HB

266

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Mary Pagenkopf

Senate Rules Committee 5/8/97 1:10pm

Alaska State Legislature

House of Representatives

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Sponsor Statement for HB 266

The Limited Partnership and Limited Liability Company Simplification Act. This bill responds to a recent change in federal tax law which affects partnerships and limited liability companies. On January 1, 1997 the "check the box" entity classification regulations issued by the IRS became final. This change in federal law simplifies the formation and operation of partnerships and limited liability companies.

The check-the-box regulations will make it easier for business entities to be taxed as partnerships for federal income tax purposes. Under old law if a business entity had two or fewer of four corporate characteristics, it was taxed as a partnership. If it had more than two corporate characteristics, it was taxed as a corporation. In most instances the profits of a corporation are taxed twice. On the other hand, income is taxed to the partners of a partnership only once. Under the check the box regulations a business entity can have all four corporate characteristics and it will still be taxed as a partnership unless the partners "check-the-box" and elect to be taxed as a corporation.

Alaska's uniform limited liability act and limited partnership act were drafted with this four corporate characteristics test in mind to make sure that by default Alaska limited liability companies and limited partnerships would be taxed as partnerships under federal law. Most of the complexity required by this four corporate characteristic test can be deleted from Alaska law Alaska has the opportunity to be the first state to amend its limited liability company and limited partnership law to conform to the new check the box regulations. If this bill is enacted it is anticipated that business men and women from outside will choose to form their limited liability companies and limited partnerships in Alaska.

This bill will simplify our law, will reduce the legal fees for those who decide to form limited liability companies and limited partnerships, and should result in increased revenue to the state.

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Memorandum in Support of House Bill NO.266

This bill was written in response to a recent change in federal tax law. On January 1, 1997 the "check-the-box" entity classification regulations issued by the IRS became final. This change in federal tax law permits more flexibility in the formation and operation of business entities.

The check-the-box regulations will make it easier for business entities to be taxed as partnerships. Most taxpayers who own a small business want to avoid being taxed as a corporation because in most instances the profits of a corporation are taxed twice. First, income is taxed to a corporation when it is earned. Second, when a corporation distributes its profits to its shareholders in the form of a dividend, the shareholders are taxed again On the other hand, a partnership is taxed only once. Income is taxed to the partners of a partnership when it is earned. However, in most cases partners pay no second tax when the partnership distributes its profits.

Under old law if an entity had more than two of four corporate characteristics, then it was taxed as a corporation. The four corporate characteristics were: (1)limited liability, (2) continuity of life, (3) centralized management, and (4) free transferability of interests.

In the past limited liability companies posed a challenge to attorneys and accountants whose clients wanted to be taxed as partnerships. It was very easy for a limited liability company to have two of the four characteristics. First, the members of a limited liability company have limited liability. Second, if the company was managed by a manager, rather than member managed, the company would have centralized management. In order to avoid any more corporate characteristics most state statutes made sure that the company would not have continuity of life or free transferability of interests. A company would not have continuity of life if it dissolved upon the death or withdrawal of a member.

A company would not have free transferability of interests if its interests could be assigned, but the assignee could not become a member of the company without the consent of all other members. In this way the limited liability statutes in most states were drafted for income tax reasons and not necessarily with the best business goals in mind.

These changes also offer a better framework for those estate plans that use limited liability companies and limited partnerships. Many families will transfer their real estate and other investment assets to limited liability companies and will gift their non-management shares to Alaskan trusts. These families will want their businesses to have the same continuity of life that corporations enjoy. They do not want to face an expensive dissolution and risk losing control of their business if a family member dies.

This bill is intended to encourage Alaskans and residents of other states to form and conduct their businesses in Alaska. Our laws should continue to foster business and economic development. This bill is intended to be another step in that direction.

FISCAL NOTE

STATE OF ALASKA **BILL NO.** HB 266
1997 LEGISLATIVE SESSION

Revision Date:
Title: Limited Liability Companies and Limited Partnerships
Sponsor: Rep. Ryan
Requestor:

Department: Commerce and Economic Development
BRU: Banking, Securities & Corporations
Component: Banking, Securities & Corporations
COMPONENT SERIAL NO. 1233

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY01	FY 02	FY 03
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 EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0

CHANGE IN REVENUES	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY 97) cost: $

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)

The proposed amendments to AS 10.50 and AS 32.11 will have no fiscal impact on the operation of the division. The conversion provision to Alaska domestic organizations may create an increase in funds collected. While work loads through increased filings may be substantial, there would be no change in process procedures and systems. The only impact would be a function of time which would be addressed through electronic efficiencies.

Prepared by: Willis F. Kirkpatrick, Director Phone: 465-2521
Division: Banking, Securities and Corporations Date:
Approved by Commissioner: William L. Hensley Date: 4/30/97
Agency: Commerce and Economic Development

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