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EASTMAN & SMITH LTD. MEMORANDUM

TO: Jason Orcena, Health Commissioner, Union County Combined General Health District; Beth E. Bickford, MS, RN, CAE, Executive Director, Association of Ohio Health Commissioners

FROM: Joseph R. Durham

DATE: May 14, 2013

RE: Local Government Innovation Fund; Formation of Single-Member Nonprofit LLC

As previously discussed, pursuant to Ohio Revised Code § 1705.04(A), the Association of Ohio Health Commissioners (AOHC), as a non-profit Ohio Corporation, may file articles of organization and form a limited liability company (LLC). The AOHC will be the single member of the LLC and the LLC will be a non-profit entity for tax purposes. As the single member, the AOHC must establish a declaration of sole member (or operating agreement) for the LLC. We suggest that the operating agreement establish that the operation or control of the LLC shall initially be placed in the managers consisting of the Health Commissioners (as AOHC members) of the original participating local health districts.

The Association of Ohio Health Commissioners (the "AOHC") is an Ohio nonprofit corporation, exempt from federal income taxation under section 501(c)(6) as a business league. The stated purposes of the AOHC are to: (1) consider, develop, and determine the policies of the Association governing public health in Ohio, and to consider any policy of any public or private agency dealing with any matter pertaining to human health which may affect the administration of public health in the State of Ohio; and (2) to accept gifts and grants for conducting research in the field of public health, including studies and evaluations.

The proposed course of action is for the AOHC to organize a wholly-owned, single member Ohio LLC to manage credentialing services for local health district members, provide billing services, and negotiate insurance contracting with private insurers which other local health departments may opt into. The subsidiary LLC (the "Subsidiary") would be manager-managed, and the managers would be the commissioners of the constituent local health departments.

ANALYSIS

I. Potential Liability of a Single-Member LLC's Member

The considerations that come into play in deciding on whether to hold a sole member liable for the actions of a limited liability company involve domination and control by the member. In Ohio, members of a limited liability company may only be reached individually if the plaintiff demonstrates that the behavior of the members merits disregarding, or piercing, the entity's limited liability structure. Pursuant to Revised Code Section 1705.48(A), 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 limited liability company. Similarly, neither the members of the LLC nor any managers of the LLC are personally liable to satisfy any judgments, debts, obligations, or liabilities of the company solely by reason of being a member or manager of the company. R.C. 1705.48(B). This protection holds whether there is one member or several members of the LLC.

The structure of a LLC, or what is commonly referred to as the "corporate veil" may be pierced when: (1) control over the corporation by those to be held liable was so complete that the corporation has no separate mind, will, or existence of its own, (2) control over the corporation by those to be held liable was exercised in such a manner as to commit fraud or an illegal act, or a similarly unlawful act against the person seeking to disregard the corporate entity, and (3) injury or unjust loss resulted to the plaintiff from such control and wrong. *Huttenbauer Land Co., LLC v. Harley Riley, Ltd.*, 1st Dist. No. C-110842, 2012-Ohio-4585, ¶¶15-16. Simply because a single member has control over the company is not sufficient to sustain liability; that control must be exercised to commit a fraud, illegal act, or otherwise unlawful act. *Id.* at ¶17. In this instance, AOHC would have to exert some unlawful control over the LLC to be held liable for its conduct. This control is further mitigated by the appointment of managers to run the day-to-day operations of the Subsidiary.

II. Tax Obligations

We advise that the LLC, for federal tax purposes, elect to be treated as a corporation separate from its single member. 26 C.F.R. §§ 301.7701-3(a), 301.7701-2(b)(2). Under Ohio law, however, a single member limited liability company that operates with a nonprofit purpose, shall be treated as part of the same legal entity as its nonprofit member for tax purposes, and all assets and liabilities of that single member limited liability company shall be considered to be that of the nonprofit member. R.C. 5701.14(B). The LLC will have an EIN, for federal tax filing purposes and for employment tax purposes.

We are suggesting the LLC elect to be treated as a corporation for federal tax purposes in order to avoid issues that could arise from the LLC's operation subjecting the non-profit AOHC to "unrelated business income" that is subject to tax.

CONCLUSION

AOHC faces no heightened potential tort or contract liability from operating a single-member limited liability company if it does not exert its control over the organization to commit any wrongful acts.

The AOHC could face potential tax liability from unrelated business income tax if the Subsidiary does not elect to be taxed as a corporation, and the income from the coordination and sale of insurance products is attributed to AOHC because the Subsidiary is disregarded as an entity for tax purposes.

The next steps include:

1. Preparation of Articles of Organization for Subsidiary (LLC) for filing with Ohio Secretary of State. AOHC needs to select a name for the LLC.
2. Preparation of application for an EIN for Subsidiary (LLC).
3. Preparation of Subsidiary's (LLC) election to be taxed as corporation.
4. Preparation of declaration of sole member (or operating agreement) establishing that the operation or control of the Subsidiary (LLC) shall initially be placed in the managers/Health Commissioners of the original participating local health districts.
5. Preparation of Participation Agreements with original participating local health districts establishing duties, obligations, and indemnifications.