

S B

354

COMMITTEE REPORT

4/25/76

HOUSE

Mr. Speaker:

Date May 22, 1976

The Committee on TERRITORIAL has had SSSB 954 BM

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
- () report it back WITHOUT RECOMMENDATION
- () "other"

Members signing the Majority report:

Members NOT concurring in the Majority report:

_____ recommends: NO REC

_____ recommends:

_____ recommends:

_____ recommends:

_____ recommends: T. W. ... Chairman

Letter of Intent CSSB #354am

The House Judiciary Committee has had committee substitute for Senate Bill # 354am(Limited Liability Companies) under consideration and has held public hearings concerning the bill.

Questions have been raised before the committee similar to those raised before the Senate Judiciary Committee, in particular in regard to what body of law would govern when questions arose as to undercapitalization and using a limited liability company to perpetrate a fraud on the public.

~~The bill is silent in this respect. The Committee is concerned with this silence.~~ Legal research has indicated that there is little history in this respect. The Committee, therefore, feels it important to expressly state the legislative intent to those situations in which the established body of law concerning corporations and "piercing the corporate veil" would apply to limited liability companies.

The Judiciary committee recognizes that in certain circumstances the veil by which the limited liability company protects its members from personal liability for the debts of the company ought to be pierced, holding the members personally liable. The committee feels that circumstances giving rise to personal liability of members ought to be closely akin to the kinds of circumstances which permit a court or administrative agency to set aside the "corporate veil" for the purpose of holding corporate shareholders personally liable for the debts of the corporation. Thus, in situations where the court would set aside the corporate entity to hold shareholders liable when the corporation is acting as the alter ego of the

shareholders, or is undercapitalized, or where a corporate fiction is used as a means of evading legal obligations, circumventing statutes, perpetrating fraud, achieving or perpetrating monopoly, or for protection of crime and justification of wrong, or any other circumstances which might give rise to the disregard of the corporate veil, the committee expects the courts to treat the limited liability company in the same manner.

In other words, the limited liability company act should not be utilized as a device by which the organizers could avoid penalties for fraudulent or non-legal propositions any more than they could if they were incorporators of a regular corporation.

Respectfully submitted,

Representative Terry Gardiner
Chairman
House Judiciary Committee

As per request by Representative Brown

Amendment to CSSB #354 (Limited Liability Companies)

Add new Subparagraph....

AS 10.50.120(c)

In those instances in which the validity of the limited liability company is brought into question by use of under capitalization, use of the limited liability company to perpetrate a fraud on creditors of the company or use of the limited company to violate public policy, the protection of the limited liability company may be disregarded and personal liability imposed on the contributing members of the company,

① *to the same extent or in same manner*

SENATE JOURNAL

ALASKA STATE LEGISLATURE

NINTH LEGISLATURE - SECOND SESSION

JUNEAU, ALASKA

Friday

February 20, 1976

Fortieth Day

Pursuant to adjournment, the Senate was called to order by President Croft at 10:16 a.m.

The roll call showed all members present.

The prayer was offered by the Chaplain, Father Dale Sarles.

Senator Kerttula moved and asked unanimous consent that the journal for the thirty-ninth legislative day be approved as certified. Without objection, it was so ordered.

MESSAGES FROM THE GOVERNOR

February 19, 1976

The Honorable Chancy Croft
President of the Senate
Alaska State Legislature
Juneau, Alaska 99811

CS
HB
550
am
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Dear Mr. President:

I have this day vetoed Committee Substitute for House Bill no. 550 amended Senate. The portion of the bill which required the veto is that which attempts to give to the Legislative Affairs Agency the power to allocate office space in the capitol building except for that occupied by the Governor's Office. Since all floors of the capitol building but the third and fourth are already occupied by the legislature, the reason for the bill appears to be to give the Legislative Affairs Agency control over the fourth floor.

Initially this bill would have given the Legislative Council administrative control over space assigned to the legislature. In the Senate the bill was amended to grant the Legislative Affairs Agency control over the physical space in the capitol building regardless of

CS

HB
550
am
S

which branch of government occupied that space. In doing that, the legislature went beyond a specific contractual agreement reached with the executive branch for the allocation of office space prior to the beginning of the session. More significantly, the legislature has attempted to establish a scheme whereby it may now engage in the administrative function of allocating office space. I am advised by the Department of Law that insofar as the bill attempts to do that, it apparently violates the doctrine of separation of powers.

Rather than engage in any extended legal discussion in this message, I am making available the opinion I received from the Department of Law on the subject. You will note that the Department finds two basic legal defects with the bill. First the Department feels that the amendment on the floor of the Senate changed the subject of the bill, which resulted in the original title of the bill not adequately expressing its subject matter. The Department also raises the strong possibility that the bill violates the separation-of-powers principle.

I sincerely hope that my veto does not result in another legal confrontation between the legislative and the executive branches of government. During the last three years, two suits have already been brought by the legislature against the administration in an effort to expand legislative powers. The legislature has lost both of those suits. In Egan v. Pipeline Impact Committee, C. A. No. 74-236, Super. Ct., 1st Jud. Dist. (Alaska 1974), appeal dismissed, Sup. Ct. No. 2424, Order of Nov. 7, 1975, the Superior Court held that while the legislature might impose conditions for allocation on impact funds, it could not administer the allocation of those funds. In Bradner v. Hammond, C. A. No. 75-383 (1st Jud. Dist. (Alaska 1976)), the Superior Court in Ketchikan recently held that the legislature could not expand its confirmation powers beyond that permitted in the Constitution. That latter decision, of course, has brought into question a whole host of confirmations which, until now, have been submitted to the legislature out of comity rather than necessarily legal obligation.

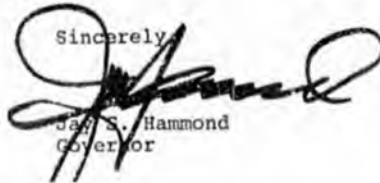
The administration has already tried hard to accommodate the legislature's need for space. During the period of one year the legislature has increased its total office space from 47,907 square feet to 67,900 square feet. Its space in the capitol building has been increased from 29,600 square feet to 40,800 square feet. After an initially confused situation over whether executive offices would move from the capitol, extensive good faith negotiations were held with the legislature to reach an amicable resolution. We thought we had achieved that resolution. We also thought that we had set the tone for additional negotiations in the future to provide adequate working space for the legislature. This bill removes the discussion from one of cooperation to a point of confrontation.

There are a great many problems facing this state. I know that legislators want to deal with those problems just as the administration wants to deal with them. I think it is disheartening for the general public to see public time and money being spent on this type of business. Surely the legislative branch and the executive branch have better things to do than to confront each other in court over whether or not particular legislators are entitled to a particular office on a particular floor of a state building.

CS
HB
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I have advised individual legislators and I advise the legislature as a whole that the administration stands prepared to try to reach long-range solutions to the space problem and to continue our dealings in good faith with the legislature to do so. I have no intention, however, of accepting another effort by the legislature to extend its constitutional powers by usurping authority of the executive branch. I think this bill would be destructive even if it were constitutional, for it makes it more difficult to reason together. The problem is simply compounded by the bill's legal defects.

Sincerely,



Jay S. Hammond
Governor

MESSAGES FROM THE HOUSE

Message of February 19 was read, stating the House has passed SENATE BILL NO. 607 (budget information available to the legislature) with the following amendment:

SB
607
am
H

Page 1, line 12: After "year" change the period to a comma and add:

"except that following a gubernatorial election year the advance copy shall be provided by the second Monday in January."

and transmitting SENATE BILL NO. 607 amended by the House for consideration.

Senator Ray moved and asked unanimous consent that the Senate concur in the House amendment to SENATE BILL NO. 607. Without objection the Senate concurred and SENATE BILL NO. 607 amended by the House was referred to the Secretary for enrollment.

CS Message of February 19 was read, stating the House has
 HB passed COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 606 amended
 606 and transmitting same for consideration.
 am

FIRST READING AND REFERENCE OF HOUSE BILLS

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 606 amended, en-
 titled:

"An Act relating to appointments to vacancies in the
 office of United States senator."

was read the first time and referred to the State Affairs
 Committee.

STANDING COMMITTEE REPORTS

SB The Judiciary Committee has had SENATE BILL NO. 670 (num-
 670 ber of superior court judges) under consideration and a
 majority of the committee recommends it do pass. The
 report was signed by Senator Ziegler, Chairman, and con-
 curred in by Senators Miller, Meland and Poland. Senator
 Tillion signed: "No recommendation."

Senator Ziegler moved and asked unanimous consent that the
 letter of legislative intent be spread in the Journal.
 Without objection, the letter follows:

"LETTER OF LEGISLATIVE INTENT

Re: Senate Bill 670 - relating to the number of superior
 court judges.

The captioned bill would increase the number of superior
 court judges in our state from 17 to 18. Four of those
 judges, rather than 3, will be assigned to the First Judi-
 cial District.

We are advised by the Supreme Court that if the legislation
 becomes law, the new superior court judge will be stationed
 permanently in Sitka. We have been assured that no new
 judge will be appointed to the district court bench in
 that city, although a vacancy now exists which is being
 filled as of this date on a temporary basis.

In other words, the district court judgeship will become
 vacant, and the superior court judge will handle the case-
 load of both courts.

Respectfully submitted,

Senator Robert H. Ziegler, Sr.
 Chairman, Senate Judiciary Committee"

SENATE BILL NO. 670 was referred to the Finance Committee.

The Finance Committee has had SENATE BILL NO. 640 (special appropriation to ACTION for the Foster Grandparent Program) under consideration and a majority of the committee recommends that it do pass. The report was signed by Senator Ray, Chairman, and concurred in by Senators Rader, Chance, Poland, Sackett and Ferguson. Senator Butrovich signed: "No recommendation." SB 640

SENATE BILL NO. 640 was referred to the Rules Committee.

The Finance Committee has had SENATE BILL NO. 664 (making of reparations to the taxpayer for late payment of tax refunds) under consideration and a majority of the committee recommends it do pass. The report was signed by Senator Ray, Chairman, and concurred in by Senators Rader, Chance, Poland, Sackett and Ferguson. Senator Butrovich signed: "No recommendation." SB 664

SENATE BILL NO. 664 was referred to the Rules Committee.

The Judiciary Committee has had SENATE BILL NO. 671 (appointment and qualifications of acting magistrates) under consideration and the committee recommends it do pass. The report was signed by Senator Ziegler, Chairman, and concurred in by Senators Miller, Meland and Tillion. SB 671

SENATE BILL NO. 671 was referred to the Rules Committee.

The Judiciary Committee has had SENATE BILL NO. 672 (small claims and magistrate jurisdiction) under consideration and the committee recommends it do pass. The report was signed by Senator Ziegler, Chairman, and concurred in by Senators Miller, Meland and Tillion. SB 672

SENATE BILL NO. 672 was referred to the Rules Committee.

The Judiciary Committee has had SENATE BILL NO. 673 (judicial appointments) under consideration and a majority of the committee recommends it do pass. The report was signed by Senator Ziegler, Chairman, and concurred in by Senators Miller and Meland. Senator Tillion signed: "No recommendation." SB 673

SENATE BILL NO. 673 was referred to the Rules Committee.

INTRODUCTION AND REFERENCE OF SENATE RESOLUTIONS

SENATE CONCURRENT RESOLUTION NO. 83 by the Judiciary Committee by request SB 83

Supporting the Governor's position for a delay in offshore lease sales for the Gulf of Alaska.

was read the first time and referred to the Resources Committee.

INTRODUCTION AND REFERENCE OF SENATE BILLS

SB SENATE BILL NO. 678 by the Health, Education and Social
678 Services Committee, entitled:

"An Act relating to the public school foundation program; and providing for an effective date."

was read the first time and referred to the Health, Education and Social Services Committee and the Finance Committee.

SB SENATE BILL NO. 679 by the Health, Education and Social
679 Services Committee, entitled:

"An Act relating to the public school foundation program; and providing for an effective date."

was read the first time and referred to the Health, Education and Social Services Committee and the Finance Committee.

Senator Kerttula moved and asked unanimous consent that the Senate recess to a call of the Chair for the purpose of Democratic and Republican party caucuses. Without objection, the Senate recessed at 10:29 a.m.

APTEE RECESS

The Senate reconvened at 11:02 a.m.

Senator Kerttula moved and asked unanimous consent that the Senate revert to Communications. Without objection, it was so ordered.

COMMUNICATIONS

Memorandum of February 20 was received from J. H. Hogan, Director of the Legislative Finance Division. This memorandum appears as Senate and House Supplement No. 3 to today's journal.

Senator Ziegler moved and asked unanimous consent the Senate revert to Standing Committee Reports. Without objection the Senate reverted to:

STANDING COMMITTEE REPORTS

SB The Judiciary Committee has had SENATE BILL NO. 354
354 (limited liability companies) under consideration and the

committee reports it back as follows: Senator Ziegler, SB
 Chairman, recommends it be replaced with COMMITTEE SUBSTI- 354
 TUTE FOR SENATE BILL NO. 354 and that the committee substi-
 tute do pass with the following amendment:

Page 17, line 17:

After "\$100" delete the period and insert: "for
 each year or part thereof the company is delinquent
 in filing."

Senators Miller, Meland, Poland and Tillion signed: "No
 recommendation."

Senator Ziegler moved and asked unanimous consent that the
 letter of legislative intent accompanying the report be
 spread in the Journal. Without objection, the letter
 follows:

LETTER OF LEGISLATIVE INTENT

Re: CSSB 354--limited liability companies

The Senate Judiciary committee has had the captioned bill under
 consideration since late in the 1975 session. It was sent us by
 the Senate Commerce committee for our review and for possible
 amendments.

We have considered the bill, taken public testimony, and the
 Committee Substitute for Senate Bill 354 represents the final
 work product of all people who have shown an interest in the legis-
 lation. The bill authorizes the creation of limited liability com-
 panies. The limited liability company is neither a corporation,
 a partnership, a limited partnership nor a joint venture. Rather,
 it is an organization which would enable the organizers of the
 company to have limited liability as is the case with corporate
 officials but which would enable the company to be taxed as a
 partnership, thereby enabling the organizers to live in the best
 of both possible worlds.

If certain criteria are met, it is likely, we feel, that the In-
 ternal Revenue Service will furnish us with a favorable ruling as
 to the mode of taxation to be applied to the company.

The Director of the Division of Banking, Securities, Small Loans
 and Corporations, Miles S. Schlossberg, is on record before our
 committee as being in favor of the act. He has devoted a great deal
 of time, research and analysis to the bill and feels that, if en-
 acted into law, it might do for the state of Alaska what corpora-
 tions have done for the state of Delaware in terms of income to
 our state.

When we began, Mr. Schlossberg's five areas of concern were:

1. Applicability of federal and state securities laws
 to a limited liability company;
2. Alien ownership disclosure;
3. Limited liability company name;
4. Piercing the corporate veil; and,
5. Miscellaneous drafting changes.

SB
354

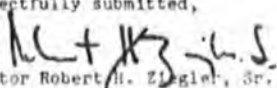
As to the items 1, 2, 3, and 5, there are no problems in the committee substitute, in his opinion. We concur. As to item 4, the Judiciary committee recognizes that in certain circumstances the veil by which the limited liability company protects its members

from personal liability for the debts of the company ought to be pierced, holding the members personally liable. The committee feels that circumstances giving rise to personal liability of members ought to be closely akin to the kinds of circumstances which permit a court or administrative agency to set aside the "corporate veil" for the purpose of holding corporate shareholders personally liable for the debts of the corporation. Thus, in situations where the court would set aside the corporate entity to hold shareholders liable when the corporation is acting as the alter ego of the shareholders, or is undercapitalized, or where a corporate fiction is used as a means of evading legal obligations, circumventing statutes, perpetrating fraud, achieving or perpetrating monopoly, or for protection of crime and justification of wrong, or any other circumstances which might give rise to the disregard of the corporate veil, the committee expects the courts to treat the limited liability company in the same manner.

(The preceding paragraph was furnished the committee by Mr. Schlosberg.)

In other words, the limited liability company act should not be utilized as a device by which the organizers could avoid penalties for fraudulent or non-legal propositions any more than they could if they were incorporators of a regular corporation.

Respectfully submitted,


Senator Robert H. Ziegler, Sr.
Chairman
Senate Judiciary Committee

SENATE BILL NO. 354 was referred to the Rules Committee.

CONSIDERATION OF THE CALENDAR

SECOND READING OF SENATE RESOLUTIONS

SJR
47

SENATE JOINT RESOLUTION NO. 47 (Congressional action on H.R. 200) was read the second time.

Senator Kerttula moved and asked unanimous consent that SENATE JOINT RESOLUTION NO. 47 be considered engrossed, advanced to third reading and placed on final passage. Without objection, it was so ordered.

SENATE JOINT RESOLUTION NO. 47 was read the third time.

The question being: "Shall SENATE JOINT RESOLUTION NO. 47 (Congressional action on H.R. 200) pass the Senate?" The roll was taken with the following result:

Yeas:	20	Bradley, Butrovich, Chance, Colletta, Croft, Ferguson, Hohman, Huber, Kerttula, Meland, Miller, Orsini, Poland, Rader, Ray, Rodry, Sackett, Tillion, Willis, Ziegler	SJR 47
Nays:	0		

And so, SENATE JOINT RESOLUTION NO. 47 passed the Senate and was referred to the Secretary for engrossment.

SECOND READING OF SENATE BILLS

Senator Rader moved and asked unanimous consent that SENATE BILL NO. 491 (state aid to school districts affected by state activities) be returned to the Rules Committee. Without objection, it was so ordered.	SB 491
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SECOND READING OF HOUSE BILLS

HOUSE BILL NO. 120 (eye examinations for needy persons) was read the second time.	HB 120
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Senator Ray moved and asked unanimous consent for adoption of the Finance Committee report, thus adopting the Senate committee substitute offered by that committee, page 335. Senator Kerttula objected, then withdrew his objection. Without further objection, SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 was adopted.

SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 was read the second time.	SCS HB 120
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Senator Kerttula moved and asked unanimous consent that SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 be considered engrossed, advanced to third reading and placed on final passage. Without objection, it was so ordered.

SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 was read the third time.

The question being: "Shall SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 (eye examinations for needy persons) pass the Senate?" The roll was taken with the following result:

SCS Yeas: 20 Bradley, Butrovich, Chance,
 HB Colletta, Croft, Ferguson, Hohman,
 120 Huber, Kerttula, Meland, Miller,
 Orsini, Poland, Rader, Ray, Rodey,
 Sackett, Tillion, Willis, Ziegler

Nays: 0

And so, SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 passed the Senate.

Senator Kerttula moved and asked unanimous consent that the roll call on the passage of SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 be considered the roll call on the effective date clause. Without objection, it was so ordered.

SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120 was referred to the Secretary for engrossment.

HB HOUSE BILL NO. 424 (membership of the advisory board on
 424 alcoholism) was read the second time.

Senator Chance moved and asked unanimous consent for adoption of the Health, Education and Social Services Committee report, thus adopting the Senate committee substitute offered by that committee, page 324. Without objection, SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424 was adopted.

SCS SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424 was
 HB read the second time.
 424

Senator Kerttula moved and asked unanimous consent that SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424 be considered engrossed, advanced to third reading and placed on final passage. Without objection, it was so ordered.

SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424 was read the third time.

The question being: "Shall SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424 (membership of the advisory board on alcoholism) pass the Senate?" The roll was taken with the following result:

Yeas:	20	Bradley, Butrovich, Chance, Colletta, Croft, Ferguson, Hohman, Huber, Kerttula, Meland, Miller, Orsini, Poland, Rader, Ray, Rodey, Sackett, Tillion, Willis, Ziegler	SCS NB 424
Nays:	0		

And so, SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424 passed the Senate and was referred to the Secretary for engrossment.

UNFINISHED BUSINESS

The reconsideration of HOUSE BILL NO. 551 (supplemental appropriation to Legislative Affairs Agency) was not taken up this legislative day. HOUSE BILL NO. 551 was signed by the President and Secretary and returned to the House. HB
551

SPECIAL ORDERS

Senator Ferguson moved and asked unanimous consent that he be excused from a call of the Senate February 23. Without objection, Senator Ferguson was excused.

ENGROSSMENT AND ENROLLMENT

The following have been engrossed, signed by the President and Secretary and transmitted to the House for its consideration:

SENATE JOINT RESOLUTION NO. 47

SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 120

SENATE COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 424

SENATE CONCURRENT RESOLUTION NO. 78 has been enrolled, signed by the President and Secretary, Speaker and Chief Clerk, and the engrossed and enrolled copies were transmitted to the office of the Governor at 3:15 p.m. February 19, 1976.

SCR
78

ANNOUNCEMENTS

Joint Gas Pipeline Impact Committee w/Resources and State Affairs	Court Bldg.	Feb 20 1:00 p.m.
Judiciary	Room 5 Capitol	Feb 22 1:30 p.m.
Commerce	Room 6 Capitol	Feb 23 3:00 p.m.
Finance	4th Floor Capitol	Feb 24 2:00 p.m.

ADJOURNMENT

Senator Kerttula moved and asked unanimous consent that the Senate adjourn until 2:00 p.m. February 23, 1976. Without objection, the Senate adjourned at 11:35 a.m.

Beverly Keithahn
Secretary of the Senate

February 1976

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.	<p><i>MEANS THEY CAN WIN ONE - ALL LOS IF ANY</i></p> <p><i>Majority (numerical minority) controls</i></p> <p>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.</p>
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 <u>majority in interest</u> 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.

AS ARE LOSSES!

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.

	<u>CORPORATION</u>	<u>PARTNERSHIP</u>	<u>LIMITED LIABILITY COMPANY</u>
COMMUNITY PROPERTY STATES	<p>Dividends from investments made from community property become community property.</p> <p><u>Electing "Small Business Corporation"</u>. Dividends from investments made from community property become community property.</p>	<p>Whether income is community or separate income depends upon the law of the state of domicile.</p>	<p>Same as partnership, with the results depending on the community property laws in the several states. Alaska does not have community property.</p>
DUAL MEMBERSHIPS	<p>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.</p> <p><u>Electing "Small Business Corporation"</u>. Stock may not be held by either a partnership or another corporation.</p>	<p>A partnership may own some or all of the stock of a corporation and so function in two capacities.</p>	<p>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.</p>

(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.

STATE OF ALASKA

DEPARTMENT OF REVENUE

STATE OFFICE BUILDING

POUCH SA - JUNEAU 99811

8354
JAY S. HAMMOND, GOVERNOR

May 19, 1976

The Honorable Terry Gardiner
Pouch V
Juneau, AK 99811

Dear Terry:

In response to your letter of May 18, please be advised that we have no statistical for estimating the impact of the limited liability companies. The proponents of this legislation have estimated that, based on their research, there may be up to 5,000 companies organizing in the State of Alaska. We have no basis on which to confirm or refute their estimate.


The exact effect of the enactment of this legislation is difficult to ascertain at this point. The law was drafted with the intent that those companies are to be treated as limited partnerships for tax purposes. Our review of the law would indicate that this is probably correct. Actually, the final decision will be made by the Internal Revenue Service after the law is enacted. To the best of our knowledge, there is no reason to believe that the State of Alaska will lose any revenue as a result of this legislation, since it would appear that the majority of organizations taking advantage of this law would have organized as partnerships anyhow.

Our fiscal note anticipated revenue being generated through our normal audit of returns filed and did not take into consideration the additional estimated \$1,000,000 which will be generated in the form of filing fees from the 5,000 companies which may organize under this statute.

In summary, based on our research, it does not appear that the State of Alaska will incur any loss of tax revenues from the enactment of this legislation. In fact, the State should receive additional revenue in the form of filing fees which it would not normally receive.

If you have any further questions regarding this law, please feel free to contact me.

Sincerely,


Sterling Callagher
Commissioner

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

Pouch K, Capitol Bldg.
Juneau, Alaska 99811

May 20, 1976

The Honorable Terry Gardiner
Chairman
House Judiciary Committee
Pouch V
Juneau, Alaska 99811

Re: SB 354 - Limited Liability Companies

Dear Representative Gardiner:

You have requested this office for an opinion for the Judiciary Committee regarding the method of taxation which would be imposed on a limited liability company. Because, as you state in your letter, the time before adjournment is short, and because of the unique character of the limited liability company, I will be unable to give you a definitive answer to your opinion request. Accordingly, I will instead indicate to you our best judgment on this matter, realizing that the Internal Revenue Service will make their own determination on the question with regard to federal income taxes.

For purposes of state income taxes levied under AS 43.20, a limited liability company will be treated as specified by the Internal Revenue Code and the regulations and rules adopted by the Internal Revenue Service (IRS). Since limited liability companies do not exist in any other state, and the Internal Revenue Service will not issue a ruling with regard to their tax status until SB 354 becomes law, no one can say with certainty how they will be treated. A fair judgment, however, can be made by testing the elements of a limited liability company under SB 354 against the requirements of Sec. 7701 of the Internal Revenue Code and the regulations promulgated thereunder. In viewing SB 354 in the light of Sec. 7701 of the Internal Revenue Code and Reg. 301.7701-2, it is our best judgment that they will be taxed as partnerships. That is not to say, however, that the IRS would not determine otherwise, since obviously they might. No one can say with certainty, but it is our belief under present rules that it would be taxed as a partnership for state income tax purposes.



"1776-A TRIBUTE FROM OUR STATE TO OUR NATION-1976"




The Honorable Terry Gardiner
May 20, 1976
Page 2

For other taxes imposed by the state, such as business license taxes and excise taxes, the method of taxation does not vary with the type of taxpayer. Accordingly, SB 354 should not change the method of taxation for other taxes, and a limited liability company would be subject to tax as any other person whether individual, corporation or partnership.

Sincerely,

AVRUM M. GROSS
ATTORNEY GENERAL

By:


John R. Messenger
Assistant Attorney General

JRM:chp



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PATRICK E. MURPHY
TOM BATCHELOR

TEL 586-2210
AREA CODE 907

May 4, 1976

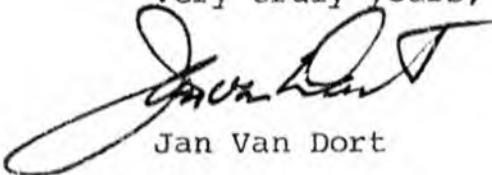
The Honorable Terry Gardiner
Chairman, House Judiciary Committee
State of Alaska
Pouch V
Juneau, Alaska 99811

Re: SB 354 -- Limited Liability Companies

Dear Chairman Gardiner:

Please be advised that Huna Totem Corporation, a village corporation organized under the provisions of the Alaska Native Claims Settlement Act, supports generally the limited liability company concept and supports specifically the version of SB 354 which is in your committee.

Very truly yours,



Jan Van Dort

JVD/amz

cc: Gerald Gray
Frank See, Sr.

Gerald Gray - Hoonah Totem Corp

Shareholder in Senco

Case 1 ~~#~~ SB 354

Pay less tax - Circulate funds to
tax one again

Bob Hoescher Goldbelt Corp

have looked at joint venture / limited partnership

$$\begin{array}{r} 242 \\ 42 - \underline{160} \\ 24 \end{array} \quad 4$$



[Title 39] 39.05.060

THE LEGISLATURE OF THE STATE OF ALASKA
FISCAL NOTE
 Second Session - Ninth Legislature

I. REQUEST

Bill No. CS SB 354 AM
 Title: "An Act related to Limited Liability Companies"
 Requested by: House Judiciary Committee Date: 05-17-1976
 Return Date Requested: 05-17-76
 Agency: Revenue Program: Audit

II. FISCAL DETAIL

Budget Request Unit(s) Affected: Audit

A. EXPENDITURES: (Thousands of dollars)

OBJECT	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81
100 PERSONAL SERVICES		39.4	39.4	63.1	63.1	86.8
200 TRAVEL		4.0	4.4	6.8	7.0	9.4
300 CONTRACTUAL		25.5	19.0	21.2	23.3	25.6
400 COMMODITIES		.4	.4	.6	.6	
500 EQUIPMENT		1.2	-	.6	-	6
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL	-0-	70.5	63.2	92.3	94.0	123.2

B. FUNDING: (Thousands of dollars)

GENERAL FUND	-0-	70.5	63.2	92.3	94.0	123.2
FEDERAL FUNDS						
OTHER						

C. POSITIONS:

PERMANENT/TEMPORARY	0 / 0	2 / 0	2 / 0	3 / 0	3 / 0	4 / 0
MAN MONTHS (P./T.)	/	24 / 0	24 / 0	36 / 0	36 / 0	48 / 0

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

This is a new type of organization for Alaska as well as the rest of the United States. The sponsors anticipate up to 5,000 companies will organize under this statute in the first year. It is imperative that there be sufficient staffing to deal with the many problems which will arise in how to file in Alaska as well as how to determine what portion of their income is taxable in Alaska. The positions requested are one (1) office auditor and one (1) tax examiner. It is anticipated that these positions will generate \$200,000 in additional revenue in the first year.

IV. ATTACHMENTS

Vr. DATE: 0 - 17 - 76 PREPARED BY: _____

Original: Legislative Finance
 cc: Budget and Management
 Prime Sponsor (First Legislator Named)

MEMORANDUM

file 354

May 26, 1976

TO: Steve Cowper and Terry Gardiner

RE: Senate Bill 354 AM

As you are both probably aware the most important aspect of any business operation is the distribution of any income or loss.

In general, income and loss to a corporation appear as an increase in the value of the company's stock or in the form of dividends. In the case of loss, lower values of stock and no dividends. Of course many tax applications exist with regard to income or loss for example, tax loss carry forwards and deferred taxes. The loss as income is distributable to the shares.

In the case of a sole proprietorship the proprietor must (obviously) bear directly the burden or benefit; though there are some tax benefits to the proprietor, they have little value.

Partnerships generally attribute distribution per agreement of the parties normally, along the lines of their financial interests. Partners are generally individually liable for all obligations. Limited partnership partners are liable to the extent of capital contributed.

Limited liability companies who get letters of intent to contribute capital or provisional letters of credit, or who have the strength and connections to have long lines of bank credit, gain a distinct tax advantage through the LLC.

EXAMPLE: Two "heavys" contribute \$ 55 K each = 110 K
Ten others contribute \$ 10 K each = 100 K

12 Individuals = 210 K

The LLC takes the 210 K plus its "line" of credit, \$700 K, and begins operations--drills a wildcat well for example. "Losses" are incurred for three years = each member of the LLC has his proportionate share of loss "distributed" to him. He may reduce, in proper circumstances,

TO: Steve Cowper and Terry Gardiner
May 26, 1976
Page 2

his taxable income in other ventures by the amount of this loss. This loss, like his gain, is assessed in the amount of his interest. If the capital and the borrowed funds (credit line) are high (\$910,000) and if all of the operation showed a loss then the partners (1-2) would have a "loss" they could use, in this example, 27 1/2% of 910,000 or \$250,250. The amount of investment was \$55 K so the limited liability allows a loss five times greater than the amount of investment.

The other partners, 3-12, have just shy of 1/2 interest (5% of total invest each) their loss benefit would be only 5% of 409,500 (20,475). For the small partner, he gets a tax benefit two times his investment. If this were to continue several years the benefit would be substantial when profits were finally made and distributed. Partners could carry tax losses forward to apply against future distribution of income. (Numberless tax "advantages" exist along side this one example of loss--carry forward.) Income could be distributed for up to five years with no tax liability. If previous losses were incurred as part of a plan. Of course in oil if you hit a big one tax liabilities are irrelevant.

In my view there would be a definite tax advantage for members of LLC's in Alaska if SB 354 becomes law. There would, concurrently, be a tax disadvantage to the state since we use the Federal Revenue Code which contains all the loopholes. The State could lose far more than it gained in filing fees. Likely as not most of these Corps would not be "Alaskan" Corps. Further, the application of this to multinational corporations should be thoroughly and carefully researched and investigated.

See Attached

Subchapter S corp

Bob Hartig - Bernard Doherty - Hamilton Brothers
Oil Co.
Corp - limited partnership - Cross

Corp - limits liability to stock can't go
through to stockholder to sue
Partnership - one layer of taxation

IRS letter

Generate \$1 million in filing fees etc
outside companies would incorporate in Alaska

Follows Corporation Act in drafting

None in any other states - same before 1900's

Corporation pays taxes on two levels
Corp

1. Centralization Under this bill - choice over centralized management not
2. No Transference " " " Sec 1376 limited restriction on transferring stock
3. Continuity to go how perpetual life

Joint Ventures + Partnerships will shift to this
they would switch because of advantage of
limited liability

Small Corporations might switch over
Potential loss of tax dollars to state?

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

A PROFESSIONAL CORPORATION

ATTORNEYS AT LAW

SUITE 201

717 K STREET

ANCHORAGE, ALASKA 99501

(907) 274-3576

HOYT M. COLE
ROBERT L. HARTIG
JAMES D. RHODES
JOHN K. NORMAN
ROBERT J. MAHONEY
KEITH A. GOLTZ
BERNARD J. DOUGHERTY

G. RODNEY KLEEDEHN

February 24, 1976

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.

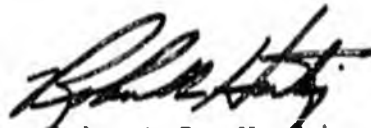
The bill should provide additional revenues to the State of Alaska in excess of one million dollars per year. This revenue will be derived from filing fees and annual fees for the registration of the limited liability company.

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 case of 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 contribute 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.

§ 301.7641 PROCEDURE AND ADMINISTRATION

SUPERVISION OF OPERATIONS OF CERTAIN
MANUFACTURERS

- § 301.7641 [Comprises Code section 7641, see 26 U.S.C.A. (I.R.C. 1954) § 7641] F, G, and H of Part 45 of this chapter (Miscellaneous Stamp Tax Regulations). For regulations relating to the manufacture of opium suitable for smoking purposes, see 26 CFR (1939) 150 (Narcotics Regulations 3, 3 F.R. 1402) as made applicable to section 7641 of the 1954 Code by Treasury Decision 6091, approved August 16, 1964 (19 F.R. 5167).
§ 301.7641-1 Supervision of operations of certain manufacturers
For regulations under section 7641, except the provisions thereof relating to the manufacture of opium suitable for smoking purposes, see Subparts E, Added Nov. 3, 1967, 32 F.R. 15241.

POSSESSIONS

- § 301.7651 [Comprises Code section 7651, see 26 U.S.C.A. (I.R.C. 1954) § 7651] § 301.7654 [Comprises Code section 7654, see 26 U.S.C.A. (I.R.C. 1954) § 7654]
§ 301.7652 [Comprises Code section 7652, see 26 U.S.C.A. (I.R.C. 1954) § 7652] § 301.7655 [Comprises Code section 7655, see 26 U.S.C.A. (I.R.C. 1954) § 7655]
§ 301.7653 [Comprises Code section 7653, see 26 U.S.C.A. (I.R.C. 1954) § 7653]

DEFINITIONS

- § 301.7701 [Comprises Code section 7701, see 26 U.S.C.A. (I.R.C. 1954) § 7701] tions fall for purposes of taxation. These categories, or classes, include associations (which are taxable as corporations), partnerships, and trusts. The tests, or standards, which are to be applied in determining the classification in which an organization belongs (whether it is an association, a partnership, a trust, or other taxable entity) are determined under the Internal Revenue Code. Sections 301.7701-2 to 301.7701-4 set forth these tests, or standards, which are to be applied in determining whether an organization is (1) an association (see § 301.7701-2), (2) a partnership (see § 301.7701-3), or (3) a trust (see § 301.7701-4).
§ 301.7701-1 Classification of organizations for tax purposes
(a) Person. The term "person" includes an individual, a corporation, a partnership, a trust or estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization or group. Such term also includes a guardian, committee, trustee, executor, administrator, trustee in bankruptcy, receiver, assignee for the benefit of creditors, conservator, or any person acting in a fiduciary capacity.
(b) Standards. The Internal Revenue Code prescribes certain categories, or classes, into which various organiza- (c) Effect of local law. As indicated in paragraph (b) of this section, the classes into which organizations are to be placed for purposes of taxation are determined under the Internal Revenue Code. Thus, a particular organization might be classified as a trust under the

DEFINITIONS

§ 301.7701-2

law of one State and a corporation under the law of another State. However, for purposes of the Internal Revenue Code, this organization would be uniformly classed as a trust, an association (and, therefore, taxable as a corporation), or some other entity, depending upon its nature under the classification standards of the Internal Revenue Code. Similarly, the term "partnership" is not limited to the common-law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. See § 1.761-1 of this chapter (Income Tax Regulations) and § 301.7701-3. The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, and an insurance company. Although it is the Internal Revenue Code rather than local law which establishes the tests or standards which will be applied in determining the classification in which an organization belongs, local law governs in determining whether the legal relationships which have been established in the formation of an organization are such that the standards are met. Thus, it is local law which must be applied in determining such matters as the legal relationships of the members of the organization among themselves and with the public at large, and the interests of the members of the organization in its assets. Nevertheless, the labels applied by local law to organizations, which may now or hereafter be authorized by local law, are in and of themselves of no importance in the classification of such organizations for the purposes of taxation under the Internal Revenue Code. Thus, a professional service organization, formed under the law of a State authorizing the formation by one or more persons of a so-called professional service corporation, would not be classified for purposes of taxation as a "corporation", merely because the organization was so labeled under local law. See *Morrissey et al. v. Commissioner*, 296 U.S. 344 (1935). The classification in which a professional service organization belongs is determined under the tests and standards set forth in §§ 301.7701-2, 301.7701-3, and 301.7701-4.

Added Nov. 3, 1967, 32 F.R. 15241.

§ 301.7701-2 Associations, including organizations labeled "corporations"

(a) Characteristics of corporations.

(1) The term "association" refers to an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than as another type of organization such as a partnership or a trust. There are a number of major characteristics ordinarily found in a pure corporation which, taken together, distinguish it from other organizations. These are: (i) Associates, (ii) an objective to carry on business and divide the gains therefrom, (iii) continuity of life, (iv) centralization of management, (v) liability for corporate debts limited to corporate property, and (vi) free transferability of interests. Whether a particular organization is to be classified as an association must be determined by taking into account the presence or absence of each of these corporate characteristics. The presence or absence of these characteristics will depend upon the facts in each individual case. In addition to the major characteristics set forth in this subparagraph, other factors may be found in some cases which may be significant in classifying an organization as an association, a partnership, or a trust. An organization will be treated as an association if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or trust. See *Morrissey et al. v. Commissioner* (1935) 296 U.S. 344.

(2) Since associates and an objective to carry on business for joint profit are essential characteristics of all organizations engaged in business for profit (other than the so-called one-man corporation and the sole proprietorship), the absence of either of these essential characteristics will cause an arrangement among co-owners of property for the development of such property for the separate profit of each not to be classified as an association. Some of the major characteristics of a corporation are common to trusts and corporations, and others are common to partnerships and corporations. Characteristics common to trusts and corporations are not material in attempting to distinguish between a trust and an association, and characteristics common to partnerships and corporations

are not material in attempting to distinguish between an association and a partnership. For example, since centralization of management, continuity of life, free transferability of interests, and limited liability are generally common to trusts and corporations, the determination of whether a trust which has such characteristics is to be treated for tax purposes as a trust or as an association depends on whether there are associates and an objective to carry on business and divide the gains therefrom. On the other hand, since associates and an objective to carry on business and divide the gains therefrom are generally common to both corporations and partnerships, the determination of whether an organization which has such characteristics is to be treated for tax purposes as a partnership or as an association depends on whether there exists centralization of management, continuity of life, free transferability of interests, and limited liability.

(3) An unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics. In determining whether an organization has more corporate characteristics than noncorporate characteristics, all characteristics common to both types of organizations shall not be considered. For example, if a limited partnership has centralized management and free transferability of interests but lacks continuity of life and limited liability, and if the limited partnership has no other characteristics which are significant in determining its classification, such limited partnership is not classified as an association. Although the limited partnership also has associates and an objective to carry on business and divide the gains therefrom, these characteristics are not considered because they are common to both corporations and partnerships.

(4) The rules of this section and §§ 301.7701-3 and 301.7701-4 are applicable only to taxable years beginning after December 31, 1960. However, for any taxable year beginning after December 31, 1960, but before October 1, 1961, any amendment of the agreement establishing the organization will, in the case of an organization in existence on November 17, 1960, be treated for purposes of determining the classifica-

tion of the organization as being in effect as of the beginning of such taxable year (i) if the amendment of the agreement is made before October 1, 1961, and (ii) if the amendment results in the classification of the organization under the rules of this section and §§ 301.7701-1, 301.7701-3, and 301.7701-4 in the same manner as the organization was classified for tax purposes on November 17, 1960.

(5) The rules of paragraph (h) of this section are applicable only to taxable years beginning after December 31, 1960. However, in the case of an organization formed as a partnership association, a business trust, an ordinary business corporation, or a professional service organization formed under a local law or regulatory rule specifically authorizing the formation of such organizations, the rules of paragraph (h) of this section shall not apply to any taxable year ending on or before December 31, 1964, if such organization made its return for any such taxable year, filed at or prior to the time (including extensions thereof) that the return for such taxable year was required to be filed, as if its income were subject to the tax imposed by section 11 of the Code (relating to tax imposed on corporations).

(b) *Continuity of life.* (1) An organization has continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization. On the other hand, if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, continuity of life does not exist. If the retirement, death, or insanity of a general partner of a limited partnership causes a dissolution of the partnership, unless the remaining general partners agree to continue the partnership or unless all remaining members agree to continue the partnership, continuity of life does not exist. See *Glensder Textile Company* (1942) 46 B.T.A. 176 (A., C.B. 1942-1, 8).

(2) For purposes of this paragraph, dissolution of an organization means an alteration of the identity of an organization by reason of a change in the relationship between its members as determined under local law. For example, since the resignation of a partner from a general partnership destroys the mutual agency which exists between

ship Act, such a general partnership cannot achieve effective concentration of management powers and, therefore, centralized management. Usually, the act of any partner within the scope of the partnership business binds all the partners; and even if the partners agree among themselves that the powers of management shall be exclusively in a selected few, this agreement will be ineffective as against an outsider who had no notice of it. In addition, limited partnerships subject to a statute corresponding to the Uniform Limited Partnership Act, generally do not have centralized management, but centralized management ordinarily does exist in such a limited partnership if substantially all the interests in the partnership are owned by the limited partners.

(d) **Limited liability.** (1) An organization has the corporate characteristic of limited liability if under local law there is no member who is personally liable for the debts of or claims against the organization. Personal liability means that a creditor of an organization may seek personal satisfaction from a member of the organization to the extent that the assets of such organization are insufficient to satisfy the creditor's claim. A member of the organization who is personally liable for the obligations of the organization may make an agreement under which another person, whether or not a member of the organization, assumes such liability or agrees to indemnify such member for any such liability. However, if under local law the member remains liable to such creditors notwithstanding such agreement, there exists personal liability with respect to such member. In the case of a general partnership subject to a statute corresponding to the Uniform Partnership Act, personal liability exists with respect to each general partner. Similarly, in the case of a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act, personal liability exists with respect to each general partner, except as provided in subparagraph (2) of this paragraph.

(2) In the case of an organization formed as a limited partnership, personal liability does not exist, for purposes of this paragraph, with respect to a general partner when he has no substantial assets (other than his inter-

est in the partnership) which could be reached by a creditor of the organization and when he is merely a "dummy" acting as the agent of the limited partners. Notwithstanding the formation of the organization as a limited partnership, when the limited partners act as the principals of such general partner, personal liability will exist with respect to such limited partners. Also, if a corporation is a general partner, personal liability exists with respect to such general partner when the corporation has substantial assets (other than its interest in the partnership) which could be reached by a creditor of the limited partnership. A general partner may contribute his services, but no capital, to the organization, but if such general partner has substantial assets (other than his interest in the partnership), there exists personal liability. Furthermore, if the organization is engaged in financial transactions which involve large sums of money, and if the general partners have substantial assets (other than their interests in the partnership), there exists personal liability although the assets of such general partners would be insufficient to satisfy any substantial portion of the obligations of the organization. In addition, although the general partner has no substantial assets (other than his interest in the partnership), personal liability exists with respect to such general partner when he is not merely a "dummy" acting as the agent of the limited partners.

(e) **Free transferability of interests.** (1) An organization has the corporate characteristic of free transferability of interests if each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member of the organization. In order for this power of substitution to exist in the corporate sense, the member must be able, without the consent of other members, to confer upon his substitute all the attributes of his interest in the organization. Thus, the characteristic of free transferability of interests does not exist in a case in which each member can, without the consent of other members, assign only his right to share in profits but cannot so assign his rights to participate in the management of the organization. Furthermore, although the agreement

provides for the transfer of a member's interest, there is no power of substitution and no free transferability of interest if under local law a transfer of a member's interest results in the dissolution of the old organization and the formation of a new organization.

(2) If each member of an organization can transfer his interest to a person who is not a member of the organization only after having offered such interest to the other members at its fair market value, it will be recognized that a modified form of free transferability of interests exists. In determining the classification of an organization, the presence of this modified corporate characteristic will be accorded less significance than if such characteristic were present in an unmodified form.

(f) **Cross reference.** See paragraph (b) of § 301.7701-3 for the application to limited partnerships of the rules relating to corporate characteristics.

(g) **Examples.** The application of the rules described in this section may be illustrated by the following examples:

Example (1). (Deleted)

Example (2). A group of seven doctors forms a clinic for the purpose of furnishing, for profit, medical and surgical services to the public. They each transfer assets to the clinic, and their agreement provides that except upon complete liquidation of the organization on the vote of three-fourths of its members, no member has any individual interest in its assets. Their agreement also provides that neither the death, insanity, bankruptcy, retirement, resignation, nor expulsion of a member shall cause the dissolution of the organization. However, under the applicable local law, a member who withdraws does have the power to dissolve the organization. While the agreement provides that the management of the clinic is to be vested exclusively in an executive committee of four members elected by all the members, this provision is ineffective as against outsiders who had no notice of it; and therefore, the act of any member within the scope of the organization's business binds the organization insofar as such outsiders are concerned. While the agreement declares that each individual doctor alone is liable for acts of malpractice, members of the clinic are, nevertheless, personally liable for all debts of the clinic including claims based on malpractice. No member has the right, without the consent of all the other members, to transfer his interest to a doctor who is not a member of the clinic. The organization has associates and an objective to carry on business and divide the gains therefrom. However, it does not have the corporate characteristics of continuity of life, centralized management, limited liability, and free transferability of interests. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (3). A group of twenty-five lawyers forms an organization for the purpose of furnishing, for profit, legal services to the public.

Their agreement provides that the organization will dissolve upon the death, insanity, bankruptcy, retirement, or expulsion of a member. While their agreement provides that the management of the organization is to be vested exclusively in an executive committee of five members elected by all the members, this provision is ineffective as against outsiders who had no notice of it; and, therefore, the act of any member within the scope of the organization's business binds the organization insofar as such outsiders are concerned. Members of the organization are personally liable for all debts, or claims against, the organization. No member has the right, without the consent of all the other members, to transfer his interest to a lawyer who is not a member of the organization. The organization has associates and an objective to carry on business and divide the gains therefrom. However, the four corporate characteristics of limited liability, centralized management, free transferability of interests, and continuity of life are absent in this case. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (4). A group of twenty-five persons forms an organization for the purpose of engaging in real estate investment activities. Each member has the power to dissolve the organization at any time. The management of the organization is vested exclusively in an executive committee of five members elected by all the members, and under the applicable local law, no one acting without the authority of this committee has the power to bind the organization by his acts. Under the applicable local law, each member is personally liable for the obligations of the organization. Every member has the right to transfer his interest to a person who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains therefrom. While the organization does have the characteristics of centralized management and a modified form of free transferability of interests, it does not have the corporate characteristics of continuity of life and limited liability. Under the circumstances presented, the organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (5). A group of twenty-five persons forms an organization for the purpose of engaging in real estate investment activities. Under their agreement, the organization is to have a life of twenty years, and under the applicable local law, no member has the power to dissolve the organization prior to the expiration of that period. The management of the organization is vested exclusively in an executive committee of five members elected by all the members, and under the applicable local law no one acting without the authority of this committee has the power to bind the organization by his acts. Under the applicable local law, each member is personally liable for the obligations of the organization. Every member has the right to transfer his interest to a person who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains therefrom. While the or-

Internal Revenue Code references are identical with 26 U.S.C.A. (I.R.C.1954) sections

ganization does not have the corporate characteristic of limited liability, it does have continuity of life, centralized management, and a modified form of free transferability of interests. The organization will be classified as an association for all purposes of the Internal Revenue Code.

Example (6). A group of twenty-five persons forms an organization for purposes of engaging in real estate investment activities. Each member has the power to dissolve the organization at any time. The management of the organization is vested exclusively in an executive committee of five members elected by all the members, and under the applicable local law, no one acting without the authority of this committee has the power to bind the organization by his acts. Under the applicable local law, the liability of each member for the obligations of the organization is limited to paid and subscribed capital. Every member has the right to transfer his interest to a person who is not a member of the organization, but he must first advise the organization of the proposed transfer and give it the opportunity on a vote of the majority to purchase the interest at its fair market value. The organization has associates and an objective to carry on business and divide the gains therefrom. While the organization does not have the characteristic of continuity of life, it does have limited liability, centralized management, and a modified form of free transferability of interests. The organization will be classified as an association for all purposes of the Internal Revenue Code.

Example (7). A group of twenty-five persons forms an organization for the purpose of investing in securities so as to educate the members in principles and techniques of investment practices and to share the income from such investments. While the agreement states that the organization will operate until terminated by a three-fourths vote of the total membership and will not terminate upon the withdrawal or death of any member, under the applicable local law, a member has the power to dissolve the organization at any time. The business of the organization is carried on by the members at regular monthly meetings and buy or sell action may be taken only when voted by a majority of the organization's membership present. Elected officers perform only ministerial functions such as presiding at meetings and carrying out the directions of the members. Members of the organization are personally liable for all debts of, or claims against, the organization. No member may transfer his membership. The organization has associates and an objective to carry on business and divide the gains therefrom. However, the organization does not have the corporate characteristics of limited liability, free transferability of interests, continuity of life, and centralized management. The organization will be treated as a partnership for all purposes of the Internal Revenue Code.

(h) Classification of professional service organizations. (1) (i) A professional service organization is treated as a corporation (or as an association and, therefore, taxable as a corporation) only if it has sufficient corporate characteristics to be classifiable as a corporation under paragraph (a) of this section, rather than as a partnership or proprietorship. For purposes of deter-

mining the classification of an organization under these regulations, the term "professional service organization," as used in this paragraph, means an organization formed by one or more persons to engage in a business involving the performance of professional services for profit which under local law, may not be organized and operated in the form of an ordinary business corporation having the usual characteristics of such a corporation. Thus, even if a professional service organization is organized as an ordinary business corporation, this paragraph applies if such corporation is subject to local regulatory rules which deprive such corporation of the usual characteristics of an ordinary business corporation. This paragraph applies irrespective of whether an organization is labeled under local law as a professional service corporation, a professional service association, a trust, or otherwise.

(ii) In determining whether a professional service organization has the major characteristics ordinarily found in a business corporation and whether any other significant factors are to be taken into account in classifying the organization, the special professional requirements of the profession engaged in by the members of the organization must be taken into consideration. Although such an organization may have associates and is engaged in business for profit, the relationships of the members of such an organization to each other as well as their relationships to employees, to clients, patients, or customers and to the public are inherently different from the relationships characteristic of an ordinary business corporation. In determining the nature of these relationships, consideration must be given to the law under which the organization is formed, the character, articles of association, bylaws, or other documents relating to the formation of the organization, and all other facts and rules governing or pertaining to such relationships in the usual course of the practice of the profession of the participants.

(2) A professional service organization does not have continuity of life within the meaning of paragraph (b) of this section if the death, insanity, bankruptcy, retirement, resignation, expulsion, professional disqualification, or election to inconsistent public office of any member will (determined without

regard to any agreement among the members) cause under local law the dissolution of the organization. A business corporation has a continuing identity as an entity which is not dependent upon a shareholder's active participation in any capacity in the production of the income of the corporation. Furthermore, the interest of a shareholder in an ordinary business corporation includes a right to share in the profits of the corporation, and such right is not legally dependent (determined without regard to any agreement among the shareholders) upon his participation in the production of the corporation's income. However, the interest of a member of a professional service organization generally is inextricably bound to the establishment and continuance of an employment relationship with the organization, and he cannot share in the profits of a professional service organization unless he also shares in the performance of the services rendered by the organization. For purposes of this paragraph, the term "employment relationship" is used to describe such active participation by the member and is not restricted to the common-law meaning of such term. If local law, applicable regulations, or professional ethics do not permit a member of a professional service organization to share in its profits unless an employment relationship exists between him and the organization, and if in such case, he or his estate is required to dispose of his interest in the organization if the employment relationship terminates, the continuing existence of the organization depends upon the willingness of its remaining members, if any, either to agree, by prior arrangement or at the time of such termination, to acquire his interest or to employ his proposed successor. The continued existence of such a professional service organization is similar to that of a partnership formed under the Uniform Partnership Act, whose business continues pursuant to an agreement providing that the business will be continued by the remaining members after the withdrawal or death of a partner (see paragraph (b) of this section), and is essentially different from the continuity of life possessed by an ordinary business corporation. Consequently, such a professional service organization lacks continuity of life.

(3) In applying the rules of paragraph (c) of this section, relating to

centralization of management, a professional service organization does not have centralization of management where the managers of a professional service organization under local law are not vested with the continuing exclusive authority to determine any one or more of the following matters: (i) The hiring and firing of professional members of the organization and its professional and lay employees, (ii) the compensation of the members and of such employees, (iii) the conditions of employment—such as working hours, vacation periods, and sick leave, (iv) the persons who will be accepted as clients or patients, (v) who will handle each individual case or matter, (vi) the professional policies and procedures to be followed in handling each individual case, (vii) the fees to be charged by the organization, (viii) the nature of the records to be kept, their use, and their disposition, and (ix) the times and amounts of distributions of the earnings of the organization to its members as such. Moreover, although a measure of central control may exist in a professional service organization, the managers of a professional service organization in which a member retains traditional professional responsibility cannot have the continuing exclusive authority to determine all of the matters described in the preceding sentence. Instead, such measure of central control is no more than that existing in an ordinary large professional partnership which has one or more so-called managing partners and in which a member retains the traditional professional autonomy with respect to professional decisions and the traditional responsibility of a professional person to the client or patient. Such measure of central control is essentially different from the centralization of management existing in an ordinary business corporation. Therefore, centralization of management does not exist in such a professional service organization.

(4) A professional service organization has the corporate characteristic of limited liability within the meaning of paragraph (d) of this section only if the personal liability of its members, in their capacity as members of the organization, is no greater in any aspect than that of shareholder-employees of an ordinary business corporation. If under local law and the rules pertaining to professional practice, a mutual

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§ 301.7701-2 PROCEDURE AND ADMINISTRATION

agency relationship, similar to that existing in an ordinary professional partnership, exists between the members of a professional service organization, such organization lacks the corporate characteristic of limited liability.

(5) (i) If the right of a member of a professional service organization to share in its profits is dependent upon the existence of an employment relationship between him and the organization, free transferability of interests within the meaning of paragraph (e) of this section exists only if the member, without the consent of other members, may transfer both the right to share in the profits of the organization and the right to an employment relationship with the organization.

(ii) The corporate characteristic of free transferability of interests exists in a modified form within the meaning of paragraph (e) (2) of this section when a shareholder in an ordinary business corporation can transfer his interest in such corporation only after having offered such interest to the other shareholders at its fair market value. In such a case, the so-called right of first refusal applies only to an interest which is a right to share in the profits, the assets, and the management of the enterprise. However, if the interest of a member of a professional service organization constitutes a right to share in the profits of the organization which is contingent upon and inseparable from the member's continuing employment relationship with the organization, and the transfer of such interest is subject to a right of first refusal, such interest is subject to a power in the other members of the organization to determine not only the individuals whom the organization is to employ, but also who may share with them in the profits of the organization. The possession by other members of the power to determine, in connection with the transfer of such an interest, whom the organization is to employ is so substantial a hindrance upon the free transferability of interests in the organization that such power precludes the existence of a modified form of free transferability of interests. Therefore, if a member of a professional service organization who possesses such an interest may transfer his interest to a qualified person who is not a member of the organi-

zation only after having first offered his interest to the other members of the organization at its fair market value, the corporate characteristic of free transferability of interests does not exist.

Added Nov. 3, 1967, 22 F.R. 15241.

§ 301.7701-3 Partnerships

(a) In general. The term "partnership" is broader in scope than the common law meaning of partnership and may include groups not commonly called partnerships. Thus, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation or a trust or estate within the meaning of the Internal Revenue Code of 1954. A joint undertaking merely to share expenses is not a partnership. For example, if two or more persons jointly construct a ditch merely to drain surface water from their properties, they are not partners. Mere co-ownership of property which is maintained, kept in repair, and rented or leased does not constitute a partnership. For example, if an individual owner, or tenants in common, of farm property lease it to a farmer for a cash rental or a share of the crops, they do not necessarily create a partnership thereby. Tenants in common, however, may be partners if they actively carry on a trade, business, financial operation, or venture and divide the profits thereof. For example, a partnership exists if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent.

(b) Limited partnerships—(1) In general. An organization which qualifies as a limited partnership under State law may be classified for purposes of the Internal Revenue Code as an ordinary partnership or as an association. Such a limited partnership will be treated as an association if, applying the principles set forth in § 301.7701-2, the organization more nearly resembles a corporation than an ordinary partnership or other business entity.

(2) Examples. The principles of this paragraph may be illustrated by the following examples:

Example (1). Three individuals form an organization which qualifies as a limited partnership under the laws of the State in which the organization was formed. The purpose of the organization is to acquire and operate various pieces of commercial and other investment property for profit. Each of the three individuals who are general partners invests \$100,000 in the enterprise. Five million dollars of additional capital is raised through contributions of \$100,000 or more by each of thirty limited partners. The three general partners are personally capable of assuming a substantial part of the obligations to be incurred by the organization. While a limited partner may assign his right to receive a share of the profits and a return of his contribution, his assignee does not become a substituted limited partner except with the unanimous consent of the general partners. The life of the organization as stated in the certificate is 20 years, but the death, insanity, or retirement of a general partner prior to the expiration of the 20-year period will dissolve the organization. The general partners have exclusive authority to manage the affairs of the organization but can act only upon the unanimous consent of all of them. The organization has associates and an objective to carry on business and divide the gains therefrom, which characterize both partnerships and corporations. While the organization has the corporate characteristic of centralized management, since substantially all of the interests in the organization are owned by the limited partners, it does not have the characteristics of continuity of life, free transferability of interests, or limited liability. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

Example (2). Three individuals form an organization which qualifies as a limited partnership under the laws of the State in which the organization was formed. The purpose of the organization is to acquire and operate various pieces of commercial and other investment property for profit. The certificate provides that the life of the organization is to be 10 years, unless a general partner dies, becomes insane, or retires during such period. On the occurrence of such death, insanity, or retirement, the remaining general partners may continue the business of the partnership for the balance of the 10-year period under a right so to do stated in the certificate. Each of the three individuals who is a general partner invests \$50,000 in the enterprise and has means to satisfy the business obligations of the organization to a substantial extent. Five million dollars of additional capital is raised through the sale of freely transferable interests in amounts of \$10,000 or less to limited partners. Nine hundred such interests are sold. The interests of the 900 limited partners are fully transferable, that is, a transferee acquires all the attributes of the transferor's interest in the organization. The general partners have exclusive control over management of the business, their interests are not transferable, and their liability for debts of the organization is not limited to their capital contributions. The organization has associates and an objective to carry on business and divide the gains therefrom. It does not have the corporate characteristics of limited liability and continuity of life. It has centralized management, however, since the three general partners exercise exclusive control over the management of the business, and since substantially all of the interests in the organization are

owned by the limited partners. While the interests of the general partners are not transferable, the transferability test of an association is met since substantially all of the interests in the organization are represented by transferable interests. The organization will be classified as a partnership for all purposes of the Internal Revenue Code.

(c) Partnership associations. The laws of a number of States provide for the formation of organizations commonly known as partnership associations. Such a partnership association will be treated as an association if, applying the principles set forth in § 301.7701-2, the organization more nearly resembles a corporation than the other types of business entities.

(d) Partner. The term "partner" means a member of a partnership. Added Nov. 3, 1967, 32 F.R. 15241.

§ 301.7701-4 Trusts

(a) Ordinary trusts. In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

(b) Business trusts. There are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of

Internal Revenue Code references are identical with 26 U.S.C.A. (I.R.C.1954) sections

file
limited
liability

Continental

Other Proposals

1. obligation to public

270
1. limit size
2. limiting control
on award

1 3 2 6 1
383
485 | 1,856,508
1455
4015
3880
1358
1455

3,800

185,000

6000

1. Income - Clinic Average per physician
2. Average premium
3. Who owns clinic - What percentage of physician clinic



D. Rodriguez

Vern GATES