



# LLC Agreements for Real Estate LLCs - Overview

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# LLC Agreements for Real Estate LLCs - Overview

## A. What is an LLC agreement?

Under the Delaware Act, an LLC agreement is, in effect, a partnership agreement that defines the rights and duties of the members and managers of a multi-member LLC who are parties to the agreement. The term for this kind of agreement under most other LLC acts is “operating agreement.”

## B. The purposes of LLC agreements

- 1) Sound LLC agreements should adequately address four main purposes:
  - a) Define rights and duties of members, etc. They should comprehensively define the above member and manager rights and duties in a manner that will bind the parties.
  - b) Teach the members and managers. They should serve as teaching documents that will enable the parties to understand their rights and duties and thus to decide whether they will be willing to be bound by them.
  - c) Users’ manuals. They should serve as a readily usable owners’ manual that will provide clear guidance to the members and managers in the operation of the LLC’s business and internal affairs—what member vote, if any,

will be necessary in order for the LLC to take a particular action.

- d) Document for third parties. They should address issues of legitimate interest to third parties who have a right to review them, including potential investors, lenders and tax authorities. This is why, for example, they should contain very clear management provisions and a qualified income offset provision (discussed later).
- 2) Agreement specifically for real property business. In addition, as LLC agreements for real property businesses, they should contain all legal and tax provisions necessary or useful for such businesses. These may include, for example, provisions under IRC section 704(c)(1)(A) and minimum gain chargeback provisions (discussed below).

### **C. What is “business organization law”?**

What is business organization law?

- 1) For purposes of this webinar, “business organization law” means the subset of state business law consisting of the statutory and common law governing the formation, operation, management and other non-tax features and procedures of business organizations (such as sole proprietorships) and business entities (such as corporations).
- 2) Business organization law procedures include, for example, statutory mergers, conversions and dissolutions.



- 3) Examples of state business organization law statutes include corporate statutes, LLC statutes, and general and limited partnership statutes.

**D. What is distinctive about *Delaware* LLC business organization law?**

- 1) The preeminence of the Delaware Act. It may be argued that that Delaware Act is superior to other LLC Acts for the following main reasons:
  - a) The Delaware Act arguably provides great flexibility than any other act and thus great scope for legal and tax creativity. For example, the Delaware Act permits the complete elimination of fiduciary duties.
  - b) The provisions of the Delaware Act are more comprehensive in addressing business organization law issues than those of any other act.
  - c) Thanks to the Delaware Chancery Court, there is a larger and better reasoned body of case law under the Delaware Act than under any other act.
- 2) Should your clients' LLC be a Delaware Act? For the above reasons, if you are forming a high-stakes real estate business or one whose members come from two or more jurisdictions, you should generally form their LLC as a Delaware LLC if you are competent to do so.

## **E. Standards of structure, format and prose style in drafting LLC agreements**

Very briefly:

- 1) Title page. To provide them with an appropriate dignity, LLC agreements should have a title page generally similar to the title page of Form 6.2.
- 2) Plain English. To accomplish the above LLC agreement purposes, LLC agreements should be written to the maximize extent possible in plain English that is free of legalisms and taxese. For example, they shouldn't have "whereas" clauses; they should have background statements. In general, they shouldn't contain any words that are used only by lawyers.
- 3) Structure; tables of contents. LLC agreements should have a clear, logical, user-friend structure, which should be manifest in a single-level table of contents, a two-level table of contents and a table of exhibits.

When to use exhibits. Complex legal, financial and tax terms should generally be relegated to exhibits, and these exhibits should often contain illustrative examples.

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