

Memo



To: Distribution List

From: Marks, Golia & Finch, LLP

Date: January 5, 2011

Re: California SB392 And Contractor's Licenses For Limited Liability Companies

1. Introduction

On September 30, 2010, the California state legislature enacted Senate Bill 392 permitting limited liability companies to obtain contractor's licenses in the State of California, and contractors for the first time to take advantage of the management and tax benefits of organizing as a limited liability company. Senate Bill 392 fundamentally revised California's Contractors State License Law and authorizes the California Contractors State License Board ("CSLB") to begin issuing contractor's licenses to limited liability companies no later than January 1, 2012.

2. Senate Bill 392

Senate Bill 392 is effective January 1, 2011, however, the CSLB has until January 1, 2012, to begin processing applications and issuing licenses to limited liability companies. The following is an outline of the key provisions of Senate Bill 392:

- A limited liability company contractor must furnish an additional bond in the penal sum of \$100,000.00 for the benefit of any employee damaged by the company's failure to pay wages, interest on wages, or fringe benefits to workers employed by the company or contracted to work for the company. For union contractors, this bond also covers welfare fund contributions, pension fund contributions, and apprentice program contributions. (Bus. & Prof. Code, § 7071.6.5.) This bond is required in addition to the existing requirements to furnish a contractor's license bond and a bond of qualifying individual where the qualifying individual owns less than 10% of the licensee. (Bus. & Prof. Code, §§ 7071.6, 7071.9.)
- A limited liability company contractor must obtain and maintain an insurance policy protecting against acts, errors and omissions of the company arising out of the performance of contracting services. For limited liability companies with five or fewer members, the aggregate limit of liability under this policy must be at least \$1,000,000.00. For limited liability companies with more than five members, an additional \$100,000.00 of insurance is required per person, up to a maximum amount

of \$5,000,000.00 in any one designated period, less amounts paid in defending, settling or discharging claims. (Bus. & Prof. Code, § 7071.19.)

- A limited liability company may be a party to a joint venture license. (Bus. & Prof. Code, § 7029.)
- A limited liability company license will be automatically suspended if the company fails to register to do business with the California Secretary of State after receipt of notice from the CSLB and 30 days to cure. In the event of such a suspension, each member or manager of the limited liability company will be personally liable for up to \$1,000,000.00 in damages resulting from the company's performance, during suspension, of any act or contract which requires a contractor's license. (Bus. & Prof. Code, § 7076.2.)
- Allows for transfer for of an existing license number to a limited liability company as part of a merger transaction. (Bus. & Prof. Code, § 7075.1.)

3. Advantages Of Operating As An LLC

Limited liability companies are a desired entity for construction companies, as they are with many other industries, because they provide the same protection against personal liability afforded by a corporation along with the option to elect the favorable tax treatment available to partnerships, including the ability to pass through profits without double taxation and to allocate profits and losses disproportionately from ownership percentage. These and other features of the limited liability company make it an indispensable tool to estate planners, and make it, in many cases, more favorable entity choice than the commonly used "S" corporation. For example, the following limitations are imposed on "S" corporations, but not on limited liability companies:

- "S" corporations may not have more than 100 shareholders.
- Corporations, partnerships, trusts and nonresident aliens may not be shareholders of "S" corporations.
- "S" corporations may only have one class of stock.
- "S" corporations must distribute profits and losses according to ownership interest.
- "S" corporations do not provide shareholders with the ability to step up the tax basis of assets on the death of a shareholder or increase a shareholders stock basis based on the corporation's debt.

4. Transitioning A Construction Company From Corporation To LLC

There are numerous legal and tax pitfalls associated with the conversion of a corporation, partnership or sole proprietorship to a limited liability company. The advice of an attorney and certified public accountant with knowledge of the construction industry is critical to avoiding the pitfalls associated with the conversion.