

»Business Alert

May 2011—Building Businesses: New Law Enables LLCs to Obtain Contractor's Licenses

Historically, contractors have had several options when choosing how to structure their businesses, including a sole proprietorship, a general partnership, a limited partnership, a C Corporation, and an S Corporation. While each of these business forms offer many benefits, each of them also have distinct drawbacks, such as personal responsibility for obligations of the business or unfavorable tax treatment.

Since California began authorizing the formation of limited liability companies ("LLCs") in 1994, many businesses have opted to organize as an LLC because of the lack of the general lack of traditional business entity disadvantages. The appeal of the LLC business structure comes from, as the name suggests, the limited personal liability that each owner maintains for the obligations of the business. Additionally, LLCs allow for wide-ranging freedom in structuring the management and finances of the business, as well as favorable pass-through tax treatment.

Despite the fact that LLCs appear ideal for utilization by contractors, California law has authorized the issuance of a contractor's licenses only to individual owners, partnerships, corporations, and joint ventures. The Corporations Code states that an LLC may not offer professional services for which a license is required. Because contractors must obtain a license from the Contractors State License Board ("CSLB") in order to legally work in California, contractors have not had the option to obtain a license as an LLC.

The legal relationship between LLCs and the issuance of contractor's licenses changed when the state legislature unanimously passed, and the Governor signed, SB 392 in 2010. SB 392 brings California in line with the majority of states by specifically authorizing the CSLB to issue contractor's licenses to LLCs beginning January 1, 2012. Not only will LLCs be able to obtain new licenses, they will also have the ability to receive transferred licenses from pre-existing licensees.

Before obtaining a contractor's license, the new law requires an LLC to satisfy two key conditions. First, the LLC must file a surety bond in the amount of \$100,000 (in addition to the required \$12,500 contractor's bond) to ensure the payment of employee wages and fringe benefits. Second, the LLC must maintain an insurance policy—in an amount of not less than \$1,000,000, and up to \$5,000,000, depending on the number of licensed personnel—against liability imposed on it for damages arising out of employee claims.

The far-reaching benefits of SB 392 can likely take credit for the unanimous legislative support. California will benefit from the enactment of the law as the Franchise Tax Board estimates that newly licensed LLCs, and their \$800 annual LLC tax, will net the state \$8.4 million in 2011-12 and \$11 million in 2012-13. And, of course, contractors represent the primary beneficiary of the new legislation. Not only will contractors have greater freedom in choosing the business entity that best fits their needs, but they will have greater potential flexibility in operating their businesses. Therefore, come 2012, contractors should carefully consider whether an LLC represents the most beneficial business structure going forward.

This alert was authored by Mark Jackson, an associate whose practice focuses on the formation and taxation of business entities, facilitating the acquisition and lease of commercial property, as well as the resolution of complex title issues. For more information, contact Mr. Jackson by sending a message to: Mark.Jackson@GreshamSavage.com or calling (909) 890-4499.

The foregoing information is intended to provide our clients and friends, along with the general public, with information on recent legal developments and issues of significant interest. This alert is not intended as, and should not be regarded as, legal advice or a legal opinion. If you have any questions about the topics covered by this alert, please consult an attorney. If you do not wish to receive future alerts, please e-mail a request to info@GreshamSavage.com. © 2011 Gresham Savage. All rights reserved.