

SB

354

COMMITTEE REPORT

3/2/76

HOUSE

JUDICIARY

Mr. Speaker:

Date \_\_\_\_\_

The Committee on COMMERCE has had CS 354

under consideration. A Majority of the members of the Committee

( ) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

( ) recommends it BE REPLACED WITH CS FOR \_\_\_\_\_ AND THAT

CS FOR \_\_\_\_\_ DO PASS

( ) "and" recommends it BE REFERRED TO THE \_\_\_\_\_

COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Members NOT concurring in the Majority report:

\_\_\_\_\_ recommends: \_\_\_\_\_

\_\_\_\_\_ recommends:

\_\_\_\_\_ recommends:

\_\_\_\_\_ recommends:

\_\_\_\_\_ recommends:

\_\_\_\_\_ Chairman

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March 22, 1976

Fairbanks Office

The Honorable Bob Bradley  
Representative  
Chairman  
House Commerce Committee  
Alaska State Legislature  
Pouch V  
Juneau, Alaska 99811

Re: CSSB 354

*Fell*

Dear Bob:

This is written to express the support of myself and some of my law partners who practice commercial law for passage of the Limited Liability Company Act embodied in CSSB 354.

The ability to use a limited liability company would provide an additional and useful tool for many Alaskans and others to invest in Alaska. While it would not be useful to everyone, we think it would bring additional badly needed capital into the state from a substantial number of people who would use it.

Very truly yours,

HUGHES, THORSNESS, GANTZ,  
POWELL & BRUNDIN

By

*Brian J. Brundin*  
Brian J. Brundin

BJB/bap  
cc: Robert L. Hartig

COLE, HARTIG, RHODES, NORMAN, MAHONEY, & GOLTZ

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February 24, 1976

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ROBERT J. MAHONEY  
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MEMORANDUM

RE: CS Senate Bill #354, Limited Liability Company Act

Senate Bill 354 was introduced by Senator Colletta in the first session of the ninth legislature and hearings on the bill have been held in the Senate Commerce and Judiciary Committees.

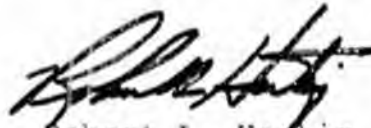
The bill should provide additional revenues to the State of Alaska in excess of one million dollars per year. This revenue will be derived from filing fees and annual fees for the registration of the limited liability company.

The Act is designed to provide a business entity to be used by persons desiring to invest both in Alaska and outside Alaska. Through its use as an investment entity outside Alaska, the Act would provide revenue to the state without corresponding liability of any kind.

Use of the limited liability company will not in any way reduce income taxes payable to the state as it will be used mainly by investors currently using a partnership or limited partnership form.

Miles Schlosberg, Director of the Division of Banking, Securities, Small Loans & Corporations, has testified before the Senate Judiciary Committee on two occasions and the administration has taken a position of "in favor" in their letter to Senator Jalmar M. Kerttula of May 5, 1975.

Enclosed are explanatory materials to assist you with regard to the proposed legislation.

  
Robert L. Hartig

MEMORANDUM

LIMITED LIABILITY COMPANY

The limited liability company has predecessors in New Jersey, Pennsylvania, Michigan and Ohio. In New Jersey and Ohio it was known as a "limited partnership association" and in Pennsylvania and Michigan as a "partnership association".

The business entity which we will now call the limited liability company had its origins in the third quarter of the 19th century. It was adopted in Pennsylvania in 1874, in Michigan in 1877, in New Jersey in 1880, and in Ohio in 1881. No other states have used this form of business entity.

The reason for its creation seems to be the particularly restrictive corporation statutes common in the late part of the 19th century. At that time in the development of the corporate entity, the restrictions in some states included the limitation of business to one state, the limitation of the corporation's business to a sole purpose stated in the Articles of Incorporation and various similar confining requirements. In the early days of the development of the corporation, the case law also was extremely restrictive on what a corporation could do and how it could do it, because of the roots in the English system that a corporation, being chartered by the Crown, was authorized to do only what the Crown specifically authorized it to do.

In the early 20th century, these restrictions on corporate activity were greatly reduced and have continued to be reduced through the introduction of the Delaware corporate statute and the Model Business Corporation Act, upon which many states have based their corporation statutes. These statutes gave much greater freedom to the shareholders and the board of directors to structure the activities of the corporation to meet their particular needs. This has especially been true in the close or closely held corporation which most often is a family corporation. Indeed, some states have adopted statutes which govern the activity of such close corporations and give them wide latitude in arranging their affairs. As these new corporate statutes were adopted by the various states and the case law governing the activities of corporations began to be less restrictive, the vehicle of the limited partnership association or partnership association fell in to disuse.

In introducing the Limited Liability Company Act in the State of Alaska, it is our desire to provide to investors, and particularly real estate investors, the opportunity to utilize this new form of business entity to conduct their business affairs with less expense and fewer restrictions.

The Ohio statute proves to be not usable for these objectives because of its preclusion of dealing in real estate

from the uses of the Ohio Limited Partnership Association, (Ohio Rev. Stats. §1783.01).

Also, the statutes in the other states are substantially more restrictive than the Alaska legislation being introduced and thus provide a less useful vehicle for conduct of a business. For example, the New Jersey statute (NJ Stats. Ann. §42.3-1) requires that the principal place of business of a New Jersey limited partnership association must be established and maintained within the State of New Jersey. The Ohio and Michigan statutes, though a little less restrictive, still require that that organization shall have its principal office or principal place of business within the state. The Pennsylvania statute was repealed in 1966, except as to professions which are not permitted to incorporate in the state.

The Alaska proposed legislation does away with this requirement as to the principal office or principal place of business. The reason for this is the desire to draw to the state investors interested in organizing under the Alaska Limited Liability Company Act for business or investment in other states as well as the State of Alaska. The legislation requires a registered agent in the state which would always insure a resident on whom process can be served in suit against the limited liability company.

The legislation proposed would provide a good amount of revenue each year to the state as there are provisions in the proposed legislation for the following fees:

1. A filing fee upon formation of the Limited Liability Company, which is based on capital invested upon a sliding scale to a maximum of \$1,000;
2. An annual fee of \$100;
3. A filing fee for amendment to the Certificate of Organization of \$25.00; and
4. A filing fee of \$25.00 upon dissolution.

It is suggested that this form of business entity will draw a substantial number of investors from other states who, up to this time, have used the limited partnership, corporation or joint venture vehicle for their investments.

In the first ten months of 1974, approximately 1,300 limited partnerships were filed in the State of Texas, which requires a filing of the limited partnership within the state. In Texas this is used as a revenue measure and there is a requirement of a filing fee which rapidly reaches the maximum fee of \$2,500 at capital contributed of \$500,000. This figure would not at all be uncommon in the real estate market of today.

It is estimated that in excess of half of these limited partnerships would be drawn to use the Limited Liability Company authorized by the proposed legislation in the

State of Alaska to conduct their business or to direct their investments, thus providing this increased revenue for the State. This figure is only for the State of Texas and it is suggested that this legislation would be attractive to investors of all states and may substantially contributed to the revenue of our state.

In addition, it is hoped that in drawing investors to the state for the purpose of utilizing our Limited Liability Company Act as a vehicle for investment in other states, such investors will also use the device as an investment entity in our state, thus providing increased work for real estate personnel, title companies, and all those persons who assist in transactions concerning real estate. In addition, it will be necessary for each limited liability company to establish and maintain a registered agent in the state and it will be necessary for the state to employ a number of additional persons to file and administer the limited liability companies.

The provisions of the act enable the persons forming a limited liability company to provide for management of the limited liability company either by the members or by a manager or managers elected by the members of the limited liability company. The voting power of the members is to be in proportion to their investment in the capital of the company. As with a corporation, the liability of the limited liability

company is to be limited to assets of the company. A member would have a liability not to exceed his contribution to the company or any amount which he is committed to contribute but has not as yet contributed. Why would this vehicle be used rather than a limited partnership? Because it combines the attractive characteristics of a corporation with the attractive characteristics of a partnership.

It is hoped that in submitting a request for a private ruling from the Internal Revenue Service of the United States Treasury Department, a limited liability company could obtain partnership classification for tax purposes.

There are four characteristics in distinguishing between partnership classification and classification and taxation as an association or corporation for purposes of the Internal Revenue Code. These are: (1) centralization of management; (2) continuity of life; (3) free transferability of interests; and (4) limited liability.

In order to be taxed as an association, an entity must have more corporate characteristics than partnership characteristics. A similar problem with regard to taxation is faced by the limited partnership vehicle which would often request advanced revenue rulings to make the limited partnership attractive to an investor.

As drafted, the limited liability company obviously would always have limited liability.

It is expected that the Internal Revenue Service would rule favorably on the continuity of life characteristic because of provision 10.50.180 which states that a limited liability company shall be dissolved upon the death, retirement, resignation, expulsion, bankruptcy, dissolution of a member or occurrence of any other event which terminates the continued membership of a member in the limited liability company, unless the business of the limited liability company is continued by the consent of all the remaining members thereof. Thus, without consent of all the remaining members, the limited liability company would be dissolved upon one of the stated events.

Free transferability of interests is treated in Section 10.50.170. This section provides that a member may always transfer his interest in the limited liability company, but unless unanimous approval is obtained from the other members, the member transferring an interest, can transfer merely the profit and loss interest and not a right to share in the management of the limited liability company.

As to the characteristic of centralization of management, the provisions of the proposed legislation enable the members of the limited liability company to choose whether the limited liability company will be governed by themselves as members or by a manager or management elected by them. If the

members choose to retain management, the limited liability company would also lack the corporate characteristic of centralization of management.

Thus, it can be seen that at least two and possibly three of the corporate characteristics may be lacking in the classification of the limited liability company as a partnership or as an association for the purposes of the Internal Revenue Code.

In conclusion, a limited liability company offers the investor a business entity which combines the attractive elements of both a partnership and a corporation. It combines the limited liability offered to shareholders of a corporation with the tax treatment of a partnership.

The possibilities of increased revenue to the state have been set forth and it appears that increased revenues in excess of one million dollars may be obtained with very little increased expense incurred.

CORPORATION V. PARTNERSHIP V. LIMITED LIABILITY COMPANY

A. NON-TAX CONSIDERATIONS

	<u>CORPORATION</u>	<u>PARTNERSHIP</u>	<u>LIMITED LIABILITY COMPANY</u>
LIFE	Perpetual in most cases.	Agreed term, or life of any partner.	Agreed. Not to exceed 30 years.
ENTITY	Separate legal person.	Not a separate entity from individual partner.	Separate legal entity.
LIABILITY	No individual liability.	General partner individually liable for all obligations. Limited partner usually liable to the amount of capital contributed.	No individual liability.
TRANSFER OF INTEREST	In absence of restrictions interest may be sold to strangers.	New partnership agreement usually required.	May be transferred; however, if all other members do not approve of the proposed transfer by unanimous written consent, the transferee has no right to participate in the management and affairs of the company or to become a member, but is entitled only to receive his share of the profit or return of contributions.
CAPITAL	Capital may be enlisted by sale of stock.	New capital secured only by loans, increase in membership or new contributions by existing partners.	Capital is contributed in money or property at inception or during the course of operation as set out in the Articles of Organization.
BUSINESS ACTION	Action authorized by specified percentage of directors and/or stockholders.	Unanimity of partners usually required.	Action authorized by majority in interest of the members.

CORPORATION

PARTNERSHIP

LIMITED LIABILITY COMPANY

CREDIT CONSIDERATIONS

The corporation possesses credit ability apart from stock membership. Certificates of stock may be used as collateral.

Credit is coincidental with membership and partners assume joint and several responsibility. Interests in partnerships are not ordinarily accepted as basis for loan or credit.

Credit will be extended to the company on the strength of its contributed or to-be-contributed capital.

MANAGEMENT

Shareholders may invest without participation in management.

All general partners involved in management responsibility

Management of the company is in the members unless management by a manager or managers to be elected by the members is provided in the Articles of Organization.

FLEXIBILITY

A corporation operates within its corporate franchise granted by the state or states in which it is authorized to do business.

A partnership is a contractual relationship which may be altered by unanimous agreement of the partners.

Flexibility is perhaps the Limited Liability Company's strongest point. The Articles of Organization will contain a minimum of restrictions and the working rules of the company may be drafted in the form of an operating agreement.

B. TAX FACTORS

TAX BURDEN

As a separate legal personality a corporation is subject to taxation, in addition to the taxation of the income received as dividends by its members.

Each partner is taxed on his proportionate share of income whether distributed or not.

Private revenue ruling will be requested of the Internal Revenue Service requesting that the company be classified as a partnership for federal tax purposes. As drafted the Limited Liability Company will lack at least two and perhaps three of the characteristics of a corporation; the third, centralization of management, will be lacking if management is reserved to the members.

Electing "Small Business Corporation". (1) Each shareholder's proportionate share of the corporation's undistributed taxable income is included in the gross income of the shareholder. The corporation pays no tax thereon. This substantially parallels the taxation of a partner's income from the partnership.

TAX CONCERN

CORPORATION

In close corporations, gross corporate income is reduced by reasonable salaries paid to officer-stockholders. Accumulation of profits may be made up to at least \$150,000 or to such larger extent as not to constitute avoidance of surtax by the stockholders and an unreasonable accumulation in terms of the requirements of business. Corporation taxes, plus individual taxes on the compensation for services or dividends, represent the tax burden of the corporate investment, as against the individual tax paid by partners.

Electing "Small Business Corporation." Undistributed taxable income of an electing corporation is taxable proportionately to each shareholder. Subsequent distributions out of this income to the shareholders are tax free. This substantially parallels the taxation of a partner's income from the partnership.

PENSION TRUST

Corporate contributions to a pension trust, within the amount allowed by law are deductible by the corporation. Stockholder-employees may be covered to same extent as other

PARTNERSHIP

All earnings and profits are taxable to the individual partner, unaffected by accumulations of earnings. However, once so taxed, there-after any distributions of these earnings are tax exempt to the individual partner.

Members of a partnership are not employees and are not proper beneficiaries under an exempt Pension Trust. However, under the Self-Employed Individuals Tax Retirement Act of 1962,

LIMITED LIABILITY COMPANY

All earnings and taxes are taxable to the members whether distributed or not. It is contemplated that the distribution rules and basis rules now applicable to the partnership interest will also be applicable to a limited liability company.

Unknown but it is suggested that the rules now applicable to a Subchapter S corporation which impose the limits of the Keogh Plan will also be applicable.

CORPORATION

employees, so long as there is no discrimination in favor of such stockholders.

Electing "Small Business Corporation". An electing corporation's contributions to a pension trust, within the amount allowed by law, are deductible by the corporation from its taxable income.

SOCIAL SECURITY TAX

Compensation paid to stockholding officers and employees is subject to Social Security Taxes.

Electing "Small Business Corporation". Compensation paid to stockholding Officers and employees is subject to Social Security Taxes.

ASSIGNABILITY OF INTEREST OR INCOME

An unqualified transfer of stock ordinarily requiring no other person's consent, will entitle transferee to dividends or distributions

Electing "Small Business Corporation". Transferee is entitled to dividends and distributions, but the stock must be transferred to an individual or estate and the transferee must consent to the continuation of the "tax option" status.

PARTNERSHIP

partners who own more than 10% of the capital or profit interest in the partnership may, deduct the full amount of their contribution to a pension plan up to \$7,500.

Partners do not pay Social Security Taxes upon their salaries from the partnership. However, they are required to pay the tax on self-employment income.

Any assignment of interest requires consent of the other partners and may create a new partnership.

LIMITED LIABILITY COMPANY

Compensation for services paid to employee, whether member or not, subject to social security tax. Distribution of profits to members would not be.

A member's interest in a Limited Liability Company may be transferred (see page 1). Income from date of transfer taxed to transferee. May be capital gain to transferor on transfer of his interest.

COMMUNITY  
PROPERTY  
STATES

CORPORATION

Dividends from investments made from community property become community property.

Electing "Small Business Corporation". Dividends from investments made from community property become community property.

DUAL MEMBERSHIPS

Because it would be extending its credit, liability and the powers of the Board of Directors beyond legal scope, a corporation cannot be a direct member of a partnership in some states. Can in Alaska.

Electing "Small Business Corporation". Stock may not be held by either a partnership or another corporation.

PARTNERSHIP

Whether income is community or separate income depends upon the law of the state of domicile.

A partnership may own some or all of the stock of a corporation and so function in two capacities.

LIMITED LIABILITY COMPANY

Same as partnership, with the results depending on the community property laws in the several states. Alaska does not have community property.

A Limited Liability Company enjoys flexibility in this area and may be owned by other entities or individuals and participate in other entities and business enterprises.

(1) An electing "small business corporation" is a domestic corporation which does not have more than 10 shareholders and which otherwise comes within the requirements of Subchapter "S" of the Internal Revenue Code, and whose shareholders elect to include in their personal income the current taxable income of the corporation.