

Estate Planners Beware: Under RULLCA, a Member Transferring a Transferable Interest Remains a Member of the LLC

by Gianfranco A. Pietrafesa

New Jersey's prior limited liability company (LLC) law, which will be repealed on March 1, 2014, provides:

A member ceases to be a member and to have the power to exercise any rights or powers of a member upon assignment of all of his limited liability company interest;...¹

The term 'limited liability company interest' is defined to mean an economic interest: "a member's share of the profits and losses of a limited liability company and a member's right to receive distributions of the limited liability company's assets."² Thus, after assignment of an economic interest, the member ceases to be a member (and he or she obviously loses all management rights).

By contrast, New Jersey's new LLC law, the Revised Uniform Limited Liability Company Act (RULLCA), provides:

Except as otherwise provided in paragraph (2) of subsection d. of section 46 of this act, when a member transfers a transferable interest, the transferor retains the rights of a member other than the interest in distributions transferred and retains all duties and obligations of a member.³

The term 'transferable interest' is defined to mean an economic interest: "the right...to receive distributions from a limited liability company in accordance with the operating agreement, whether or not the person remains a member or continues to own any part of the right."⁴

As noted in the above-quoted statutory provision, there is an exception under the RULLCA whereby a transferor does not retain the rights of a member. A person may become dissociated as a member of an LLC

by being expelled by the unanimous consent of the other members if there has been a transfer of all of the person's transferable interest in the company.⁵ Thus, for any LLC formed on or after March 18, 2013, and for all LLCs effective March 1, 2014, after a transfer of a transferable interest (*i.e.*, an economic interest), the member continues to be a member (with all rights and duties, except the right to receive distributions), unless expelled by the other members. An expelled member is a dissociated person who has no management rights, but who remains liable for any obligations incurred while a member.⁶

This change in the law may have, in addition to other consequences not anticipated by the LLC members, an adverse impact on a member's estate planning if not addressed in the LLC operating agreement or in an agreement made with the other members at the time of the transfer. Among other things, a transfer of a transferable interest over which the member retains management rights at the time of death may result in the transferable interest (or the entire membership interest) being included in the member's estate under Internal Revenue Code (IRC) Sections 2036 through 2038.

The estate tax issue has been summarized by one practitioner as follows:

The intent behind sections 2036, 2037, and 2038 is that estate tax should be imposed on property that was given away by a decedent during his or her lifetime when the decedent has either retained the economic benefit or control of the property (sections 2036(a)(1) and 2036(b)), or made what is the equivalent of a testamentary transfer because the possession and enjoyment of the gift by the donee is deferred until the decedent's death (sections 2036(a)(2), 2037, and 2038).⁷

If a member transfers his or her transferable interest, but remains a member with management rights, arguably he or she has retained an interest in the LLC and control over the amount and timing of distributions. The members can address this issue in their operating agreement. There is nothing in the RULLCA that prevents the members from doing so.⁸ Thus, if desired, the members may provide in their operating agreement that a transferor's status as a member of, or a transferor's rights in, the LLC will cease upon a transfer (*i.e.*, an assignment) of a transferrable interest (*i.e.*, an economic interest).

The following is sample language that may be included in an operating agreement to address this issue:

Any Member who transfers, or is deemed to have transferred, any part of such Member's transferable interest, without the prior written consent of the other Members, shall immediately cease to have any voting rights or other rights as to such transferable interest. Any Member who transfers, or is deemed to have transferred, all of such Member's transferable interest, without the prior written consent of the other Members, shall immediately cease to a Member of the Company.

The transferring member and the other members may also address this issue at such time as a transferable interest is transferred, for example, by agreeing that the transferring member ceases to be a member at such time or by transferring the entire membership interest to the transferee with the other members agreeing that the transferee will become a member of the LLC at such time. ■

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Endnotes

1. N.J.S.A. 42:2B-44(b)(2).
2. N.J.S.A. 42:2B-1.
3. N.J.S.A. 42:2C-42(g).
4. N.J.S.A. 42:2C-2.
5. N.J.S.A. 42:2C-46(d)(2).
6. N.J.S.A. 42:2C-47.
7. Barbara A. Sloan, "Retained Interests and Powers: Sections 2036, 2037, and 2038," *ALI-ABA Estate Planning Course Materials Journal* (April 2012) at 51. For an explanation of IRC §§2036-§2038, see also Glenn A. Henkel, Steven K. Mignogna and Gerard G. Brew, *New Jersey Estate Planning Manual: Theory, Practice, & Forms* (NJICLE 2007), Chapter 6, §VI.A.8 (Lifetime Transfers) at 6.139 to 6.142.
8. See N.J.S.A. 42:2C-11(c) (listing statutory provisions that cannot be eliminated or altered in an operating agreement).