

CALIFORNIA RULLCA REVIEW

RULLCA Profit and Loss Allocations

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The California Revised Uniform Limited Liability Company Act (RULLCA; 2012 Ch. 419 [SB 323]), codified at Section 17701.01 *et seq.* of the California Corporations Code (in effect or repealed, the Code), repealed the Beverly-Killea LLC Act (the Old Act) effective January 1, 2014.

One significant change of RULLCA relates to the allocation of profits and losses and the maintenance of capital accounts. Specifically, RULLCA contains no default provisions to allocate profits and losses of an LLC or that define a capital account. The Old Act contained default provisions in Sections 17001(d) and 17202 of the Code and provided a default definition for "capital account. Those provisions would have been default provisions because allocations set forth in the operating agreement would otherwise govern.

Omitting default allocation provisions for profits and losses appears to be a first in California. Both the Uniform Limited Partnership Act of 2008, governing California limited partnerships, and the Revised Uniform Partnership Act (RUPA), governing California general partnerships, contain default allocation provisions.

The prefatory explanation in SB 323 of what RULLCA changes does not address the reasoning of the California legislature in making this change. That language merely states that the bill revises and recasts a list of provisions, including the allocation provisions. Presumably, the legislature saw benefit in adopting law uniform with the law of other states.

Comments to Section 404 of the Revised Uniform Limited Liability Company Act as prepared by The National Conference of Commissioners on Uniform State Laws (NCCUSL) explain that the "applicable tax, accounting and other regulatory requirements ... are the proper source of guidance" for allocations, not that Act. Can you picture the NCCUSL drafters throwing their hands up in the air as they review sample allocation provisions in a typical operating agreement?

Additionally, the Comments to Section 404 are taken from the Uniform Limited Partnership Act (2001). Therefore, it appears that California held onto default allocation provisions when it enacted the Uniform Limited Partnership Act of 2008 in 2006 even though the uniform act upon which that legislation was based had discarded those provisions. In other words, it appears someone in Sacramento

specifically may have negotiated to keep default allocation provisions for limited partnerships in California as recently as 2006.

In any event, RULLCA no longer fills in rules for LLCs and its members that could conflict with the capital account maintenance, qualified income offset, liquidation-in-accordance-with-positive-capital-account-balance and minimum gain chargeback requirements, targeted allocation or other income tax rules and provisions for profit and loss allocations to have substantial economic effect under detailed Treasury Regulations and the IRC. As with other provisions of RULLCA that favor the freedom to contract, drafters of operating agreements will need to continue to focus on providing accurate allocation provisions to accomplish the economic arrangement of LLC members.

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