

# CORPORATE MATTERS: DELAWARE LAW ALLOWS L.L.C. DIVISIONS

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## INTRODUCTION

In 2018, Delaware amended its limited liability company (“L.L.C.”) act to add Section 18-217, which enables an L.L.C. to divide into two or more newly formed L.L.C.’s, with the dividing company either continuing or terminating its existence.

A division is something to consider in the context of a business divorce when the members of an L.L.C. cannot agree on how to proceed jointly. Instead of fighting or terminating the L.L.C., they can agree to proceed separately by dividing the L.L.C. into multiple entities in a straightforward way. For example, in a fact pattern in which an L.L.C. owning two distinct assets of relatively similar value is inherited by two siblings who no longer get on well with each other, a division allows ownership of the assets to be split easily, with each family member receiving a separate asset in a separate single-member L.L.C. This split would end the partnership and the headaches of dual management. In addition, a division would not require a “buyout” by one partner or a sale, but instead would encompass one L.L.C. splitting into two, where each member walks away from the other with a portion of the own property.

In previous [Corporate Matters](#), we have described the general flexibility of Delaware law when it comes to matters of governance of L.L.C.’s. The amendment to the Delaware Limited Liability Company Act (the “Act”) allowing for division of an L.L.C. provides members with significant flexibility in managing and disposing of the assets, liabilities, rights, and duties of the company.

## PLAN OF DIVISION

The new law became effective August 1, 2018. Under its provisions, any Delaware L.L.C. may adopt a plan of division and divide into two or more Delaware L.L.C.’s. The plan of division must include the following provisions:

- The terms and conditions of the division, including the conversion or exchange of the L.L.C. interests of the dividing company into or for L.L.C. interests or other securities of two or more resulting L.L.C.’s and the allocation of assets, properties, rights, series, debts, liabilities, and duties of the dividing L.L.C. among the resulting L.L.C.’s
- The name of each resulting L.L.C. and, the name of the surviving company if the dividing company will survive the division<sup>1</sup>

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<sup>1</sup> Section 18-217(d) of the Act states that unless otherwise provided in a plan of division, the division of a domestic L.L.C. shall not require such L.L.C. to wind up its affairs or pay its liabilities and distribute its assets, and the division shall not constitute a dissolution of such L.L.C. Note, however, Section 18-217(j) of

- The name and business address of a division contact that has custody of a copy of the plan of division
- Any other matters that the dividing company determines to include

Pursuant to the new law, ownership of the dividing L.L.C.'s assets vests by operation of law in the resulting L.L.C.'s to which allocated. The liability for L.L.C. debts vests similarly by allocation agreed to in the plan of division. Vesting of assets by operation of law provides a potential benefit of avoiding transfer restrictions that might be triggered in a different type of transaction, as well as avoiding cumbersome documentation requirements associated with transferring title to assets.

The plan of division is not required to be filed with the Delaware Secretary of State or otherwise be publicly available. The only filing required with the Secretary of State in order to effectuate the division is the certificate of division.

The division contact is required to keep a copy of the plan of division for at least six years after the effective date. The division contact is responsible for keeping records of and updating important information regarding the new and resulting L.L.C.'s.

## APPROVAL

In the absence of specification in the L.L.C. agreement, as will be the case initially for nearly all entities due to the law's recent enactment, Section 18-217 provides that a plan of division must be adopted in the same manner as a plan of merger, if the manner for adopting a plan of merger is specified in the L.L.C. agreement.

In the absence of a specific provision in the L.L.C. agreement with respect to adoption of plans of mergers, a plan of division must be adopted by 50% or more of the members of the dividing L.L.C.

In addition, an L.L.C. agreement may provide that an L.L.C. will not have the power to divide, in which case this option is not available to members in the absence of a revision to the L.L.C. agreement.

## CREDITOR PROTECTION

The statute provides protection for creditors of the dividing company. If the plan of division does not allocate any liability or obligation to a resulting entity, all L.L.C.'s remaining after the division are jointly and severally liable for the obligation. Joint and several liability also arises if a court determines that the allocation of assets or liabilities constituted a fraudulent transfer with regard to creditors.

In addition, if an L.L.C. is formed prior to August 1, 2018, and is a party to a written agreement entered into prior to that date which contains restrictions, conditions, or prohibitions on mergers, consolidations, or asset transfers, such restrictions are deemed to apply to a division as if it were a merger, consolidation, or asset transfer. Parties that enter into agreements with L.L.C.'s on or after August 1, 2018, wishing to restrict divisions must specifically provide for such restrictions in their agreements.

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the Act states that a certificate of division shall act as a certificate of cancellation for a dividing company that is not a surviving company.

*“Any Delaware L.L.C. may adopt a plan of division and divide into two or more Delaware L.L.C.’s.”*

Creditor protection is furthered by obligations imposed on the division contact. It must retain records for six years following the division regarding the name and address of the resulting L.L.C. to which such creditor's claim was allocated for and must make that information available during that period.

All debts, liabilities, and duties of the dividing company that have been allocated to a resulting L.L.C. pursuant to a plan of division remain vested in that L.L.C. They are not considered to have been assigned or transferred to such division company for any purpose of the laws of the State of Delaware. Assignment or transfer restriction provisions in contracts should be broad enough to capture assignments or transfers by operation of law, such as conversions and mergers (including divisive mergers).

## APPLICATION TO SERIES L.L.C.'S

The procedure set forth in Section 18-217 of the Act is well suited for use in connection with a series L.L.C. Because meticulous records within a series L.L.C. are needed for business reasons – *i.e.*, the allocation of assets and liabilities among various silos within the series L.L.C. – the allocation of assets and liabilities to resulting companies in a division should be a relatively straight forward task.

## FEDERAL INCOME TAXATION

The division of an L.L.C. can result in unexpected and potentially adverse tax consequences. Generally, an L.L.C. is treated as a partnership for tax purposes when it has two or more members and has taken no action to be taxed as a corporation. The tax consequences for the members of the dividing L.L.C. will depend, in part, on the number of members in each divided L.L.C. Special tax regulations promulgated under Code §708 will apply when an L.L.C. divides into two or more L.L.C.'s where each is owned by at least two members of the former L.L.C. Under these rules, a resulting L.L.C. may be treated as either a continuing or a new partnership, with different tax consequences applicable to each.

As indicated above, it is possible for a L.L.C. to elect to be taxed as a corporation. Hence, the rules of Subchapter C of the Code will be applicable to the division of an L.L.C. having made that type of election for Federal income tax purposes. In that set of circumstances, the division of an L.L.C. most likely results in tax at both the corporate and member levels unless the division is structured to qualify as a divisive D-reorganization or a tax-free split-off, each of which contains its own set of complexities.