SB
347

95TH STORY of Level 1 printed in FULL format.

Copyright 1993 The New York Times Company
The New York Times

June 19, 1993, Saturday, Late Edition - Final

SECTION: Section 1; Page 34; Column 1; Financial Desk; Your Money Page

LENGTH: 575 words

HEADLINE: TAXES;
The Many Advantages Of a Hybrid Company

BYLINE: By Jan M. Rosen

BODY

NEW YORK and New Jersey are expected to enact legislation soon allowing privately owned businesses and partnerships to organize as limited liability companies, which combine the tax advantages of a partnership with the legal protection of incorporation.

California and a dozen other states are considering similar proposals, and 31 states already recognize limited liability companies -- so named because liability for such things as legal judgments against a company or bankruptcy are limited to the entity's assets like a corporation. These businesses do not put their owners' personal assets at risk beyond their original investment.

"It's the wave of the future; it provides more flexibility with protection from liability," said Assemblywoman Harriet Derman, Republican of Metuchen, who is sponsoring the measure in New Jersey and expects passage this month.

Accounting firms, for example, are eager to avoid a repeat of "the fiasco when Laventhol & Horwath went under," and partners were personally liable for millions of dollars owed by the partnership, she said. That bankruptcy, which led to a snarl of litigation, caused some managers of other firms to voice doubts about accepting partnerships, if offered.

Kenneth J. Norcross, a partner in Pitney, Hardin, Kipp & Szuch in Morristown, N.J., said that limited liability companies could be useful for "everything from new ventures at A.T.& T. down to the corner deli."

With partnerships, income and losses flow directly to the partners, avoiding corporate taxation, but partners' personal assets can be at risk for their firm's liabilities.
To protect themselves from liability, business owners can incorporate. But they will face Federal corporate taxation unless the business meets the rigorous requirements for an S corporation: no more than 35 partners, no foreign partners and only one class of stock.

Family businesses often want two classes of stock, voting shares for the family members active in the business and nonvoting for those who are not. Thus, they are precluded from a S corporation, but they could set up a limited liability company.

LEXIS·NEXIS LEXIS·NEXIS LEXIS·NEXIS
Services of Mead Data Central, Inc.
- ARTICLES ON LIMITED LIABILITY COMPANIES

Most existing corporations are not likely to want to convert, Mr. Norcross said, because they would face "an exit tax" for dissolving their current incorporation.

He predicts, however, that when the legislation passes in New York, New Jersey and California -- all important states for business -- there will be a rush to adopt the new form, which is already permitted in other big business states, including Illinois, Texas, Florida and Delaware.

Brian L. Schorr, a partner in Paul, Weiss, Rifkind, Wharton & Garrison, and co-chairman of a drafting committee for the measure pending in Albany, said, "I think it has broad application in real estate, joint ventures, atrical investments, high technology and venture capital," as well as oil and gas, replacing both actively managed partnerships and passive investment partnerships. However, attention should be given the state tax treatment of limited liability companies, Mr. Schorr said.

The measures pending in New York and New Jersey, like the one recently adopted in Delaware, are flexible, allowing businesses to tailor their limited liability companies for their own purposes, Mr. Schorr pointed out. But to qualify for the same tax breaks as partnerships, he cautioned, the limited liability companies must comply with Internal Revenue Service requirements.

SUBJECT: CORPORATIONS; PARTNERSHIPS

NAME: ROSEN, JAN M

GEOGRAPHIC: NEW YORK STATE; NEW JERSEY

WALL STREET JOURNAL TUESDAY, MAY 14, 1991

Partnership, Corporation Aren't Only Ways to Start Out

Forming as a Limited Liability Company Offers Best of Both Worlds

By JEFFREY A. TANNENBAUM
Staff Reporter of THE WALL STREET JOURNAL

Robert H. Kane's start-up enterprise is a mouthful: Octagon Communications Limited Liability Co.

The name doesn't exactly have a ring to it. It's rather awkward on stationery and business cards. It even fails to convey the company's intended business: investments in rural cellular-telephone companies.

But loud and clear, the name conveys something else: a new form of ownership that Mr. Kane and his seven partners expect will serve them well. Their enterprise—to be based in Denver—is neither a traditional partnership nor a traditional corporation. Rather, under Colorado law, it is a "limited liability company," or LLC.

Growing Interest

Mr. Kane and his partners expect to enjoy the best of both worlds: the tax advantages of a partnership and the legal safeguards of a corporation. Yet they face none of the drawbacks associated with forming a so-called subchapter S corporation, which also is taxed much like a partnership. For example, S corporations can't have corporate shareholders, but LLCs can. "If some corporation ever wants to offer me jillions of dollars for my interest, I'll be able to sell it," Mr. Kane says.

Not yet worth jillions, Octagon doesn't even have an office. But it is in the forefront of a movement toward the LLC as a form of ownership for small U.S. businesses and joint ventures. "Interest in the LLC concept is growing remarkably fast," says John R. Maxfield, a Denver lawyer who helped write the LLC law there.

Fast, anyway, by the slow-paced standards of lawmaking. In 1977, Wyoming became the first state to authorize LLCs, but it took until 1988 for the Internal Revenue Service to confirm that the new Wyoming entities would be treated as partnerships for federal tax purposes.

To date, only five other states—Colorado, Florida, Kansas, Virginia and, most recently, Utah—have followed Wyoming in authorizing their own LLCs, according to an American Bar Association survey. But lawyers in many other states report growing interest because of the IRS ruling. Two ABA panels are studying the topic, as is the National Conference of Commissioners on Uniform State Laws, a group allied with the ABA. Meantime, moves are afoot to introduce LLC statutes in Arizona, Illinois, Maryland, Michigan, Nevada, Ohio, Oklahoma and Texas, the ABA survey found.

"I'm stunned by the amount of excitement generated by these entities," says Barbara C. Spudis, a Chicago attorney and the head of one ABA panel on LLCs.

Flexibility of a Partnership

One appeal of LLCs is that, as with partnerships, any income flows through untaxed to the individual owners. Such owners don't avoid personal taxes, but they do avoid corporate taxes. Regular corporations face higher maximum taxes in the first place. And if the corporations pay dividends, owners are taxed again.

Of course, S corporations avoid double taxation—but they don't enjoy all the advantages of partnerships when it comes to juggling income and deductions. For example, the 20%-owner of an S corporation normally must pay taxes on 20% of any income. By contrast, partnership members are free to divvy up any income and tax liability as they see fit. Thus, equal partners might change the allocations of profit or loss year to year to fit their individual tax needs. LLCs offer the same freedom.

With LLCs, as with regular corporations, only the company's assets, and not the owners' personal assets, are at risk in business-related lawsuits. In partnerships, so-called limited partners enjoy such protection, but general partners don't. And limited partners face restrictions on how active they can be in the business. LLCs are designed to protect all partners while imposing no limits on their activity.

Not surprisingly, lawyers in a few states say LLCs are an easy sell. Since Colorado's LLC statute went into effect in April 1990, 250 LLCs have been organized there, an official says. Forming an LLC usually costs $1,000 to $5,000 in attorney and filing fees, depending on complexity, says Mr. Maxfield, the Denver lawyer.

But some state programs have drawbacks. Florida LLCs are exempt from federal corporate taxes but subject to the state's 5.5% corporate-income tax. Since Florida has no personal income tax affecting partnership income, "that 5.5% is enough to scare people off," says Jose M. Sariego, a Miami lawyer.

Moreover, the IRS has yet to give its imprimatur to any state LLC program except Wyoming's, though a few LLCs elsewhere have gotten favorable private-letter rulings. And lawyers say it's unclear how enterprises treated as LLCs in their home states will be treated in states without LLC laws. Of the states without LLCs, Indiana alone explicitly recognizes LLCs organized elsewhere. "There has been no litigation on LLCs," says Robert R. Keatinge, a Colorado lawyer who heads the other ABA panel on LLCs. "And nobody wants to be the test case."

Benefit for Foreigners

Still, proponents say the LLC raises little risk for enterprises operating only in their home state or outside the U.S. And it's ideal for foreign investors—normally barred from S corporations.

LLCs don't limit the number or type of owners, as S corporations do, except for a two-owner minimum. But because of other restrictions, only closely held enterprises are suited to be LLCs. For example, if any owner leaves, the others must all formally agree to keep the enterprise going. "If you have 200 members, it's hard to get everybody to sign off on anything," Mr. Keatinge says.

But even closely held companies face uncertainties on a number of technical and procedural issues, such as whether the conversion of a partnership into an LLC amounts to a "termination" under tax law, which might increase tax liability. IRS rulings are still awaited. In the meantime, warns Ms. Spudis, the Chicago lawyer, many LLC investors are entering uncharted territory.

INTRODUCING THE

Limited Liability Companies: Gaining Momentum

By Thomas Earl Geu

The limited liability company (LLC), a unique and relatively new form of unincorporated business organization, is available by statute in 24 states and is being considered to some extent in almost every other jurisdiction. An LLC is a hybrid form of business created by combining the organizational and tax attributes of partnerships and corporations in a unique mix.

In many respects the LLC resembles its organizational cousin, the limited partnership, because it may qualify for partnership "flow through" federal income taxation while retaining limited liability for its members. Unlike a limited partnership, however, an LLC is not required to have a general partner with "unlimited" liability. In that regard the LLC more closely resembles the S corporation, which also approximates the "flow through" income taxation. Conceptually, therefore, the LLC may be analogized under existing law to a combination entity consisting of a limited partnership with an S corporation general partner. The LLC, however, carries much less tax and organizational baggage and complexity than a *combination* entity. In short, the LLC seems to be an efficient and flexible form of business that allows its members both limited liability and partnership federal income tax treatment.

Origins: The Limitada Model

LLCs are also similar, and owe their origin, to other types of recognized business organizations. For example, the legislative history of the seminal 1977 Wyoming LLC act expressly compared the LLC to the partnership association adopted in Pennsylvania in 1874, in Michigan in 1877 and in several other states. The LLC is also similar to "limitada," a Latin American business form that in turn is similar to the German GmbH.

Partnership associations largely became extinct as viable business entities because they generally placed a cap on the maximum number of members; suffered from the lack of widespread availability of enabling or registration provisions to facilitate interstate business; and, after the advent of the federal income tax, suffered from uncertain tax treatment.

The limitada, by contrast, was viable in foreign jurisdictions when Wyoming adopted its LLC act in 1977; and its viability continues today. The attributes of the limitada generally include management by an "administrator"; limited liability; and continuous life for at least 20 years without limitation by death, separation or dissociation of its members.

The limitada was, in fact, the genesis for the original Wyoming legislation, which was prompted by the request of an oil company to make the benefits of the limitada available in this country. The limitada was also important in Florida's enactment of the second LLC act. The Florida legislative committee examining the act heard testimony that the LLC would encourage international investment from Central and South America by giving investors from that region a familiar investment vehicle in the United States. Thus the LLC, at least in a sense, evolved from the old partnership association in the United States, and its development was encouraged by the success of limitadas and similar organizations in the western hemisphere and in other civil law nations such as France, Germany, Greece and Saudi Arabia.

Neither Wyoming nor Florida LLCs were immediately popular with business planners. Only two Florida LLCs were formed in the first year after enactment of enabling legislation. Wyoming LLCs formed at an average rate of only three a year between 1978 and 1988. In 1988, however, the IRS issued Rev. Rul. 88-76, which classified a Wyoming LLC as a partnership for federal tax purposes. Since the issuance of Rev. Rul. 88-76, neither the IRS nor state legislatures have looked back. Two states adopted LLC acts in 1990, four in 1991, 10 in 1992, and legislation has been introduced in more than 20 states in 1993. The increase in the number of states

"Thus the LLC, at least in a sense, evolved from the old partnership association in the United States, and its development was encouraged by the success of limitadas and similar organizations in the western hemisphere and in other civil law nations such as France, Germany, Greece and Saudi Arabia."

adopting LLC legislation led the National Conference of Commissioners on Uniform State Laws (NCCUSL) to appoint a committee to draft a uniform LLC law, which could be approved as early as August 1994.

Federal Income Tax Classification

One way to understand the LLC is to look at the criteria that distinguish an organization taxed as a partnership from an organization taxed as a corporation (an "association" in tax classification parlance). In addition to an aid in understanding the LLC, tax classification is a critical factor in entity choice.

The primary source for determining whether a business organization will be taxed as a partnership or a corporation is Treas. Reg. § 301.7701, which lists six basic characteristics usually found in corporations: (1) associates (members), (2) an objective to carry on business and to divide the gains therefrom, (3) continuity of life, (4) centralized management, (5) liability for debts limited to corporate property and (6) free transferability of interests. The first two "major characteristics" are common to both partnerships and corporations and are ignored in distinguishing the two entities.

To be classified as a corporation for federal income tax purposes, an organization must have at least three of the last four characteristics. To be classified as a partnership, therefore, the LLC must *fail* at least two of the four tests for corporations.

- **Continuity of life.** An organization lacks continuity of life, according to Treas. Reg. § 301.7701-2(b), if the death, insanity, retirement, resignation or expulsion of any member of a general partnership, or of the general partner of a limited partnership, causes a dissolution. The fact that the remaining members may agree to continue the partnership does not necessarily mean that the organization possesses continuity of life. The continuity of life standard was applied to a Wyoming LLC in Rev. Rul. 88-76 and the IRS ruled that the LLC lacked continuity of life.

The Wyoming LLC statute provided that the LLC dissolved at the death, retirement, resignation, bankruptcy, expulsion, dissolution or any other event terminating a member's membership unless *all* remaining members consented to continue the business under a right to do so stated in the organizational documents. Newly proposed tax regulations, however, would allow a majority (rather than all) of the remaining general or limited partners in a limited partnership to continue business after a dissolution event involving a general partner without that organization being deemed to have continuity of life. Presumably the same rule would apply to an LLC classified as a partnership for tax purposes.

- **Free transferability of interests.** Federal regulations provide that free transferability of interests exists if substantially all of the complete interests in the partnership, including governance and economic rights, can be transferred "without the consent of other members." The regulatory language does not require all other members to consent to the transfer. As a result the IRS informally has ruled in PLR 9210019 that a Texas LLC requiring only the majority vote of the other members to transfer a "complete interest" lacked free transferability.

- **Centralized management.** Centralized management exists if a group that does not include all members has the exclusive authority to make management decisions on behalf of all members. The Wyoming LLC in Rev. Rul. 88-76 vested management in three of 25 members. Therefore the IRS ruled that the LLC had centralized management.

Recent LLC rulings help to define the parameters of centralized management. In Rev. Rul. 93-6 (Colorado), the IRS ruled that centralized management existed in a five member LLC, where all five members were elected managers. The IRS reasoned that the act vested management authority in managers rather than members and, thus, that membership alone did not permit management authority. Therefore, the five "managers" constituted centralized management even though the "managers" were also the only members of the LLC. Further, in Rev. Rul. 93-5 (Virginia) the IRS stated that centralized management could result from the use of various techniques

that concentrate power in fewer than all members. The ruling identified the use of proxies as among the several techniques that can result in centralized management.

• **Limited liability.** Almost by definition, and in almost all cases by express design, an LLC will possess limited liability. In most cases limited liability is one of the reasons for organizing an entity as a limited liability company. The regulations state that an organization possesses limited liability if no member is personally liable for debts or claims against the LLC.

Based on these four "major characteristics," it is relatively easy to obtain partnership classification of an LLC for federal income tax purposes. The importance of the tax factors to the LLC form of business has led to a variety of approaches to drafting statutes. These approaches are usually labeled either "bulletproof" or "flexible." Bulletproof statutes *mandate* failure of at least two of the four major corporate tax attributes, most commonly continuity of life and free transferability.

Flexible statutes, by contrast, allow the members to pick and choose which tax classification characteristics they want the LLC to fail. Thus, LLC's organized in compliance with flexible statutes grant the members discretion in structuring the LLC. LLCs organized under flexible statutes, however, will not "automatically" meet the partnership classification requirements. Nonetheless, even flexible statutes provide "default" provisions that will govern in the absence of agreement to the contrary. These default provisions *usually* result in partnership classification. Obviously, planners in states that have flexible statutes must be very careful to structure the LLC so that it qualifies as a partnership for federal income tax purposes if such treatment is important to the members of the LLC.

Partnership Taxation Advantages

Although a comparison of S corporation taxation and partnership taxation is beyond the scope of this article, a basic understanding of a few of the tax differences is necessary to understand when to use an LLC instead of an S corporation. Two of the big advantages of partnership taxation when compared to S corporations are eligibility and special allocations.

The S corporation eligibility requirements are very specific and severely limit the businesses that may avail themselves of S status. The most important of these eligibility requirements are the requirements that only domestic corporations (those formed in the United States) qualify for S status, that S corporations have no more than 35 shareholders, that each shareholder be an individual or a limited type of trust (a qualifying trust), that none of the shareholders is a nonresident alien, that the corporation have only one class of stock, and that the corporation timely elect and file to be taxed as an S corporation.

Although perfection of the election might seem perfunctory, complications may arise because the statute governs both when and by whom the election must be made. S status terminates whenever any of the eligibility requirements cease to be met. This could occur, for example, when the 35 member limitation bumps into a second or third generation estate plan, when a decedent fails to craft a trust as a qualifying trust or when it is necessary to seek more equity capital for a growing concern. Limitations exist on the percentage amount of passive revenue that may be received by an S corporation before risking termination. Limited liability companies do not suffer from these limitations when they are taxed as partnerships.

Another major advantage of partnership taxation, compared to S corporation taxation, is that income and loss my be specially allocated to different partners (within statutory parameters). S corporation shareholders must receive their pro rata share of the corporation's income and loss. The availability of the special allocation is probably most important in capital intensive organizations, including real estate transactions, where pass-through loss treatment may be an important factor in the investment decision.

Other differences between the federal income taxation of S corporations and partnerships include different tax treatment on liquidation and basis treatment of a member's or shareholder's debt.

Unfortunately, tax questions arise when an LLC is classified as a partnership, in part because several tax issues turn on the distinction between general and limited partners. The distinction between general and limited partners creates interpretive questions because an LLC member is neither a limited nor a general partner. There are also unresolved tax issues concerning accounting method, passive loss limitations, at-risk limitations, the unified audit rules, and self-employment taxes. Even so, the combination of partnership tax treatment and organizational flexibility are generally viewed as advantages of the LLC compared to the S corporation, and in many instances these more sophisticated tax issues will not be determinative of entity choice.

Estate and gift tax valuation issues also may be important in the selection of an entity for a closely held (especially family) business. The troublesome valuation issues that arise in the use of other organizations also exist for LLC use. One of the valuation pressure points, for example, is IRC § 2704(b), a successor to the old anti-freeze § 2036(c). Section 2704(b) imposes valuation limitations in the family business setting when there are greater liquidation restrictions by agreement than according to state law. This places a premium on the careful crafting of the LLC. Further, administrative rulings like Rev. Rul. 93-12, which deals with minority discount, would apply by analogy to the LLC.

Finally, state tax treatment of LLCs may be important in entity selection. Indeed, state revenue loss projections because of LLCs have been hotly contested in many state legislatures. Revenue projections may vary widely, depending on the assumptions used

"One problem with the use of LLCs is their 'extra-territorial' use in multi-state business. Fortunately, this problem is becoming less important as more states adopt LLC legislation that provides for registration of foreign LLCs."

concerning which entities will choose or convert to the LLC form. A lack of uniformity characterizes the state tax treatment of LLCs. Several states simply mirror the federal income tax scheme and classify LLCs as partnerships for state tax purposes. Delaware, Minnesota and other states require LLCs to pay a minimum annual filing fee or tax. Florida and Texas tax LLCs essentially as corporations under their income or business franchise taxes. In other states, like Illinois, the taxing structure is more complicated and somewhat ambiguous.

Multi-State LLC Operations

One problem with the use of LLCs is their "extra-territorial" use in multi-state business. Fortunately, this problem is becoming less important as more states adopt LLC legislation that provides for registration of foreign LLCs. When an LLC does business in a state that does not statutorily recognize LLCs, a risk exists that the forum (non-adopting) state will not recognize the limited liability of the LLC granted by the adopting state.

"Comity," as a general matter, requires the forum state to recognize and admit the operation of the laws of the domiciliary state (the state of organization) when those laws are not contrary to its own public policy. Matters of comity, therefore, often involve difficult policy issues unique to the forum state. Two lines of reasoning exist to resolve the problem:

• The forum state may recognize the limited liability of the LLC because it already recognizes by statute the limited liability of corporations and limited partnerships.

• The forum state may reason that the public policy of the state is to grant limited liability only by express statute and, in the absence of statute, that the forum state does not recognize the limited liability of LLCs. Ultimate resolution of this "comity" issue also may involve general conflicts of laws, full faith and credit, due process and the commerce clause.

State Operating Provisions and Choice of Entity

The various state LLC acts address the same organizational issues addressed by statutes governing other business organizations. LLC statutes, for example, address formation, contributions, filing, agency powers of members, governance rights of members, liability of members, organizational record and information requirements, sharing and allocation of profits and losses, the identification of dissolution events, effect of occurrence of dissolution events, and rights on liquidation. Because of the present lack of uniformity in state LLC acts, it is not possible to state general principles that apply in every state. However, a common statutory LLC pattern does exist:

1. Almost all state acts provide for two organizational documents, usually identified as the "articles of organization" and the "operating agreement." The authoritative weight given these documents is consistent with flexibility, one of the hallmarks of the LLC. As a result, many matters may be agreed on by the members. A trend may be developing that the operating agreement serves as the basic organizational document (like the limited partnership agreement) and the articles serve only a notice function (like the certificate of limited partnership). Several states more closely follow the corporate model, however, under which the articles play a far greater role in the hierarchy of authority than that just described.

2. Except in a few states, governance and agency authority is vested in the members unless otherwise provided in the organizational documents. The documents usually may vest governance in either "managers" or in "members."

3. The statutes provide for dissolution on the happening of specified events and at the end of a term of years (usually 30). Whether the parties may continue the business after dissolution or may avoid dissolution altogether is uniquely a matter of the particular state law and also has federal income tax implications.

4. Upon dissolution or withdrawal of a member, the statutes provide for a "buy-out" or "put" of that membership interest, much like that afforded by the Revised Uniform Limited Partnership Act.

5. States have treated voting and profit sharing either on the basis of membership (one person/one vote, per capita) or on the ratio of the

member's original contribution or capital account to the total original contribution or the total capital accounts of all members (pro rata). Again, the voting and profit sharing arrangements may vary in the LLC documents.

6. One of the most important state law LLC attributes is the limited liability of members. Particularly in LLCs with a small membership, however, there are several ways this advantage may be nullified in the normal course of business, much as limited liability is subject to nullification in the close corporation context. Tort liability, for example, will accrue to any individual member who has personal responsibility in the commission of the tort. Contract liability for the debts of the organization is often dealt with contractually by using guarantees and similar arrangements. "Piercing the veil" issues, although generally an open question for LLCs, also may be addressed by courts. Finally, creditors and others might attempt to assert the law of agency in an attempt to find personal liability.

Rules of thumb for LLC use are difficult to state because of the flexible LLC structure. Nonetheless, commentators have suggested the LLC be used for real estate investment, receivables financing, corporate joint ventures and entrepreneurial and family businesses. Most states also allow professionals to organize as, and use, LLCs subject to the state's professional corporation act.

Foreign investors may favor LLCs over unfamiliar forms of business such as the corporation. The comfort level of foreign investors may play an increasingly important role, given the current status of the North American Free Trade Treaty. Finally, many knowledgeable lawyers believe that the LLC choice is most appropriate to organizations that otherwise would choose a different flow-through tax entity such as a partnership, limited partnership or S corporation.

Conclusion

The limited liability company is an important organizational development for business planners. It offers many advantages over other business organizations. It is, however, only an additional arrow in the business planner's quiver of available organizations and clearly not a panacea. Indeed, the demise of other business forms due to the LLC is probably greatly exaggerated, because most LLCs will suffer the disadvantages of lack of free transferability of interests and lack of perpetual life. As a result, many, perhaps most, entities choosing to operate as C corporations before the advent of LLCs probably will continue to choose C corporation status. Moreover, federal income tax classification as a partnership brings the LLC under the same package of "tax shelter" rules designed to combat abusive limited partnerships. These rules include, for example, the publicly traded limited partnership rules, the passive activity loss limitations and the at-risk rules.

The primary advantage of the LLC may be its efficiency in accomplishing business planning goals that already can be accomplished by using a combination of other organizations.

Although the LLC form of business is an extremely important addition to the existing menu of business entities, the LLC is neither the first nor the last business form to evolve through time. LLC use must be matched carefully to client needs, just as the use of more familiar organizations must be matched to client needs.

Thomas Earl Geu is an assistant professor of law, University of South Dakota. Geu is a Section co-advisor to the Limited Liability Drafting Committee of NCCUSL.

MEMORANDUM

HUGHES THORSNESS
GANTZ POWELL & BRUNDIN
ATTORNEYS AT LAW

TO: Senator Tim Kelly
Senate Labor & Commerce Committee
ATTN: Josh Fink (Via Fax 465-3756)

FROM: Robert L. Manley
Chairman, Working Group on Limited Liability Companies
Composed of Members of the Tax Law and Business Law
Sections of the Alaska Bar Association

RE: Senate Bill 347
Limited Liability Companies

DATE: March 22, 1994

I am writing to provide you with some additional information on limited liability companies. LLC's are a relatively new form of business entity in the United States. At the present time, 37 states have enacted LLC legislation and legislation is pending in a number of other states. Enclosed for your reference is a brief bibliography on the subject.

LLC is a business entity which combines the best features of a corporation and a partnership. Like corporate shareholder, LLC owners are not responsible for company liabilities beyond their investment. Like a partnership, there is no corporate double taxation. Rather, owners (like partners) incur federal income taxation at the individual level based on the profits and losses allocated to them.

The proposed legislation is drawn largely from a prototype act drafted by a working group of the Business Law Section of the American Bar Association with input from the Alaska Department of Labor & Commerce. The Alaska working group has modified various provisions to conform with Alaska procedure and additional developments in the law.

At this point, the lack of LLC legislation puts Alaska at a competitive disadvantage in attracting investment from outside. This is particularly so with foreign investors who are familiar with the limited liability company format because it is commonly used in European, Asian and South American countries.

An LLC can provide investors with conduit tax treatment, limited liability for investors, and freedom from many of the restrictions imposed on S-corporations and limited partnerships. As indicated LLC legislation is particular important to facilitate foreign investment. At the present time, non-resident aliens may not be S-corporation shareholders. Thus, in order for those investors to secure limited liability, they must operate as C-corporation shareholders (subject to double taxation) or as limited partners in a limited partnership (giving up operational control).

LTRS OF SUPPORT / INFORMATION

On the estate planning side, the primary asset of many small businessmen is the S-corporation stock of their business. The tax laws governing S-corporations prohibit many types of estate planning trusts from acting as S-corporation shareholders. Thus, the businessmen must accept certain limitations on estate planning if they also want corporate liability protection and the avoidance of double taxation. Even where businesses could organize as S-corporations, the partnership-type conduit tax treatment available to LLC's provide significant advantages in the allocation of tax attributes among investors, the ability to create tax basis by loans to the company and in areas of the passive loss and at-risk tax limitations.

The LLC is also useful to major corporations participating in joint ventures. Most large corporations create corporate subsidiaries which in turn form a partnership or joint venture. That way, profits and losses are allocated in the partnership among the two subsidiary corporations and the subsidiary corporations are able to transfer income to the parent corporations by way of dividends subject to the wholly owned subsidiary deduction. This, however, creates an extra legal entity and additional accounting complications both operationally and for the consolidated tax return.

We urge your support of this important piece of legislation.

3513:XXXH

LIMITED LIABILITY COMPANIES BIBLIOGRAPHY

By: Robert L. Manley

1. L. Ribstein and R. Keatinge, Limited Liability Company, (Shepards / McGraw-Hill 1992).

2. R. Keatinge, L. Ribstein, S. Hamill, M. Gravelle, and S. Connaughton, The Limited Liability Company, a Study of the Emerging Entity, 47 Business Lawyer 375 (1992). An 85-page article covering most of the relevant tax and non-tax issues.

3. Special Study, Limited Liability Company (LLC) Can Be Preferred Choice of Entity (RIA/Federal Tax Coordinator, August, 1992). A 10-page article covering basic entity choice issues including a good checklist of federal tax consequences to consider in making a choice of entity.

4. F. Wirtz and K. Harris, The Emerging Use of the Limited Liability Company, 1992 Taxes 337 (1992). A 20-page article covering basic classification issues, entity comparison and the conversion of existing entities into limited liability companies.

5. C. Price, Tax Aspects of Limited Liability Companies, 1992 Journal of Accountancy 48 (1992). A brief summary of limited liability company issues.

6. R. Platner, Limited Liability Companies Are Increasingly Popular, 20 Taxation for Lawyers 225 (1992).

HUGHES THORSNESS
GANTZ POWELL & BRUNDIN
ATTORNEYS AT LAW
509 WEST THIRD AVENUE
ANCHORAGE, AK 99501
(907) 274-7522

MAR 22 '94 03:28PM HUGHES THORSNESS P.4

Snell & Wilmer
LAW OFFICES

One Arizona Center
Phoenix, Arizona 85004-0001
(602) 382-6000
Fax: (602) 382-6070

PHOENIX, ARIZONA
TUCSON, ARIZONA
IRVINE, CALIFORNIA
SALT LAKE CITY, UTAH

Matthew P. Feeney (602) 382-6239

March 21, 1994

VIA FACSIMILE

Mr. Robert Manley
509 West Third Avenue
Anchorage, Alaska 99501

Dear Bob:

I enjoyed talking to you this morning regarding Arizona's experience with its limited liability company statute. I understand that the Alaska legislature is considering adopting limited liability company legislation and that elements of the banking industry have expressed concern about the liability and signing authorization aspects of the legislation as they relate to banking activities.

As we discussed, I am not aware of any banks in Arizona that have had difficulties with these issues. I noted that our firm represents banks and that we provided educational seminars to these clients when the legislation was passed. We advised the banks that, from a liability perspective, they should assume that an LLC is analogous to a closely-held corporation. If the bank does not feel comfortable lending to a closely-held corporation on the basis of the corporation's assets, the bank will usually require security or personal guarantees. The same result applies in the case of an LLC.

With respect to signing authorization, I understand that the Alaska legislation is based on the ABA Prototype Act, which specifically provides that a manager in a manager-managed LLC has the authority to bind the LLC, and that a member in a member-managed LLC has the authority to bind the LLC. A bank can review the publicly-filed Articles of Organization to determine whether the LLC is manager-managed or member-managed, the same way that a bank will review the publicly-filed Articles of Incorporation in the case of a corporation. The diligence then required in confirming that the party signing has appropriate authority is the same diligence that is required in determining whether a corporate officer has the requisite authority, e.g., a review of LLC/corporate records and the receipt of appropriate certificates.

Snell & Wilmer

In short, LLC signing authorization does not present any unique problems.

More important than the foregoing two issues, in my judgment, is the fact that over 35 states have adopted LLC legislation and the remaining states have legislation pending. The legislation has proven to be workable in the states in which it has been adopted. A Uniform Limited Liability Company Act is also in the process of being drafted. In short, LLC's are here to stay. States that choose not to adopt LLC legislation may find themselves at a competitive disadvantage in the area of capital formation.

Please feel free to call me at (602) 382-6239 if you have any questions or comments.

Very truly yours,

SNELL & WILMER

Matthew P. Feeney

MPF:mo
cc: Danielle Lopez

PHX3:PFEUDYM / 2051606.

HOLLAND & HART
ATTORNEYS AT LAW

DENVER
DENVER TECH CENTER
COLORADO SPRINGS
ASPEN
BILLINGS
BOISE
CHEYENNE
JACKSON
WASHINGTON, D.C.

SUITE 2900
555 SEVENTEENTH STREET
DENVER, COLORADO 80202-3979
MAILING ADDRESS
P.O. BOX 8749
DENVER, COLORADO 80201-8749

TELEPHONE (303) 295-8000
FACSIMILE (303) 295-8261
TWX 910-931-0568

ROBERT R. KEATINGE
OF COUNSEL
(303) 295-8595

March 21, 1994

By Fax 907/465-3834

Danielle Lopez
Office of Rep. Brian Porter
House of Representatives
Alaska State Legislature
Alaska State Capitol
Juneau, AK 99801-1182

Re: Alaska Limited Liability Company Act

Dear Ms. Lopez:

I spoke this morning with Robert Manley regarding the Alaska Limited Liability Company Act, which I understand is based on the ABA Prototype Act. From my discussion with him, I understand that there is some question with regard to the operation of LLCs. In my experience, there have not been any problems with respect to the operation of limited liability companies (LLCs).

By way of background, I am a member of the committee that drafted the Prototype, chair of an American Bar Association (ABA) Subcommittee on LLCs, the ABA Liaison to the National Conference of Commissioners on Uniform State Laws drafting committee drafting a Uniform Limited Liability Company Act and co-author of *Ribstein and Keatinge on Limited Liability Companies*, a two-volume treatise on the subject. This is not to indicate that I am particularly wise, but rather to support the fact that I spend I fair amount of time discussing the development of LLCs around the country with others working in this area. With the exception of the change of some documents to reflect the new type of organization, the development of LLCs has not caused a change in the manner of conducting commercial or real estate transactions. Now that more than thirty-six states have LLC legislation, use of LLCs is becoming more regularized and lenders and title insurance companies have developed ways of dealing with LLCs.

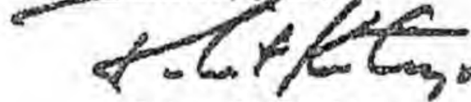
The Prototype Limited Liability Company Acts is based primarily on the Revised Uniform Limited Partnership Act. As such, many of the authority issues are exactly the same as those for a limited partnership. We did not include the identification of a specific member or manager in the articles of organization for the same reasons that no person other than the organizer is identified in the articles of incorporation under most corporation acts. As in all transactions with any type of business organization, the lender

HOLLAND & HART
ATTORNEYS AT LAW

will need to satisfy itself with the authority of person executing documents, whether it is an officer of a corporation, a general partner in a general or limited partnership or a member of a member-managed LLC or a manager of a manager-managed LLC. Once lenders and others have focused on this similarity, they seem to have no trouble dealing with LLCs.

I think that the "newness" of LLCs will not cause a problem for lenders and others dealing with the entity. If you have any questions in this regard, please contact me.

Sincerely yours,



Robert R. Keatinge

encl.

Coopers
&Lybrand

certified public accountants

550 West Seventh Avenue
Suite 600
Anchorage, Alaska 99501-3558

telephone (907) 274-3602

facsimile (907) 272-6814

March 21, 1994

Senator Tim Kelly
Alaska State Legislature
State Capitol Building
Juneau, Alaska 98801

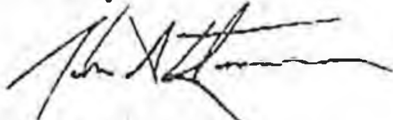
Dear Senator Kelly:

We are in support of SB 347 providing for the formation, registration and regulation of limited liability companies (LLC). We feel that the LLC offers business owners the desirable benefit of protection from personal liability for the debts of the business. The LLC also allows for a great deal of flexibility in making day-to-day business decisions such as business structuring and acquisitions, financing techniques, distributing earnings to members, providing compensation and fringe benefits, managing cash flow, and estate planning.

In addition, the more states that recognize limited liability companies, the more useful this type of entity is to business operations with interstate activities. It is our understanding that, at the current time, 37 states have adopted limited liability company legislation.

We ask that you support this legislation.

Sincerely,



John A. Letourneau
Tax Director

:mmb

Coopers & Lybrand is a member firm of Coopers & Lybrand (International)

Coopers
&Lybrand

certified public accountants

550 West Seventh Avenue
Suite 600
Anchorage, Alaska 99501 3558

telephone (907) 274-3602

facsimile (907) 272-6614

March 21, 1994

Senator Tim Kelly
Alaska State Legislature
State Capitol Building
Juneau, Alaska 98801

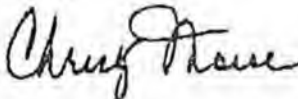
Dear Senator Kelly:

We are in support of SB 347 providing for the formation, registration and regulation of limited liability companies (LLC). We feel that the LLC offers business owners the desirable benefit of protection from personal liability for the debts of the business. The LLC also allows for a great deal of flexibility in making day-to-day business decisions such as business structuring and acquisitions, financing techniques, distributing earnings to members, providing compensation and fringe benefits, managing cash flow, and estate planning.

In addition, the more states that recognize limited liability companies, the more useful this type of entity is to business operations with interstate activities. It is our understanding that, at the current time, 37 states have adopted limited liability company legislation.

We ask that you support this legislation.

Sincerely,



Christy K. Morse
Tax Manager

:mmb

HARTIG, RHODES, NORMAN, MAHONEY & EDWARDS
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW
717 K STREET
ANCHORAGE, ALASKA 99501-3307
TELEPHONE: (907) 276-1592
TELECOPIER: (907) 277-4352

ROBERT L. HARTIG (1920-1980)

PETER B. BRAUTIGAM
G. KENT EDWARDS
ROBERT B. FLINT
LAWRENCE L. HARTIG
LINDA J. HIEMER
CHRISTINE FOOTE HYATT
SUZANNE K. ISHII-REGAN
ROBERT J. MAHONEY
JOHN K. NORMAN
DOUGLAS C. PERKINS
JAMES D. RHODES
L. ANDREW ROBINSON
BONNIE J. STRATTON
MICHAEL D. WHITE

PALMER OFFICE
L. ANDREW ROBINSON
808 S. BAILEY STREET
SUITE 101
PALMER, ALASKA 99645
TELEPHONE: (907) 745-5031
TELECOPIER: (907) 745-6067

RECIPROCAL RELATIONSHIP
GRUENING & SPITZFADEN
217 SECOND STREET, SUITE 204
JUNEAU, ALASKA 99801
TELEPHONE: (907) 586-8110

REPLY TO:
Anchorage

March 21, 1994

Senator Tim Kelly
Chairman
Senate Labor & Commerce
State Capital, Room 101
Juneau, AK 99801-1182

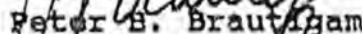
Re: House Bill 420

Dear Senator Kelly:

This letter is sent in regard to the Sponsor Substitute for Senate Bill 347 which deals with a new form of business entity, limited liability companies. I am very much in favor of this bill. Having a limited liability business entity would provide Alaskan business investors with partnership tax treatment along with corporate-type limited liability.

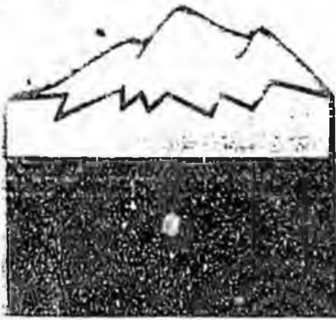
Sincerely,

HARTIG, RHODES, NORMAN,
MAHONEY & EDWARDS

By:

Peter B. Brautigam

PBB/kp

kp\docs\579\kelly.ltr



ALASKA SOCIETY OF CPA'S
341 W TUDOR #105
ANCHORAGE, AK 99503
(907) 562-4334
800-478-4334
FAX (907) 562-4025

FEB 25 RECD

February 22, 1994

Senate Judiciary Committee
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Re: Limited Liability Company Bill

Dear Sirs:

On February 17, 1994 the Board of the Alaska Society of Certified Public Accountants unanimously voted to endorse the introduction of legislation allowing businesses to form and operate as a Limited Liability Company in the State of Alaska.

The membership of the Alaska Society of Certified Public Accountants is State wide. The Board is representative of the membership.

In order for the State to continue to grow through new commerce, it is important that there is flexibility in the type of entity a business can form. The State should be able to offer the same type of entities as any other state offers (right now there over 30 States that allow Limited Liability Companies).

We look forward to the passage of this law in a swift and expedient manner. Businesses that want to operate as a Limited Liability Company may not wait for the legislature, and will seek an operating "home" in some other state.

Very truly yours,

William D. Arnold
President

DIVISION OF LEGAL SERVICES

LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

M E M O R A N D U M   March 22, 1994

SUBJECT: Sectional summary of SB 347 (Work Order No. 8-LS1419\J)

TO: Senator Tim Kelly
Chair, Senate Labor and Commerce Committee
Attn: Josh

FROM: TB
Theresa L. Bannister
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Contains a new chapter on limited liability companies.

Sec. 10.50.010 states that a limited liability company ("company") may be organized for any lawful purpose.

Sec. 10.50.015 requires a company to comply with other applicable laws.

Sec. 10.50.020 requires a company name to contain certain words or abbreviations. Allows the name to use the name of a city, borough, or village but not to contain certain words or to otherwise imply the company is a municipality. Prohibits a person from adopting a name containing "limited liability company" unless the person is organized under this chapter or is registered as a foreign limited liability company under this chapter.

Sec. 10.50.025 requires a company name to be distinguishable on the records of the Department of Commerce and Economic Development ("department") from certain other names.

Sec. 10.50.030 authorizes certain persons to reserve a company name.

- SECTIONAL ANALYSIS -

Sec. 10.50.035 establishes the procedure for reserving a company name.

Sec. 10.50.040 authorizes the holder of a reserved name to transfer the name to another person. Establishes how the transfer is accomplished.

Sec. 10.50.045 requires a company to maintain in this state a registered office and a registered agent for the service of process.

Sec. 10.50.050 establishes how a company may change its registered office or agent and how an agent may change the agent's address.

Sec. 10.50.055 establishes when a change of a registered office, a registered agent or the address of a registered agent becomes effective.

Sec. 10.50.060 authorizes a registered agent to resign. Indicates how the agent may resign and when the resignation becomes effective.

Sec. 10.50.065 appoints the commissioner of the department under certain circumstances as the agent of a company for the service of process, notice, or demand. Establishes how a person may serve the commissioner. Directs the commissioner to keep a record of documents served on the commissioner. States that this section does not affect the right to serve process, notice, or demand on a company in another manner permitted by law.

Sec. 10.50.070 authorizes one or more persons to organize a company. Establishes the procedure for organization.

Sec. 10.50.075 identifies what the articles of organization must contain, which includes certain information about any election to continue the company until a certain date or event.

Sec. 10.50.080 determines when a company's organization is effective. Provides that the company's existence terminates if its articles are nonconforming and not cured within the specified time.

Sec. 10.50.085 states that a company's existence continues until specified date or event, except under certain circumstances, if the company has made an election to continue until the certain date or event and the election is stated in the articles of organization. Prohibits revocation of an election unless certain specified persons revoke the election. Allows an election to expressly limit the membership terminations that can cause dissolution.

Sec. 10.50.090 establishes that articles of organization that are file-stamped and marked with the filing date are conclusive evidence that the company is organized.

Sec. 10.50.100 authorizes a company to amend its articles at any time and indicates the procedure for doing so.

Sec. 10.50.105 authorizes a company to restate its articles and establishes the procedure for doing so.

Sec. 10.50.110 declares that the members of a company manage the company, unless an operating agreement names a manager for the company or the chapter provides otherwise. Declares that if an operating agreement authorizes a manager for the company, the manager has the exclusive power to manage the company to the extent of the authorization.

Sec. 10.50.115 requires over one-half of the members to approve before a manager is appointed, removed, or replaced, unless an operating agreement provides otherwise.

Sec. 10.50.120 allows a manager to be other than an individual or a company member, unless a company operating agreement provides otherwise.

Sec. 10.50.125 establishes how long a manager holds office.

Sec. 10.50.130 declares that a member who is not a manager of a company that is managed by a manager does not have a fiduciary duty of a manager to the company or to other members when acting solely as a member, unless an operating agreement provides otherwise.

Sec. 10.50.140 requires the members and the managers to account to the company and hold as trustee for the company certain identified benefits obtained without the described consent, unless an operating agreement provides otherwise.

Sec. 10.50.145 establishes what authorization is required for company affairs, depending on whether the company is managed by its members or by managers.

Sec. 10.50.155 indicates that a person may become a company member if the person acquires a company interest in certain ways.

Sec. 10.50.160 establishes when a person's admission to membership in the company is effective.

Sec. 10.50.165 establishes the conditions for an assignee of a company interest to become a company member.

Sec. 10.50.170 establishes the rights, powers, and liabilities of an assignee who becomes a member.

Sec. 10.50.180 establishes that when an assignee of a member's entire membership interest becomes a member with respect to the assignor's entire interest, the assigning member ceases to be a member, unless otherwise provided in an operating agreement.

Sec. 10.50.185 states that a person's company membership terminates if the person withdraws voluntarily from the company. Authorizes a member to voluntarily terminate a company membership at any time, unless an operating agreement provides otherwise.

Sec. 10.50.190 establishes that, if a company has a definite term or undertaking, the voluntary withdrawal of a member before the end of the term or the accomplishment of the undertaking is a breach of the operating agreement, unless the operating agreement provides otherwise.

Sec. 10.50.195 establishes that a company can recover damages from a member who withdraws wrongfully. Authorizes the company to offset the damages against a distribution owed to the member and to pursue other remedies against the member.

Sec. 10.50.205 states that, except as otherwise provided in an operating agreement for the removal of a member, a person's company membership terminates if the person assigns all of the membership interest and if a majority of the members who have not assigned their interests authorize the removal of the member.

Sec. 10.50.210 states that a person's company membership terminates if the member dies or is declared incompetent by a court, unless otherwise provided in an operating agreement.

Sec. 10.50.215 states that the company membership held by a trust or trustee terminates when the trust terminates and that a company membership held by an estate terminates when the estate's entire company interest is distributed by the estate, unless otherwise provided in writing in an operating agreement or by the written consent of all of the members.

Sec. 10.50.220 states that the company membership of a member that is a separate limited liability company terminates when the member dissolves and begins to wind up, unless otherwise provided in writing in an operating agreement or by the consent of all members. Also states that the membership of a corporate member terminates when the corporation is dissolved and 90 days elapse without reinstatement, unless otherwise provided in writing in an operating agreement or by the consent of all members.

Sec. 10.50.225 identifies other events that terminate a company membership.

Sec. 10.50.240 provides that secs. 10.50.185 - 10.50.225(a)-(b) don't apply to the termination of a membership unless the member is also a company manager, if an election has been made to continue the company until a certain date or event.

Sec. 10.50.250 states that a company member is an agent of the company for the purpose of conducting the company's affairs, except under certain circumstances, including where the articles name a manager for the company. If a manager is named, the manager is an agent of the company for the purpose of conducting its affairs, except in certain circumstances. Establishes when a member's or manager's act binds the company.

Sec. 10.50.255 states that an admission or representation by a company member about the company is evidence against the company, except in certain circumstances, including where the articles name a manager for the company. If a manager is named, an admission or representation by a manager is evidence against the company under certain circumstances, and the admission or representation by a member acting solely as a member is not evidence against the company.

Sec. 10.50.260 indicates when a company is charged with the knowledge of or a notice given to a member or manager.

Sec. 10.50.265 states that a company member is not liable, solely by reason of being a member, for a company liability.

Sec. 10.50.275 authorizes a company to issue company interests for property, services, or a promissory note or other obligation to contribute property or services.

Sec. 10.50.280 states that a member's promise to contribute property or services to the company is enforceable only if the promises is in a writing signed by the member. Makes the promise enforceable even if the member is unable to perform because of death, disability, or other reason, unless otherwise provided by an operating agreement. Requires a company member who has not made the required contribution of property or services to contribute cash equal to the shortfall. States that an assignor of a company interest remains liable for a contribution even if the assignee becomes a member with respect to the assigned interest, unless otherwise provided in an operating agreement.

Sec. 10.50.285 prohibits the compromise of a company member's obligation to make a contribution, unless otherwise provided in an operating agreement.

Sec. 10.50.300 declares that, unless otherwise provided in writing in an operating agreement, members are to be repaid their contributions to capital and share equally in the assets of the company after liabilities are satisfied.

Sec. 10.50.305 requires interim distributions to members to be made according to an operating agreement, if an operating agreement provides for the distributions. The operating agreement may authorize different interim distributions for different classes of members.

Sec. 10.50.310 requires interim distributions to members to be equal, unless ar operating agreement provides for the distribution.

Sec. 10.50.315 indicates at what times a company member is entitled to an interim distribution.

Sec. 10.50.320 directs a company to distribute to a terminated member any distribution that the member was entitled to receive before the termination, except where the member is removed or the termination does not cause dissolution. In addition, directs the company to distribute to the terminating member the amount of the member's company interest. Establishes the amount of the interest if a company operating agreement does not establish the amount or how to calculate the amount. If an election has been made to continue the company until a certain date or event, the distribution provisions don't apply unless the member is also a company manager.

Sec. 10.50.325 prohibits a member from demanding and receiving a distribution in other than cash, unless otherwise provided in an operating agreement. Prohibits a company from compelling a company member to accept assets in a form other than cash under certain circumstances.

Sec. 10.50.330 states that a company member entitled to receive a distribution becomes a creditor of the company and is entitled to all available creditor remedies.

Sec. 10.50.350 states that property transferred to or otherwise acquired by a company is the property of the company and not of the members individually. States that a company may acquire, hold, and convey property in the name of the company. States that when the company acquires an interest in real property the company holds the title and not the members individually.

Sec. 10.50.355 indicates how a company's property may be transferred, depending on whose name the property is held in and whether the company has a manager.

Sec. 10.50.360 authorizes a company to recover its transferred property if the company proves certain facts, unless certain circumstances exist.

Sec. 10.50.365 authorizes, under certain circumstances, the transfer, free of company or member claims, of company property held in the name of a person other than the company.

Sec. 10.50.370 states that a company interest is personal property.

Sec. 10.50.375 authorizes the assignment of a company interest. States that an assignment entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor is entitled. States that an assignment does not dissolve the company or entitle the assignee to participate in the management and affairs of the company, to become a member, or to exercise member rights. The assignor continues to be a member unless the assignee becomes a member with respect to the interest. Allows a written operating agreement to vary the terms of the section. States that certain activities of a member do not amount to assignments and do not terminate the membership or the rights and powers of the member, unless otherwise provided in an operating agreement.

Sec. 10.50.380 authorizes a court to charge a member's company interest for payment of a judgment creditor against the member. Indicates the effect of the charge.

Sec. 10.50.385 states that in the case of a member's death or incompetency the member's legal representative has the rights of an assignee of the member's company interest.

Sec. 10.50.390 states that if a member (not an individual) terminates or is dissolved, the member's legal representative or successor has the rights of an assignee of the member's interest.

Sec. 10.50.400 identifies the events that dissolve a company and require winding up of its affairs.

Sec. 10.50.405 authorizes the superior court to order a company's dissolution under certain circumstances.

Sec. 10.50.410 indicates who may wind up a company's affairs, unless otherwise provided in an operating agreement.

Sec. 10.50.415 identifies the acts that a person winding up a company's affairs may perform.

Sec. 10.50.420 establishes when, how, and under what circumstances a member or manager can bind a company that is dissolved and winding up its affairs.

Sec. 10.50.425 establishes the manner and priority for the distribution of a company's assets upon its winding up.

Sec. 10.50.430 allows a company to file articles of dissolution with the department after it dissolves. Describes what the articles must state.

Sec. 10.50.435 establishes how a company after its dissolution may dispose of the known claims against it. Declares under what conditions a known claim against the company is barred.

Sec. 10.50.440 establishes how a company after its dissolution may dispose of unknown claims against it. Declares that unknown claims are barred unless the claimant takes certain action within three years after the later of certain events. Authorizes the claimant to enforce a claim against the company's undistributed assets or against company members under certain circumstances; limits a member's total liability.

Sec. 10.50.500 authorizes a company to merge or consolidate with or into a domestic or foreign limited liability company, subject to the law applicable to the other company and unless otherwise provided in an operating agreement.

Sec. 10.50.505 authorizes the rights of, or interests in, a party to a merger or consolidation to be exchanged for or converted into cash, property, obligations, rights or other interests of, or interests in, the surviving or resulting company.

Sec. 10.50.510 establishes what member or other approval is required before a company may approve a proposed merger or consolidation. Authorizes a party to a merger or consolidation to abandon the merger or consolidation as provided in the merger or consolidation agreement.

Sec. 10.50.515 requires the company surviving or resulting from a merger or consolidation under this chapter to file articles of merger or consolidation with the department. The articles must be signed by each company that is a party to the merger or consolidation.

Sec. 10.50.520 describes what the articles of merger or consolidation must state.

Sec. 10.50.525 requires articles of merger or consolidation to be signed by a company that is a party to the merger or consolidation.

Sec. 10.50.530 states that articles of merger or consolidation constitute articles of dissolution for a company that is not the surviving or resulting company in a merger or consolidation.

Sec. 10.50.535 indicates when a merger or consolidation takes effect.

Sec. 10.50.540 states that a merger or consolidation agreement may amend a company's operating agreement or adopt a new operating agreement for the company, if the company is the surviving or resulting company in a merger or consolidation. Authorizes an approved merger or consolidation agreement to provide

that a company's operating agreement will be the operating agreement of the company that is the surviving or resulting company. States when an amendment to an operating agreement or the adoption of a new operating agreement under this section is effective. States that this section does not limit the accomplishment of a merger or other matter covered by the section by other means allowed under an operating agreement, another agreement, or another law.

Sec. 10.50.545 describes the general effects of merger or consolidation. These include the termination of companies that are not the surviving or resulting companies and the transfer of the applicable rights, privileges, immunities, powers, franchises, restrictions, disabilities, and duties of the participating companies to the surviving or resulting company.

Sec. 10.50.550 describes the effects of merger or consolidation on the property of the participating companies.

Sec. 10.50.555 describes the effect of merger or consolidation on the liabilities of the participating companies.

Sec. 10.50.560 declares that creditor rights and liens on the property of a company that is a party to a merger or consolidation are not impaired by the merger or consolidation.

Sec. 10.50.565 states that upon a merger or consolidation a company's interests that are to be converted or exchanged into other property under the merger or consolidation agreement are converted as provided by the merger or consolidation agreement. States that the former holders of interests so converted have the rights provided in the merger or consolidation agreement or otherwise provided by law.

Sec. 10.50.590 defines "limited liability company" for secs. 10.50.500 - 10.50.590.

Sec. 10.50.600 states that, subject to this state's constitution, a foreign company's organization, internal affairs, and the liability and authority of its managers and members are governed by the law of the jurisdiction where the company is organized. Prohibits the department from denying registration to a foreign company because of differences between the law of this state and the jurisdiction where the foreign company is organized.

Sec. 10.50.605 requires a foreign company to register with the department before conducting affairs in this state. The foreign company is required to deliver an application for registration to the department.

Sec. 10.50.610 requires the registration application to be signed by a person who is authorized to sign by the law of the jurisdiction where the company was organized.

Sec. 10.50.615 describes what the registration application must state.

Sec. 10.50.620 prohibits the department from filing the registration of a foreign company unless the company name satisfies certain requirements.

Sec. 10.50.625 authorizes a foreign company to amend its registration by filing articles of amendment with the department.

Sec. 10.50.630 establishes what the articles of amendment must state. Authorizes the amendment of the application in any way as long as the amended application only contains provisions that are otherwise allowed by this chapter to be contained in an application for registration at the time of the amendment.

Sec. 10.50.635 requires a foreign company to maintain an agent in this state for the service of process. Indicates which persons qualify to be an agent.

Sec. 10.50.640 establishes the procedure for changing a foreign company's registered agent or the agent's address.

Sec. 10.50.645 provides guidelines for when the change of registered agent or agent address for a foreign company becomes effective.

Sec. 10.50.650 describes how a registered agent of a foreign company may resign as the registered agent. Requires the department to mail a copy of the resignation to the company. Indicates when the resignation becomes effective.

Sec. 10.50.655 authorizes a foreign company to cancel its registration by filing an application for cancellation with the department.

Sec. 10.50.660 describes what an application for cancellation must state.

Sec. 10.50.665 describes the form, manner, and execution of an application for cancellation of the registration of a foreign company.

Sec. 10.50.670 states that the cancellation of a registration does not terminate the authority of the department to accept service of process on the foreign company with respect to causes of action arising out of the company's conduct of affairs in this state.

Sec. 10.50.675 prohibits an unregistered foreign company conducting affairs in this state from maintaining a action or other proceeding in a court of this state until it has registered. States that the failure to register does not impair the validity of the company's contracts or acts, affect the rights of another party to a company contract

to maintain an action or other proceeding on the contract, or prevent the company from defending an action or other proceeding in a court of this state.

Sec. 10.50.680 states that a foreign company that conducts affairs in the state without being registered appoints the department as its agent for service of process with respect to a cause of action arising out of conducting affairs in this state.

Sec. 10.50.685 provides for service on the commissioner in the manner provided under sec. 10.50.065(b) and under certain circumstances. Requires the commissioner to keep a record of the processes, notices, and demands served on the commissioner. States that this section does not affect the right to make service in another manner permitted by law.

Sec. 10.50.690 states that a foreign company conducting affairs in this state without registration is liable to the department for certain fees and penalties.

Sec. 10.50.700 states that a foreign company that conducts affairs in this state without registration is subject to a civil penalty and authorizes the attorney general to recover the penalty.

Sec. 10.50.710 authorizes a court, under certain circumstances, to issue an injunction against a foreign company conducting affairs in the state in violation of this chapter. Indicates how long the injunction may continue.

Sec. 10.50.715 states that a member or manager of a foreign company is not liable for the debts and obligations of the company solely because the company conducts affairs in this state without registration.

Sec. 10.50.720 lists the transactions that do not constitute conducting affairs for a foreign company in this state.

Sec. 10.50.730 authorizes a court action to be brought by or against the company in the name of the company.

Sec. 10.50.735 prohibits a person from bringing a court action on behalf of a company in the name of the company unless the requirements of the section are met. Sets out these requirements.

Sec. 10.50.740 prohibits a company from asserting the lack of authority of a company member or manager to bring court action on behalf of a company as a defense to the action or as a basis for bringing a subsequent action on the same cause of action.

Sec. 10.50.800 declares that, unless an operating agreement provides otherwise, a company member or manager is not liable to the company or the company members

for damages or other relief for an act or a failure to act on behalf of the company unless the act or failure to act amounts to gross negligence or wilful misconduct. Provides that an operating agreement may limit or eliminate the personal liability of a company member or manager for breaches of duty under secs. 10.50.130 - 10.50.140 or subsec. (a).

Sec. 10.50.805 authorizes a company to use an operating agreement to authorize the company to indemnify a company member or manager for judgments, settlements, penalties, fines, or expenses incurred by the person under certain circumstances.

Sec. 10.50.810 states that a company member is not a proper party to a proceeding by or against the company just for being a member, except in certain circumstances.

Sec. 10.50.820 states that a company operating agreement may authorize a company to issue a certificate as evidence of a company interest and to authorize and provide for the assignment or transfer of the interest represented by the certificate.

Sec. 10.50.830 establishes how a document is to be delivered to or filed with the department.

Sec. 10.50.840 establishes the department's procedure and criteria for filing documents. Prohibits the department from filing a document if the section's requirements are not met.

Sec. 10.50.850 establishes who is to sign documents filed with the department and how the documents are to be signed. Authorizes a person to sign as an attorney-in-fact.

Sec. 10.50.855 establishes a procedure for obtaining a court order to direct the department to file certain documents.

Sec. 10.50.860 directs the department to charge fees for filing and other services it provides under the chapter.

Sec. 10.50.870 requires a company, unless otherwise provided in writing in an operating agreement, to maintain certain described records at its principal place of business.

Sec. 10.50.875 authorizes a company member to inspect and copy the company's records under certain conditions.

Sec. 10.50.880 requires certain persons to disclose to a member under certain circumstances true and full information of all matters that affect the members of a company.

Sec. 10.50.890 states that a company's failure to maintain a required record or information does not make a member or manager liable for the company's obligations.

Sec. 10.50.900 authorizes the department to adopt regulations to implement the chapter, in addition to any regulations the department is required to adopt under this chapter.

Sec. 10.50.910 authorizes a company organized and existing under this chapter to conduct its affairs and exercise the powers granted by this chapter in another jurisdiction, subject to the laws of that jurisdiction.

Sec. 10.50.920 declares the chapter's support of the principle of freedom of contract and enforceability of operating agreements States that the rule that statutes in derogation of the common law are to be strictly construed does not apply to the chapter.

Sec. 10.50.990 defines terms for the new chapter.

Sec. 10.50.995 gives the new chapter a short title.

Section 2. Amends the for-profit corporations code to prevent that code from prohibiting a limited liability company from using "limited" in its name.

Section 3. Describes how a section of the new chapter amends the Alaska Rules of Civil Procedure.

Section 4. Makes the Act effective January 1, 1995.

If I may be of further assistance, please advise.

TLB:lmb
94-096.lmb

FISCAL NOTE

STATE OF ALASKA **BILL NO.** CSSB 347 (L&C)
1994 LEGISLATIVE SESSION

Revision Date:
Dept. Affected: Revenue
Title: Limited Liability Companies
BRU: Revenue Operations
Component: Income and Excise Audit
Sponsor: (S) JUD
Requestor: (S) L&C
COMPONENT SERIAL NO. 113

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY95	FY96	FY97	FY98	FY99	FY00
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL						
REVENUE FUND SOURCE: General	(5.5 - 2,975.0)	(22.0-11,900.0)	(33.0-17,850.0)	(44.0-23,800.0)	(55.0-29,750.0)	(66.0-35,700.0)

FUNDING: (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year (FY94) impact: $ 0.0

ANALYSIS: (Attach a separate page if necessary.)

SEE ATTACHED

Prepared by: Larry E. Meyers
Phone: 465-2320
Division: Income and Excise Audit Division
Date: April 7, 1994
Approved by Commissioner: Darrel J. Rexwinkel
Date: April 7, 1994
Agency: Department of Revenue

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE
For further distribution information call the Governor's Legislative Office

(Rev 11/93) 94fiscal.nte/lal

lpb.94fiscal.nte

Overview

Limited liability companies (LLC) are hybrid entities possessing corporate and partnership attributes. Under existing Alaska law, corporations pay an income tax while partnerships do not. This legislation does not address how the LLCs will be taxed for state purposes. Of 36 states which have enacted LLC legislation, the vast majority have adopted federal Internal Revenue Code (IRC) provisions which classify LLCs as partnerships. Without a further clarification in this bill, Alaska would similarly follow with partnership classification pursuant to AS 43.20.021 which incorporates IRC provisions by reference, including definitions of corporations and partnerships.

If LLCs are determined to be partnerships they will join another group of tax return filers, namely subchapter S corporations that generally do not pay tax at the corporation level. Instead, the income is passed through to the recipient level which are often times individuals. It is anticipated that numerous existing corporations will migrate toward becoming LLCs and that new business ventures will initially register as LLCs to escape liability for state corporation net income tax.

The impact of LLCs on state revenues in the other 36 states that have enacted similar legislation remains unclear. LLCs are relatively recent entities (they have become an available form of business organization in a majority of states only within the past year), and states have developed little specific experience within the past year. Those states that have projected revenues to remain neutral or increase are relying on individual income taxes and fees from increased business filings. Alaska has no similar tax base. Other states have projected losses on an annual basis including California ($50 million), New York ($70 million) and Minnesota ($2 million).

All but two of the states that have enacted LLC legislation have a state individual income tax which insures that taxes are not avoided by choosing LLC status. The two states, Florida and Texas, which like Alaska, have no individual income tax have classified LLCs as corporations for tax purposes. This follows the similar trend seen with subchapter S corporations where states with no individual income tax have closed the tax loophole.

Operating Costs

Department of Revenue does not anticipate that this bill will affect its operating budget. The status of the corporation, whether a regular corporation or LLC, will not affect their corporation tax filing requirement with the Department. Although LLCs will not incur a corporaion net income tax, they will be required to file returns.

Revenue

Over the past 3 years, Department of Commerce and Economic Development has experienced an average of 1100 new corporations registered each year.

For calendar year 1992 tax filing period, Department of Revenue received 3000 corporation net income tax returns indicating a tax liability owed. Total revenue collected from the returns amounted to $32,455,000 or an overall average of $10,818 per taxpayer. Of the returns filed. 1800 had a tax liability of less than $500 per return. This group averaged $100 per corporation in tax liability.

If 10% (or 110) of new corporations registered as LLCs, the potential loss in tax revenue would be a range of from $11,000 (110 X $100) to $1,189,980 (110 X $10,818) per year. Subsequent years would experience the cumulative effect of corporations registered as LLCs in prior years.

Although it is not known how many corporations will register as LLCs, Department of Revenue estimates that between 10% and 50% of corporations may be affected. Following are tables which reflect impact on revenue under low and high range scenarios.

Effect of Filers From:	Fiscal Year Revenue Impact (10% of Corporations Register as LLC)					
	FY 95*	FY 96	FY 97	FY 98	FY99	FY 00
FY 95	(5.5 - 595.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)
FY 96		(11.0 - 1,190.0)	(11.0 - 1,190 0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)
FY 97			(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)
FY 98				(11.0 - 1,190.0)	(11.0 - 1,190.0)	(11.0 - 1,190.0)
FY 99					(11.0 - 1,190.0)	(11.0 - 1,190.0)
FY 00						(11.0 - 1,190.0)
Total	(5.5 - 595.0)	(22.0 - 2,380.0)	(33.0 - 3,570.0)	(44.0 - 4,760.0)	(55.0 - 5,950.0)	(66.0 - 7,140.0)

Effect of Filers From:	Fiscal Year Revenue Impact (50% of Corporations Register as LLC)					
	FY 95*	FY 96	FY 97	FY 98	FY99	FY 00
FY 95	(27.5 - 2,975.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)
FY 96		(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)
FY 97			(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)
FY 98				(55.0 5,950.0)	(55.0 - 5,950.0)	(55.0 - 5,950.0)
FY 99					(55.0 - 5,950.0)	(55.0 - 5,950.0)
FY 00						(55.0 - 5,950.0)
Total	(27.5 - 2,975.0)	(110.0 - 11,900.0)	(165.0 - 17,850.0)	(220.0 - 23,800.0)	(275.0 - 29,750.0)	(330.0 - 35,700.0)

* Since this bill doesn't become effective until January 1, 1995, Department of Revenue will only receive half of a year's revenue (from estimated payments through June 30, 1995) for FY 95.

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. SB 347

Revision Date:
Title: An Act relating to limited liability companies

Sponsor: Senate Judiciary
Requestor: Senate Labor & Commerce

Department Affected: Commerce and Economic Development
BRU: Banking, Securities and Corporations
Component:

COMPONENT SERIAL NO. 1233

Expenditures/Revenues:

OPERATING EXPENDITURES	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL EXPENDITURES	0	0	0	0	0	0
CHANGE IN REVENUES ( )	0	0	0	0	0	0

FUND SOURCE

1002 Federal Receipts	0	0	0	0	0	0
1003 GF Match	0	0	0	0	0	0
1004 GF	0	0	0	0	0	0
1005 GF/Program Receipts	0	0	0	0	0	0
1006 GF/MHTIA	0	0	0	0	0	0
Other	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

Estimate of current year (FY 94) cost: $ 0

POSITIONS

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary.)

Prepared by: Willis F. Kirkpatrick, Director
Division: Banking, Securities and Corporations
Phone: 465-2521
Date:

Approved by Commissioner: Paul Fuhs
Agency: Commerce and Economic Development
Date: 3-16-94

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE
For further distribution information call the Governor's Legislative Office

v 11/93
KP/dgl300FN.kp

FISCAL NOTES

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. SB 347

Revision Date:
Title: An Act relating to limited liability companies
Sponsor: Judiciary
Requestor:

Dept. Affected: Alaska Court System
BRU: Trial Courts
Components:
COMPONENT SERIAL NO. 768

EXPENDITURES/REVENUES (Thousands of Dollars)

OPERATING EXPENDITURES	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS & CLAIMS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year (FY 94) cost: $ None

ANALYSIS: (Attach a separate page if necessary)
No fiscal impact.

Prepared by: C. S. Christensen III, Staff Counsel
Agency: Alaska Court System
Phone: 264-8228
Date: 03/21/94

Approved by: Arthur H. Snowden, II, Administrative Director
Agency: Alaska Court System
Date: 03/21/94

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE