....	6-6
C.	Wrongful Dissociation .....	6-8
D.	Purchase of a Member’s Interest Upon Dissociation .....	6-9
E.	Agency of Dissociated Members .....	6-11
F.	Other Methods to Change Relationships Among the LLC and its Members.....	6-12

## CHAPTER 7: CONVERSIONS AND MERGERS

---

I.	Conversions.....	7-1
A.	Plan of Conversion.....	7-1
1.	Domestic LLC Converting to Foreign LLC or Another Entity ..	7-1
2.	Foreign LLC or Other Entity Converting to a Domestic LLC ...	7-2
3.	Abandonment .....	7-2
B.	Articles of Conversion .....	7-3
C.	Effect of Conversion.....	7-4
II.	Mergers .....	7-5
A.	Plan of Merger.....	7-5
B.	Termination .....	7-6
C.	Articles of Merger .....	7-7

- D. Dissolution ..... 7-8
- E. Effect of Merger..... 7-9
- III. Forms ..... 7-9

**CHAPTER 8: DISSOLUTION and LIQUIDATION**

---

- I. Dissolution, Winding Up and Articles of Termination ..... 8-1
  - A. Overview ..... 8-1
  - B. Events of Dissolution..... 8-2
  - C. LLC Continues After Dissolution ..... 8-3
  - D. Winding Up the LLC’s Business..... 8-3
  - E. Distribution of Assets ..... 8-4
  - F. Known Claims ..... 8-4
  - G. Unknown Claims ..... 8-5
  - H. Articles of Termination ..... 8-6
- II. Administrative Termination ..... 8-7
  - A. Grounds ..... 8-7
  - B. Procedure and Effect ..... 8-7
  - C. Reinstatement..... 8-8
  - D. Appeal..... 8-8

APPENDIX

**CHAPTER 9: FOREIGN LLCs**

---

- I. General Law ..... 9-1
- II. Transacting Business in Hawaii..... 9-1
- III. Certificate of Authority ..... 9-2
  - A. Application Requirements ..... 9-2
  - B. Issuance of Certificate of Authority..... 9-3
- IV. Name of Foreign LLC ..... 9-3
- V. Revocation and Cancellation of Certificate of Authority..... 9-4
  - A. Revocation ..... 9-4

B.	Cancellation of Authority .....	9-4
VI.	Effect of Failure to Obtain Certificate of Authority.....	9-5
VII.	DCCA Forms for Foreign Limited Liability Companies .....	9-6
APPENDIX		

## CHAPTER 10: SECURITIES LAW

---

I.	Introduction.....	10-1
II.	Federal and State Securities Laws Considerations .....	10-2
A.	Federal Securities Laws.....	10-2
1.	Registration Requirement.....	10-2
2.	Definition of Security.....	10-2
3.	Investment Contracts.....	10-3
4.	Exemptions from Registration.....	10-7
a.	Private Offering Exemption, Section 4(2).....	10-7
b.	Regulation D (17 C.F.R. Section 230.501-508).....	10-9
c.	Accredited Investors Exemption, Section 4(6) .....	10-16
d.	Intrastate Offering Exemption, Section 3(a)(11).....	10-16
e.	Rule 147 Safe Harbor .....	10-17
f.	Regulation S (Rules Governing Offers and Sales Made Outside the United States without Registration Under the Securities Act of 1933). .....	10-18
5.	Private Resales .....	10-18
B.	Hawaii Securities Laws Registration Requirement.....	10-19
1.	Registration of Securities Under HRS Chapter 485A .....	10-21
a.	Registration by Qualification .....	10-21
b.	Small Company Offerings Registration .....	10-22
2.	Definition of Security Under HRS § 485A-102.....	10-23
3.	Exemptions from Registration.....	10-24
a.	NSMIA (Federal Law Preemption) .....	10-24
b.	HRS § 485A-202(a)(12) (Offers and Sales to Institutional Investors) .....	10-25

- c. HRS § 485A-202(a)(13) (Limited Offerings) ..... 10-25
    - d. HRS § 485A-202(a)(26) (Non-Public Offering) ..... 10-26
    - e. HRS § 485A-202(a)(15)(A) (Offerings to Accredited Investors ..... 10-27
    - f. HAR § 16-39-202(a) (Compliance with Rules 505 and 506)..... 10-27
  - 4. Burden to Establish Exemption..... 10-28
  - 5. Other Jurisdictions..... 10-28
- C. Disclosure, Subscription and Related Documentation ..... 10-29
- D. Notice of Sale and Other Filings..... 10-30
  - 1. Form D; Electronic Filing ..... 10-30
  - 2. Other Filings ..... 10-32
    - a. Amendments..... 10-32
    - b. Withdrawal, Termination or Completion ..... 10-32
    - c. Advertising and Financial Reports ..... 10-32
    - d. Rescission Offers..... 10-33
- E. Failure to Comply with Registration Requirements ..... 10-34
  - 1. Criminal Liability ..... 10-34
  - 2. Civil Liability..... 10-34

- III. Conclusion..... 10-36

## CHAPTER 11: BANKRUPTCY

---

- I. Introduction..... 11-1
  - A. Background..... 11-1
  - B. Eligibility of the LLC to be a Debtor ..... 11-2
  - C. Chapters Available ..... 11-3
  - D. Voluntary Petition ..... 11-3
    - 1. Authority of the LLC to File a Voluntary Petition..... 11-3
    - 2. Procedure for Filing..... 11-5
    - 3. Place to File ..... 11-5
  - E. Involuntary Petition..... 11-6

- 1. Filing Requirement..... 11-6
- 2. Procedure after Filing..... 11-7
- F. Effects of the LLC’s Bankruptcy ..... 11-7
  - 1. Section 541 – Property of the Estate..... 11-7
    - a. Executory Contracts and Unexpired Leases ..... 11-8
  - 2. Automatic Stay ..... 11-9
    - a. Relief From the Automatic Stay ..... 11-11
    - b. Effect of an LLC Bankruptcy on Member’s Liabilities..... 11-12
  - 3. Chapter 11 Debtor-in-Possession Management - Duties and Powers ..... 11-13
  - 4. Chapter 11 Trustee – Duties and Powers ..... 11-15
  - 5. Chapter 7 Trustee – Duties and Powers ..... 11-15
  - 6. Consequences of Chapter 7 Liquidation of an LLC..... 11-15
  - 7. Chapter 11 Plan of Reorganization ..... 11-16
  - 8. Confirmation of a Plan of Reorganization..... 11-17
- G. Bankruptcy of a Member of the LLC..... 11-19
  - 1. Dissociation – HRS §428-601(6)(a) ..... 11-19
  - 2. Effects of Bankruptcy Code §§363(l), 365(e) and 541(c) .... 11-20
  - 3. Disposition of the Member’s Interests in Bankruptcy..... 11-23
- H. “Bankruptcy Remote” LLCs..... 11-23
  - 1. Conduit Loans..... 11-23
  - 2. Typical Bankruptcy Remote Special Purpose Entity Requirements..... 11-25
- II. Conclusion..... 11-27

APPENDIX

**CHAPTER 12: FEDERAL INCOME TAXATION OF LLCs**

- I. Classification of LLCs for Federal Tax Purposes..... 12-1
  - A. “Check-the-Box” Election ..... 12-1
  - B. Default Rules..... 12-1



- II. Basic Formation Issues ..... 12-2
  - A. LLC Formation ..... 12-2
  - B. Basic Basics..... 12-3
    - 1. LLC’s Basis in Its Assets (“Inside Basis”) ..... 12-3
    - 2. Member’s Basis of its Interest in the LLC (“Outside Basis”) .. 12-3
- III. Capital Accounts..... 12-5
  - A. Book Capital Accounts ..... 12-6
    - 1. Contributions ..... 12-6
    - 2. LLC Income and Loss..... 12-6
    - 3. Distributions..... 12-7
    - 4. Liabilities..... 12-7
    - 5. Example: Adjustments to a Member’s Book Capital Account 12-7
  - B. Tax Basis Accounts..... 12-8
- IV. Allocations ..... 12-8
  - A. The LLC Operating Agreement ..... 12-9
  - B. Exceptions ..... 12-9
    - 1. Whether the Allocation Has Substantial Economic Effect.... 12-10
      - a. Whether an Allocation Has Economic Effect ..... 12-10
        - 1) Primary Test ..... 12-10
          - a) Maintenance of Capital Accounts..... 12-11
          - b) Liquidation..... 12-11
          - c) Deficit Make-up Requirement..... 12-12
        - 2) Alternate Test ..... 12-12
          - a) Qualified Income Offset Provision ..... 12-12
          - b) Member Capital Account Adjustments 12-13
      - b. Whether the Allocation is Substantial ..... 12-13
        - 1) Shifting Tax Consequences..... 12-14
        - 2) Transitory Allocations ..... 12-15
        - 3) Overall Tax Effect Rule..... 12-15
    - 2. Whether the Allocation Shifts Built-In Gain or Loss to Noncontributing Member ..... 12-17

- a. Traditional Method & the “Ceiling Rule” ..... 12-18
      - b. Traditional Method with Curative Allocations..... 12-19
      - c. Remedial Allocation Method..... 12-20
    - 3. Whether Allocations of nonrecourse Deductions
      - Comply with the Regulations..... 12-21
      - a. The Consistency Requirement ..... 12-22
      - b. Minimim Gain Chargeback Provision ..... 12-23
    - 4. Whether Liabilities Are Properly Allocated..... 12-24
      - a. Recourse Liabilities ..... 12-26
      - b. Nonrecourse Liabilities ..... 12-27
  - C. Hawaii Allocation Rules..... 12-27
- V. Distributions ..... 12-28
  - A. Classifying the Distribution..... 12-28
  - B. Tax Consequences..... 12-28
    - 1. Recognition of Gain and Loss ..... 12-28
      - a. The LLC..... 12-28
      - b. The Distributee Member ..... 12-29
    - 2. Basis of Distributed Property..... 12-30
  - C. IRC § 734(b) Optional Basis Adjustments..... 12-31
  - D. Transactions Subject to Recharacterization..... 12-34
    - 1. Sales ..... 12-34
      - a. IRC § 707(a)(2)(B) ..... 12-35
      - b. IRC § 704(c)(1)(B) ..... 12-38
      - c. IRC § 737 ..... 12-38
    - 2. Guaranteed Payments ..... 12-39
    - 3. Distributions of IRC § 751 Assets  
 (“Disproportionate Distributions”) ..... 12-40
- VI. A Member’s Death or Retirement from the LLC..... 12-41
- VII. A Member’s Sale of Its LLC Interest ..... 12-41
  - A. The Seller ..... 12-41
  - B. The Buyer ..... 12-42

- C. The LLC ..... 12-43
- VIII. Other Tax Concepts ..... 12-44
  - A. IRC § 469 Passive Activity Rules..... 12-44
  - B. At Risk Rules ..... 12-47
- IX. Anti-Abuse Rules..... 12-49
  - A. General Rule..... 12-49
  - B. Abuse-of-Entity Rule ..... 12-50

## CHAPTER 13: SELECTED EMPLOYMENT TAX & STATE TAX ISSUES

---

- I. Selected Federal Tax Issues ..... 13-1
  - A. Federal Self-employment Tax ..... 13-1
    - 1. The Limited Partner Exclusion..... 13-2
    - 2. Self-Employment Tax and LLCs ..... 13-3
  - B. Fringe Benefits..... 13-5
    - 1. Summary of Fringe Benefits..... 13-6
    - 2. Tax Treatment of Fringe Benefits..... 13-7
- II. Hawaii State Tax Issues ..... 13-8
  - A. Income Tax ..... 13-8
  - B. General Excise Tax & Use Tax..... 13-8
  - C. General Excise Tax Exemption for Related Entities ..... 13-10
  - D. Honolulu County Surcharge..... 13-10
  - E. Conveyance Taxes ..... 13-11
  - F. Other State Taxes..... 13-11

## CHAPTER 14: LIMITED LIABILITY COMPANY NAMES AND INTELLECTUAL PROPERTY RIGHTS

---

- I. Business Names in Hawaii ..... 14-2
  - A. Statutory Provisions Common to the Names of All Business Entities ..... 14-2

- 1. Substantially Identical Names and Marks ..... 14-2
- 2. Overcoming a “Substantially Identical” Refusal..... 14-6
- 3. Other Grounds for Refusing Registration of a Name or Mark14-6
- 4. Reservation of Entity Names..... 14-8
- 5. Administrative Orders of Abatement ..... 14-8
- B. Provisions Regulating Names Specific to  
Different Business Entities ..... 14-9
  - 1. Names of Domestic Corporations ..... 14-9
  - 2. Names of Professional Corporations..... 14-9
  - 3. Names of Domestic General Partnerships ..... 14-10
  - 4. Names of Domestic Limited Liability Partnerships ..... 14-10
  - 5. Names of Domestic and Foreign Limited Partnerships ..... 14-10
  - 6. Names of Domestic Limited Liability Limited Partnerships. 14-10
  - 7. Names of Domestic Limited Liability Companies ..... 14-10
- II. Trademarks, Service Marks and Trade Names ..... 14-10
  - A. Trademarks as a Sunset of Intellectual Property Rights ..... 14-11
  - B. Trademark Formats ..... 14-12
  - C. Spectrum of Trademark Distinctiveness ..... 14-12
  - D. Relationship and Priority between Common Law,  
State Statutory and Federal Trademark Rights..... 14-14
  - E. Trademark Infringement..... 14-16
  - F. Proper Use of Trademark, Service Mark  
and Registration Symbols..... 14-18
  - G. Searching State and Federal Name and Mark Registrations ..... 14-18
- III. State Trademark and Trade Name Law and Registration Practice..... 14-19
  - A. Right Acquired Under the Common Law..... 14-19
  - B. Right Acquired by Statute ..... 14-20
  - C. Agency Hearings ..... 14-25
- IV. Unfair Competition Under Federal and Hawaii State Law ..... 14-26
- V. Publicity Rights in Hawaii ..... 14-29

## CHAPTER 15: MISCELLANEOUS

---

I.	Other Resource Material .....	15-1
II.	Employment Law .....	15-1
A.	Who is the “Employer”? .....	15-1
1.	Single Member LLCs.....	15-1
2.	Multiple Member LLCs .....	15-2
3.	Payment of Salaries or Wages.....	15-2
4.	LLPs.....	15-2
B.	When Does Employment Exist? .....	15-3
1.	Workers Who Are Owners .....	15-3
2.	Workers Who Are Not Owners.....	15-3
C.	Consequences of Employment.....	15-3
1.	Workers Compensation.....	15-3
a.	Exclusive Remedy.....	15-3
b.	Third Party Claims.....	15-4
2.	Tort Liability and Respondeat Superior .....	15-4
3.	Employment Taxes .....	15-4
a.	ID Numbers and Filing Requirements .....	15-4
b.	Responsible Person Liability .....	15-5

### APPENDIX

