

JOHN CUNNINGHAM'S LLC NEWSLETTER FOR TAX AND LEGAL PROFESSIONALS

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PROTECTING NEW HAMPSHIRE MEMBERS OF MULTI-MEMBER LLCs FROM THE NEW HAMPSHIRE INTEREST AND DIVIDENDS TAX

EXECUTIVE SUMMARY. In order to protect New Hampshire persons that are members of a multi-member LLC from Interest and Dividends Tax liability on distributions from their LLC, the LLC agreement of the LLC in question generally should provide as follows:

- No member of the LLC may transfer all or any part of the member's membership rights to any person except with the approval of at least one other member.
- Upon any transfer by a member of the member's membership rights, the LLC will automatically dissolve.
- However, this dissolution will be rescinded and the LLC will again become a going concern if the members either (i) vote to rescind the dissolution; or (ii) notwithstanding the dissolution, continue the LLC's ordinary business.

DISCUSSION

- 1) The RSA 77:4,III exception to the applicability of the Interest and Dividends Tax to New Hampshire persons. In general, the Interest and Dividends Tax applies at a rate of 5% to interest and dividends received by New Hampshire residents, including New Hampshire members of single- and multi-member LLCs. However, under RSA 77:4,III, this tax does *not* apply to distributions from LLCs with "nontransferable shares." The regulation of the New Hampshire Department of Revenue Administration that defines the RSA 77:4,III term "transferable shares"—and thus, by implication, the term "nontransferable shares"—is Rev. 901.17.
- 2) The application of Rev. 901.17 to multi-member LLCs. Technically, the members of LLCs do not have "shares" in their LLCs; rather, they have membership rights. I interpret Rev. 901.17 as providing, in effect, that the membership rights of an LLC are nontransferable for purposes of RSA 77:4,III if they meet either of two tests:
 - a) The "approval" test. Under the first of these tests (the "approval" test), the membership rights of a multi-member LLC will be nontransferable if, under the governing LLC act or the provisions of the governing LLC agreement, no member can transfer any of the member's membership rights to a *non*-member except with the approval of at least one other member. (In my view, there are strong reasons for interpreting RSA 77:4,III and Rev. 901.17 as not requiring nontransferability as a condition for exempting New Hampshire members from

- the Interest and Dividends Tax in the case of members' transfers of membership rights to other *members*.)
- b) The "dissolution" test. Under the second test (the "dissolution" test), the membership rights of a multi-member LLC will be nontransferable if, under the governing LLC act or the provisions of the governing LLC agreement, a member's transfer of all or any of the member's membership rights will cause the dissolution of the LLC. (In order to understand this "dissolution" test properly, it is necessary to understand that the dissolution of an LLC does not mean the termination of its legal existence; rather, it merely means the change of its legal status from that of a going concern to that of a company required to be wound up and liquidated in an orderly manner unless the members vote to rescind its dissolution.)
 - 3) Application of Rev. 901.17 to New Hampshire LLCs *without* written LLC agreements. In my view, the better interpretation of Rev. 901.17 is that LLCs formed under the New Hampshire Limited Liability Company Act that do not have written LLC agreements *automatically* have nontransferable shares. This is because a default rule contained in Section 46,I of that act and in certain other provisions of the act provides that unless an LLC's LLC agreement provides otherwise, none of its members may transfer any of their management rights to non-members without the approval of all other members. (For complex reasons outlined in Issue 22 of this newsletter, I believe that the Rev. 901.17 term "share" as applicable to LLCs must be interpreted to refer only to LLC *management* rights and not to LLC *economic* rights.) However, the impact of the above LLC statutory rule under Rev. 901.17 is not entirely clear.
 - 4) Application of Rev. 901.17 to New Hampshire LLCs *with* written LLC agreements; advisability of dissolution provisions. Furthermore, for many multi-member LLCs *with* written LLC agreements that, as is very often the case, contain provisions governing members' transfers of their membership rights, the above lack of clarity can be far greater. This is because, in order to meet members' needs, these transfer provisions are often tailored in complex ways whose impact under Rev. 901.17 may be impossible to determine.

Thus, while in LLC agreements for multi-member LLCs, the above transfer provisions should always be carefully drafted in an effort to meet the above approval test, these agreements should also generally reflect a "belt-and-suspenders" approach. That is, they generally should contain not only the transfer rules outlined in the first bullet point of the above executive summary but also the "dissolution rescission" provisions that are outlined in the second and third bullet points of that summary.

- 5) Addressing the risk in dissolution provisions. Obviously, if a dissolution rescission provision merely provides that, upon an LLC's dissolution resulting from a transfer of a membership right, the members must vote to rescind the dissolution, the members may overlook the need for a vote. If this happens, the dissolution will continue in effect, and this may invalidate the legality of LLC actions occurring after the dissolution. This is why the dissolution provisions outlined in the third bullet point in the above executive summary provide that the very continuation of a multi-member

LLC's ordinary business will be deemed to constitute a vote to rescind any dissolution resulting from a transfer of LLC membership rights.