



Legal Note - Conversion of Corporations

Owners of closely held corporations should consider converting the corporation to a limited liability company. The principle advantage of conversion is the protection of business assets. Moreover, if structured properly, the conversion will generally not create a taxable event.

Corporate shareholders sued on matters unrelated to corporate business are subject to the loss of their stock as an asset available to creditors. A shareholder subject to a judgment must therefore generally surrender his or her stock to a judgment holder. The judgment holder then becomes a shareholder with all shareholder voting and liquidation rights. As the number of shareholders in a corporation increases, litigation involving a shareholder (exposing the shareholder to loss of his or her stock and potential liquidation of the corporation) usually becomes more likely.

LLC organizational statutes generally offer so called “charging order” protection of LLC membership interests. Such protection generally limits the creditor of a member to LLC distributions to such member. Unlike corporate stock, which may be attached by the creditors of a shareholder, claims on LLC interests are generally limited to a charging order. Such statutory protection therefore generally prevents involuntary transfers of LLC equity or voting rights.

Conversion of a corporation to an LLC will generally therefore avoid the business disruption and loss of equity associated with an action against a shareholder. The conversion of a corporation with valuable assets to an LLC is therefore typically very advantageous.