Limitations on Transfer of Limited Liability Company Membership Interests

By James J. Vlasic*

Introduction
Michigan limited liability companies are entities created by statute to provide to their owners the advantage of avoiding personal liability for the obligations of the company while enjoying flow-through federal income tax attributes and the benefits of operating under a partnership-like organizational structure. Transfer of membership in a Michigan Limited Liability Company ("LLC") is limited by statute, unless expanded by agreement of all LLC members. In this way, LLC membership interests more closely resemble limited partnership interests than corporate stock. These limitations under Michigan law are generally consistent with limitations under the Uniform Limited Liability Company Act, and with those found in several other states. Limited transferability of membership interests meaningfully impacts both LLC governance and membership share value.

Treatment of Transfers of Membership Interests under LLC Statutes

Michigan
A person may become a member of a multiple member Michigan LLC only in one of the following ways: (1) upon formation of the LLC by signing the initial operating agreement complying with its requirements,1 in accordance with a written agreement of the members in connection with formation of the LLC,2 and (2) after formation of the LLC by unanimous vote of the members entitled to vote, through an assignment of a member’s membership interest in compliance with the terms of the operating agreement allowing full membership, or as the result of a merger or conversion.3 In conditioning membership in an LLC after its initial organization on the unanimous vote of existing members, absent operating agreement provisions to the contrary, the Michigan statute, MCL 450.4501, makes LLCs similar to partnerships and limited partnerships,4 and dissimilar to corporations.5 This limitation is reinforced by MCL 450.4505(2), which provides that:

An assignment of a membership interest does not of itself entitle the assignee to participate in the management and affairs of the company or to become or exercise any rights of a member. An assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled.

The purpose of conditioning admission to membership in an LLC on existing member consent has been described, referencing a similar LLC statute, as intended “to protect other members of an LLC from having to involuntarily share governance responsibilities with someone they did not choose.”6 The Michigan Court of Appeals in the unpublished opinion of Gibbs v Gibbs,7 found LLC operating agreement provisions that tracked MCL 450.4502(2) to be valid and enforceable, insofar as they provided that a transferee of an LLC membership interest who did not receive unanimous approval to become a full member could only receive distributions to which the transferor member would have been entitled, but could not participate in management.

A judgment creditor of an LLC member can obtain a court order charging the membership interest of the member with payment of the unsatisfied amount of the judgment, with interest. The charging order is a lien on the membership interest of the debtor member, but the lien may not be foreclosed, nor does it result in an assignment of the member’s entire interest such that the member ceases to be a member.8

*The author would like to thank Timothy Danscroder and Robert Diehl for their editorial comments.”

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The Uniform Limited Liability Company Act of 2006

The Uniform Limited Liability Company Act of 2006 (ULLCA) takes a somewhat different approach from the Michigan statute, but similarly protects LLC members from the admission of unwanted persons into membership in an LLC. The ULLCA bifurcates a member’s interest into (a) economic rights, called a “transferable interest” and (b) governance rights, such as voting on management and receiving information. The transferable interest is personal property that can be transferred and owned by a transferee without that transferee ever becoming a member of the LLC. The transferable interest can be subject to the lien of a charging order and can be sold on foreclosure of that lien. The transferable interest entitles the transferee to distributions to which the transferor would otherwise be entitled, and to an accounting upon dissolution. Admission to membership requires unanimous consent of the members.

The member transferring the transferable interest retains the rights of a member other than the interest in distributions transferred, except that a transfer of all of a member’s transferable interest allows the member to be expelled as such upon unanimous consent of all other members.

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**Other State Statutes**

As there is almost no Michigan appellate case law interpreting the Michigan Limited Liability Company Act, it is instructive to look at similar limited liability company acts in other states and the cases interpreting them. The treatment of assignee interests by selected other state statutes is summarized on the chart on the previous page.

**Arkansas**

The Eighth Circuit Court of Appeals, interpreting Arkansas law in *Ault v. Brady*, enforced an LLC operating agreement provision limiting the transfer of a membership interest without the written consent of the other members to the transfer of the right to receive distributions made with respect to the transferred interest. This restriction was enforced, even though the transferee was already a member of the LLC before the transfer. He was left with only distribution rights on the transferred interest, even though he had full membership rights as to his previously owned interest. The court observed that this result was also mandated by the Arkansas Limited Liability Company statute, which entitled the assignee to receive only the distributions to which the assignor would be entitled. Admission to membership requires unanimous consent of the members.

**California**

The California Code divides limited liability company ownership interests into membership interests and economic interests and provides that a membership interest cannot be assigned without consent of a majority in interest of the non-assigning members. An assignment of an economic interest entitles the assignee to receive distributions, as well as allocation of income, gains, losses, deductions, and credits to the extent assigned, but it carries with it no right to participate in management or to exercise any rights of a member. While Michigan law requires the unanimous consent of existing LLC members to admit an assignee to membership, unless the operating agreement provides otherwise, the California statute requires only the vote of a majority in interest of the other members for admission to membership.

**Colorado**

The Colorado LLC statutes are as restrictive as those of Michigan, providing that after filing of the original articles of organization, additional members may be admitted to an LLC only on consent of all members. A transferee of a membership interest who is not admitted as a member is entitled only to receive the share of income and profits, and any return of contributions, to which the transferor would have been entitled, but obtains no right to participate in management of the LLC.

**Connecticut**

Under the Connecticut Limited Liability Company Act, an assignee of a membership interest becomes entitled to receive only the distributions to which the assignor would be entitled. As in Michigan, the assignee acquires no right to participate in the management of the LLC, to become a member, or exercise any other rights of a member. Admission to membership requires approval of the majority of members, other than the assignor.

**Delaware**

The Delaware LLC Act contains many of the same restrictions found in MCL 450.4504, including that an assignee has no right to participate in management of the LLC or to become or exercise any rights of a member. An assignment only entitles the assignee to share in such profits and losses and to receive such distributions and allocations of income to which the assignee was entitled, to the extent assigned. Admission to membership requires unanimous consent of the members. Delaware differs from Michigan in this regard by permitting the assignee to share in profits and losses, rather than only in actual distributions. In Delaware, as in Michigan, no creditor of a member or of a member’s assignee has any right to obtain possession of or to otherwise exercise legal or equitable remedies with respect to the property of the limited liability company.

The Delaware courts have been protective of the policy behind members’ statutory right to exclude unwelcome members thrust upon them.

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The Delaware courts have been protective of the policy behind members’ statutory right to exclude unwelcome members thrust upon them. In the unpublished case of *Lusk v Elliott*, the Delaware Chancery Court required unanimous written consent of the members to assign a membership interest, absent a provision in the LLC operating agreement permitting such assignment as an exception to the statutory limitation of assignments to only economic interests. The Delaware Chancery Court, in *Eureka VIII, LLC v Niagara Falls Holdings LLC*, fashioned a remedy for a member’s breach of an operating agreement provision requiring that the member remain controlled by a designated person by treating
the member, under the control of a new party, as an assignee, depriving it of its right to participate in management, while preserving its economic interest in the LLC. The court reasoned that in this way the other member would be protected from having an unwelcome member forced upon it, without causing a forfeiture of the breaching member’s economic stake in the LLC.\textsuperscript{30}

\textbf{Florida}

In Florida, a “membership interest” includes all of a member’s rights to profits, losses, and distributions, as well as voting and management rights.\textsuperscript{31} Although these rights are freely assignable, the assignee receives no right to participate in management of the LLC except on approval of all members other than the transferring member, or on compliance with procedures provided for as in the LLC articles or operating agreement.\textsuperscript{32} Unless the articles or operating agreement provide otherwise, the assignee is not entitled to exercise any rights of a member but is entitled to receive distributions, income, gain, and losses, to the extent assigned.\textsuperscript{33} An assignee may become a member only if all members, other than the member assigning the interest, consent. This limitation has been found to have no application to a single-member LLC.\textsuperscript{34}

\textbf{Illinois}

The Illinois Limited Liability Company Act follows the 1996 edition of the Uniform Limited Liability Company Act, dividing LLC interests into distributional interests and membership interests. The distributional interests are personal property that may be transferred in whole or in part but that confer on the transferee only the right to receive distributions to which the transferor would be entitled.\textsuperscript{35} A transferee of a distributional interest may only become a member of the LLC in accordance with the provisions of the LLC operating agreement, or by unanimous consent of the members.\textsuperscript{36} A transferee who does not become a member is not entitled to participate in management or to demand access to information concerning LLC transactions.\textsuperscript{37}

\textbf{Indiana}

The Indiana Business Flexibility Act defines an “interest” to be an LLC member’s economic rights only, including the member’s share of profits and losses and right to receive distributions from the LLC.\textsuperscript{38} Unless provided otherwise in the LLC operating agreement, this interest is assignable, but an assignment entitles the assignee to receive, to the extent assigned, only the allocations to which the assignor would be entitled.\textsuperscript{39} An assignee of an interest may become a member only if the other members unanimously consent.\textsuperscript{40}

\textbf{Louisiana}

The rights of an assignee of an LLC member’s interest in Louisiana are similar to the assignee’s rights in Delaware. The transferee is entitled not only to receive distributions to which the transferor would be entitled, but also “to share in such profits and losses, and to receive such allocation of income, gain, loss, deduction, credit, or similar item to which the assignor was entitled to the extent assigned.”\textsuperscript{41} The assignment does not entitle the assignee to become a member or to exercise any rights of a member until the assignee is admitted as a member by the unanimous written consent of the existing members. Although an assignee is not entitled to act as a member of an LLC, the assignee is entitled to receive whatever profits, losses, income, losses and distributions the assignor-member was entitled to receive.\textsuperscript{42}

\textbf{North Carolina}

In North Carolina, an assignment of a membership interest entitles the assignee to receive only, to the extent assigned, distributions and allocations to which the assignor would be entitled, but for the assignment. The assignee is not entitled to become a member, or to exercise any of the rights of a member.\textsuperscript{43} Admission to membership requires unanimous consent of all existing members, unless the articles or operating agreement of the LLC provide otherwise.\textsuperscript{44}

\textbf{New York}

Under New York law, the only effect of the assignment of a membership interest is to entitle the assignee to receive, to the extent assigned, the distributions and allocations of profits and losses to which the assignor would be entitled.\textsuperscript{45} An affirmative vote of the majority in interest of members is required to elevate an assignee to membership.\textsuperscript{46}

\textbf{Ohio}

Assignees of Ohio LLC membership interests receive, to the extent assigned, distributions of cash and property, as well as allocations of profits, losses, income, gains, deductions, and credits to which the assignor would
have been entitled. The assignee is not entitled to become a member or to exercise any rights of a member. Admission to membership requires written consent of all members, unless the LLC operating agreement provides otherwise.48

**Texas**

Under Texas law, a membership interest in an LLC is assignable, but assignment does not entitle the assignee to participate in management of the LLC or to exercise any rights of a member.49 The assignment does entitle the assignee to receive any distributions the assignor is entitled to receive; to be allocated income, gain, loss, deductions, and credits to the extent assigned; and to make reasonable inspection of LLC books and records or request a reasonable accounting of LLC transactions.50 A court may charge the membership interest of an LLC member with payment of the unsatisfied amount of a judgment, but the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise be entitled in respect of the membership interest.51 An assignee can become a member of an LLC only if all other members consent.52

**Rights of Creditors of an LLC Member**

**In General**

A creditor of an LLC member can acquire the rights of an assignee of an LLC member’s interest in three ways. First, a creditor can acquire a consensual security interest in the membership interest of an LLC member, which security interest can be foreclosed, with the buyer at the foreclosure sale becoming an assignee of the member’s interest in the LLC. Second, a judgment creditor can cause a judicial charging lien to be attached to the judgment debtor’s membership interest in the LLC. Lastly, the bankruptcy estate of a member may assume the member’s LLC interests owned at the time that the bankruptcy petition is filed, to the extent that the bankruptcy code allows.

**Security Interest**

A creditor can obtain a security interest in an LLC member’s membership interest as a general intangible, or as a security, if it is registered as such on the LLC’s books. This interest is perfected by filing a financing statement, or, if a registered security, by registration, or control of a certificated security.53 When the interest is foreclosed, the purchaser at the foreclosure sale is treated as the assignee of the membership interest. In Michigan, a membership interest is assignable by means of a security agreement, “except as provided in an operating agreement” that it is not. The assignment itself does not entitle the assignee to participate in management of the LLC or otherwise exercise the rights of a member, but rather only to receive distributions to which the assignor member would be entitled, to the extent assigned.54 The Michigan Court of Appeals in the Gibbs case54 enforced this limitation, recited in an operating agreement, as to the assignment of a membership interest received in settlement of litigation. The statutes governing assignments in other states, discussed above, apply to assignments for the purpose of security.

**Charging Liens**

In Michigan, MCL 450.4507, as amended on December 16, 2010, provides that a court may charge the membership interest of a member with payment of the unsatisfied amount of a judgment, with interest. This entitles the judgment creditor to receive any distributions with respect to the member’s membership interest to which the judgment creditor is entitled under its judgment. While the charging order constitutes a lien upon the member’s interest, that lien cannot be foreclosed, and does not cause the member to cease to be a member. The creditor’s remedy is essentially limited to a receipt of distributions that the member would otherwise receive.55

In Connecticut, Delaware, Indiana, Louisiana, North Carolina, and Ohio, the court is expressly authorized by statute to charge the membership interest of a member with payment of the unsatisfied amount of a judgment against that member. Judgment creditors, however, have only the rights of an assignee to receive distributions that would have been paid to the member-assignor. These other state statutes do not provide that the charging lien cannot be foreclosed and the membership interest sold. The North Carolina Court of Appeals has held that this charging interest right to receive distributions does not include the right to force a sale of the member’s interest, stating that “because the forced sale of a membership interest in a limited liability company to satisfy a debt would necessarily entail the transfer of a member’s ownership interest to another, thus permitting the purchaser to become a member, forced sales...are prohibited.”56 This rule, however, has been found not to apply to single member LLCs. The Florida
Supreme Court, in Olmstead v Federal Trade Comm’n, has held that the provision in Section 608.433(4) of Florida’s LLC Act, providing that a judgment creditor obtaining a charging lien as a membership interest “has only the rights of an assignee of such interest,” did not operate to prohibit a judgment creditor of the member of a single member LLC from subjecting the member’s entire interest to levy and sale on execution. The court reasoned that Section 608.432(1)(a), allowing an assignee of a member’s interest to become a member only if all members other than the member assigning the interest consent, was inapplicable because there are no other members in a single member LLC, other than the member whose interest is subject to execution. “Accordingly, an assignee of the membership interest of the sole member in a single-member LLC becomes a member—and takes the full right, title, and interest of the transferor—without the consent of anyone other than the transferor.”

Under the Uniform Limited Liability Company Act (2006), if the judgment will not be paid by distributions under a changing order within a reasonable time, “the court may foreclose the lien and order the sale of the transferable interest.” The transferable interest carries with it, however, only the right to receive distributions, and no right to participate in management. The statutes in California, Colorado, and Illinois also provide that charging liens in those states can be foreclosed by court order. The purchaser at the foreclosure sale in California and Illinois acquires the rights of an assignee. In Colorado, the membership interest may be sold, but consent to the sale of all members whose interests are not being sold is required to avoid having the sale of the interest to a non-member cause a dissolution of the company.

Bankruptcy

Bankruptcy court decisions concerning the status of the bankruptcy trustee as successor to the pre-filing debtor’s membership interest run the gamut from the trustee receiving all of the membership rights that the debtor held prior to bankruptcy to the trustee being treated as an assignee of economic interests only.

One bankruptcy court has held that a trustee in an LLC member’s bankruptcy is not merely treated as an assignee of the member’s interest, but instead acquires all rights of the LLC member.

But instead acquires all rights of the LLC member.

The harder question would involve an LLC where one member effectively controls and dominates the membership and management of an LLC that also involves a passive member with a minimal interest. If the dominant member files bankruptcy, would a trustee obtain the right to govern the LLC? Pursuant to Colo. Rev. Stat. § 7-80-702, if the non-debtor member did not consent, even if she held only an infinitesimal interest, the answer would be no. The Trustee would only be entitled to a share of distributions, and would have no role in the voting or the governance of the company.

The court stated that the trustee instead can employ 11 USC 544(b) and 548(a) to attack fraudulent transfers, if necessary. The bankruptcy court for the District of Maryland reached the same conclusion, applying the Delaware LLC Act, in the case of In re Modanlo. The debtor, who was the sole member of an LLC, which owned 63 percent the stock in
a corporation, argued that his trustee in bankruptcy obtained only an assignee’s economic interest in profits, losses, and distributions of the LLC, but not the governance right to vote the shares that the LLC owned in the corporation. The bankruptcy court found that sections 18-702 and 18-704 of the Delaware Act, requiring approval “of all of the members of the limited liability company other than the member assigning the limited liability company interest” for the assignee to become a member and participate in management of the LLC, did not apply to an assignee of the single member’s interest because there were no other members. The court held that the bankruptcy trustee succeeded to both the economic and governance rights of the debtor-member in the single member LLC. The Maryland bankruptcy court did, however, appear prepared to respect “decisional law interpreting LLC acts that divest bankruptcy trustees of an LLC member’s management rights” in the context of a multi-member LLC.76

In In re Garrison-Ashburn, LLC,77 the court held that, on filing bankruptcy, both the debtor’s “membership interest,” including his share of profits, losses, and distributions, as well as his non-economic rights and privileges as a member, became property of the bankruptcy estate. The court held, however, that the debtor-members rights and privileges prior to filing were burdened with all of the duties and obligations that came with them, and that consequently Va. Code § 13.1-1040.1 “disassociated” the member from the LLC on the filing of his bankruptcy petition leaving the bankruptcy estate with only the “membership interest” rights of an assignee under Va. Code § 13.1-1039, because the limited liability company operating agreement was not an executory contract. The court found that debtor-member’s economic interests remained in the estate and were available for the benefit of creditors, but that the inability of the trustee as an assignee to participate in the management of the company also remained. This result may have been attributable to the fact that under Va. Code § 13.1-1002, a “membership interest” is the “member’s share of profits and losses in the limited liability company and the right to receive distributions,” which is what other courts have described as the members “economic interest,” without the right to participate in management. In the case of Northrop Grumman Tech Servs v Shaw Group Inc (In re The IT Group, Inc),78 the debtor, which owned a membership interest in The Space Gateway Support, LLC, tried to transfer its membership interest after filing bankruptcy. The court interpreted 6 Del. Code § 18-702(b)(2) as permitting the members of an LLC to assign only their bare economic interests to another entity, concluding that the state statute defined what was assignable by the debtor. Because applicable law did not excuse the other members from sharing profits, losses, and distributions with the assignee, the court concluded that the economic interests of the debtor-member were assignable, subject to a right of first refusal in the other members provided for in the operating agreement. This is not a case determining the membership rights of the debtor-in-possession or trustee, but rather determining what the debtor may assign. It holds that the transferable interest of the debtor-in-possession is limited by the state statute to the member-debtor’s economic interest in the LLC.

The Delaware Court of Chancery in Milford Power Co v PDC Milford Power, LLC,79 held that an ipso facto clause in the LLC operating agreement requiring a member filing bankruptcy to assign its membership interest to the other members without consideration was preempted to the extent that it deprived the debtor member of its economic rights on its membership interest, but not to the extent that it deprived it of its rights to participate in management. The court, relying on the reasoning of the U.S. District Court in In re IT Group, essentially treated the bankruptcy filing as causing an assignment governed by 6 Del. Code § 18-702(b)(2). The Delaware court relied on 6 Del. Code § 18-702(b)(2), which provides that the members of an LLC are permitted to assign their bare economic interests to another entity that is “entitled to share in such a profits and losses, to receive such distribution or distributions, and to receive such allocation of income, gain, loss, deduction or credit or similar item to which the [debtor] was entitled.” The court held that Del. Code § 18-304, stating that a person ceasing to be a member of the limited liability company on the filing of a voluntary bankruptcy petition, remained applicable, but that the debtor, on ceasing to be a member, became an assignee with the economic rights specified in Del. Code § 18-702(b). Although the finding of the Delaware Court of Chancery does not bind a bankruptcy court, it offers persuasive authority in support of the decision in In re The IT Group, interpreting the Delaware statutes in a manner that leaves sufficient economic interest in the debtor so as not to eradicate
the value of the debtor’s membership interest.

**Federal Income Taxation of Assigned Interests**

An assignee of an LLC membership interest under the laws of Michigan, Arkansas, Connecticut, Florida, Illinois, Indiana, and New York acquires only the right to the distributions to which the assignor would be entitled, to the extent assigned. An assignee of an LLC membership interest under the laws of Colorado, Delaware, Louisiana, North Carolina, and Ohio acquires an interest in the profits and losses of the LLC. In no state can the assignee participate in management of the LLC or exercise other rights of a member without being admitted to membership, either by vote of the existing members or according to the terms of the LLC operating agreement. Consequently, it can be said that an assignee who does not become a member of the LLC does not become vested with sufficient dominion and control of the assignor’s membership interest to be treated as a partner in an LLC taxed as a partnership.\(^1\) See TIFD III-E Inc v United States,\(^4\) discussing factors to consider in finding a shift in dominion and control.\(^2\)

A finding of no partnership interest may be reversed by the assignor’s contracting to exercise his or her residual membership rights only for the benefit of the assignee.\(^3\) In Evans v Commissioner,\(^4\) the taxpayer transferred his entire interest in a partnership to a corporation in which he was sole stockholder. The applicable Wisconsin partnership statute provided that an assignee was entitled to receive the profits and distributions to which the assigning partner would be entitled, including at dissolution of the partnership. The court found that the corporation had obtained for federal income tax purposes a capital interest in a partnership under Treas. Reg. 1.704-1(e)(1)(v), which describes a capital interest as an interest in partnership assets that is distributable to its owner on his withdrawal or liquidation of the partnership. In response to the Commissioner’s argument that the assignor had retained incidents of ownership, the court held that, as president of the corporation, he was bound to act as its agent to pursue the corporation’s best interests and, because he had a fiduciary duty to exercise his power in favor of the corporation, the fact that the corporation had not been admitted as a partner would not be decisive of the tax status of the corporate assignee.\(^5\) The Evans court distinguished the case of Poggetto v United States,\(^6\) as one involving a partnership where capital was not a material income-producing factor, so that income from personal services remained attributable to the person rendering those services, rather than the assignee of a partnership interest acquired in exchange for a capital contribution and a guaranty.\(^7\)

**Effect of Transfer Limitation on Membership Share Value**

In the analogous partnership context, the Fifth Circuit Court of Appeals has focused on the effect that a statutory limitation on assignment has on the value of a transferred interest for tax purposes. In Estate of McLendon v Commissioner,\(^8\) an unpublished opinion, the decedent, a resident of Texas, had signed annuity agreements purporting to transfer outright to his children remainder interests in a partnership and a limited partnership. Both the partnership agreement and the limited partnership agreement prohibited admission of new partners without the consent of all partners, which consent was not forthcoming as to either transfer. Texas law provided that no person could become a member of a partnership without consent of all partners, and that a conveyance by a partner of his interest does not entitle the assignee to participate in partnership management but only to receive profits to which the assigning partner would be entitled, together with the right to reasonable inspection of partnership books. Nonetheless, the U.S. Tax Court held that, for purposes of estate tax valuation, the decedent had “transferred partnership interests, not mere assignee interests or monetary interests in the partnership interests.”\(^9\) The Fifth Circuit disagreed, holding:

First, neither partnership agreement permitted sale or transfer of partnership interests without consent of the partners. No person could demand admission to the partnership unless consent was granted by all the partners, in the case of Tri-State, § 7.04 of the partnership agreement, or by the partners of the McLendon Company, § 6. Texas law reinforced this right of exclusivity, born of the intimate nature of the partnership relationship and the apparent authority of each partner to conduct partnership business. Thomas v. American Nat’l. Bank, 704 S.W.2d, 321, 323 (Tex.1986). The Commissioner agrees that if,
under Texas law, a partner attempts to transfer a general partnership interest without the other partners’ consent, the transferred interest is an assignee interest, limited to the non-control right to receive distributions from the partnership. IRS Brief at 17, n. 16, and 29-30 citing Thomas, supra; Tex.Rev.Civ. Stat. Ann. Art 6132b § 27(1); Art. 6132a § 20(c). 90

The Fifth Circuit concluded that the decedent had transferred no more than assignee interests in the two partnerships, and that the interests transferred must be valued accordingly. This reasoning should apply equally to valuation of membership interests in limited liability companies, which are treated as partnerships for federal income tax purposes. 91

The Fifth Circuit Court again, in Adams v United States, 92 held that under Texas law there is no clear right of an assignee of a partnership interest to liquidation rights. As a consequence the court directed the U.S. District Court to determine the applicability of lack of marketability and lack of control discounts to the assignee’s interest in that light. The District Court, on remand, removed any uncertainty surrounding the assignee’s rights to liquidate its assigned interest by assuming the assignee would not have that right, and then discounting the value of the assignee’s interest accordingly. 93

**Effect of Transfer Limitation on Gifts of Present Interest**

In Hackl v Commissioner, 94 the U.S. Tax Court, and the Seventh Circuit Court of Appeals held that a transfer restriction in an LLC operating agreement contributed to the denial of a substantial economic benefit to a transferee of membership shares, such that a gift of those shares was not a gift of a present interest under IRC 2503(b). The operating agreement of the subject LLC, formed under Indiana law, provided that no member could transfer the member’s interest without prior written consent of the manager. If the manager consented, the transferee would be admitted as a substitute member in the LLC. If not “the transferee would be afforded no opportunity to participate in the business affairs of the entity or to become a member; rather, he or she would only be entitled to receive the share of profits or distributions which otherwise would have incurred to the transfer.” 95

The manager was also a member of the LLC, so this limitation in the operating agreement was consistent with Ind. Code. Ann. § 23-8-6-4.1(b), in providing that an assignee of an interest in an LLC can become a member only if the other members unanimously consent, as well as with Ind. Code. Ann. § 23-18-6-3.1(b), providing that an assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor would be entitled. The Seventh Circuit acknowledged that “[i]f a member transferred his or her shares without consent, the transferee would receive the shares’ economic rights but not any membership or voting rights.” 96 The court held that, “as the Tax Court found, the possibility that a shareholder might violate the operating agreement and sell his or her shares to a transferee who would then not have any membership or voting rights can hardly be called a substantial economic benefit.” 97 The court’s decision that gifts of membership shares that the member-manager had approved (and actually made) did not represent “[a]n unrestricted right to the immediate use, possession or engagement of property or the income from property…” 98 was undoubtedly influenced by the fact that the LLC had never reported a profit or made a distribution. Nonetheless, it decided that membership shares actually transferred in an LLC with substantial net assets conferred no substantial economic benefits. Arguably, giving the new members a right to sell shares having the value of the annual exclusion back to the LLC for a limited period of time would avoid this result.

**Conclusion**

A survey of limitations on transfer of limited liability company membership interests in Michigan and several other states reveals that the statutory limitations protect existing LLC members from forced association with prospective new members. This protection increases existing members’ control, with the collateral result of reducing the market value of membership shares.

**NOTES**

1. MCL 450.4501(1)(a) and (b) (as amended Dec 16, 2010).
2. MCL 450.4501(1)(c). (As amended Dec 16, 2010).
3. MCL 450.4501(2) and MCL 450.4506. (As amended Dec 16, 2010).
4. MCL 449.27, MCL 449.1301 and MCL 449.1401.
5. MCL 450.1471 and MCL 440.8302.
8. MCL 450.4507 (as amended Dec 16, 2010).
9. ULLCA 102(21).
10. ULLCA 501.
11. ULLCA 502(a).
12. ULLCA 503(a), (c).
13. ULLCA 502(b),(c), ULLCA 401(d)(3).
14. ULLCA 502(g), ULLCA 602(4)(B).
15. 57 Fed Appx 222 (8th Cir 2002).
17. Cal. Corp. Code §§ 17001(n), (x) and 17301(a)(1).
19. MCL 450.4506 (as amended December 16, 2010).
Compare Del. Code 18-702(b)(2) with MCL 450.4505(2).
27. 6 Del. Code 18-703(e). See MCL 450.4504.
29. 899 A2d 95 (Del Ch 2006).
35. Ill. Stat. 180/30-5 and 180/30-10(e).
37. Ill. Stat. 180/30-10(d).
44. N.C.Gen.Stat. § 57C-3-03(2).
45. McKinney’s Limited Liability Company Law § 603(a).
47. O.R.C. §§ 1705.18, 1705.14. Firstmerit Bank, NA v Washington Square Enters, No 88798, 2007 Ohio App LEXIS 3561 (Aug 2, 2007) (“Assignees of membership interests do not become members, but only have the right to receive distributions that would have been paid to the member – assignor.”).
52. UCC §§ 8-106, 8-401, 8-106, 9-310, 9-312, 9-313 and 9-314. See also, In re Witherral Corp v Turnbull, 146 BR 715 (Bankr ED Mich 1992) (perfection of security interest in limited partnership interest).
53. MCL 450.4505 (as amended Dec 16, 2010).
54. Supra, footnote 7.
57. 6 Del.Code § 18-703.
63. 44 So3d 76 (Fla 2010).
64. 44 So3d 76 at 81.
65. ULLCA §§ 503(c) and 502.
67. Colo.Rev.Stat.§ 7-80-703. This statute also allows appointment of a receiver with the right to “make all other orders, directions, accounts, and inquiries that the debtor member might have made, or that the circumstances of the case may require.”
68. 805 ILCS 180/30-20(b).
70. 319 BR 200 (Bankr D Ariz 2005).
71. 319 BR 200, 206.
72. 291 BR 538 (Bankr D Colo 2003).
73. 291 BR 538, 541, ftn.9.
75. 412 BR715 (Bankr D Md 2006).
76. 412 BR at 730-731.
77. 253 BR 700 (Bankr ED Va 2000).
78. 302 BR 483 (D Del 2003).
79. 866 A2d 738 (Del Ch 2004).
82. See also Kalinka, Assignment of an Interest in a Limited Liability Company and the Assignment of Income, 64 U Cin L Rev 443, at 498-522.
84. 447 F2d 547 (7th Cir 1971).
85. 447 F2d at 551.
86. 306 F2d 76, 79-80.
87. 306 F2d 76 (9th Cir 1962).
89. Id at 18.
90. Id. at 25-26.
91. Id. at 26..
92. 218 F3d 383, 388 (5th Cir. 2000).
95. 118 TC at 283.
96. 335 F3d at 666.
97. 335 F3d at 668.
98. Treas. Reg. 25.2503-3(b).

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