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# *The Illinois Limited Liability Company*

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Seminar Topic: This material provides an in-depth examination of Illinois law that heavily awards the protection afforded Illinois Limited Liability Companies (LLCs). There are a number of crucial considerations one should take when determining whether to create an LLC or do business with one. This presentation delves into a broad analysis of Illinois LLCs and considerations one should take when entering into Illinois transactions utilizing LLCs.

This material is intended to be a guide in general and is not legal advice. If you have any specific question regarding the state of the law in any particular jurisdiction, we recommend that you seek legal guidance relating to your particular fact situation.

The course materials will provide the attendee with the knowledge and tools necessary to identify the current legal trends with respect to these issues. The course materials are designed to provide the attendee with current law, impending issues and future trends that can be applied in practical situations.





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The Apex Jurist, [www.ApexJurst.com](http://www.ApexJurst.com) is  
Published by ApexCLE, Inc.  
[www.ApexCLE.com](http://www.ApexCLE.com)

119 South Emerson St.,  
Suite 248  
Mount Prospect, Illinois 60056

**Ordering Information:**

Copies of this monograph may be ordered direct from the publisher for \$64.95 plus \$4.25 shipping and handling. Please enclose your check or money order and shipping information. For educational, government or multiple copy pricing, please contact the publisher.

**Library of Congress Cataloging-in-Publication Data**

ApexCLE, Inc.

1. ApexCLE, Inc. 2. Law-United States – Guide-books.
3. Legal Guide 4. Legal Education.



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Mr. Rifkind is licensed to practice law in both Illinois and Wisconsin and has extensive courtroom experience. He has participated in over 2000 hearings/trials while maintaining a 5.0/5.0 Client Review rating on Martindale/Lawyers.com/Avvo.com.

Mr. Rifkind is an accomplished speaker, having presented in numerous speaking forums, including: National Organization of Social Security Claimants' Representatives in Philadelphia, National Disability Awareness Day in Las Vegas, and many non-profit organizations.

In addition to his public speaking experience, Mr. Rifkind also has knowledge and experience as a licensed real estate broker in the state of Illinois. This has given him further insight into real estate transactions. During law school, Mr. Rifkind participated in the law review and moot court competition.

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# The Illinois Limited Liability Company

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## Introduction

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Introduction--My name is Aaron Rifkind and I will be presenting a CLE today on the Illinois Limited Liability Company. In 2016, I published an article entitled "The Power of the Illinois LLC" for the Daily Herald Business Ledger and am excited for the opportunity to come before you today to talk about Illinois Limited Liability Companies. I am licensed to practice law in Illinois and Wisconsin and currently serve as Co-Managing Partner of the law firm Rifkind Patrick LLC in Chicago. My primary practice is business litigation and business transactions. I have represented hundreds of Plaintiffs/Defendants in litigation involving LLC's and know from personal experience how difficult it can be to pierce an LLC in Illinois. I have also advised many small to medium sized businesses and LLC's with various transactions, including: setup, filing, operating agreements, partnership agreements, asset acquisitions, share purchase agreements, and partnership disputes. I look forward to delving into controlling case law and statutes governing Illinois Limited Liability Companies as well as sharing my personal experiences with you today.

## Limited Liability Companies

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In Illinois, both potential and existing business owners have a multitude of business formation options. Some of the most popular entities include: S-Corporations, limited liability partnerships, and limited liability companies. However, many business owners choose the limited liability company for asset protection because of its strong ability to prevent the "piercing of the corporate veil."

For example, my law firm recently represented an individual who had transferred close to a half a million dollars to an Illinois limited liability company under the auspices that the funds would be used to acquire various goods and services. The matter entered litigation due to the funds being misappropriated to other limited liability companies owned by the same individuals – a ponzi scheme of sorts. Litigation, which should have been a straight shot, turned into a maze of defenses ranging from "piercing the corporate veil" to the "business judgment rule." Needless to say, it took over a year for our client to obtain a judgment in the matter, and one of the defendant owners was protected by the limited liability company, personally.

While our clients ultimately won their case, the lesson that can be learned is just how protective the Illinois limited liability company really is -



especially for silent partners (technically called ‘members’) who had no involvement with a tortious action of other members.

The limited liability of the company provides its members with significant shielding from both creditors, lawsuits, and day to day operational issues. Even an allegation of breach of fiduciary duties or fraud can prove challenging to get to the individual members, if those members acted within the governing operating agreement. See *Sklodowski v Countrywide*, 358 Ill. App. 3d (1<sup>st</sup> Dist. 2005). Additionally, an Illinois LLC operating agreement can be written as a powerful contract created to govern the company that, when acting within the realm of that agreement, can severely limit any of its members’ liability. In fact, members of an Illinois LLC may be shielded from liability even when the LLC ceases to be in good standing with the Secretary of State of exist.

In *Puleo v. Topel*, the Appellate Court of Illinois, First District, Fourth Division, was presented in 2006 with a case of first impression whether members of an LLC may be held personally liable for obligations incurred by an involuntarily dissolved LLC . 368 Ill.App.3d 63, 306 Ill.Dec. 57, 856 N.E.2d 1152 (2006). Defendant, Topel, was the sole member/manager of Thinktank, LLC. The Plaintiffs, independent contractors hired by Defendant, Topel, alleged substantial sums of money owed by Thinktank LLC. In 2002, the LLC was involuntarily dissolved by the Illinois Secretary of State for failure to file its annual report. In their argument, “plaintiffs assert that is has long been the law in Illinois that an officer or director of a dissolved corporation has no authority to exercise corporate powers and, thus is personally liable for any debts he incurs on behalf of the corporation after its dissolution.” *Id* . at 66, citing to *Cardem, Inc. v. Marketron International, Ltd.* , 322 Ill.App.3d 131, 255 Ill.Dec. 376, 749 N.E.2d 477 (2001). In its ruling, the Court found “When the legislature amended section 10-10 (805 ILCS 180/10-10 (west 2004)), it clearly removed the provision that allowed a member or manager of an LLC to be held personally liable in the same manner as provided in section 3.20 of the Business Corporation Act. Thus the Act does not provide for a member or manager’s personal liability to a third party for an LLC’s debts and liabilities, and no rule of construction authorizes this court to declare that the legislature did not mean what the plain language of the statute imports.” *Puleo* at 70, citing *Solich v. George & Anna Portes Cancer Prevention Center of Chicago, Inc.*, 158 Ill.2d 83, 196 Ill.Dec. 655, 630 N.E.2d 820 (1994). As such, even in the face of a completely dissolved LLC, Plaintiffs were not able to collect from its sole owner.

The controlling case law in Illinois affirms nearly unlimited protection to members within Illinois Limited Liability Companies. In *Dass v. Yale*, the First

District Appellate Court issued a 2013 opinion confirming member immunity arising even from auspices of fraud. 2013 IL App (1st) 122520. The Dasses were a married couple who purchased a condominium rehab from developer Wolcott, LLC. Wolcott, LLC had only one member, the Defendant, Yale. After moving into the home the Dasses immediately noticed flooding through the plumbing and sewage system. The Dasses discovered through various inspections that Yale's representations prior to closing were materially false and that he had signed a fraudulent property report with complete knowledge that the system was not as represented. The report was signed by Yale "as manager" of Wolcott, LLC.

The First District Appellate Court analyzed the plain language of the Illinois Limited Liability Act in rejecting Plaintiffs' arguments and dismissing the case. Specifically, the Illinois Limited Liability Company Act provides, "except as otherwise provided in subsection (d) of this Section, the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company. A member or manager is not personally liable for a debt, obligations, or liability of the company solely by reason of being or acting as a member or manager." 805 ILCS 180/10-10(a). Section (d) of the statute provides, "all or specified members of a limited liability company are liable in their capacity as members for all or specified debts, obligations, or liabilities of the company if: 1) a provision to that effect is contained in the articles of organization; and 2) a member so liable has consented in writing to the adoption of the provision or to be bound by the provision." 805 ILCS 180/10-10(d). Plaintiffs did not plead that the Wolcott LLC Articles of Organization allowed for Yale to be sued personally, nor did they allege that he consented in writing to being sued. Rather, the Plaintiffs argued that personal liability should apply because Yale's fraudulent acts would have resulted in personal liability had he acted in his individual capacity. The Appellate Court soundly rejected Plaintiffs' argument and in doing so created a strong precedent for member protections even under allegations of fraud within actions done under the name of the LLC.

The protections afforded under the Illinois Limited Liability Company Act unquestionably promote doing business as an LLC. Likewise, small to medium sized businesses should think twice when signing agreements to do business with LLC's. Before entering into an agreement to do business with an LLC, I would suggest performing some of the following due diligence: (1) make sure the LLC has a good reputation and is well respected in the community; (2) make sure the LLC has assets; (3) do not be satisfied with oral agreements, reduce them to writing when possible; (4) hire an experienced attorney to

review your written contract before signing; (5) if the LLC is a small company ask for a personal guarantee in the contract by the owner; and (6) ask for a list of recommendations.

The Illinois LLC can also provide its members with preferential tax treatment. A multi-member LLC provides the tax advantages of a partnership with the limited liability of a corporation. Members can elect to be treated as a partnership (the default setting), or a corporation. A single member LLC can elect to be disregarded and receive pass-through taxation consistent with a Schedule C on the owner's 1040 tax return. A disregarded entity is both flexible and a relatively informal system compared to the formalities of an S or C corp.

While limited liability companies in Illinois cost more to file than corporations, they have reduced maintenance work (usually at the cost to the corporation). Corporations in Illinois, however, have more formal requirements than LLCs, such as reporting to a board or arranging corporate meetings. LLCs generally involve less of these stringent requirements. The Illinois LLC business structure does not require corporate minutes and resolutions and is much easier to operate.

Historically, the biggest argument against creating an Illinois Limited Liability Company has been cost. The Initial filing fee with the Secretary of State was \$500 and annual report fees were \$250, among the highest fees in the country. However, in 2017 Governor Bruce Rauner signed legislation to substantially reduce startup, annual filing and other fees pertaining to LLCs. Specifically, the initial filing fee was reduced from \$500 to \$150 and the annual report fees were reduced from \$250 to 75. The effort was obviously done to encourage more small businesses to form in Illinois. The legislation also makes LLC costs more in line with the rest of the country. The changes also serve to remove the remaining obstacle hindering small and medium sized companies pursuit of obtaining better protection and tax advantages through incorporating as an LLC.

## Series LLC

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One special type of LLC that we have not yet addressed is something called a "Series LLC". Illinois is one of eight states that offer the option to form a Series LLC, including: Alabama, Delaware, District of Columbia, Illinois, Iowa, Kansas, Minnesota, and Montana. A Series LLC is similar to a corporation with subsidiaries. Once a Series LLC is created there is one master with series entities formed beneath it. Each entity or "series" can have its own members, income,

liabilities, business, and personal and real property. The filing fee to create a Series LLC used to be \$750, but Governor Bruce Rauner's new legislation has decreased the cost to \$400. The most obvious administrative advantage of having a Series LLC is minimal cost of creating each new series compared to that of having to pay the initial filing fee repeatedly for each new entity. One common example of businesses that frequently use Series LLC's are real estate developers. If you were a real estate developer you could create a LLC and have each series LLC own each separate piece of real estate. By segregating the properties under Series LLC's, the developer is in a powerful position to protect the liabilities of each business. Additionally and unlike corporations, the same developer can avoid the financial burden of double taxation that may come if it had chosen to have corporations instead. A Series LLC affords the same limited liability protection, pass through taxation, and flexibility of corporate structure as a regular LLC. Yet, rather than having to pay substantial costs to set up multiple separate entities under a typical c-corporation, a Series LLC offers substantial cost savings and reduced maintenance for each respective series "subsidiary."

In 2017, I briefly discussed how Governor Bruce Rauner signed legislation to substantially reduce startup, annual filing and other fees pertaining to LLCs. I would like to very briefly discuss recent changes that took effect as of July 1, 2017 under the Illinois Limited Liability Company Act. Most of the changes that will be discussed bring the Illinois Limited Liability Company Act more closely in line with the Uniform Limited Liability Company Act followed by most other states. For example, prior to the change the LLC Operating Agreement was required to be signed by the Members and in writing. After July 1, 2017, Illinois does not require Operating Agreements to be in writing. I personally disagree with the change. It is my belief that requiring the Operating Agreement to be reduced to writing promotes transparency and reduces the risk of misunderstanding between members. This is especially true given the large number of small to medium sized businesses that decide to incorporate as LLCs in the first place. Another change to the Illinois Limited Liability Company Act that I am thrilled about is the ability to change/convert entity type. Prior to the July 1, 2017 changes, LLCs could not convert to a different entity, such as a corporation. However, the recent changes allow for conversion, which clearly allows for greater flexibility for unit owners. One of the major changes to the Illinois Limited Liability Company Act that does not appear to have received much discussion is governing the fiduciary duties between members. Prior to July 1, 2017, the Operating Agreement could not reduce a member's fiduciary duties. The Operating Agreement also could not eliminate the duty of good faith and fair dealing--implied in every Illinois contract. Following the July 1, 2017

changes an Operating Agreement may reduce a member's fiduciary duty of loyalty and may also limit or modify the duty of care--although it cannot authorize intentional misconduct or purposeful violations of the law. I would strongly encourage you to review the Illinois Limited Liability Company Act in its entirety so that you can review all of the updates and changes in effect since last July 1st.

## Conclusion

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Choosing to structure your business as a limited liability company in Illinois involves asset protection, tax, liability, and corporate maintenance benefits. The same due diligence that is done in determining to create an LLC should also be done when determining whether to do business with one. Thank you for taking the time to watch this CLE and hopefully it has provided you with more to think about when dealing with Illinois Limited Liability Companies.