ALASKA LEGISLATURE COMMITTEE FILES 1993-1994 8672
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Trouble at school: Gun incidents rise

By ROSEMARY SHINOHARA
Daily News reporter

A 16-year-old girl at Bartlett High School was accidentally shot in the shoulder last September by a fellow student. The shooting took place in a car in the school parking lot when a 17-year-old boy in the right rear seat fired the weapon, a .357-caliber handgun.

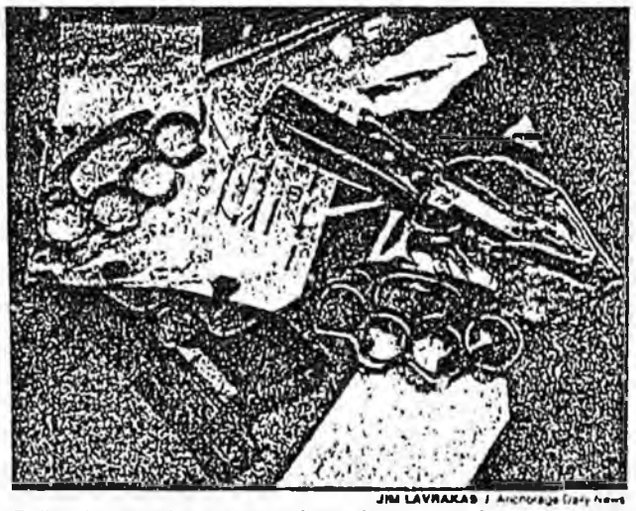
The incident traumatized Bartlett, but it was by no means the worst case of misconduct involving weapons in Anchorage schools last year, said Bill Mell, director of secondary education for the Anchorage School District.

"It was the one in which a student was hurt. But I don't think there was malice involved. We've had people threaten people — never with a gun, but with knives. I consider those more serious," Mell said in an interview Tuesday.

He describes weapons as a "serious but stable" issue in an annual report to the Anchorage School Board. The number of junior high and high school students suspended from school for weapons incidents increased from 69 three years ago to 96 two years ago to 106 last year.

District records show some alarming incidents:

Please see Page B-2, WEAPONS



JIM LAVRAKAS / Anchorage Daily News

Police have collected a variety of weapons from students.

Dispute costs kidney

One man shot

By S.J. KOMARNITSKY
Daily News reporter

An apparent argument over a woman in front of the Panhandle Bar downtown turned ugly early Saturday morning, leaving a 40-year-old man shot in the stomach and another in custody.

Police charged Arthur Wayne Goodman, 33, with

WEAPONS: More guns, knives showing up in Anchorage schools

Continued from Page B-1

• At Clark Junior High, a girl was seen with a knife, and then kicked a staff member in the groin when he tried to confront and restrain her. She was expelled, arrested and sent to McLaughlin Youth Center, a local juvenile detention facility.

• Several West High students skipped school and went to visit Dimond High. One of the West students attempted to scare a Dimond student by showing a loaded handgun. The offender was expelled and arrested.

• Chugiak High and East High each had an incident in which a student with a knife threatened another student. Those students were expelled and reported to police. Also at Chugiak, a female student attacked a male student with a pair of scissors. She received a lengthy suspension.

Most of the serious weapons cases reported to the district administration by the secondary schools are for possession of a weapon, not for use of them.

The weapons include baseball bats, pellet guns, revolvers, a variety of knives, and in one case, a derringer that fit into a belt buckle.

Of the 106 high school and junior high students suspended for weapons incidents, 24 cases involved guns, Mell said. Possession of a gun results in an automatic recommendation for expulsion from school. But only 13 students were actually expelled, including the boy who shot the 16-year-old at Bartlett and the driver of the car the students were in.

School administrators agree that guns are more prevalent than they used to be. Teresa Johnson, a secondary-education supervisor who works with Mell, said there was no separate category for weapons on the district's suspension reports three or four years ago. "We're seeing more 'acting out' behavior that has a violent tinge to it," she said.

Kathi Gillespie, president of the Anchorage PTA Council, said she was surprised at the number of gun incidents reported. "I think it's very disturbing. . . . It's kind of a double-edged sword. Whenever an incident happens, a lot of times the more publicity it gets, the more copycat incidents there are in the schools."

But parents need to be aware of the environment, and to understand that because kids are impulsive, they can get into trouble, trust the child doesn't mean that one time, that child couldn't have bad judgment."

As for getting guns and knives out of schools, students who turn in other kids are the most effective tool, Mell said. "Probably 80 percent of the time we know something it's because a student told us." School officials work hard at making sure students know who to tell and how to do it safely, he said.

Schools also search lockers several times a year to look for weapons, and because of those searches, "Kids tell us the lockers are pretty clean now," Mell said.

But the problem continues in school parking lots. The district requires students who park on campus to obtain stickers, and to acknowledge that school authorities have a right to search their vehicles. Practically speaking, Mell said, such searches are generally not conducted unless there's reasonable cause, such as a tip that alcohol, drugs or weapons will be found.

The district has also considered metal detectors, but that's an expensive and limited solution, he said. The secondary-school administration has also considered metal detectors not for school operations, but for extracurricular activities.

But teachers seem more concerned about what happens to students who are caught with weapons than about the district's efforts to detect them. Tom Bronga, an East High special-education teacher, said he doesn't feel comfortable as a teacher "knowing that East has a lot of weapons and a lot of violence." He said the administration does a good job of standing firm with students found with weapons, recommending expulsion and going through the hearings that are part of the process.

The problem is that expulsion is not necessarily permanent, he said. Students who have been expelled show up at another school, often an optional program like SAVE or REACH, which help students in danger of dropping out or those with drug or alcohol problems. "I think the school board should expel permanently for any weapon," Bronga said.

Ron Fuhrer, a Clark Junior High teacher and board member for the teachers union, said he's concerned about the [illegible] teachers ought to be better informed about students involved in them, though he recognizes the students' rights to privacy may inhibit that. He's also concerned about the possibility of students re-entering the school system after they've been disciplined for possessing weapons.

Mell said it's true that expelled students can be returned to school. Some will not be readmitted, but any student can appeal an expulsion. And if a forensic psychologist recommends readmittance, a student may be allowed to return. Generally, the process takes about a year.

Although all students found guilty of gun violations are recommended for expulsion, some students guilty of weapon violations are sent to a new district program that counsels and continues educating students away from their home schools.

Eight students attended the pilot weapons program last semester, education supervisor Johnson said. For the coming school year, there will be a full-fledged alternative suspension program for students judged to

BAR: Man shot outside saloon

Continued from Page B-1

According to witnesses, the 40-year-old man had been talking to a woman when another man approached and said something like, "Don't talk to my woman." A shot was fired and the first man doubled over. The woman and the shooter fled, the woman by car and the man on foot, police said.

Several taxi drivers followed the man and saw him throw a gun behind the Sixth Avenue Jail. A semi-automatic pistol was later recovered from the area, Moen said.

Police officers, led by the taxi drivers, caught up with Goodman and arrested him in front of the Federal Building, police said. They said he smelled of alcohol.

The injured man had a slightly different story to tell. From his hospital bed, he told police he was trying to stop Goodman from beating the woman when he was shot. He described himself as an innocent victim.

So far, police have been unable to locate the woman involved.

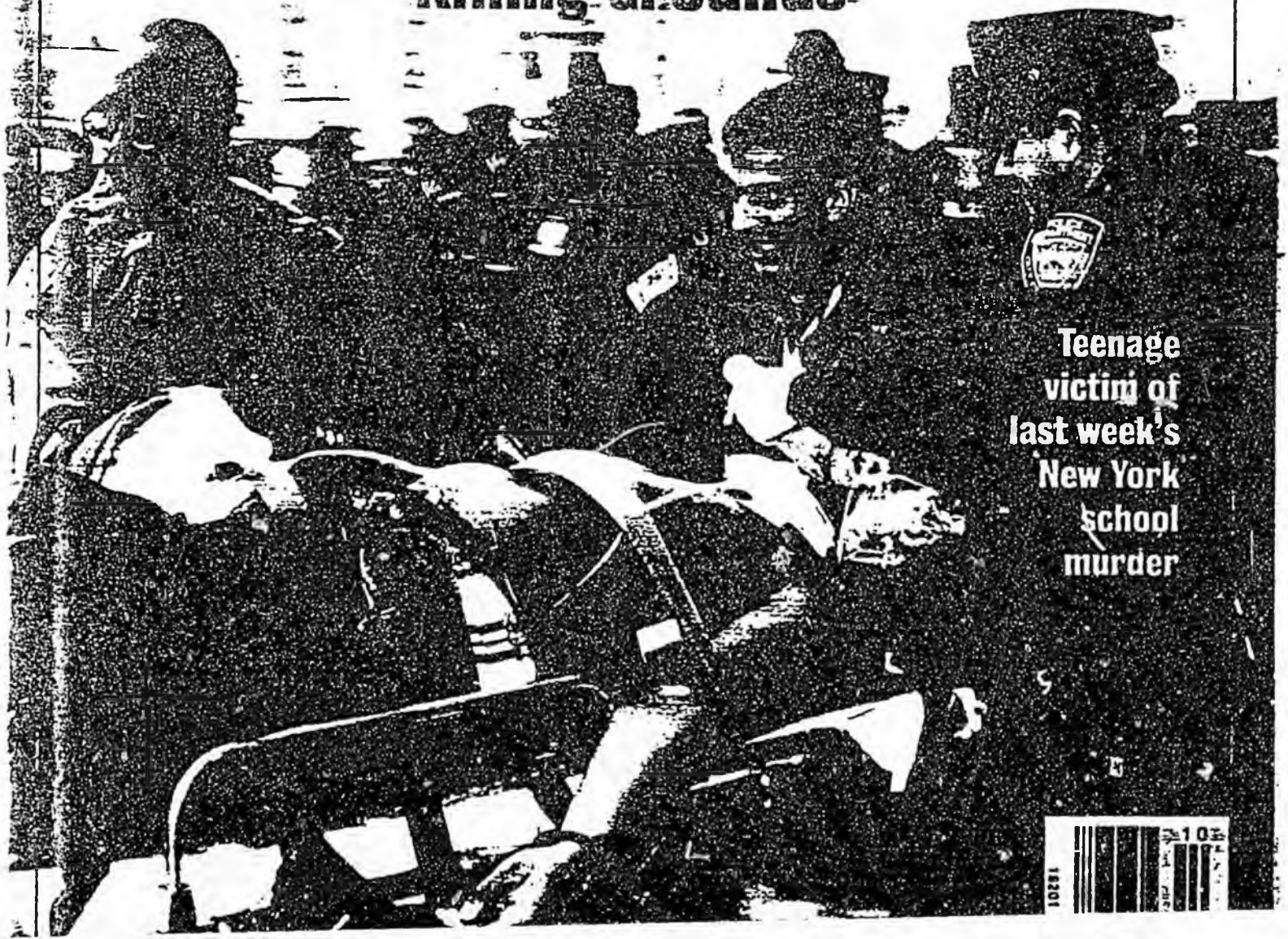
A preindictment hearing

GETTING NASTY
The Politics of Super Tuesday

Newsweek

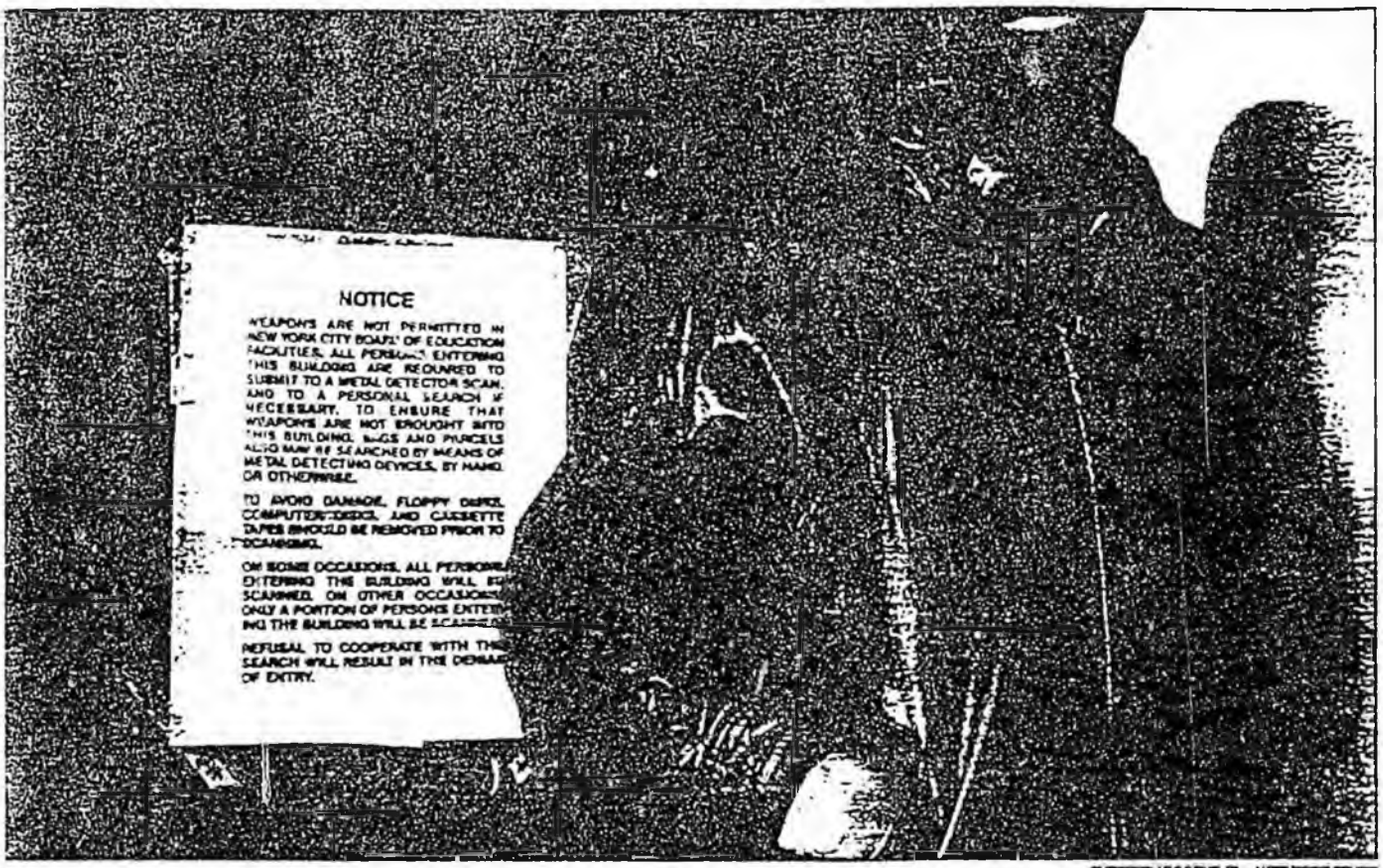
Kids and Guns

A Report From America's Classroom Killing Grounds



Teenage victim of last week's New York school murder

DEADLY LES



CHESTER HIGGINS JR.—NEW YORK TIMES

BY ROD NORDLAND

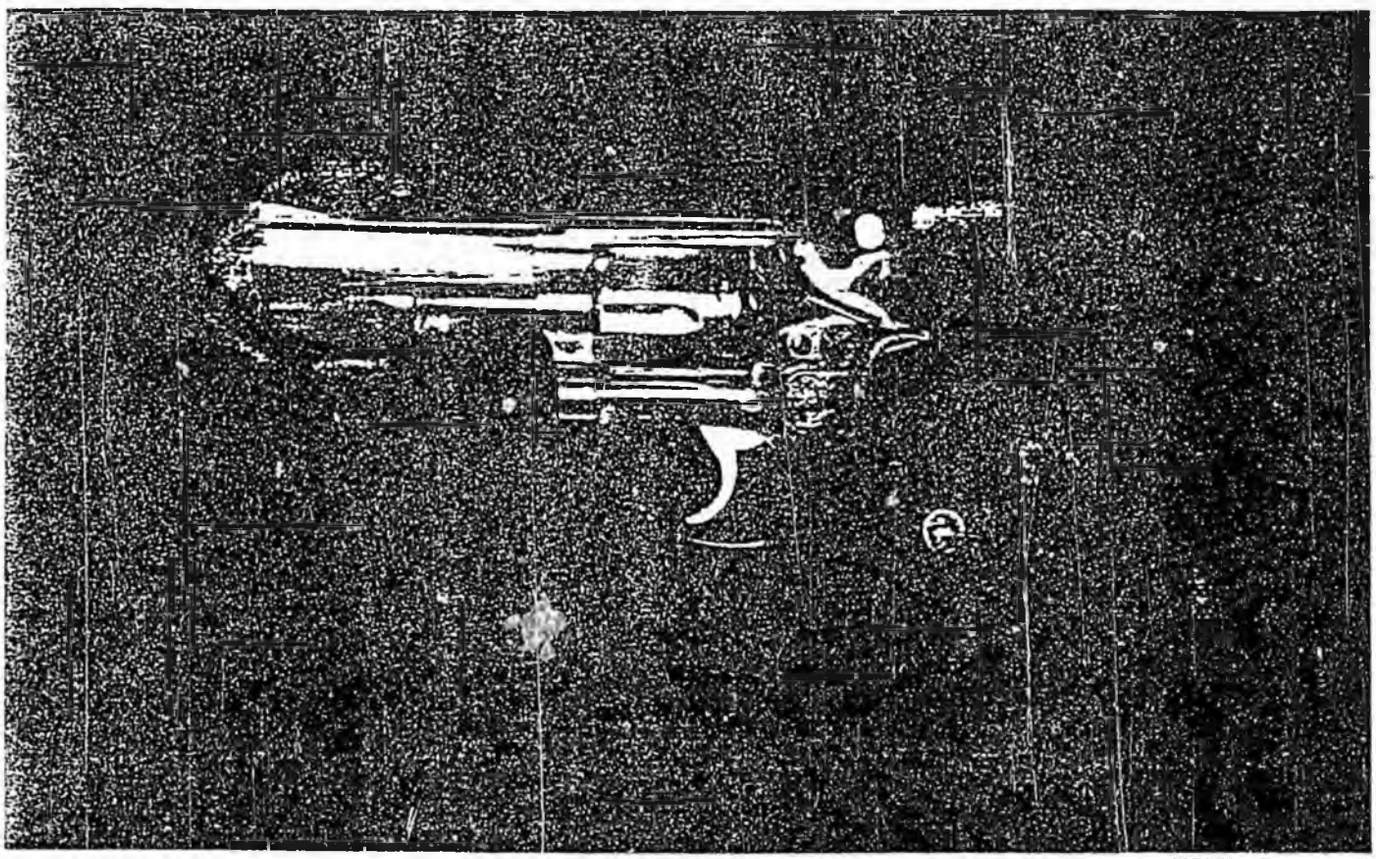
From the outside, Thomas Jefferson High School in Brooklyn is an inner-city fortress—a four-story pile of faded brick with security screens on the windows and steel plate on the doors. Guns are as familiar as book bags to the kids inside. "If you had the money, you could get yourself a 'tool' in 15 minutes," says Nicole Solomon, a 15-year-old sophomore. "I would say, out of 100 kids, 90 got guns or can get them. I had a weapon myself when I first went in there." Glenn Kirkland, now a city police officer assigned to the school, attended "Jeff" a decade ago. "Back then we used to duke it out," he says. "Now you hear these guys: 'Hey, you stole my girlfriend, boom!' Then his friends say, 'Hey, you shot my friend, boom!' Pretty soon it's boom, boom, boom!"

The cop knew his beat: across the country, kids with guns are becoming small angels of death, transforming dead-end streets and tough-luck schools into free-fire zones. "Our last place of safety is the school," says Carol A. Beck, Jeff's embattled principal. "Next to Mother's arms, that should be the safest place." No longer. Drug gangs have put more guns on the street than ever before. But many kids who aren't otherwise criminals are suddenly reaching for their equalizers. And guns have become the leading cause of death among older teenage boys—white and black—in America.

No school has felt the pain more than Jefferson High. Last week New York's Mayor David N. Dinkins booked a stop to show the flag and give a speech. The same day, Khalil Sumpter, 15, allegedly smuggled in a chrome-plated .38-caliber Smith & Wesson revolver. Police say he had murder on his mind and two bullets in his gun, and that Sumpter was going after Tyrone Sinkler, 16, and his inseparable buddy, Ian Moore, 17. Sumpter and Sinkler had been partners in a botched mugging last spring. Sinkler did time, Sumpter got probation, and they had been fighting about it ever since. "He called me a rat," Sumpter told the police. He thought Sinkler meant to kill him and he decided to strike first. "He indicated it was kill or be

SONS

Kids with guns are setting off an arms race of their own across the country—as a double murder in a New York high school showed. Are schools doomed to become free-fire zones?



MICHAEL A. ACH—NEWSDAY

At Jefferson High, a sign next to the metal detector warns students of random spot checks for weapons, a police officer displays the handgun used in the shooting

killed," said Detective Sgt. Michael Race.

With cinematic timing, the bang-bang-you're-dead fantasy turned into bloody reality. The morning of the shooting, Moore's mother, Linda, rustled him out of bed and pointed him toward school. He'd been up late watching the Grammys on TV. Sinkler hit his father for 60 cents because he needed lunch money. Sumpter arrived late. He was well known to school cops as a "hallwalker," a kid more interested in hanging out than sitting in class. When the bell rang at the end of first period, Moore and Sinkler stepped into the hallway together, where Sumpter was waiting. "He just pulled the gun and started shooting," eyewitness Rafael Montalvo, 15, told Newsday. "Wasn't no words said, no hands thrown—just bullets hitting." David Lerner, a teacher on duty as a hall monitor, pushed through the screaming kids and looked down at the victims. "The officer was already pressing his finger against their necks," he recalled.

A hundred students, some weeping, some numb, gathered in the school's six "grieving rooms," struggling to cope with what they had seen: Sinkler in convulsions bleeding from the head, Moore lying still, shot through the heart. "It's sad to go to school like this," said Marvin McLaurin, 16. "It makes you feel like an animal." Marlon Smith, a 16-year-old friend of the victims, left for home in hysterics. He later phoned a friend, who heard a clicking sound over the line and asked what it was. "I'm playing Russian roulette," Smith replied. Then he pulled the trigger again and killed himself. Sinkler's anguished father threatened to sue the city. "Why in the world was there a gun in school?" he said. "Now my son's in the morgue over some bulljive."

The shootings added three more bodies to an awful calculation: kids with guns have set off their own kind of arms race. The latest murders made it New York City's bloodiest school year ever, with 56 shooting incidents in and around schools. In all, 5 teachers, 1 cop, 2 parents and 16 students have been shot—6 of the kids fatally. "These children are children of war," Beck says. "They worry that in the blink of an eye they could be killed—this is a reality—and they think they have to protect themselves." A kid can now be "carrying" for as little as $25. In Brooklyn they even have rent-a-guns. Says Beck. "You could find a gun in this neighborhood faster than you could find a copy of NEWSWEEK."

Sumpter's gun was stolen, "used" in street talk, so it wasn't too expensive. Other tools cost plenty. Last November a furious

Before the gunplay, a mugshot of Moore at right; after the murder, a glimpse of his girlfriend Schemeka Smith in tears

JONATHAN FINE—NEWSDAY

argument over a book bag led a 14-year-old at Jefferson High to whip out his "nine," a 9-mm semiautomatic pistol that can cost as much as $1,000. He fired wildly down a crowded hallway at Jefferson High. The fusillade killed Darrell Sharpe, 16, and wounded teacher Robert Anderson in the neck. Both were innocent bystanders.

The larger tragedy was Jefferson High had far more to offer than the way of the gun and an early grave. If the measure of a good school is how well it helps its students rise above their limitations, Jefferson High was exemplary. The East New York neighborhood runs to public-housing projects and vacant lots, glass-strewn streets under elevated subways. On cul-de-sacs outside abandoned houses, young men stake out turf. When strangers approach, they thrust their hands deep in their pockets or under their jackets, a signal every boy in the 'hood, along with every man, woman and child, understands.

Safe haven: By comparison, Jeff seemed to promise at least the illusion of a safe haven. Step inside, pass the metal detectors and the security detail, and you were in another world. The floors were clean, the brightly painted walls were decked with quotations from the Rev. Martin Luther King Jr. and Nelson Mandela, and posters exhorting kids to get their diplomas (DON'T LEAVE SCHOOL WITHOUT IT). A remarkable number didn't. Most students are black or Hispanic, with a smattering from 27 foreign countries. Last school year, 81 percent applied to college—from a high school in an urban wasteland.

Principal Beck relished a good fight. Two weeks before the shooting, she suffered a heart attack—but it didn't slow her down. With school officials and students swirling around her last week, she was on the telephone telling a caller, "I'm pissed because I can't go kick butt and solve this." Someone thrust a fistful of pills at her, insisting she take them before another distraction could come up. Some were for her ulcer, others for her heart. "It's nothing," she said. "If I couldn't stand the heat, I'd get out of the kitchen."

Role models: When Beck took over in 1987, Jeff was a school with an illustrious past, a lousy present and no future. Only one in four ninth graders was staying on to earn diplomas. Earlier waves of immigrant East New Yorkers—Italians, Irish and Jewish—had filled Jeff's roster with celebrities, among them Shelley Winters, Steve Lawrence and Danny Kaye. Beck brought some of them back to meet the students. When H. Donald Gelber, another alumnus, was sworn in as U.S. ambassador to Mali last year, the principal bused many of the students to the ceremony at the United Nations. "What I have done, you can do," he told them. Beyond offering role models, the principal threw her own office door open to students, working late in the evenings, partly so that kids would have a place to stay off the streets. "Some of them would rather be here than in their own homes," said Helen Baker, a teacher. Beck recruited a staff that was fiercely loyal to her and to the students. The Reader's Digest gave her one of its American Heroes in Education Awards in 1991, donating a $10,000 prize to the school.

In the end, she was outgunned. For a while, she was able to cut the crime rate in half by banning gold chains and door-knocker earrings. But over the past year, Jefferson High has seen four stabbings among 35 reported crimes. Beck took a survey and found that half her students had puncture wounds of some kind. On any given day, a fourth of them were absent, hanging on the corners or hustling drugs. Many were too scared to come to class. No wonder. Since December, spot searches have turned up 121 weapons.

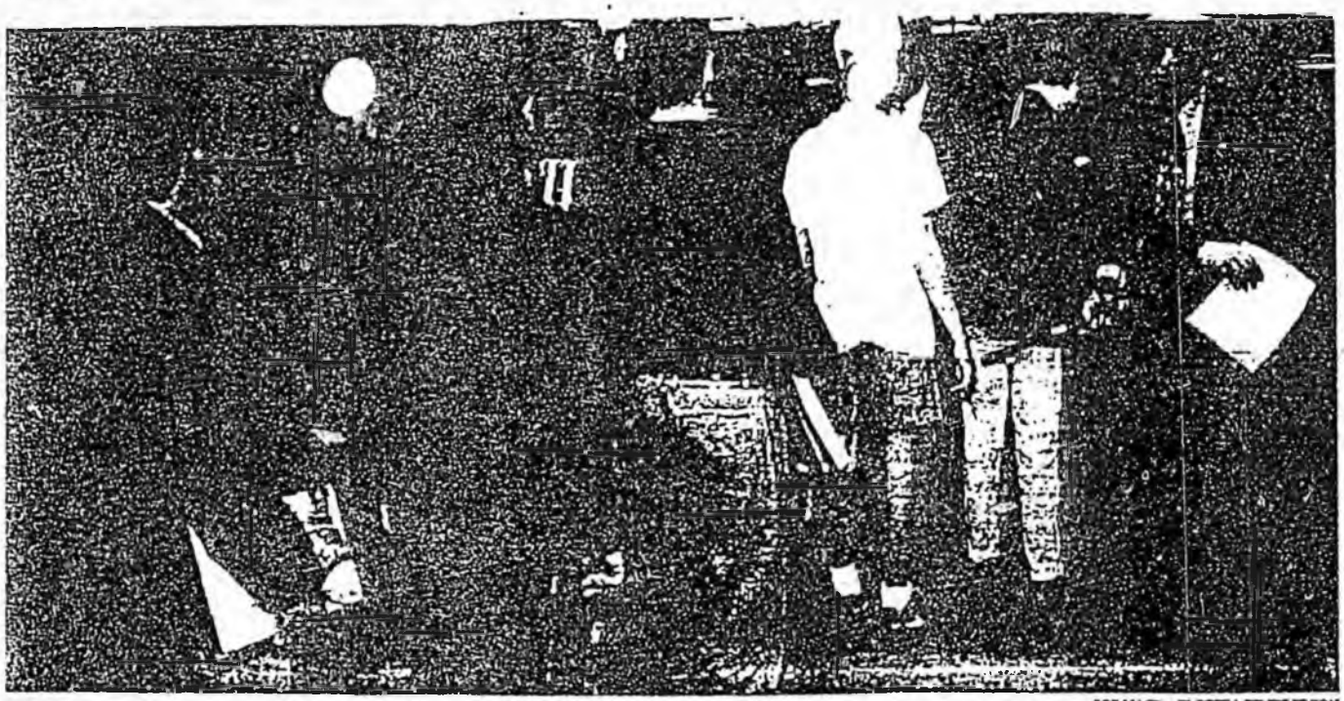
Jefferson could excel, but it couldn't escape. Perhaps it was naive for anyone to expect it to. "What really gets people is that this happened in a *school*," says Beck. After last fall's shooting, the city made Jeff one of 21 "metal-detector schools," but there were only enough funds to spot-check for weapons once a week. Last week that check was on Tuesday. The shooting was on Wednesday. Now there will be metal detectors every day. Too late for Moore and Sinkler. Turning things around, says teacher Lerner, is "like trying to throw bricks into the Grand Canyon to fill it." And it takes a lot more than bricks to fight guns. ■

No Recess From the Violence

It is already New York City's bloodiest school year ever, with 58 shooting incidents in and around schools. Some of them:

- **10/7/91, PS 309, Brooklyn:** Parent shot in back by pellet or BB gun.
- **10/8/91, James Monroe High School, the Bronx:** Student, 17, shot and killed.
- **10/8/91, IS 115, the Bronx:** 14-year-old shot in stomach.
- **10/28/91, PS 178, the Bronx:** Student shot in legs.
- **11/1/91, Westinghouse High School, Brooklyn:** Student, 19, shot in back by gang of armed intruders in school hallway.
- **11/10/91, Brooklyn Alternative High School:** Teacher shot in left arm on street.
- **11/21/91, McKee High School, Curtis High School, Staten Island:** A student shot three students, killing one 18-year-old.
- **11/25/91, Thomas Jefferson High School, Brooklyn:** Student, 16, killed and teacher wounded in hall.
- **1/21/92, IS 324, Brooklyn:** Police officer shot on street by student.
- **1/30/92, IS 49, Brooklyn:** Two students (13 and 11) wounded when another student fired into playground.

SOURCE: UNITED FEDERATION OF TEACHERS



BOB MACK—FLORIDA TIMES-UNION

Reading, writing and metal detectors: An embattled security unit in Florida uses a sensitive metal detector to frisk students for concealed weapons

It's Not Just New York . . .

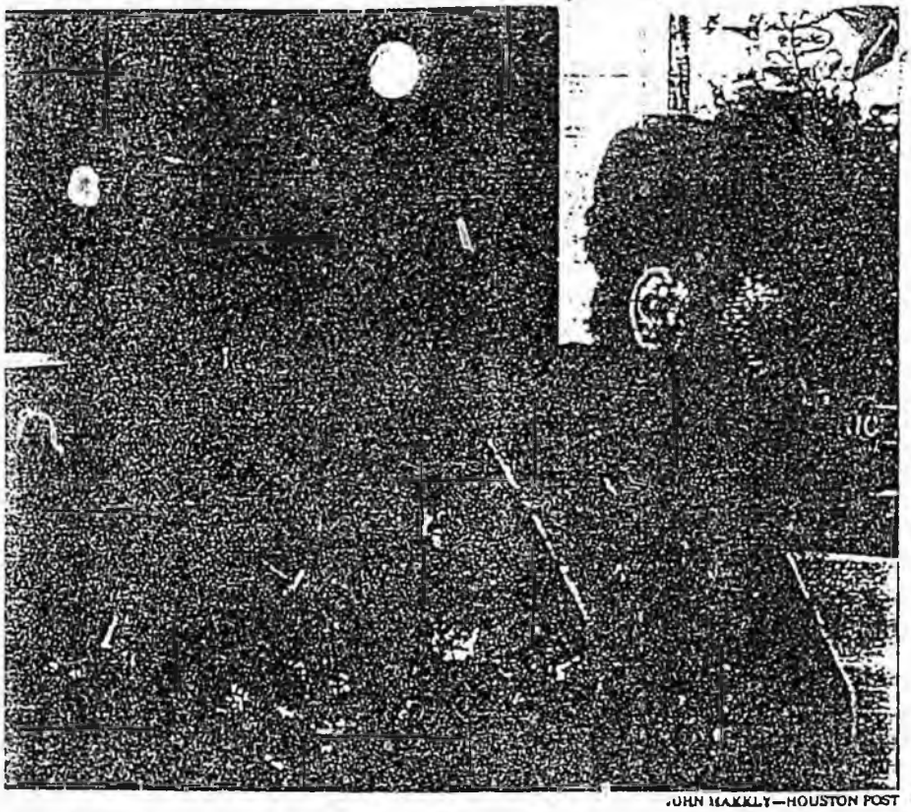
Big cities, small towns: more and more guns in younger and younger hands

A tragedy came to Crosby, Texas, over breakfast in the high-school cafeteria. The victim was Arthur Jack, 17, captain of the varsity football team, and the day was Sept. 18, 1991. According to witnesses, Jack was helping himself to orange juice in the serving line when he heard someone say, "You called me a bitch." He looked up to see another student, identified by police as La-Keeta Cadoree, 15, pointing a .38-caliber revolver. Jack tried to take cover but the shooter was too quick: hit in the back by a bullet that traveled upward to pierce his heart, he died on the floor behind the serving counter. Because Crosby (population: 1,811) is a quiet little town on the outer fringe of the Houston metro area, the incident made big news for weeks. "When I heard it happened, I didn't want to believe it," Arthur Jack's father said. "It was like, 'This only happens in the city—Chicago or New York or something'."

The truth, sadly, is otherwise. Gun violence is on the rise in schools all over America, and the nation's children are trapped in its path. According to the federal Centers for Disease Control, one student in five reports carrying a weapon of some type and about one student in 20, or 5.3 percent, reports carrying a gun. The number of young Americans killed by firearms each year more than doubled, from 1,059 to 2,162, between 1970 and 1990, and homicide is now the leading cause of death among black males under the age of 35. There are no national statistics on the number of shootings and gun-related incidents in schools. But the anecdotal evidence is compelling: kids, even fourth and fifth graders, are arming themselves, and teachers and school officials are running scared. "You think it's a bunch of bad kids [who] are carrying the guns, but it's not," says Paul Kingery, director of health promotion at Texas A&M University in College Station, Texas. "The kids are the victims of violence, and the schools are not creating safe environments. Law enforcement is not adequately involved."

The root causes of this bizarre and lethal trend include all the usual demons of American society—the easy availability of guns, the rise of drug-related crime, parental irresponsibility and so on. As always, educators contend that public schools merely mirror the broader trends in society—and if guns, drugs and violent crime are on the increase, they say, schools will be affected, too. Rightly or wrongly, most school officials cling to the ideal of schools as friendly, open and noncoercive institutions, and few favor the kind of draconian security measures that would be needed to eliminate guns entirely. "The school setting is almost impossible to police without tyrannical dictatorship," says Mark Karlin, president of the Illinois Council Against Handgun Violence. "At what point do we create such a hostile environment that these are no longer schools?" The schools, Karlin says, "are in an impossible situation . . . we expect them to do what the rest of us cannot."

But no one doubts that the impact of guns and gun violence is very large. Fully a quarter of the nation's large urban school districts now use metal detectors to search for weapons carried by students, and teachers and parents are joining forces to make school safety a major issue. A shooting at Castlemont High School in Oakland, Calif., sparked a teacher walkout last fall—and in Washington, D.C., last week, parents and teachers joined in protest after a 13-year-old boy was allowed to return to Noyes Elementary School after being arrested for carrying a gun. "Teachers are much more fearful in the middle schools and upper elementary grades—fifth and sixth grades—than they ever were before," says Bill Martin, a spokesman for the National Education Association. "It's not an issue [that is] centered on the large cities any-



JOHN MARKLY—HOUSTON POST

Taking offense—then taking aim: Police lead Cadores off to stand trial as an adult for killing a football hero

more." Texas A&M's Kingery, whose research shows an alarming rise in the number of children who carry guns in rural Texas schools, agrees. "It's a myth that rural schools are safe havens from the problem," Kingery says. "All the people who are taking their kids out of urban schools and moving to rural areas are living on false hope."

But big-city schools are still the primary battleground. In city after city—from New York to Los Angeles and everywhere in between—schools are struggling to protect their children from the violence all around them. Metal detectors, locker shakedowns and armed police patrols are now taken for granted in many big-city high schools. Teachers are learning a new kind of civil-defense drill—hitting the dirt when gunfire erupts. It did at Fulton Junior High School in Van Nuys, Calif., just last week. As kids ran for cover, a lone gunman opened fire across the school playground, wounding two students in the legs. When the incident was over, the faculty prepared to comfort a school full of frightened students. But, says assistant principal Jean Yearout, the Fulton kids "were very calm. There's so much violence on TV and in the community that many kids expected this kind of thing." "Our kids hit the ground if they hear gunfire," says Wesley Mitchell, chief of police for the Los Angeles Unified School District. "That's what they do at home."

Or consider Clarence Notree's close encounter with gang violence. Notree, 44, is a veteran instructor in the Chicago school district's after-school activities programs for inner-city kids. He was running a basketball clinic at Woodson North Elementary School last Sept. 17 when a car pulled up outside the school. A young man, probably a gang member, came into the gym and wordlessly opened fire with a 9-mm handgun. Kids scattered everywhere—into the hall, into the girls' gym—and Notree, acting on instinct, spread out his arms to protect as many of the children as possible. After firing 12 rounds, the gunman walked out the door, got back into his car and made a successful getaway.

Miraculously, Clarence Notree was the only casualty that day—he took a bullet through the right wrist and missed 13 days on the job. Now he's back at Woodson North. "I try to keep as many kids as busy as I can with as many activities as I can," he says. "It's calm here, but it's always in the back of your mind: it could happen again." The kids, on the other hand, seem to have forgotten all about it. "These kids see a lot of death. They don't get much chance at childhood," Notree says. "When I was growing up, we used our fists. These kids have *guns*. The respect for life is nothing."

Cops and school officials say very few guns are actually obtained in school. Instead, according to experts like Ronald D. Stephens, executive director of the National School Safety Center in Westlake Village, Calif., 80 to 90 percent of the guns that wind up being seized by school officials come from the home. They are usually the parents' guns, and that fact has led some states to impose new restrictions on gun ownership. California, for example, now makes parents criminally responsible for shootings involving their children.

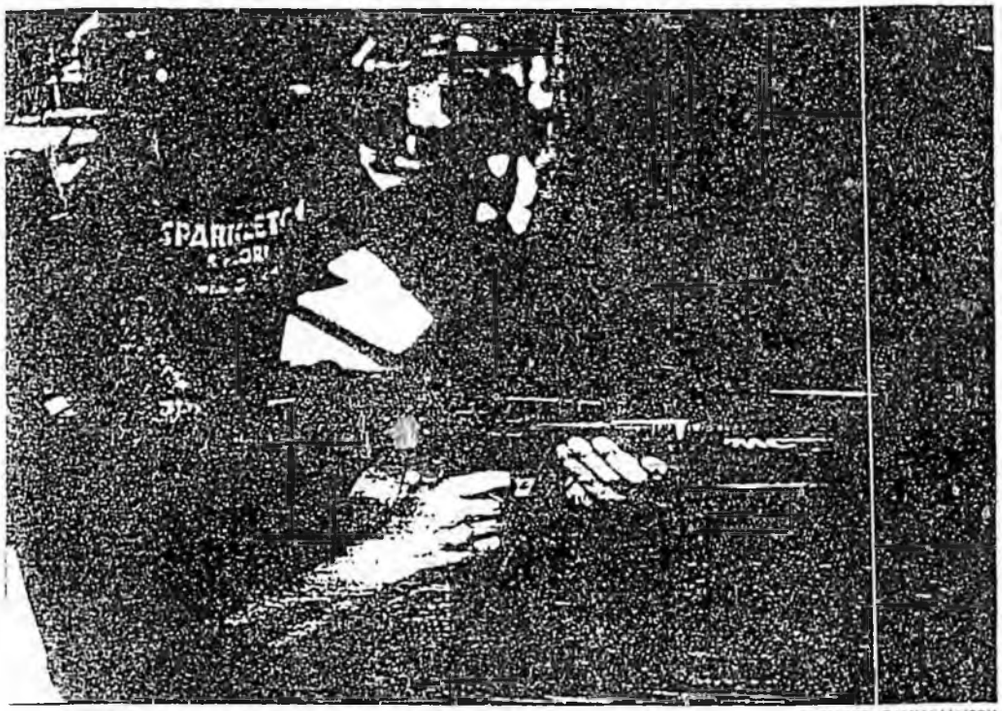
Teacher hostage: A terrifying incident in Dalton, Ga., last week has helped fuel a similar effort in the Georgia Legislature. In the Dalton case, a 13-year-old boy came to school with a loaded .22-caliber rifle and took his teacher hostage in a classroom at Valley Point Middle School. Principal Nick Ownbey went to the classroom and confronted the boy, who finally handed over the rifle. The boy, whose name was not released by authorities, was charged with aggravated assault and false imprisonment. The Georgia version of a parental-responsibility bill has already passed the House of Delegates, though its prospects in the Senate are uncertain.

But few families in Georgia or anywhere else seem ready to do what it takes to stop the kiddie arms race. The days of zip guns and Saturday-night specials are over. These days, teenagers routinely pack top-of-the-line weapons like .357 magnums, 9-mm semiautomatics and even Uzi assault rifles. "I have friends who are proud they've taught their children gun safety and marksmanship," says George Sams, director of safety and security for Chicago public schools. "It doesn't occur to them that when the kid runs into difficulty, he'll remember where that weapon is." Sams also sees street gangs as a major source of weapons used by kids. "We find these kids with these beautiful Uzis and .357s," he says. "Good weapons are expensive and the drug money is fast. Parents say they never noticed that their son was wearing $150

Trigger-Happy High School

- According to the National Crime Survey, almost 3 million crimes occur on or near school campuses every year—16,000 per school day, or one every 6 seconds.
- One fourth of major urban school districts now use metal detectors.
- Almost one third of the students in 31 high schools in Illinois said they had brought a weapon to school for self-protection at some time during their high-school career. One in 20, or 5.3 percent, said they had brought a gun.
- In California in the 1988-89 school year, assaults were up 16 percent, to 69,191. Armed assaults were up 25 percent over the previous year, to 1,830.

SOURCE: RONALD D. STEPHENS, NATIONAL SCHOOL SAFETY CENTER



RICHARDS--GAMMA-LIAISON

High-powered lessons: Teaching the rules of gun safety on a shooting range in southern Florida

sneakers and riding a new motorcycle. I spent a lot of years in homicide. Parents will tell you, 'I never knew he was in a gang' all the way to the morgue."

What is going on in many big-city schools today is a perverse and deadly sort of trickledown effect. Older kids—the boys, anyway—flaunt guns and their membership in gangs as marks of status. Younger kids get guns, too—sometimes to emulate the gangbangers, sometimes just to keep from being beaten up or shaken down for their lunch money. These kids finally join gangs, says John Cochran, a Los Angeles youth counselor, "when they get tired of being beaten up. Then they have a gun in their hand, they kill their first person, and that's it. It's glamorous and it's powerful." The threat of violent crime is very real to millions of American schoolchildren. A national survey conducted by the U.S. Bureau of Justice Statistics last year showed, for instance, that more than 400,000 students between the ages of 12 and 19 say they have been the victims of violent crime, and that younger children are more likely to report victimization than older teens.

Close range: Take, for example, the kids at Parme Lee Elementary School in downtown Los Angeles. Parme Lee is a school where kids like Kristal, who is 10, see crack deals at very close range. "They sell drugs and they try to get the hookers to buy them," Kristal says, pointing to a building across the street. "Two boys named Slamp and Juju died there." Another Parme Lee student, Dontay McDay, says she doesn't like to play outside her house. "I'm scared because a lot of gang members go by my house. I see police a lot," she says. And Eric, a fourth grader, says he doesn't like to talk about the violence in the neighborhood. Why not? "The gangs might hear you," Eric says.

The obvious question, for anyone who cares about children, is what all this is doing to the kids. Mental-health experts are increasingly concerned about the psychological impact of ceaseless violence on city kids. Children, they say, are durable and resilient, and the effect of violent drama on television is usually overstated. But today, millions of young Americans are routinely confronted with real-life violence—in the home, in the neighborhood and sometimes in the school. A survey conducted last summer by the University of Alabama at Birmingham shows, for example, that 43 percent of a sample of inner-city children age 7 to 19 say they have actually witnessed a homicide. To UAB sociologist Kevin Richardson, such findings suggest an epidemic of posttraumatic stress syndrome. Posttraumatic stress, he says, "has significant developmental implications for these children" if only because it takes energy and will to keep the nightmares away. "They see it every day, and they try not to let it affect them too much," Richardson says. "But we know for a fact that it's affecting them."

Sneaker murder: The end result—or one of them, anyway—is a generation of streetwise, battle-hardened kids who are desensitized to violence and grief. Kids who have seen everything—kids like the survivors of civil war in Lebanon and Northern Ireland. How else to explain Kenyatta Miles of Philadelphia, who was sentenced to death last week for shooting another boy for his sneakers? "It still ain't going to bring him back," Miles taunted the boy's family when his sentence was announced. And how else to explain the fact that authorities in Monterey, Calif., uncovered what appeared to be a plot by 11 junior-high-school students to shoot a classmate to death? The murder, fortunately, never took place—but two 13-year-olds and a 14-year-old accomplice have pleaded guilty to conspiracy to commit manslaughter. Authorities still aren't sure why they did it.

What all this says to people like Lee Burton, chief of police for the Houston Independent School District, is that it is finally time to restrict the availability of handguns nationwide. But there is little sign of a breakthrough in the long impasse over handgun control, and war-weary observers like Rita Walters, a Los Angeles city councilwoman, are pessimistic that effective legislation can be passed. Meanwhile, as she says, gun violence continues at a level that can only suggest a national character flaw. And if that is what it is—the American disease—it can be no surprise our children have it, too.

TOM MORGANTHAU *with* PETER ANNIN *in Houston,* JOHN MCCORMICK *in Chicago,* PAT WINGERT *in Washington,* DONNA FOOTE *in Los Angeles,* HOWARD MANLY *in Atlanta,* PATRICIA KING *in San Francisco and bureau reports*

Life on the Front Line

■ "Fire drill" doesn't mean what it used to. Oakland and Los Angeles, Calif., and even towns like Cokeville, Wyo., have drills to teach youngsters to hit the floor when they hear gunfire.

■ An Illinois study showed that one in 12 public high-school students reported being the victim of a physical attack in school or on the way to school. One in 12 also said he'd stayed home from school one or more days out of fear.

■ Teachers, too, are worried. A 1990 survey found that 20 percent had been threatened.

SOURCE: RONALD D. STEPHENS, NATIONAL SCHOOL SAFETY CENTER

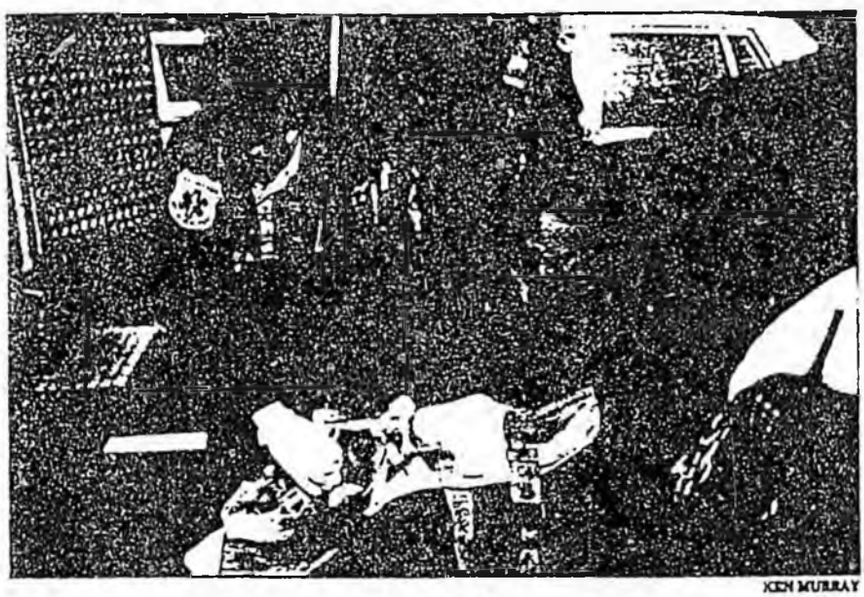
How to Keep Kids Safe

Teachers, principals and parents can help

School violence has become a dismal fact of life, yet many educators continue to respond with not-in-my-schoolyard denial. Not George Sams, an ex-cop who in June 1990 became director of safety and security for Chicago's 410,000 public-school students. With his former police comrades, Sams launched a program called SAFE: Schools Are For Education. Since the program began, he says, there hasn't been a single shooting in the district during school hours.

Operation SAFE hasn't cleared all the guns out of Chicago's schools, but its success has intrigued other districts. Nearly a quarter of all major urban high schools now use metal detectors; what's different in Chicago is the surprise factor. The district moves its three walk-through detectors from school to school on a random basis. "A lot of school districts want to put detectors in every school and use them every day," says Sams. "It won't work. If kids know they have to pass through a metal detector, they'll get the guns into schools through windows or back doors." Another key component is cooperation between city cops (150 of them paid for by the district to patrol Chicago's 70 public high schools) and 412 unarmed security officers. While as a rule police searches require probable cause, in school settings authorities can act on the less stringent standard of reasonable suspicion. In Chicago, once a guard's suspicions prove on target, a police officer can make the arrest.

Legality aside, many school-safety experts worry about turning campuses into armed camps. Arguably, the message search-and-seize tactics convey to kids is: don't get caught. Instead, many educators believe schools won't be safe unless they can find a way to instill basic values of right and wrong, and teach young people to respect themselves and others. Some of the best proposals from the nation's experts:



KEN MURRAY

A frightening fact of life: One of the victims of last week's double murder in New York

■ **Teach the teachers:** Teacher training needs to prepare instructors to deal with disruptive students and to break up fights—before they escalate into murder. The National School Safety Center (NSSC) has developed a training program in crisis prevention, management and resolution. Too many teachers come to class unprepared—like the one who told NSSC executive director Ronald D. Stephens, "I got my training the day the kids pointed the gun at my face."

■ **Teach the children:** Schools need to identify fight-prone kids when they're young and introduce them to nonviolent alternatives. Schools can help by offering peer mediation, clear-cut standards for behavior and consistent discipline. But the lessons have to begin at home. Researchers believe that children who witness violent altercations among parents are likely to use weapons themselves. In certain communities, such violence is far from rare. In a study published in 1990, Chicago psychiatrist Carl Bell found that 74 percent of the 1,000 inner-city schoolchildren screened had witnessed a killing, stabbing, shooting or robbery.

■ **Get involved:** Schools need more adults on campus to provide supervision. Paul Kingery, director of health promotion at Texas A&M University, believes principals should have parents conduct "safety watches," especially at tense events such as football games. Businesses can help by giving time off for employees who want to participate in school programs. And parents should pay attention to signs their kids may be hanging out with a bad crowd—if teens suddenly have a lot of cash to throw around, for example.

■ **Keep weapons away from kids:** An estimated 80 to 90 percent of gun-toting kids get their firearms at home. Les Burton, a man whose job as chief of police for Houston's schools is itself a sign of the times, believes communities should conduct programs to teach parents how to handle and store their guns. Several states, including California, Iowa, Connecticut and Florida, now have laws that make adults responsible for crimes committed by children wielding their weapons. But while it's important to keep firearms away from kids, forbidding toy guns might actually backfire. Children need to discharge their aggressive feelings, not bottle them up. "Shooting games provide outlets for accumulated frustrations and thus are apt to reduce them," wrote child psychologist Bruno Bettelheim.

■ **In the meantime, be ready to duck:** Cities like Oakland and Los Angeles, and even small towns such as Cokeville, Wyo., have started DBS (drive-by shooting) drills and "drop drills," teaching kids how to hit the floor when gunfire breaks out. It's a sad day when DBS replaces the ABCs, but for too many kids, the No. 1 lesson is staying alive.

ELOISE SALHOLZ with BARBARA KANTROWITZ in *New York*, JOHN MCCORMICK in *Chicago and bureau reports*

Revamp juvenile system or give up our streets

By PAUL JENKINS

Alex Felker thinks kids may be changing, getting more malevolent, more violent.

He bases that on recent experience with a pack of punks in Spenard who gave him 16 stitches around his right eye, a busted lip, a painful lump on the back of his head, a cut on his forehead and too many bruises and scratches to count.

His offense? He says he had left his job on the North Slope, stopped in Anchorage to buy Christmas gifts for his family in the Bush and went for a walk to a nearby convenience store. He says he was minding his own business. That somehow offended the five juveniles hanging around a convenience store. They cursed him, screamed at him, chased him down in their Suburu Brat.

They did that even after he crossed the road to avoid a confrontation; even after he made it clear he wanted no problems.

They punched and kicked and clubbed the 37-year-old, unemployed emergency medical technician bloody. They beat him to the ground right beside Spenard Road, with traffic whizzing by a few feet away. At least one of them wielded a large flashlight or club in the attack.


Jenkins

If a cab driver had not stopped, Alex Felker might well have gone home in a coffin to his wife and four children at Crooked Creek — a small village in Southwest Alaska on the Kuskokwim River.

"They were really whaling on him," says the cab driver, who asked not to be identified. "He was out on the ground. They really did it to him. He was just covered with blood."

The cab driver says when he saw what was happening and stopped, he inadvertently blocked the assailants' vehicle. Felker and the driver got the Suburu's license tag number, and Felker says he reached into the vehicle and grabbed its keys before his assailants could speed away — getting bashed again on the head and knocked senseless in the process.

Then the punks did what punks do. They ran away.

"They said, 'We'll get you, too,'" as they fled, the cab driver says. "I just can't understand it. Why in the middle of Spenard Road? It was very public."

Felker says he doesn't know why either.

"It looked like they were a rowdy bunch, and they were just looking for someone," he says. "I happened to be that person."

Felker now faces what he estimates will be a $600 hospital and ambulance bill. He has no medical insurance. He has no job.

But Felker, who says he wouldn't raise his kids in Anchorage on a bet, is lucky. The cab driver is lucky. And most of all, the kids — stupid, invulnerable and sadly mean — are lucky.

They are lucky Mr. Felker was not killed. They are lucky they were not hurt or killed.

And they are lucky we have a juvenile justice system that will protect their identities and never acknowledge that violent kids are as dangerous as violent adults. They are lucky it's a system built on the premise that kids can be rehabilitated, and that it is a system geared to the notion that juveniles cannot commit real crimes.

Make no mistake: what happened to Felker was a crime. His attackers were coldly cruel and violent and malicious, and while they may end up paying some restitution, they never will have to pay the full price for what they did.

As of early this week, only one had been charged with assault. But it's likely, authorities say, the rest also will be charged. That may be all we'll ever know about the case, the system being the way it is.

You have to wonder what makes some kids do things like this, why they go well beyond the bounds of normal teen-age yahooism. You have to wonder why they think almost beating someone to death is acceptable..

We can blame it on television and Hollywood. We can blame it on broken homes or rotten parents or poor nutrition or poor potty training. We can blame it on drugs, alcohol, abuse — almost anything. All these things most certainly could play a role. We can find any number of reasons why junior, in his pointed little noggin, finds it necessary to nearly kill someone for fun.

But all that doesn't explain the millions of teen-agers who are good citizens despite those adversities, and more.

Nope, it's time to lay the blame where it belongs. Squarely in junior's lap. He does it because he thinks he'll get away with it, and it's that simple.

* Junior needs to know, and learn to believe, that violence is unacceptable, that it will not be tolerated, that it will be met with swift, sure justice. Those few need to know early on there is no room in school or on our streets for violent punks. We must make that known without losing sight of the fact that most teen-agers who screw up only need a firm nudge and time to get them back on the right track.

* With the Legislature about to convene in Juneau, we should start letting our lawmakers know we are dissatisfied, that it's time to change the juvenile system to identify and punish those with violent tendencies.

This time, when five punks thought it would be OK to nearly kill someone, their prey was a guy lucky enough to survive, but it could have been any one of us, or our loved ones. A flat tire, an overheated engine or any other car problem — or just going for a walk — could have put any of us on that street, at that time, in those circumstances. We might not have been so lucky.

We can either start working to fix the system, or give up our streets and neighborhoods to punks.

Paul Jenkins is an editor of The Anchorage Times.

WED. 12/30/92

Eight-year-old Chicago student shoots classmate

By DAVID C. RUDD
and ANGELA BRADBERY
[illegible]

CHICAGO — The brand new Sharon Christa McAuliffe Elementary School received its initiation into the violence that is plaguing Chicago public schools on Tuesday.

An 8-year-old boy shot an 8-year-old girl in their third-grade class, the first time a pupil has been shot in one of the city's elementary schools.

It was a stunning crime involving children who are barely old enough to cross the street by themselves. And when it was finished, it was clear that a watershed had been crossed in the steady encroachment of guns and deadly violence into childhood here.

One day, a boy boasts to his friends that he will bring a gun to school. Sure enough, the next day he packs a semi-automatic pistol in his bookbag, pulls it out in reading class and shoots a girl in the back, according to police.

The boy has no history of disciplinary problems, principal Lois Perez said, but police said he appeared unfazed by his act.

"I've seen very calm, collected adults, but this kid put them all to shame," said Cmdr. Charles Roberts of the Grand Central Area detective division.

Because of his age, the boy was not taken into custody but was allowed to remain with his parents Tuesday night.

Officials at Children's Memorial Hospital said the girl, Michelle Rodriguez, was in serious but stable condition after doctors removed a bullet from her spine.

Doctors were optimistic about the girl's recovery, said Erin Shields, assistant director of public affairs at Children's Memorial.

But Shields would not comment as to whether the girl would require rehabilitative therapy or whether her spine had been so badly damaged to cause paralysis.

Police said Michelle had been shot with a .380-caliber semi-automatic handgun that belonged to someone in the shooter's family, probably an older brother.

Grand Central Area Detective Charlie Richter said police were told by some children at the Northwest Side school that the boy may even have brought a different gun to class on Monday.

Roberts said it was unclear whether any charges would be filed against the boy. Under Illinois law, he is too young to be tried as an adult, but police could request that he be charged as a juvenile delinquent, a spokesman for the Cook County State's Attorney's Office said.

If charged, a court would determine the length of time he would have to remain in the custody of the Illinois Department of Corrections.

It is also possible that if the boy's home life is deemed to be unfit or unsafe, he could be removed from his parents and placed in the custody of the Illinois Department of Children and Family Services.

DCFS spokesman Ed McManus said Tuesday night that he was unaware of any request that the agency investigate the boy's home situation.

The shooting occurred shortly before 11 a.m. Tuesday in a class of about 30 children. The teacher had just finished teaching reading to a group of children in the back of the classroom, according to Perez, who refused to name the teacher.

While her back was turned, children clustered at the front of the class, and suddenly the teacher heard "a muffled noise," Perez said. She turned and "saw the child on the floor," he said.

Perez said he originally understood that the gun might have gone off accidentally while in the boy's bookbag.

But Roberts said children had told police that the boy held the gun up and announced he was going to fire it. However, police are not sure if the boy knew the gun was loaded, Roberts said.

A school, a child – and a gun – become props for a nightmare

Times 2/27/92

Terry Carr
TIMES COLUMNIST

An 8 year old walking around with a gun.

In school.

With hundreds of other little kids everywhere, laughing, horsing around, bumping into each other.

I don't know what picture came into your head when you read the story about the second grader at Denali Elementary School who came to school with a loaded .25-caliber pistol. But that was my picture.

The props, in all, for a nightmare.

Understand that this is *elementary school* we're talking about. These are little boys and girls. These are folks who don't always think before acting, who emulate what they see, who will try anything they can get their hands on.

Including guns.

And some of them, no doubt, get most of what they know about guns from television day in and day out.

Which means some also think the way guns are used on television — day in and day out — are the way guns are supposed to be used.

A nightmare.

We talk a lot about school in my house. Part of the family is a kid in seventh grade. Another part is a junior high teacher. Another part is a newspaper columnist who talks about schools and would like to write more about teachers and schools but can't because there is an obvious conflict there.

But there wasn't a heck of a lot to say at my house about a kid in second grade bringing a gun to school.

"It's just another pressure you have to deal with," the teacher said. "You'd think you could send your kids to school, and they'd be safe."

You just reach a point, I suppose, where you have to realize that anything is possible in school. Not every kid, not every teacher, not every administrator is going to qualify for heaven.

And not every home is going to lock up the guns so the kid won't take them to school.

That, of course, is at the bottom of it all.

I sought a policeman's view. I called Capt. George Novaky at the Anchorage Police Department.

Who, it turns out, has a kid in the second grade at Denali Elementary School.

"How does the child get access to the gun?" Novaky said. "This is not just an issue of having possession of a firearm. This is an issue regarding parenting."

Which states it well.

Still, like some of the rest of us, Novaky had a bunch of other questions.

"Why wasn't the weapon secure? Why wasn't it at a place where it's locked up and the child can't get access to it? What if it goes off in recess?"

And, given the kid he has in the school, he also took the whole episode very personally.

"We tell young people it is bad to use drugs," he said. "We talk to them about AIDS. I'm not so sure that agencies like the National Rifle Association ... shouldn't be pushing national advertising that says weapons aren't meant to be taken into schools.

"I'm a police officer. I've got guns. I have a safe in my house, and it is *locked*."

Darryl Jordan, Anchorage School Board president, said much of the same.

"It is a parent problem, in general," he said. "But we can't ignore it, though. We can't say this is a parent problem and ignore it."

Which is true, too, and is the justification for stiff penalties — up to expulsion for kids who bring weapons to school.

But banging on the problem kids isn't going to solve the entire problem.

There are still the parents.

From what I read, it's becoming routine in big cities for kids to bring weapons to school. Guns, and the violence they inevitably harvest, are a fact of life there.

A survey last year of gun possession on school grounds in Anchorage revealed 16 incidents. Three of them took place at elementary schools.

A nightmare.

Alaskans covet their guns. They use them for hunting, for protection, for tinkering.

Talk to an Alaska gun owner, and he or she will tell you guns are a fundamental, inviolable human right.

And most of them will go to the wall defending their right to own as many as they want of any type they want.

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But some of us know nothing about the responsibility that comes with them.

Terry Carr's commentary appears Tuesday, Thursday and Sunday.

Times 2/25/92

Second-grader takes loaded gun to school

By DIANA ELLIOTT
TIMES WRITER

A second-grader played a dangerous game of show and tell Monday when he brought his father's loaded gun to school and flaunted it in front of his classmates at Denali Elementary School, police said.

The weapon, a .25-caliber semiautomatic pistol, was confiscated by school officials after a classmate took the gun away from the boy and turned it over to teacher Joey Jigliotti.

Jigliotti, a substitute teacher, was approached by a girl who handed her a gun and pointed out the boy who brought the weapon to school.

"It was a case of students self-policing themselves," said police Sgt. Marilyn Bailey. "It sounds like there are some kids who won't tolerate this."

The boy, whose name was not released because of his age, told police he took the gun from his father, loaded it and brought it to school because he was afraid.

"The explanation he offered was that he was scared, but he wasn't being specific," Bailey said.

The boy's father told police he had taken his son shooting in the past. The man said he stored the gun separately from the ammunition, so the boy must have gotten into both, police said.

The student was taken to the principal's office, and police were called.

Bob Christal, assistant superintendent of the Anchorage School District, said some action had been taken against the child, probably some form of suspension.

"It's an extraordinary situation," Christal said.

Christal said this is the second time an elementary school student has brought a loaded gun to a district school. The other incident was last year at Mountain View Elementary School.

Carol Comeau, the district's executive director of elementary education, said the child's parents "have been very, very cooperative."

Bailey said it is disturbing to police that students get their hands on guns so easily.

"It's sad that children who have no concept of deadly weapons have such easy access to them," Bailey said.

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ADN 2/24/92

Classroom stabbing kills girl, 14

The Associated Press

ARCHDALE, N.C. — A 14-year-old girl died Tuesday after being stabbed in a classroom as 25 other eighth-graders watched, and her former boyfriend was arrested on a murder charge, authorities said.

"Everybody was running down the hall screaming," said 14-year-old Karalee Cameron.

The attacker entered the Archdale-Trinity Middle School classroom and asked to speak to Patricia Mounce, but she refused, said Police Chief Larry Allen.

He stabbed her once near the heart and fled the classroom. The youth ran to a nearby business, telephoned police and surrendered, Allen said.

"We understand that it was an ex-boyfriend," said Worth Hatley, associate Randolph County school superintendent. "I can't remember anything this terrible happening in our school system."

Willis Odell Graveiy Jr., 16, of High Point was charged with murder and heid without bond in the Randolph County Jail.

The former boyfriend had been a student at the school but no longer lives in the district. He had been charged with kidnapping recently in another incident involving her and may have been upset about the charge, Allen said.

The girl died during surgery at High Point Regional Hospital near Archdale, about 15 miles southeast of Winston-Salem in central North Carolina.

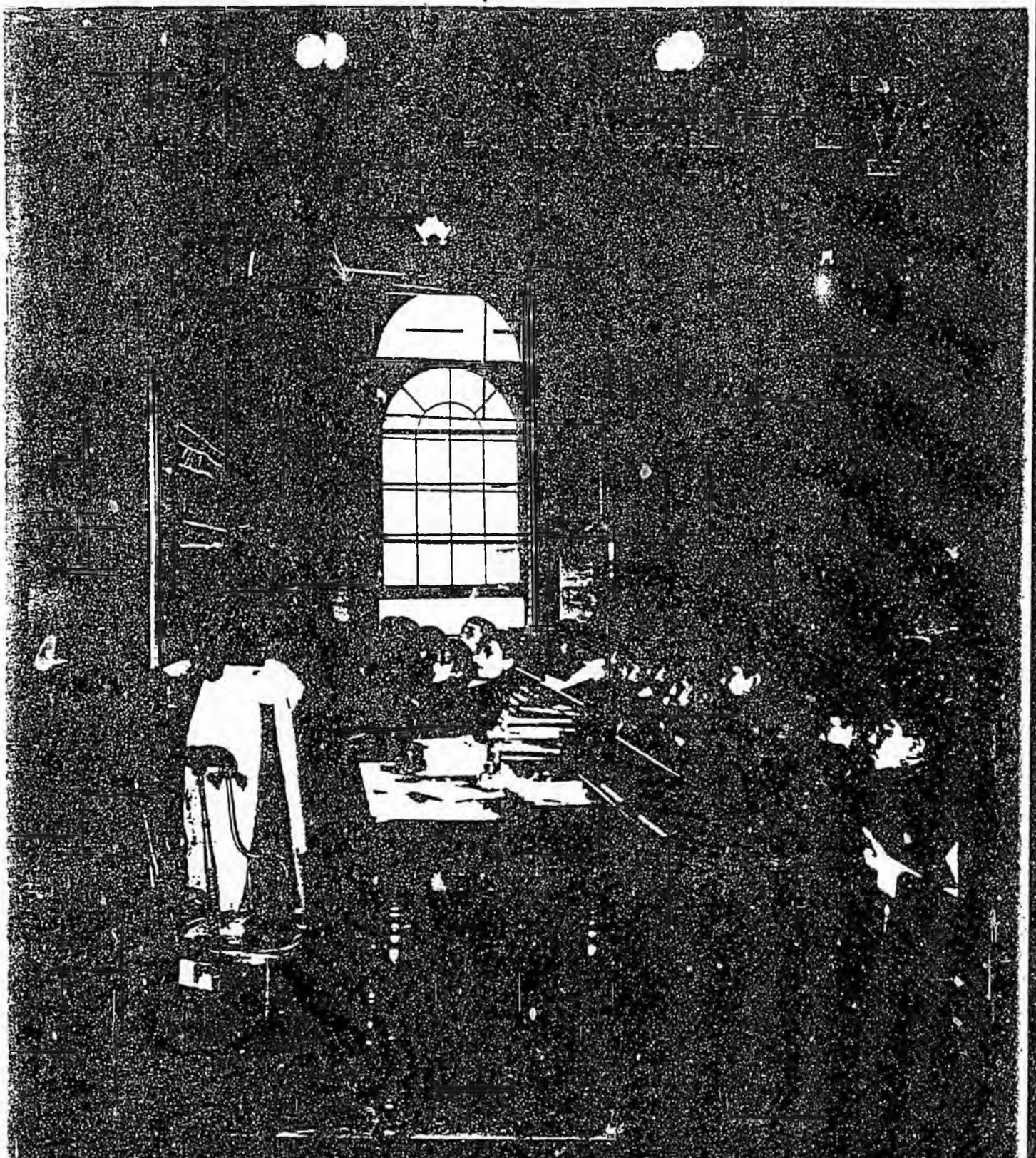
Classes continued and other students were told of the slaying. Counselors were brought in to talk to students.

"I think everyone is still trying to remain calm and trying to understand the tragedy that's occurred," said George Fleetwood, county school superintendent.

NATION NEWS ADN 2/27/92

Student shoots 2 schoolmates dead

NEW YORK — A 15-year-old student shot and killed two schoolmates Wednesday in a high school swarming with security guards preparing for a visit from the mayor, police said. Ian Moore, 17, and Tyrone Sinkler, 16, were shot point-blank in a second-floor hallway at violence-plagued Thomas Jefferson High School in the rough East New York neighborhood of Brooklyn. The suspect went to school looking for them, then "walked right up to them without saying a word and shot them," said Deputy Inspector Patrick Carroll. The suspect apparently carried a grudge, authorities said. The shooting occurred 90 minutes before Mayor David Dinkins arrived for a speech.



From [illegible] writing and arithmetic to rage, risk and re[illegible]achers today face many new challenges.

From fistfights to gunfights

For educational excellence to be achieved, schools must be safe and hospitable places for teachers and students. Yet, in an ever-increasing number of our schools, students and teachers are expected to endure violence, fear and intimidation on a daily basis.

Violence within the schools of America has increased dramatically over the past decade and continues to escalate at an alarming rate. Gang encroachment, drug and alcohol abuse, poverty, child abuse and neglect, overcrowded classrooms and lack of parental supervision and discipline have rendered the once "safe harbor" of the classroom a microcosm of today's social ills.

In a case heard by the U.S. Supreme Court, *New Jersey v. T.L.O.*, Justice Powell commented on the growing problem of violence in schools. He wrote:

> Without first establishing discipline and maintaining order, teachers cannot begin to educate their students. And apart from education, the school has the obligation to protect pupils from mistreatment by other children, and also to protect teachers themselves from violence by the few students whose conduct in recent years has promoted national concern.

Most people equate school violence with large urban areas such as New York, Chicago or Los Angeles. While there has been ample reporting of the violence plaguing big-city schools, violence has invaded suburban and rural schools with little notice by the national media.

A bill introduced into the House of Representatives of the U.S. Congress (H.R. 4538, "Classroom Safety Act of 1992") summarized the rising tide of violence in America's schools thusly:

- Nearly 3,000,000 crimes occur on or near school campuses every year;
- One fourth of the major school districts now use metal detectors in an attempt to reduce the number of weapons introduced into the schools by students;
- Twenty percent of teachers in schools have reported being threatened with violence by a student;
- The despair brought on by poverty and disenfranchisement that affects millions of our youth is rapidly entering the schools;
- Schools are being asked to take on responsibilities that society as a whole has neglected, forcing teachers to referee fights rather than teach;
- Teachers are staging walk-outs to protest the violence which denies interested students the opportunity to learn.

Teachers and administrators require special skills to cope with potentially explosive situations and violent students. Yet, they are not receiving those skills in their university preparation programs. The California Legislature, believing that "certificated school personnel often are not prepared effectively in their professional programs to cope with potentially violent situations or with violent youth," amended the California Education Code (California Senate Bill 2460, Green, 1990). The revised code will require the California Commission on Teacher Credentialing (CTC), the state agency that regulates teacher preparation and licensing, to undertake leadership activities directed toward establishing appropriate standards of preparation for teachers and other certificated personnel concerning violent behavior by students.

Anticipating that a requirement for training teachers and principals in handling violence in schools would be forthcoming from the CTC, Pepperdine University began developing a violence prevention curriculum to be included in the training of future teachers and administrators.

In June of 1992, a grant from the Pacific Telesis Foundation enabled the teacher preparation program to begin developing and field testing a model curriculum for creating a safe school environment. The model curriculum will be designed to be presented in an applied, hands-on, interactive mode. The training will focus on skills that teachers need to maintain a safe, secure and welcoming school climate. The curriculum will also address skills teachers need to help build confidence, self-esteem and pride in their students — attitudes crucial to creating and maintaining a positive and cohesive campus climate.

In addition to the faculty of Pepperdine's Graduate School of Education and Psychology, curriculum developers will draw upon the resources of the Pepperdine School of Law and the National School Safety Center, a resource center administered by Pepperdine University and funded by the U.S. Departments of Education and Justice.

The model curriculum will be field tested with the teachers at Broadway Elementary School in the Los Angeles Unified School District, a partnership school with Pepperdine University. Broadway School serves a diverse student population in an area plagued with social problems. Poverty, crime and racial tension severely inhibit the instructional process. In the past year, two parents of Broadway students have been killed in gang-related incidents.

After further development and field testing, the model curriculum will be made available to other universities for use in teacher and administrator preparation programs. The target date for completion of the model curriculum is January 1, 1993.

H. Woodrow Hughes, Ph.D., is the Associate Dean for Education in the Graduate School of Education and Psychology, Pepperdine University.

Lots of advice, no examples

Dear Editor:

I am a student at Service High School. Two of my classmates and I are doing a report on weapons and gun control in schools for our U.S. government class. While doing the research for this report, I have had to observe people and their reactions to the topic.

I have found that teen-agers realize more about what is going on around them than they let on. We teen-agers know that guns are bad, that stabbing someone is bad, that anything to do with gangs, drugs and sex is usually bad. Everyday we get bombarded with more facts on why we shouldn't do this or why we shouldn't do that.

We aren't as stupid as a lot of people say. It's not that teen-agers don't care about important issues like gun control, it's just that adults sit there and act like we're so dumb that we can't understand.

So, we show that we understand by getting adults' attention as well as we can, with the means that we have on hand. Unfortunately, some teen-agers have taken up arms, thinking, "If you aren't going to listen to us, then we'll make you listen."

I agree that teen-agers have become more violent, but then, so has everything else. There are adults fighting in wars. There's prejudice everywhere, with lots of fighting and no solution in sight. Anywhere you look, you'll most likely find violence — on television, in the newspapers, on the radio.

All our lives, we have been surrounded by some sort of violence, and people can't understand why we're so violent.

Talking usually brings no solutions, so try demonstrating this to us. Try showing us that adults can be as non-violent and peace-loving as they want us to be. Try for our sakes, as well as yours.

Anzimee Harris, 18
Anchorage

ADN 2/26/92

Classroom stabbing kills girl, 14

The Associated Press

ARCHDALE, N.C. — A 14-year-old girl died Tuesday after being stabbed in a classroom as 25 other eighth-graders watched, and her former boyfriend was arrested on a murder charge, authorities said.

"Everybody was running down the hall screaming," said 14-year-old Karalee Cameron.

The attacker entered the Archdale-Trinity Middle School classroom and asked to speak to Patricia Mounce, but she refused, said Police Chief Larry Allen.

He stabbed her once near the heart and fled the classroom. The youth ran to a nearby business, telephoned police and surrendered, Allen said.

"We understand that it was an ex-boyfriend," said North Hatley, associate Randolph County school superintendent. "I can't remember anything this terrible happening in our school system."

Willis Odell Gravely Jr., 15, of High Point was charged with murder and held without bond in the Randolph County Jail.

The former boyfriend had been a student at the school but no longer lives in the district. He had been charged with kidnapping recently in another incident involving her and may have been upset about the charge, Allen said.

The girl died during surgery at High Point Regional Hospital near Archdale, about 15 miles southeast of Winston-Salem in central North Carolina.

Classes continued and other students were told of the slaying. Counselors were brought in to talk to students.

"I think everyone is still trying to remain calm and trying to understand the tragedy that's occurred," said George Fleetwood, county school superintendent.

NATION NEWS ADN 2/27/92

Student shoots 2 schoolmates dead

NEW YORK — A 15-year-old student shot and killed two schoolmates Wednesday in a high school swarming with security guards preparing for a visit from the mayor, police said. Ian Moore, 17, and Tyrone Sinkler, 16, were shot point-blank in a second-floor hallway at violence-plagued Thomas Jefferson High School in the rough East New York neighborhood of Brooklyn. The suspect went to school looking for them, then "walked right up to them without saying a word and shot them," said Deputy Inspector Patrick Carroll. The suspect apparently carried a grudge, authorities said. The shooting occurred 90 minutes before Mayor David Dinkins arrived for a speech.

Students and Weapons: A Deadly Combination

The statistics are frightening: One in five high school students [illegible] carries a gun, knife, or other weapon with the intention of using it if necessary.

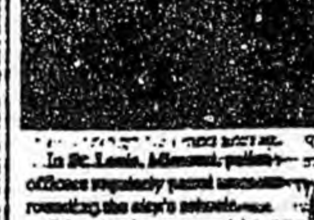
The findings by researchers with the Centers for Disease Control paint an alarming portrait of today's teenagers: Nearly half of the 11,000 teenagers surveyed said they had been [illegible] four or more times in the previous month. [illegible]

The CDC findings and [illegible] incidents of violence in [illegible] public schools across the U.S. have [illegible] questions regarding school [illegible] today ("How Safe Is Your School?" [illegible] May/June 1989).

In a 1990 U.S. Education Department survey, [illegible] percent of teachers surveyed said they saw more disruptive behavior than five years ago; 42 percent said they [illegible] at least one serious fight in the previous month; 20 percent said they had been threatened [illegible]

Across the country, school districts are taking [illegible] measures to [illegible] the rising [illegible] of school violence. [illegible]

In Prince George's County, Maryland [illegible]



[illegible]

In St. Louis, Missouri, police officers regularly patrol [illegible] surrounding the city's schools [illegible]

Other [illegible] at school entrances [illegible]

HB

418

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. HB 418

Revision Date:
Dept. Affected: Corrections
Title: An Act extending the Parole Board
BRU: Admin/Support
Component: Parole Board
Sponsor: Rep. B. Davis
Requestor: House HESS
COMPONENT SERIAL NO. 605

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						
MISCELLANEOUS						
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 (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

Estimate of any current year (FY94) cost: $ 0

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

The Parole Board is contained in the department's proposed FY95 budget.

Prepared by: Diane Schenker, Special Assistant Phone: 465-4643/786-2147
Division: Office of the Commissioner Date: 2/8/94
Approved by Commissioner: J. Frank Prewitt, Jr. Date: 2/8/94
Agency: Department of Corrections

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MINORITY WHIP

CHAIR
CHILDREN'S CAUCUS

HEALTH, EDUCATION
& SOCIAL SERVICES

STATE AFFAIRS

ECONOMIC TASK
FORCE

REPRESENTATIVE BETTYE DAVIS
DISTRICT 21

SPONSOR STATEMENT
HB 418 - EXTENDING THE BOARD OF PAROLE

HB 418 would extend the Board of Parole for the customary four-year period under A.S. 44.66.010(c). Under current law, and without passage of this legislation, the Board is scheduled to end its operations on June 30, 1994.

The State Board of Parole was created in 1960 and has been an essential component of Alaska's criminal justice system. There are currently 700 felons on parole supervision. Each year, about 400 prisoners are eligible to be released to discretionary parole supervision for a portion of their sentence. In addition, 500 prisoners are released to mandatory parole supervision for a period equal to one-third of their sentence.

Expiration of the Parole Board will not alter the state's responsibility under Title 33, Chapter 16, which provides for prisoners to be eligible for and supervised on discretionary and mandatory parole. The State will almost certainly be a party to costly litigation to determine the legal status of prisoners, parolees and victims.

The Board of Parole has been an effective vehicle in administering the parole process. I urge your support of HB 418.

STATE OF ALASKA

BOARD OF PAROLE

1993 ANNUAL REPORT TO THE GOVERNOR

AND THE ALASKA LEGISLATURE

JANUARY 1994

BACKUP

STATE OF ALASKA

DEPARTMENT OF CORRECTIONS

BOARD OF PAROLE

WALTER J. HICKEL, GOVERNOR

ALASKA BOARD OF PAROLE
P.O. BOX T
JUNEAU, ALASKA 99811-0000
PHONE: (907) 465-3384
FAX: (907) 465-2006

December 30, 1993

To the Honorable Walter J. Hickel, Governor
and the Honorable Members of the Alaska
State Legislature and the Citizens of the
State of Alaska:

Ladies and Gentlemen:

It is my pleasure to offer the Annual Report of the Alaska Board of Parole for the calendar year 1993. I believe you will find the information contained in this report to be both interesting and informative.

The Board and the Department of Corrections are faced with many challenges. At the forefront is the growing prisoner population and the limits of our resources. The Board takes a great deal of pride in the dedication and commitment to excellence exemplified by our administrative staff and by the Department's employees during the last year. Often employees go beyond the call of duty to bring about positive change in many who have known only failure.

We as a Board are first and foremost accountable to the citizens of Alaska and we will endeavor to uphold their trust through informed decision-making and successful reintegration of the offender back to the community.

Sincerely,

Alonzo B. Patterson, Jr.
Chairman

ALASKA BOARD OF PAROLE

1993 ANNUAL REPORT

TABLE OF CONTENTS

MISSION STATEMENT

Alaska Board of Parole

OUR MISSION IS

To protect the public by focusing on risk and by making careful, just and equitable parole decisions.

To have a clear, articulate policy and numerical guidelines so the public, offenders and criminal justice components can easily understand discretionary parole release decisions.

To have professionally trained Board Members, with close ties to the community, who are representative of the ethnic, racial, sexual, and cultural populations of the state.

To use Department and community resources as a bridge to help parolees become contributing members of society.

To set realistic parole conditions and to return to prison those who show they will not be law-abiding.

OUR STATUTORY OBLIGATIONS

AS 33.16.100(a) The Board may authorize the release of a prisoner on discretionary parole if it determines that a reasonable probability exists that:

(1) the prisoner will live and remain at liberty without violating any laws or conditions imposed by the Board;

(2) the prisoner's rehabilitation and reintegration into society will be furthered by release on parole;

(3) the prisoner will not pose a threat of harm to the public if released on parole; and

(4) release of the prisoner on parole would not diminish the seriousness of the crime.

AS 33.16.010(d) A prisoner released on discretionary or mandatory parole is subject to the conditions of parole imposed under AS 33.16.150.

AS 33.16.220 The Board may revoke parole for conduct in violation of AS 33.16.150(a) or (b).

OUR RESPONSIBILITIES

To Alaska Citizens

To keep refining our ability to select persons for parole who will succeed as law-abiding citizens; to help parolees become productive citizens for the benefit of society, themselves and their families; and to use our revocation authority wisely and to promptly return to prison those parolees who present a danger to the community.

To Victims

To welcome and consider views and information from crime victims and their families and to respond positively to their requests for information and notification.

To Corrections Employees

To provide leadership, training and resources so they can perform their job effectively and efficiently.

To Offenders

To consider each offender as an individual by one set of standards and to provide a fair and unbiased hearing; to provide realistic parole conditions and helpful positive supervision.

To Justice

To uphold appropriate punishment, to advance equal treatment of offenders serving for similar offenses with similar histories and needs, and to work with other justice components to reduce criminality.

THE BOARD MEMBERS

Chairman Alonzo B. Patterson, Jr. was appointed to the Board in February 1984 by Governor Sheffield. He was reappointed by Governor Sheffield in 1986 and by Governor Hickel in 1991. Reverend Patterson is the pastor of Shiloh Missionary Baptist Church in Anchorage. He has a Bachelor of Arts Degree in Psychology from the University of Alaska/Anchorage, and a Doctor of Divinity Degree from the American Bible Institute. Reverend Patterson is a resident of Anchorage.

Member David Cooper was appointed by Governor Sheffield in February 1984. He was reappointed by Governor Sheffield in 1986 and again by Governor Cowper in 1990. He has an Associate Arts Degree in Behavioral Science from the University of Alaska/ Anchorage. Mr. Cooper is retired from the position of Assistant Superintendent at the Palmer Correctional Center after 19 years of exemplary service. He was born and raised near Ninilchik. He and his family operate a commercial fishing business in Cook Inlet. Mr. Cooper is a resident of Palmer.

Member Elsabeth Demeksa was appointed by Governor Hickel in 1992. She has a Bachelor of Arts Degree in English Literature from New York State University. Ms. Demeksa is the owner, manager of a women's apparel store. From 1980 to 1991 she was an Aide to the Alaska Legislature, the last two years as Chief of Staff to the House Minority Leader. She is active in numerous women's and family organizations, and in 1984 was honored as one of the Outsta ing Young Women of America. Ms. Demeksa is a residen J au.

Member James McLain was appointed by Governor Hickel in 1993. He has a Bachelor of Arts Degree in Criminal Justice from the University of Alaska/Fairbanks and was the Justice Student of the Year in 1988. He is currently employed as a paralegal. Mr. McLain is a resident of Fairbanks.

Member Mary Vollendorf was appointed by Governor Hickel in 1994. She has a Bachelor of Arts Degree in Political Science/Pre Law from the University of Northern Arizona University. Since graduation from coll ge she has worked for several legislators. Ms. Vollendorf is a resident of Anchorage.

THE EMPLOYEES OF THE PAROLE BOARD

During 1993 the administrative office of the Board was located at the corner of 4th & Harris, Juneau, Alaska. As of January 21, 1994 the office will be located at 802 Third St., Douglas, Alaska. Our mailing address is:

Alaska Board of Parole
P.O. Box 112000
Juneau, Alaska 99811-2000
Phone: (907) 465-3384
Fax: (907) 465-2006

EXECUTIVE DIRECTOR

Richard E. Collum

The Executive Director is appointed by the Board and is responsible for day to day operations of the agency. The Executive Director attends parole release hearings and parole revocation hearings and provides technical assistance to the Board.

Secretary I
Georgina Weitzel

Clerk Typist III
Mary Engdahl

PAROLE ADMINISTRATOR

Donna E. White

The Parole Administrator assists the Executive Director in agency administration and supervision of the staff. The Parole Administrator is a resource for parole officers to use in the daily management of cases, scheduling hearings and compiling statistics.

PAROLE BOARD OFFICER

Daniel L. Stroeing

The Parole Board Officer assists the Parole Administrator and handles conditions of supervision and Executive Clemency applications and investigation.

THE PAROLE BOARD

Society through legislation has determined that some people who commit crimes must be incarcerated in correctional institutions as a deterrent to others and for punishment for their crime, as well as for protection of the public and for reformation. The optimum period of time that will meet this criteria, for any given crime, is unknown and consequently sentence length varies considerably across the United States. We know from experience that a number of offenders can be released to community supervision prior to the expiration of their sentences without jeopardizing the public and at a tremendous cost savings to the public.

The Alaska Board of Parole was created by the legislature at the time of statehood to fulfill the State's constitutional requirement for a parole system. The Board was originally comprised of three volunteer members appointed by the Governor, the staff was provided by the Division of Corrections. In the mid 1960's the Board was increased to five members. In 1972, a separate parole office was created within the Department of Health and Social Services to make the Board independent of the Division of Corrections and provide the Board Members with their own administrative staff. When the Division of Corrections became the Department of Corrections in 1984 the Board's Budget Request Unit was moved from Health and Social Services to this newly formed Department.

Prior to 1986, Board Members were appointed to four year terms. Beginning January 1, 1986 the five members are appointed to staggered five year terms. One term expires every year on December 31. The Staff presently consists of an Executive Director, Parole Administrator, Parole Board Officer, a Secretary and a Clerk Typist.

In addition to holding discretionary parole release hearings, the Board holds parole revocation hearings on both mandatory parolees and discretionary parolees. The Board sets conditions of parole, conducts preliminary revocation hearings and preliminary recision hearings, and issues arrest warrants and subpoenas. During the years from 1984 to 1986, the Board reviewed cases in accordance with the Prisoner Overcrowding Emergency Conditional Commutation Plan. The staff conducts all of the Executive Clemency investigations for the Executive Clemency Advisory Committee and the Governor.

The Board meets quarterly in Fairbanks, Anchorage and Juneau. The Board meets quarterly as necessary in other areas which have a State Correctional Facility, such as Seward, Nome, Bethel, Kenai,

and Ketchikan. Occasionally it is necessary for the Board to travel outside Alaska to the Federal Bureau of Prisons Facilities and other contract institutions to hold parole hearings. The Board members are not state employees but are paid perdiem and travel expenses plus $150 compensation for each full day they are in session.

In 1981, following three years of research and analysis the Board adopted a parole guidelines model which rates a prisoner's social and criminal history to determine risk. This risk score is compared to the severity of the crime to determine a range of time the prisoner should serve prior to discretionary parole. These guidelines were revised in 1983 based on criminal code revisions and again in 1989 following additional research into the validity of the risk factors.

THE HISTORY OF PAROLE ELIGIBILITY

Eligibility for discretionary parole and for mandatory parole has changed considerably over the last three decades since Statehood and has become extremely complicated. The following information is presented as a historical review of what has occurred and may provide some perspective on the limited numbers of prisoners who are currently eligible for release.

The Alaska legislature determined, with passage of the criminal code in 1960, that a prisoner sentenced to a term of at least 181 days would be eligible for discretionary parole. Former AS 33.15.180. Although there was no statutory minimum term a prisoner had to serve before release on parole, the court had the discretion to set a minimum term, not to exceed one-third of the total sentence. Former AS 33.15.230(a)(1). No other restrictions or guidelines applied.

Effective May 16, 1974, the Alaska Legislature amended former AS 33.15.080 to require a prisoner to serve one-third of the period of confinement prior to being eligible for release on discretionary parole. In the case of a prisoner serving a life sentence, the mandatory minimum was set at fifteen years. In addition, former AS 33.15.230(a)(1) was amended so the court could further restrict eligibility up to the maximum term.

In 1980, as part of the revised criminal code and with the inception of presumptive sentencing, parole eligibility was altered significantly. Crimes were grouped according to severity of the offense. Murder I, Murder II and Kidnapping were unclassified felonies. Murder I and II and Kidnapping were changed from a maximum term of life to a maximum term of 99 years. The mandatory

minimum for discretionary parole eligibility for Murder I was increased to 20 years [AS 12.55.125(a)] or one-third of the period of confinement (former AS 33.15.080), whichever was greater. The mandatory minimum term for Murder II and Kidnapping was set at five years [AS 12.55.125(b)] or one-third of the period of confinement, whichever was greater.

All other felony offenses were classified as A, B, or C felonies. First time felony offenders and all misdemeanor offenders with a sentence of 181 days or longer were eligible for parole after serving one-third of the period of confinement. The remaining felony offenders (those with one or more prior felony convictions) were to be given a non-parole eligible presumptive term. AS 12.55.125. As in the past, the court could further restrict parole eligibility beyond the statutory minimums. AS 12.55.115.

The 1980 revised criminal code also provided for a Three-Judge Sentencing Panel (AS 12.55.175) to review cases with extraordinary circumstances. AS 12.55.165. The Three-Judge Panel may sentence a defendant to any sentence authorized under AS 12.55.015, including making an otherwise ineligible defendant eligible for parole.

Effective October 1, 1982, Sexual Assault I and Sexual Abuse of a Minor I, previously class A felonies, were moved to a new category of unclassified presumptive's [AS 12.55.125(i)] and first time offenders were no longer eligible for parole. In addition, Class A first time offenders were now subject to presumptive terms and were not eligible for parole. AS 12.55.125(c).

Effective January 1, 1983, drug offenses were included in the revised criminal code and Misconduct Involving a Controlled Substance in the First Degree became an unclassified felony with a five year mandatory minimum. AS 12.55.125(b).

Effective January 1, 1986, class A, B and C felony offenders eligible for parole, had their parole eligibility reduced from one-third of the period of confinement to one-quarter. [AS 33.16.100 (c)] In addition, enhanced or aggravated presumptive's were declared eligible for discretionary parole after completing the initial presumptive term plus the minimum (one-third or one-quarter) applicable to the enhanced portion of the term. [AS 33.16.090(c)].

In order to correct what they believed to be a previous oversight the legislature made Class A offenders eligible for parole after serving one-third of the period of confinement, effective September 12, 1987. Eligibility on these offenders had been mistakenly reduced the previous year to one-quarter along with class B and C offenders. [AS 33.16.100(d)].

In 1988, it was determined an offender sentenced prior to 1986 to an enhanced (aggravated) presumptive sentence [AS 12.55.155(c)] was eligible for parole after serving the presumptive term, less good time, and at least one-third of the composite term. Merry v. State, 752 P.2d 475 (Alaska App. 1988). In 1990, it was determined an offender sentenced to a consecutive presumptive sentence prior to 1986 was eligible for parole after completion of the initial presumptive sentence, less good time, and after serving the applicable minimum (one-third or one-quarter) of the consecutive presumptive term.

It has been long established that good time does not reduce the minimum term for parole eligibility. Attorney General Opinion, 01/30/74, Mills v. State, 592 P.2d 1247 (Alaska 1979). However good time does reduce the term of a presumptively sentenced prisoner and thus affects parole eligibility on enhanced presumptive sentences and consecutive presumptive sentences. AS 33.16.090(c).

Effective September 14, 1992, Three Judge Panel sentencing based on a finding of an exceptional potential for rehabilitation became more restrictive. After that date the panel is required to sentence the defendant to the presumptive term, shall order the defendant to participate in appropriate programs of rehabilitation, and may provide that the defendant is eligible for discretionary parole during the second half of the sentence imposed if the defendant successfully completes all rehabilitation programs ordered. AS 12.55.175(e), AS 33.16.090(e).

WHO IS ELIGIBLE FOR DISCRETIONARY PAROLE NOW?

As indicated in the previous history of parole, the parole eligibility laws have become extremely complicated. A quick overview follows:

In order for a prisoner to be eligible for discretionary parole, the prisoner must be sentenced to a term of 181 days or more. In the case of classified felonies, first time class B and C offenders are eligible after serving one-quarter of their term. All other classified felonies and unclassified sex offenses fall under presumptive sentencing and are eligible for parole after serving the initial presumptive terms. Prisoners convicted of Unclassified felonies must serve mandatory minimums (20 yrs. for Murder in the first Degree, five years for all others) or one-third of the total term, whichever is greater.

WHO IS ON MANDATORY PAROLE?

A prisoner who is not eligible for discretionary parole or has not been granted discretionary parole will be supervised on mandatory parole if the composite term the prisoner is serving is two (2) years or more. The term of mandatory parole is equal to the period of time the prisoner's sentence was reduced for good behavior, in most cases this is one-third of the total sentence.

Mandatory parole can be revoked prior to a prisoner's release to supervision if the prisoner does not comply with court ordered treatment while incarcerated. Once released from the institution, mandatory parole can be revoked by the Board if the prisoner violates a condition of the mandatory parole. A prisoner cannot refuse to be released to mandatory parole supervision.

The Board's Workload

The workload for the Alaska Board of Parole increased significantly during the 1980's at a time when the prison population mushroomed. As an example, the 1980 criminal code revision did not begin to show an impact until about 1983 **(Figure #1)**. In 1982, the Board's total workload including parole hearings, parole revocation hearings, warrants and preliminary hearings was under 400 cases. From 1982 to the current peak, the Board's workload increased fourfold. The increase was substantially related to the 1980 presumptive sentence law and mandatory parole law. Discretionary parole hearings and discretionary parole releases did not increase during that period in spite of the growing prison population. Each year, as a higher percentage of prisoners entering the system were sentenced after 1979 under the presumptive sentence law, the number of prisoners eligible for discretionary parole and the number of prisoners released on discretionary parole decreased.

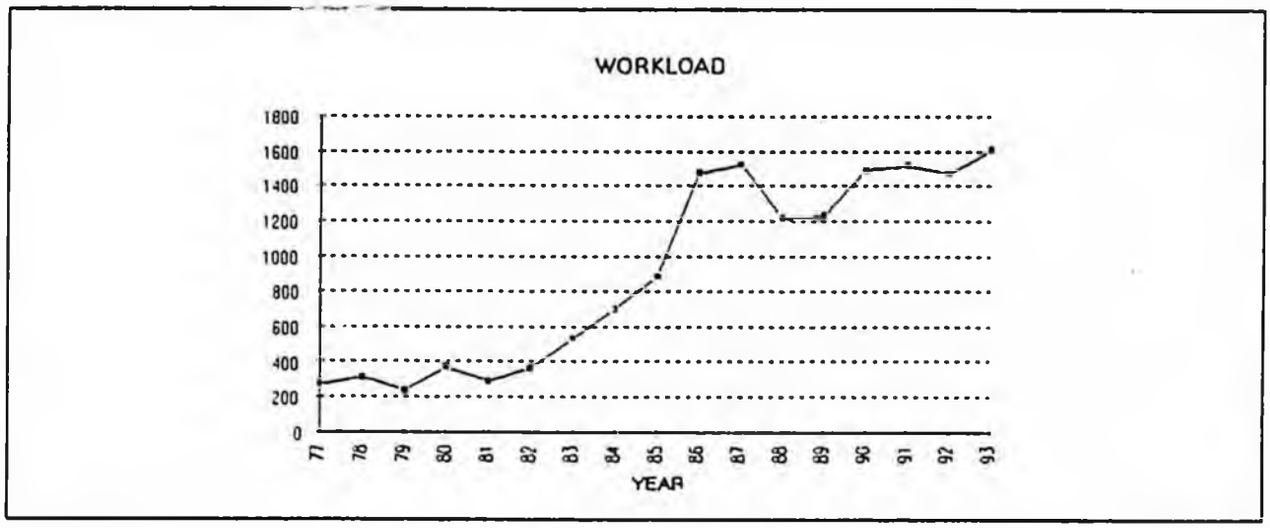

Figure #1

The Board's sharp increase in workload in 1986 and 1987 as indicated in **Figure #1** is attributed to the added responsibility during those two years of reviewing prisoners eligible for release under the Governor's Emergency Conditional Commutation Release Plan.

During calendar year 1993, the Board held a total of 1608 hearings, 697 of which were in-person hearings. The remaining 911 case decisions included issuing warrants, setting or changing conditions, and reviewing appeals.

Discretionary Parole

During the calendar years 1991, 1992 and 1993 the Board held a total of 461 discretionary parole release hearings. Of that total, 178 prisoners were granted discretionary parole for a parole rate of 39%. (Figure 2). In addition, during that three year period, the Board released another 225 prisoners following revocation of their mandatory parole.

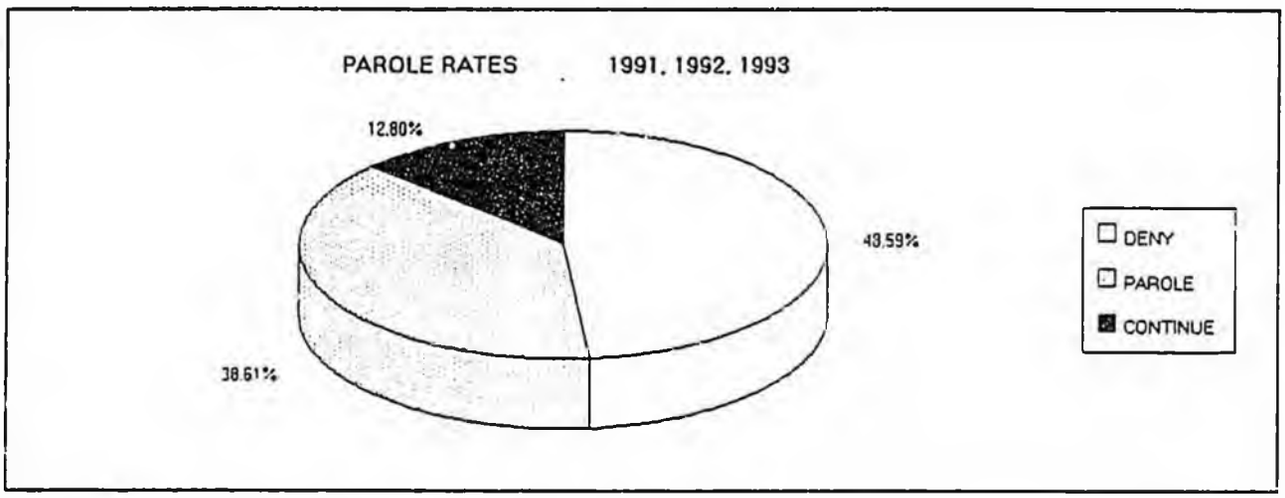

Figure #2

The Board has completed a recidivism study every year since at least the mid 1970's. This was traditionally a one year follow up of prisoners released to discretionary parole. In 1988, the study was expanded to follow the parolee for more then one year. Success is measured by the parolee's ability to complete the followup period on supervision without having been revoked by the Board.

Failure is also divided into four categories based on the nature of the violation. If the violation was for a condition of parole that was not a violation of a law or local ordinance, such as consuming alcohol or failing to report a change of residence, the violation is considered to be a **technical** or conditions violation. If parole is revoked as a result of a conviction for a **misdemeanor** or **felony** while on supervision, the violation is noted accordingly. A parolee who does not report to the parole office as instructed and is unable to be located by the parole officer is coded as an **absconder.** If multiple violations occur, the most serious one is the one coded.

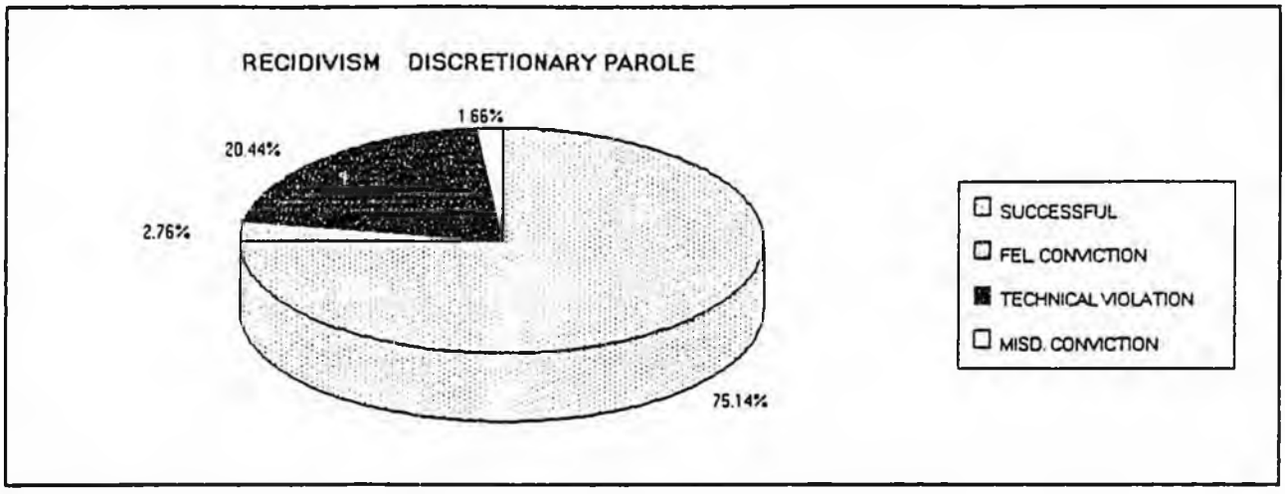

Figure #3

The Board is very proud of its consistently low felony revocation rate. A felony revocation rate of 10% is acceptable and expected in many jurisdictions across the United States. The Alaska Board of Parole has consistently had a felony violation rate of 5% or less. *A follow-up of the prisoners released to discretionary parole during the years 1989, 1990, 1991 and 1992 indicates a felony violation rate of 5 out of 182, or 3%.* **(Figure #3).**

The combined violation rate for discretionary parolees during that period of time is 25%. However, many of those prisoners were ordered back to prison for only a short period of time and then released to supervision again at a later date. This low felony and misdemeanor revocation rate is an indication the field parole officer is doing a good job of monitoring cases to assure the parolee is removed from the community at the first sign of serious supervision violations and before a new crime is committed.

Mandatory Parole

The Department of Corrections currently releases over 500 prisoners each year who are to be supervised on mandatory parole for the period of time their sentence was reduced for good behavior in the institution. This number has increased considerably as the prison population has increased. In 1986, less then 300 prisoners were released to mandatory parole supervision. At the present time, the Department is supervising about 700 mandatory parolees.

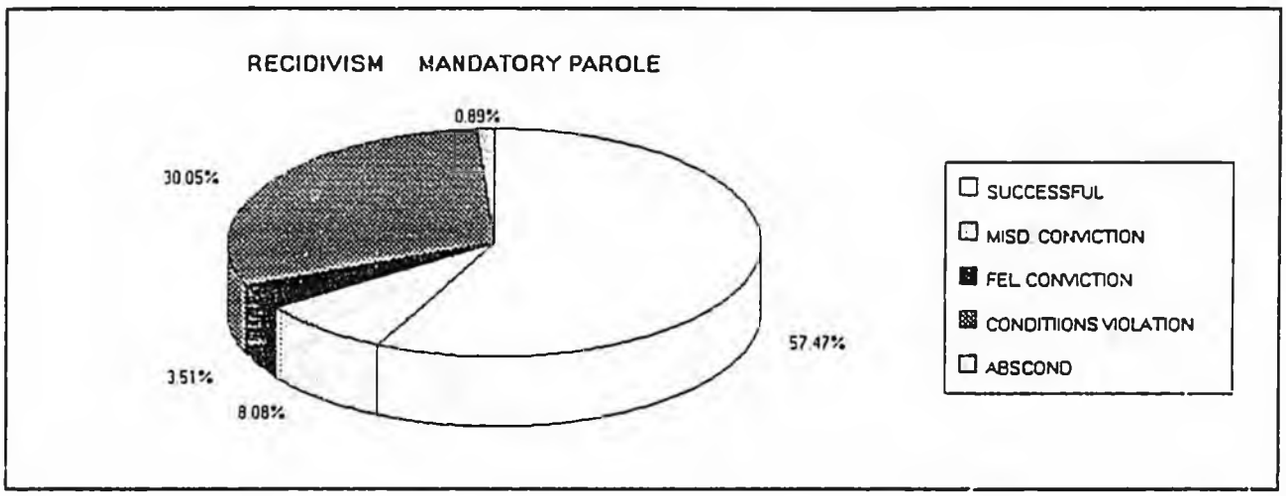

Figure #4

During the years 1989, 1990,1991 and 1992, it is estimated 1907 prisoners were released to mandatory parole supervision. This estimate is based on the number of cases submitted to the Board so they could set conditions prior to release. As **Figure #4** indicates, 811 of them were returned to prison. This is a violation rate of 43%. *This violation rate is nearly eighteen (18%) percentage points higher than prisoners released to discretionary parole*. In addition, on the average these prisoners were not as closely supervised as discretionary parolees who are often required to participate in residential programs, halfway houses or the Intensive Supervision Program. This revocation rate for mandatory parolees could increase considerably if they were supervised as closely as discretionary parolees.

Risk Factors

The parole guidelines model developed in 1981 and the subsequent revisions to that model have always included a risk score sheet. The current risk factors were adopted in 1989 and provide for a scoring range of 0 to 49. The lower the score, the lower the risk to reoffend. Risk scores are divided into four categories as follows:

A = 0-6 B = 7-14 C = 15-29 D = 30-49

During the years 1990, 1991, 1992, and 1993, the parole rate for prisoners in category A was 52%; the parole rate for category B was

48%; the parole rate for category C was 33%; and the parole rate for category D was 23%. **(Figure #5).** This is a good indication the Board is paying a great deal of attention to an applicant's risk to the community at the time parole is granted.

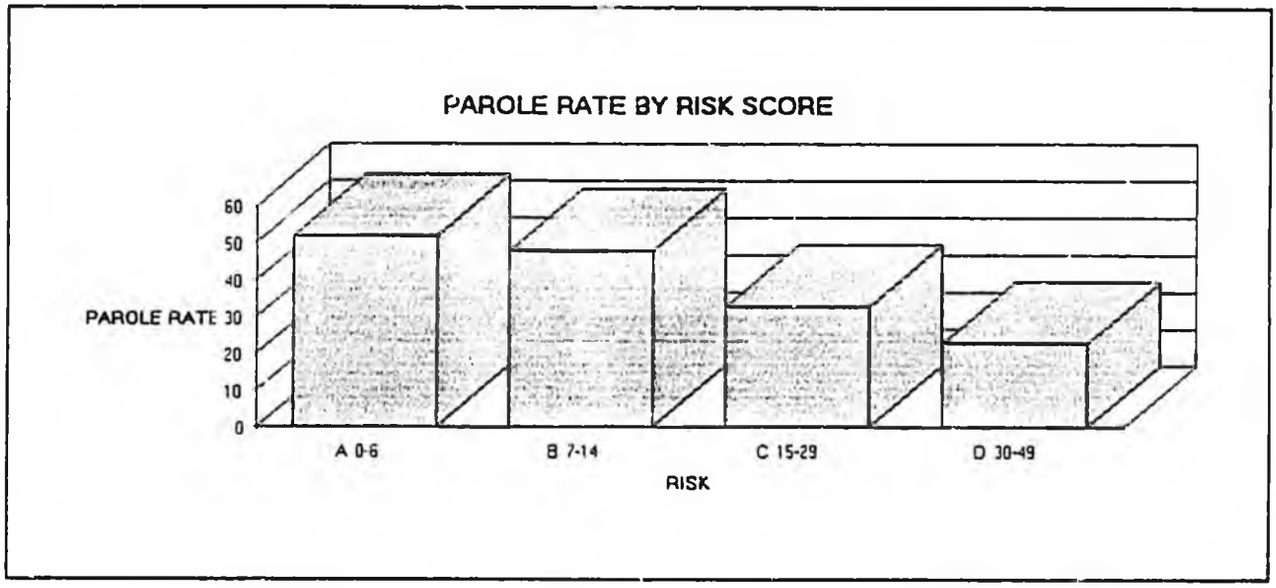

Figure #5

Information obtained from risk scores for prisoners appearing in revocation hearings during the years from 1988 to 1993 further support the validity of the scores and the Board's reliance on these scores. Of the 1350 prisoners revoked during that six year period, only 7% were in the two best risk categories (A & B). **(Figure #6).** Nearly all of the parolees violated during those years (93%) had a risk score of 15 or higher.

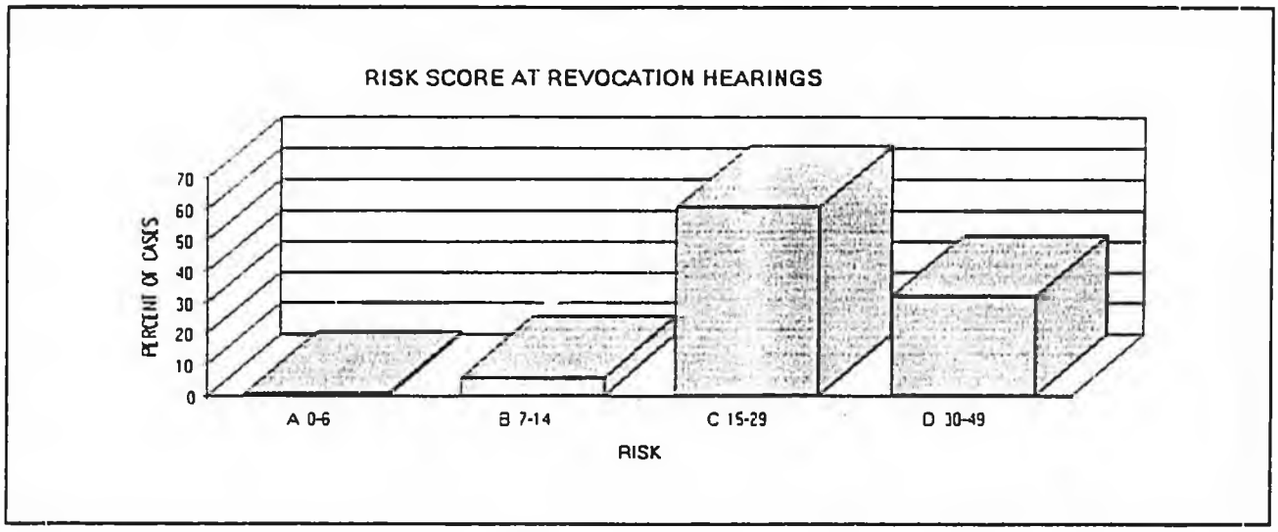

Figure #6

Parole Guidelines

The Board has utilized numerical guidelines for releasing prisoners since 1981. See 22 AAC 20.142. The guidelines are designed for non-presumptively sentenced offenders eligible for discretionary parole. Many other states have guidelines models, including the U.S. Parole Commission. One of the goals in utilizing a guidelines system is to limit the number of cases where a decision is made outside of the suggested guidelines range. In some cases the Board will release a prisoner below the minimum range by making a formal finding of mitigating factors; or the Board will deny parole and thus require a prisoner to serve a term above the guidelines by making a formal finding of aggravating factors. As **Figure #7** indicates, the Alaska Board of Parole is finding mitigation in about 7% of the cases appearing before them and is making a finding of aggravation in about 10% of the cases appearing before them.

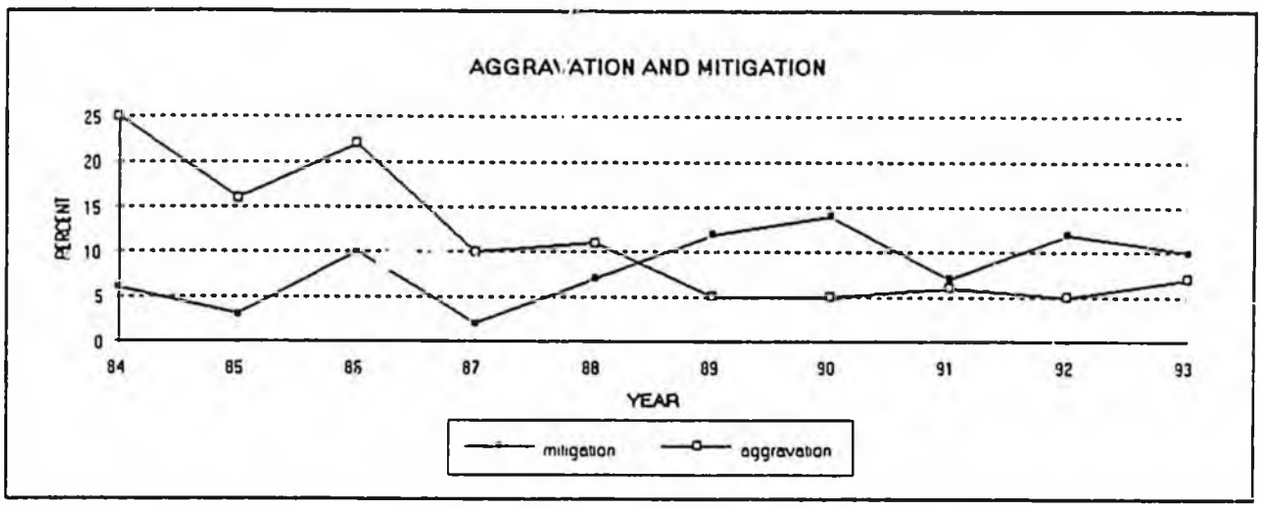

Figure #7

The remaining 83% of decisions are made within the guidelines range and this high percentage of conformity to the guidelines is an indication the Board is making a conscious effort to apply the discretion they have in a fair and equitable manner.

HB

420

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. HB 420

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

Sponsor: Representative Therriault
Requestor: House Labor & Commerce

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

COMPONENT SERIAL NO.

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: 2/16/94

Approved by Commissioner: Paul Fuhs
Agency: Commerce and Economic Development
Date: 2-17-94

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House Of Representatives

HB 420: "An act relating to limited liability companies; amending Alaska Rules of Civil Procedure 20 and 24; and providing for an effective date."

Sponsor: Representative Gene Therriault

Sponsor Statement:

The limited liability company is a relatively new, hybrid form of business structure that combines the tax advantages of a partnership and the liability safeguards of a corporation. Although a combination of these two business structures is currently allowed in statute through formation of an S corporation, this structure has limitations that are avoided by LLCs. For example, S corporations do not allow ownership by certain types of shareholders.

Under current law, corporate earnings are subject to double taxation through the payment of corporate taxes and personal taxes after distribution of dividends. LLCs avoid this double taxation by allowing earnings to flow through to individual owners in the same manner partnership income is handled. Although businesses can be organized through an S corporation to avoid double taxation and encompass some of the advantages of partnerships, they do not enjoy all the advantages of partnerships when it comes to allocating income and deductions.

One of the greatest advantages is, as the name implies, the limited liability offered by the LLC structure. With LLC's, as with regular corporations, only the company's assets, and not the owner's 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 members while imposing no limits on their involvement in operation of the business.

Thirty-four states now permit limited liability companies, and passage in most of the remaining states is expected. Wyoming passed the first LLC act in 1977. Other states slowly followed suit until 1988, when the Internal Revenue Service issued Rev. Rul. 88-76, which classified a Wyoming LLC as a partnership for federal tax purposes, even though none of the members or managers were personally liable for any debts of the company. Following the ruling, formation

of LLCs burgeoned, with two states adopting LLC acts in 1990, four in 1991, 10 in 1992 and more than 20 states introducing measures in 1993.

LLCs have tended to be family businesses, professional service firms, venture capital companies, real estate businesses and startups. I believe the LLC will provide these business owners with an efficient and flexible investment vehicle that allows both limited liability, and federal income tax treatment as a partnership. I introduced the bill, which is based on a prototype American Bar Association draft, with the intention of generating discussion on this topic, and am more than willing to discuss proposed changes.

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February 28, 1994

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Representative Bill Hudson
Chairman, House Committee On Labor and Commerce
State Capitol, Room 108
Juneau, AK 99801-1182

Re: Sponsor Substitute for House Bill 420
Limited Liability Companies
Our File No. 2270-45

Dear Representative Hudson:

I am the chairman of a working group on limited liability companies composed or members of the Tax Law and Business Law Sections of the Alaska Bar Association. I am writing to request that you promptly schedule a hearing before your committee regarding the limited liability company bill.

Limited liability companies are a relatively new form of business entity in the United States. More than 30 states have now enacted limited liability company legislation and legislation is pending in a number of other states.

A limited liability company is a business entity which combines the best features of a corporation and a partnership. Like corporate shareholders, limited liability company owners are not responsible company liabilities beyond their investment. Like a partnership, there is no corporate double taxation. Rather owners

HUGHES THORSNESS
GANTZ POWELL & BRUNDIN
ATTORNEYS AT LAW

(like partners) incur federal income taxation at the individual level based on the profits and losses allocated to them.

Enclosed for your reference are a May 14, 1991 Wall Street Journal article and a June 19, 1993 New York Times article on limited liability companies. Also enclosed is a brief bibliography on the subject and a February 22, 1994, letter from the Alaska Society of CPA's endorsing Sponsor Substitute for House Bill 420.

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. Our Alaska working group has modified various provisions to conform with Alaska procedure and additional developments in the law. At this point the lack of limited liability company 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 in common use in European, Asian and South American countries.

We appreciate your assistance in this matter. If you have any questions, please contact me.

Very truly yours,

HUGHES, THORSNESS, GANTZ,
POWELL & BRUNDIN

By: Robert L. Manley
Robert L. Manley

RLM/kah/3463:XKAH
Enc.

LIMITED LIABILITY COMPANIES BIBLIOGRAPHY

By: Robert L. Manley

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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.

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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).

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95TH STORY of Level 2 printed in FULL format.

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 Menuchen, 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.

Department of Commerce & Economic Development / POSITION PAPER

HB 420: "An Act relating to limited liability companies; amending Alaska Rules of Civil Procedure 20 and 24; and providing for an effective date."

The department strongly supports the concept of Limited Liability Company legislation. The primary goal for the state to adopt this legislation is to offer increased business opportunities in the State of Alaska. Limited Liability Companies (LLC) offer individual liability protection to its members and managers while avoiding the restrictions place upon subchapter "S" corporations. LLC also avoid the multi-level taxation of "C" corporations. This type of arrangement is especially attractive to individuals, corporations, and other enterprises interested in establishing joint ventures, both domestically and with foreign countries.

While the provisions of HB 420 provide for the foundation of LLC law, it lacks the department's administrative procedures established for other types of business organizations. These procedures are effective in required filings of limited partnerships, profit and nonprofit corporations, both domestic and foreign, professional corporations, cooperatives, and in the administration of trade names. The department over this past year has been working with the Alaska Bar Association to develop an LLC law that would meld into the existing efficient administrative procedures that are now in place. With the ABA proposal, the new LLC law would not be a "new" program but a new category of existing procedures requiring no additional expense to initiate and administer.

Again, the department endorses the LLC legislation but must encourage consideration for the work that has been done by the Alaska Bar Association and the department to efficiently administer the Act. It is our understanding that the ABA bill will be introduced in the Senate within the next ten days.

for S. E. Beed
Paul Fuhs, Commissioner

2-17-94
Date

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March 4, 1994

REPLY TO:
Anchorage

Representative Bill Hudson
Chairman
House Committee on Labor and Commerce
State Capital, Room 108
Juneau, AK 99801-1182

Re: House Bill 420

Dear Representative Hudson:

This letter is sent in regard to the Sponsor Substitute for House Bill 420 which deals with a new form of business entity, limited liability companies. I am very much in favor of this bill and would hope that there would be a hearing scheduled soon. 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
cc: Brian Porter
Joe Green
Eldon Mulder
kp\docs\579\hudson.ltr

Multistate Tax Commission

REVIEW

Supreme Court Decisions In *Allied-Signal* And *Kraft* Push States To Consider Combined Reporting

Paull Mines, Counsel
Multistate Tax Commission

The following is an account of why States now employing separate entity accounting principles[1] will inevitably face the adoption of combined reporting following the 1991 term of the U.S. Supreme Court.[2] This view is based on the Court's strong reinforcement of the unitary business principle in *Allied-Signal Inc. v. Director, Div. of Taxation*, 112 S.Ct. 2251 (1992), and *Kraft General Foods, Inc. v. Iowa Dept. of Revenue & Finance*, 112 S.Ct. 2365 (1992).

In *Allied-Signal*, the U.S. Supreme Court embraced the unitary business principle as the governing precept for determining the apportionability of the income of a multistate business enterprise in a particular taxing State.[3] In *Kraft General Foods*, the Court rejected the attempt to justify Iowa's disparate taxation of foreign dividends by reference to how other States were taxing the same unitary business. *Kraft General Foods* is important, because it requires States to stand or fall under the unitary business principle on their own, separate state tax systems. In *Kraft General Foods*, Iowa was required and failed to justify its ostensibly disparate treatment of foreign dividends (which, ar-

See Combined Reporting, Page 3.

In This Issue:

Limited Liability Companies: What Are They, And What Are Their Implications For State Taxation?

(Part I)

Scott D. Smith, Assistant Counsel
Multistate Tax Commission

Many complex and unanticipated state tax issues may be presented by the limited liability company ("LLC"), a new form of business entity being authorized by a rapidly-increasing cohort of states. At present, eighteen States have enacted legislation creating LLCs,[1] and several others are contemplating LLC legislation.[2] Part I of this article describes LLCs and examines issues surrounding their entity classification for federal and state tax purposes. Part II (to be published in the next issue of the *MULTISTATE TAX COMMISSION REVIEW*) will discuss a number of state tax issues presented by LLCs classified as partnerships for state tax purposes.

I.
THE NATURE AND ADVANTAGES OF LLCs.

An LLC is a hybrid, unincorporated business association providing all of its members with limited liability for their equity investments, flexible management alternatives, and liberal member qualification requirements. In many respects, LLCs combine traditional partnership and corporation attributes. LLCs resemble limited liability organizations existing in several European and South American countries and elsewhere.[3] Although relatively few LLCs have yet been organized, as more States enact LLC enabling legislation, they will likely become increasingly important entities for doing business by providing an alternative to the traditional corporation and partnership.[4]

Since LLC interests are generally subject to significant transfer restrictions, LLCs may be of questionable utility for

See Limited Liability Companies, Page 5.

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Volume 1992 Number 1 December 1992

Limited Liability Companies, from Page 1.

ventures traditionally conducted by widely held limited partnerships and C corporations. These transfer restrictions may also limit LLCs in raising capital. Similarly, unless all members desire to manage the entity, a limited partnership can, as a practical matter, obtain pass-through tax advantages yet still provide limited liability to all partners by using a corporate general partner. An S corporation can be utilized to achieve [illegible]ame results. Likewise, if members do not want pass-through tax treatment, they can form a C corporation to manage themselves while having limited liability. LLCs may, however, represent a sound choice of organizational form for such high-risk operations as highly-leveraged real estate and natural resources ventures, in which ensuring limited liability for all members and providing pass-through tax advantages, without the restrictions of a limited partnership or S corporation, are substantial concerns.

The Internal Revenue Service (the "Service") has classified an LLC formed under Wyoming's LLC Act as a partnership for federal tax purposes.[5] A series of private letter rulings indicate that the Service continues to classify most LLCs as partnerships.[6]

The hybrid character of LLCs (encompassing corporation and partnership attributes) means that they offer certain advantages over other "pass-through" entities. For example, LLC members can retain the principal economic benefit of being a limited partner – limited liability – yet suffer neither of the principal drawbacks: an inability to participate in the management of the business and potentially being subject to "passive activity loss" limitations on utilizing losses to shelter other income.

In addition, the treatment of LLCs as partnerships for federal tax purposes provides them with several advantages over S corporations. LLCs avoid S corporation "qualification" restrictions: the 35 shareholder limit applicable to S corporations does not apply to LLCs; corporations, partnerships, trusts, non-resident aliens, ESOPs, retirement plans, and charitable organizations can be LLC members; and LLCs are not prohibited from having more than one class of interests.[7] LLCs provide greater flexibility than S corporations in other ways as well: LLC members may increase their tax bases to the extent of their share of LLC liabilities; LLCs avoid the built-in gains tax and passive investment income tax imposed on S corporations; and LLC members can utilize Code 754 elections to adjust their inside tax bases to reflect the purchase price of their LLC interests. (This step-up in basis is not permitted to a person who buys or inherits stock in an S corporation). Finally, LLCs are not subject to S corporation inadvertent termination and, unlike S corporations, can utilize subsidiary corporations to operate their business.[8]

II.
LLC FEDERAL TAX CLASSIFICATION ISSUES.

A. Current Federal Tax Classification of LLCs.

It is important to understand federal tax classification of LLCs, because (as will be discussed below) most States are likely to adopt the federal classification for state tax purposes. Whether a business organization is treated as a partnership or a corporation for federal tax purposes does not depend on its characterization under state law.[9] Rather, the federal tax classification regulations classify an organization by applying a mechanical test that looks to see whether the organization possesses at least three of four declared "corporate characteristics."[10] If this test is satisfied, then the organization is classified as an association taxable as a corporation.[11] The four characteristics relevant to the Service's classification of an organization as an "association" taxable as a corporation for federal tax purposes are:

(1) continuity of life;
(2) centralized management;
(3) limited liability; and
(4) free transferability of interests.

These four characteristics are given equal weight.[12]

The Service applied this test to the LLC at issue in *Rev. Rul. 88-76*, which was structured as follows:

(1) Upon the death, bankruptcy, retirement, expulsion, resignation, or dissolution of any member of the LLC, the LLC would dissolve unless all remaining members consented to continuing the LLC. The Service held that the LLC lacked continuity of life. (The lack of continuity of life is a partnership tax characteristic).

(2) The LLC had the discretion under the Wyoming Act to be managed either by a board of designated managers or by all of the members. The members chose to have the LLC managed by a board of designated managers. The Service held that the LLC possessed centralized management (a corporate tax characteristic).

(3) No members were personally liable for the LLC's debts or obligations. The Service held that the LLC possessed limited liability (a corporate tax characteristic).

(4) A member could transfer or assign his interest but the transferee/assignee member did not acquire all the attributes of ownership in the LLC unless all remaining members consented to the transfer. The Service held that the LLC lacked freely transferable interests. (The lack of freely transferable interests is a partnership tax characteristic).

Because the LLC possessed two partnership and two corporate characteristics, the Service classified the Wyoming LLC as a partnership for federal tax purposes.

B. Application of the "Declared Corporate Characteristics" to Specific State LLC Provisions.

The Wyoming LLC statute at issue in *Rev. Rul. 88-76* varies in a number of respects from the statutes in the other LLC States. Moreover, the interaction of the federal classification regulations with a variety of options the States provide with respect to the formation of LLCs makes it likely that the classification of LLCs for federal and state tax purposes will continue to be made on a case-by-case basis. For both of these reasons, it is important to understand thoroughly the federal classification regulations and the manner in which the Service has applied them to LLCs.

1. Centralized Management.

An LLC will possess the corporate characteristic of centralized management under the federal classification regulations when "any person (or any group of persons which does not include all members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed."[13]

Compared to corporations and limited partnerships, one feature of LLCs that taxpayers may consider to be a virtue is the relative flexibility LLCs provide for establishing the management

See Limited Liability Companies, Page 6

Limited Liability Companies, from Page 5.

structure of the entity. Although a limited partnership must be managed by its general partner and a corporation must be managed by its directors and officers, most of the LLC States permit all members to manage the LLC or to elect member or non-member managers.[14] Members can therefore establish an LLC's management structure in accord with their business and tax entity classification considerations. Accordingly, for LLCs organized in most States, the determination of whether the LLC possesses the corporate characteristic of centralized management must be made on a case-by-case basis.

Colorado and Minnesota vary from the other LLC States with respect to the flexibility allowed in the LLC management structure, however. Colorado does not permit all LLC members to manage an LLC; rather, it requires management by a board of designated managers.[15] The mandated management structure of a Minnesota LLC is similar to that of a corporation. A Minnesota LLC must have a "board of governors" who manage the "business affairs" of the LLC,[16] and it must also have a "chief manager" and a "treasurer."[17] Consequently, Colorado and Minnesota LLCs will always possess two federal corporate characteristics: limited liability and centralized management.

2. Free Transferability of Interests.

The federal classification regulations treat an organization as having the corporate characteristic of freely transferable interests if the members owning substantially all of the interests in the organization have the power to transfer all rights and attributes of ownership to a non-member without the consent of the other members.[18] The LLC states fall into three groups with respect to this characteristic.

Colorado, Florida, Kansas, Nevada, Virginia, West Virginia, and Wyoming require unanimous consent of LLC members for an interest to be transferred with all rights and attributes of ownership.[19] Accordingly, all LLCs formed in these seven states will lack "free transferability of interests."[20]

Iowa, Maryland, and Texas comprise the second group. These three states generally require the unanimous consent of LLC members to the transfer of an LLC interest, but permit the LLC's operating agreement to provide otherwise.[21]

Utah, Arizona, and Minnesota comprise the third group, each of them providing their own variations on transfers of interest. Utah requires only that members who will constitute a majority of the profit interests following the transfer of an LLC interest consent to the transferee's receiving all rights and attributes of ownership.[22] Arizona requires unanimous consent as a general rule, but permits an LLC to empower one or more members with the authority to admit additional members without the consent of the other members.[23] Minnesota generally requires unanimous consent to a transfer, but does not require it if the transfer is made to another member.[24]

The federal classification regulations do not indicate whether a transfer-of-interest approval requirement providing for less than unanimous consent will cause a business association to be characterized as possessing freely transferable interests. Arguably, some LLCs in both the second and third group of states could be so-characterized. Nonetheless, the Service appears willing to provide LLCs with substantial flexibility in structuring transfer restriction alternatives in a way that provides members with freedom to transfer their interests with all rights and attributes of ownership without being characterized as possessing freely transferable interests.[25]

3. Continuity of Life.

An organization possesses the corporate characteristic of continuity of life if "the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization."[26] A "dissolution" means an "alteration of the identity of an organization by reason of a change in the relationship between its members as determined under local law."[27] If a "dissolution event" occurs but the business of the organization is continued with the unanimous consent of the "remaining members," the organization will not be characterized as possessing continuity of life.[28]

The States of Colorado, Iowa, Maryland, Minnesota, Nevada, Virginia, West Virginia, and Wyoming require unanimous consent of the remaining members for an LLC to continue following a dissolution event. Accordingly, all LLCs organized in these states will lack the corporate characteristic of continuity of life.

The Arizona, Florida, Kansas, Texas, and Utah provisions may permit the LLC to continue after a dissolution event with less than unanimous consent of the remaining members. Arizona generally requires unanimous member consent to continue an LLC following a dissolution event. However, an Arizona LLC can, alternatively, empower one or more managers or members to decide whether to continue the LLC after a dissolution event without the consent of all remaining members.[29] A Florida LLC will dissolve if any dissolution event occurs, "unless the business of the limited liability company is continued by the consent of all the remaining members *or under a right to continue stated in the articles of organization* of the limited liability company."[30] Kansas provides a similar rule.[31] Utah requires only the "consent of the remaining members *entitled to receive a majority of the capital* of the limited liability company" in order to continue an LLC following a dissolution event.[32] Texas requires unanimous consent to continue or, alternatively, consent by a stated number of members or of a particular class as provided in the LLC's articles of organization or regulations.[33]

The Service has required unanimous consent to continuation of an LLC following a dissolution event in order for the LLC to avoid being characterized as possessing continuity of life. In *Ltr. Rul. 9010027*, the Service ruled that a Florida LLC had continuity of life because its articles of organization required only a majority of members to consent to continuation of the LLC following a dissolution event. Consequently, Utah LLCs and LLCs organized in Arizona, Florida, and Kansas and using their entity continuation alternatives will possess the corporate characteristic of continuity of life.[34]

Moreover, a Texas LLC whose articles of organization or regulations require less than unanimous consent by remaining *members* to continuation following a dissolution event should also run afoul of the Service's position as expressed in *Ltr. Rul. 9010027*. It is unclear, at this point, whether a Texas LLC requiring unanimous consent only from a particular *class* of members under the alternative provision of Texas' LLC statute will be characterized as possessing continuity of life.[35]

Although private letter rulings do not constitute authority,[36] *Ltr. Rul. 9010027* is an expression of the Service's position on the application of the continuity of life principle.[37] In short, although provisions allowing less than unanimous consent to the transfer of an LLC interest will apparently not cause an LLC to possess free transferability of interests, provisions allowing less than unanimous consent of members to the continuation of an LLC following a dissolution event appear likely to result in a characterization of the LLC as possessing the corporate characteristic of continuity of life.[38]

4. Limited Liability.

The federal classification regulations define "limited liability" as follows: "[a]n organization has the corporate characteristic of limited liability if under local law there is no member who is personally liable for the debts of or claims against the organization. Personal liability means that a creditor of an organization may seek personal satisfaction from a member of the organization to the extent that the assets of such organization are insufficient to satisfy the creditor's claim."[39]

The LLC states provide *all* LLC members with limited liability from the debts, obligations, or liabilities of an LLC.[40] The limited liability of *all* members of an unincorporated association is an issue that is not addressed by the federal classification regulations, by *Rev. Rul. 88-76*, or by Service private letter rulings. When all members of an entity are cloaked with limited liability, however, the entity closely resembles a corporation rather than a partnership. As a result, LLCs obviate the need for any "limited liability" analysis under the federal classification regulations.

The arbitrariness of the equal weighing of the four "corporate characteristics" contained in the federal classification regulations becomes readily apparent when every member of an entity has limited liability. It makes sense to weigh limited liability equally with the other declared corporate characteristics when a true state law partnership is being classified since the extent of limited liability requires a factual inquiry (*i.e.*, does the general partner have "substantial assets -- other than his interest in the partnership -- which could be reached by a creditor of the organization, or is the general partner "merely a 'dummy' acting as the agent of the limited partners"?).[41] On the other hand, limited liability vested in every member is such a strong corporate characteristic that it appears to deserve greater emphasis.[42]

5. Summary Analysis of Declared Corporate Characteristics.

From the foregoing discussion, it is apparent that the entity classification for federal tax purposes of LLCs will have to be done on a case-by-case basis and may effectively be elective in a number of LLC States. In other words, where state laws provide for a number of organizational options, the form of the organizational documents, and not the provisions of the State laws themselves, will determine whether the corporate characteristics of centralized management, free transferability of interests, and continuity of life are avoided or satisfied for a specific LLC. States permitting election of one or more of the declared corporate characteristics other than limited liability (which will always be present, at least in the LLC States[43]) are summarized in the following table.

Centralized Management: States permitting election to be managed by designated managers or all LLC members.	**Free Transferability of Interests:** States permitting election to require unanimous consent or less than unanimous consent to transfer of an LLC interest.	**Continuity of Life:** States permitting election to require unanimous consent or less than unanimous consent to continue the LLC following a dissolution event.
Arizona	Arizona	Arizona
Florida		Florida
Iowa	Iowa	
Kansas		Kansas
Maryland	Maryland	
	Minnesota	
Nevada		
Texas	Texas	Texas
Utah	Utah	Utah
Virginia		
West Virginia		
Wyoming		

See Limited Liability Companies, Page 8.

Limited Liability Companies, from Page 7.

The table indicates that LLCs organized in Colorado (by its absence from the table), Minnesota, Nevada, Virginia, West Virginia, and Wyoming will always be classified as partnerships since they can have, at most, two corporate characteristics (including limited liability). LLCs organized in the other seven States would have the option to organize themselves in such a way that they would be characterized as corporations for federal tax purposes.

The ability to be classified as a partnership for tax purposes and yet provide all members with limited liability and management options is, arguably, the greatest attraction of LLCs. Nonetheless, LLCs organized in those States in which it is effectively possible to elect federal corporate tax treatment provide additional flexibility in meeting members' tax objectives. For example, the members may desire corporate tax classification in order to be able to utilize net operating loss and capital loss carryforwards and carrybacks. (A partner may only deduct losses from a partnership to the extent of the partner's basis.)[44] A corporation may select a fiscal year for its tax accounting period,[45] whereas a partnership's tax accounting period is generally restricted to the calendar year.[46] The shareholders of a corporation, unlike the partners of a partnership, can also be employees and thereby eligible for tax favored employee fringe benefits. If the LLC anticipates holding inventory that will substantially appreciate or will have unrealized receivables, then the members may realize tax benefits if they elect corporate tax classification. Although a partner generally realizes a capital gain on the sale of its partnership interest, the sale will generate ordinary income to the extent of the partnership's unrealized receivables and substantially appreciated inventory.[47] Lastly, the member may simply want to operate as a corporation without being subject to S corporation restrictions[48] and without the necessity of adhering to corporate formalities.[49]

C. Other Classification Issues.

As suggested, the entity classification of LLCs for federal tax purposes is largely elective in the LLC States that provide organizational options affecting two or more of the declared corporate characteristics. There are two additional issues, however, which may dictate how LLCs are classified for federal tax purposes.

1. Impact of Related Members.

Under the Service's "no separate interests theory," a limited liability organization whose members are related (under common control) is deemed to have freely transferable interests. The Service will so rule even if state law (or foreign law, in the case of a foreign entity) and/or the organization's operating instrument requires unanimous consent of the members to transfer an interest.[50]

In *Rev. Rul. 76-435*[51] the Service classified a domestic limited partnership as an association taxable as a corporation since its corporate general partner was owned equally by the two limited partners.[52] Likewise, *Rev. Rul. 93-4*[53] concerned a German GmbH, an unincorporated business organization, formed by two U.S. subsidiaries of the same U.S. parent. The GmbH had limited liability and centralized management under German law. The Service held that the GmbH possessed freely transferable interests, even though unanimous consent to transfer was required under the GmbH's "memorandum of association." Because the members of the GmbH were under common control, consent to transfer was deemed not meaningful. In short, the Service's "no separate interests" theory may effectively eliminate the ability of some LLCs, consisting of commonly controlled members, to be treated as partnerships for federal tax purposes, unless an LLC's operating agreement either prohibits the transfer of interests or provides that a transfer of interests causes a dissolution of the LLC. *Rev. Rul. 93-4.*

2. A "Substantial Interests" Requirement for LLC Managing Members?

In *Ltr. Rul. 9029019* (April 19, 1990), the Service imposed what appears to be a "substantial interests" requirement in order for an LLC to avoid having its favorable (partnership tax classification) private letter ruling retroactively revoked. The Service required that the LLC continuously satisfy *Rev. Proc. 89-12*[54] and in particular 4.01 and 4.03 therein. These provisions of *Rev. Proc. 89-12* apply to the circumstances under which the Service will consider a private letter ruling request from a limited partnership (or LLC) with regard to its classification for federal tax purposes. (The ruling requirements of *Rev. Proc. 89-12* are procedural only and do not constitute substantive law).

Section 4.01 conditions the Service's consideration of a ruling request for partnership classification purposes on all general partners (or LLC managing members)[55], "taken together," having interests in each "material item of partnership income, gain, loss, deduction, or credit" at least equal to 1 percent of each item at all times during the existence of the partnership (or LLC). Section 4.03 requires general partners (or LLC managing members), "taken together," to maintain minimum capital account balances equal to 1 percent of total capital account balances or $500,000, whichever is less.

Consequently, even though they are not part of the federal classification regulations, a managing LLC member may have to satisfy the Service's minimal interest and capital account requirements in order for the LLC to be recognized as a partnership by the Service.[56] At this time, the only apparent exception to the "substantial interests requirement" is if the LLC is managed by all members[57] or, if the LLC is managed by designated managers, if the managers are not members.[58] For LLCs organized under the Arizona, Maryland, and Minnesota LLC statutes, the Service's revocation of an LLC's partnership classification letter ruling may cause the LLC to be classified for state tax purposes as other than a partnership.[59]

III.
LLC RECOGNITION AND CLASSIFICATION AT THE STATE LEVEL

The LLC States themselves are not uniform in their classification of LLCs for tax purposes, with some classifying them as corporations and others conforming to the federal classification (which, as discussed above, will usually be as a partnership). In addition, some ambiguity exists concerning the tax classification of foreign LLCs, particularly in non-LLC States.

A. Current State Tax Classification of LLCs in LLC States.[60]

1. Corporate Classification.

Florida and Texas have classified LLCs as corporations for tax purposes. Florida treats LLCs as "artificial entities", imposes its corporate income tax on LLCs, and treats LLC distributions

as dividends.[61] Texas defines "corporations" to include LLCs and imposes its corporate franchise tax on LLCs.[62] Neither Florida nor Texas has a personal income tax.

2. Partnership Classification.

The only LLC State that unequivocally classifies an LLC as a partnership for tax purposes is Colorado.[63] Arizona, Maryland, and Minnesota classify LLCs as partnerships for state tax purposes if they are so classified for federal tax purposes.[64]

Although Kansas, Iowa, Utah, Virginia, and West Virginia have not specifically classified LLCs for state tax purposes, it appears these States will conform with the federal classification. Virginia should treat LLCs as partnerships given its general conformity statute and its conformity to federal tax definitions.[65] Utah will probably conform to the federal classification because it conforms to Code 761.[66] Iowa does not provide any specific definition of a partnership for tax purposes, but Iowa's tax regulations require an organization to file an Iowa partnership information return if it must file a federal partnership information return Form 1065.[67]

Similarly, although Kansas has not definitively classified LLCs for tax purposes, it conforms to the Internal Revenue Code under a general conformity provision. This provides, in pertinent part, that: "[a]ny term used in this act shall have the same meaning as when used in a comparable context in the federal internal revenue code."[68] West Virginia characterizes an LLC as an "unincorporated association"[69] and may, therefore, treat an LLC as a partnership for tax purposes because it defines a "partnership" for its business franchise tax in conformity with Code 761.[70]

B. Tax Classification of Foreign LLCs by LLC and Non-LLC States.

Twelve of the LLC States explicitly provide for registration of foreign LLCs.[71] Most of these twelve States will, presumably, conform to the federal tax classification of foreign LLCs for State tax purposes.[72] It should be noted, however, that complete interstate uniformity will not necessarily follow. For example, an LLC formed in Florida or Texas will always be taxed as a corporation in its domiciliary state[73] but will be treated as a partnership if it registers to do business in Colorado.[74] LLCs organized in Minnesota, Virginia, and West Virginia will always be classified as partnerships, but some foreign LLCs doing business in those states could be taxed as corporations if they were organized in states that effectively permitted them to elect to be so-classified for federal tax purposes.[75]

Among the non-LLC states, California[76], Indiana[77], and North Carolina[78] have already indicated that they will treat foreign LLCs as partnerships for tax purposes.

How the LLC states that do not recognize foreign LLCs and the non-LLC states (other than California, Indiana, and North Carolina) will treat foreign LLCs for tax purposes is ambiguous at this time. As a general rule, state tax classification of organizations is not well developed; most states simply conform to the federal classification. Thus, it seems likely that these states will do the same.[79]

Even assuming that non-LLC states will conform to the federal tax classification, an additional ambiguity remains: whether LLCs classified as partnerships will be treated for state tax purposes as general or limited partnerships. A general partnership is a creature of the common law, is formed voluntarily without the need for statutory authorization, and is founded upon contract, not statute.[80] A limited partnership, on the other hand, is a creature of statute and cannot exist unless the partnership satisfies state limited partnership law.[81] Although an LLC is also a creature of statute, it is not a limited partnership. Consequently, in the absence of specific legislation, an LLC may well be treated as a general partnership for state tax purposes.[82] This has obvious state tax consequences in those States in which limited partnerships are taxed at the entity level or are subject to minimum taxes.[83]

IV.
CONCLUSION

Until the ambiguities surrounding the tax treatment of foreign LLCs in many LLC and non-LLC States are resolved, it seems unlikely that these relatively new entities will be widely used to conduct a general multistate business.[84] This is perhaps fortunate, because it may give the States some time in which to resolve some thorny issues involving the taxation of individual and corporate members of LLCs, particularly non-resident and non-domiciliary corporate members.[85] States will also have to confront tax issues arising from transactions involving LLCs and their members such as mergers/conversions involving corporations/partnerships into LLCs and the income and sales tax ramifications thereof, unitary combination issues relating to LLCs and their corporate members, LLC cash and property distributions, and sales of LLC member interests. These issues are the subject of Part II of this article.

FOOTNOTES

1. *See, e.g.*, Arizona Limited Liability Company Act, Title 29, Chap. 4, 39-601, *et seq.* (S.B. 1084, June 2, 1992) (hereinafter, the "Arizona Act"); COLO. REV. STAT. /-80-101, *et seq.*; FLA. STAT. ANN. 608.401, *et seq.*; Iowa Limited Liability Company Act, 490A.100 *et seq.* (H.F. 2369, 1992) (hereinafter, the "Iowa Act"); KAN. STAT. ANN. 17-7601, *et seq.*; Maryland Limited Liability Company Act, Title 4A, 4A-101, *et seq.* (H.B. 373, May 26, 1992) (hereinafter, the "Maryland Act"); Minnesota Limited Liability Company Act, 211B.15, Subd. 1, *et seq.* (H.F. 1910, April 29, 1992) (hereinafter, the "Minnesota Act"); NEV. REV. STAT. 86.011, *et seq.*; TEX. CORPS. & ASS'NS. CODE ANN. Title 32, Art. 1528n, art. 1.01 *et seq.*; UTAH CODE ANN. 48-2b-101, *et seq.*; VA. CODE 13.1-1000, *et seq.*; W. VA. CODE 31-1A-1, *et seq.*; and WYO. STAT. 17-15-101, *et seq.* In this article, these thirteen States shall be collectively referred to as the "LLC States." Delaware, Illinois, Louisiana, Oklahoma, and Rhode Island enacted LLC legislation after the author completed his comparison of LLC provisions in the various States. Accordingly, provisions of the LLC laws in these five States are not cited in the remainder of the article. *See* Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, 18-101, *et seq.* (H.B. 608, Ch. 434, Del. Laws 1992, July 22, 1992) (eff. Oct. 1, 1992); Illinois Limited Liability Company Act, S.B. 2163 (September 11, 1992) (eff. Jan. 1, 1994); Louisiana Limited Liability Company Law, 1992 La. Laws Act 780 (H.B. 1262) (eff. July 7, 1992); Oklahoma Limited Liability Company Act, 1992 Okla. Sess. Laws Ch. 148 (S.B. No. 456) (May 1, 1992); and Rhode Island Limited Liability Company Act, 1992 R.I. Pub. Laws Ch. 92-380 (Sept. 19, 1992).

See Limited Liability Companies, Page 10.

Limited Liability Companies, from Page 9.

2. It has been reported that at least 17 other States are considering or have considered legislation creating LLCs. These States are: California, Georgia, Hawaii, Indiana, Michigan, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, South Dakota, and Washington.
3. *See, e.g., Ltr. Rul. 7817129* (Jan. 30, 1978) and *Ltr. Rul. 8003072* (Oct. 25, 1979) (both considering *limitadas* formed under the limited liability company laws of Brazil); *Ltr. Rul. 8221136* (Feb. 26, 1982) (considering *Gesellschaft mit beschraenkter Haftung (GmbH)* formed under the laws of the Federal Republic of Germany); *Ltr. Rul. 7826023* (March 28, 1978) (considering *sociedate por quotas de responsibilidade limitade* formed under the laws of Portugal); and *Ltr. Rul. 8006086* (Nov. 19, 1979) (considering limited liability partnerships formed under the laws of the Kingdom of Saudi Arabia).
4. It has been reported that Florida enacted its LLC statute in the hope of attracting foreign business and capital to the State from South and Central American executives familiar with the *limitada* form of business entity. *See* Comment, *The Limited Liability Company Act*, 11 FLA. ST. U. L. REV. 387, 387-388 (1983). Wyoming enacted its LLC statute as special interest legislation for an oil company. *See* Keatinge, Ribstein, Hamill, Gravelle and Connaughton, *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 383, n. 36 (February 1992) (hereinafter, "*Keatinge*"). For an examination of the history of LLCs and their earliest American and foreign precursors see *Keatinge* at 381-384.
5. *Rev. Rul. 88-76*, 1988-2 C.B. 360. Effective September 19, 1988, the Service began providing advance rulings and determination letters on the classification of LLCs. *See, Rev. Proc. 88-44*, 1988-2 C.B. 634.
6. As this article was going to press, the Service has issued private letter rulings and revenue rulings classifying LLCs as partnerships for LLCs formed under the statutes of only 6 States (excluding Wyoming). In addition to *Rev. Rul. 88-76* (with respect to Wyoming's LLC statute), LLCs formed in Colorado, Florida, Nevada, Texas, Utah, and Virginia have received partnership classification rulings. *See Rev. Rul. 93-6*, 1993-3 I.R.B. ___ (Jan. 19, 1993) (Colorado); *Ltr. Rul. 89371010* (September 16, 1989), *Ltr. Rul. 9030013* (April 25, 1990) (Florida); *Ltr. Rul. 9227033* (April 8, 1992) (Nevada); *Ltr. Rul. 9210019* (December 6, 1991); *Ltr. Rul. 9218078* (January 31, 1992); and *Ltr. Rul. 9242025* (July 22, 1992) (Texas); *Ltr. Rul. 9219022* (February 6, 1992) (Utah); and *Rev. Rul. 93-5*, 1993-3 I.R.B. ___ (Jan. 19, 1993) (Virginia). There are several other private letter rulings involving LLCs formed in the aforementioned States as well as for LLCs formed in States not disclosed in the letter ruling. These rulings are on file with the author.
7. *See, e.g.*, 1361(b), Internal Revenue Code of 1986, as amended (hereinafter "the Code"). Texas LLCs are specifically permitted to have different classes of members (TEX. CORPS. & ASS'NS. CODE ANN. art. 4.02) and LLCs in the other States are not expressly prohibited from having more than one class of interests. This provides LLCs with greater financial flexibility than an S corporation in determining allocation of losses and income since S corporations cannot specially allocate items of income and losses without violating the one class of stock restriction.
8. *See, e.g.*, 1362(d), (e), and (f) of the Code. S corporations cannot be members of an affiliated group of corporations (1361(b)(2)(A) of the Code). *See also* Keatinge, *supra*, note 4; Jordan and Kloepfer, *The Limited Liability Company: Beyond Classification*, 69 TAXES 203 (April 1991) (hereinafter, "*Jordan and Kloepfer*"); Hamill, *The Limited Liability Company: A Possible Choice for Doing Business*, 41 FLA. L. REV. 721, 748-757 (1989); Comment, *The Wyoming Limited Liability Company: A Viable Alternative to the S Corporation and the Limited Partnership?*, 23 LAND & WATER L. REV. 523 (1988); Comment, The Limited Liability Company: An Organizational Alternative for Small Businesses, 70 NEB. L. REV. 150 (Winter 1991).
9. Treas. Reg. 301.7701-1(c).
10. There are actually six relevant characteristics, but LLCs, like corporations and partnerships, will undoubtedly satisfy the two characteristics common to most business organizations: "associates," and "an objective to carry on business and divide the gains therefrom." Treas. Reg. 301.7701-2(a)(2). Generally, if an organization lacks associates and a joint profit motive, the organization will be classified as a trust. Treas. Reg. 301.7701-2(a)(2).
11. Treas. Reg. 301.7701-2(a)(3). The U.S. Tax Court in *Phillip G. Larson*, 66 T.C. 159 (1976), recognized the bias in the federal classification regulations toward a partnership classification. It noted that at the time the regulations were originally promulgated, the Service was concerned with attempts by non-corporate entities, such as professional partnerships, to qualify as corporations in order to deduct costs of medical insurance and retirement plans. 66 T.C. at 186-187. Virtually all of these advantages of corporate classification were eliminated by the Tax Equity and Fiscal Responsibility Act of 1982 and subsequent legislation.
12. *See, e.g., Phillip G. Larson, supra*, note 11. The *Larson* court majority explained the equal-weighing "as an attempt [by the Service] to impart a degree of certainty to a subject otherwise fraught with imponderables." 66 T.C. at 172. The court further stated: "we can find no warrant for such refined balancing in the regulations or in cases which have considered them. . . Our task herein is to apply the provisions of the respondent's regulations as we find them and not as we think they might of ought to have been written." 66 T.C. at 172.
13. Treas. Reg. 301.7701-2(c)(1). The managers need not be members of the LLC. Treas. Reg. 301.7701-2(c)(2). No centralized management exists if the purported manager(s) has/have authority "merely to perform ministerial acts" and does/do not have "continuing exclusive authority to make independent business decisions on behalf of the organization which do not require ratification by members of such organization." Treas. Reg. 301.7701-2(c)(3).
14. Texas provides a "default" election with respect to centralized management. A Texas LLC must be managed by designated managers in the absence of an agreement of the members to reserve management to themselves. TEX. CORPS. & ASS'NS. CODE ANN. art. 2.12.
15. COLO. REV. STAT. 7-80-401.
16. Minnesota Act 322B.606, Subd. 1. The members can, however, supersede any action taken by the board of governors by unanimous vote. Minnesota Act 322B.606, Subd. 2.
17. Minnesota Act 322B.67. The "chief manager" partakes in the "general active management of the business of the limited liability company." Minnesota Act 322B.673, Subd. 2. The "treasurer" is the LLC's financial officer. Minnesota Act 322B.673, Subd. 3.
18. Treas. Reg. 301.7701-2(e). The term "freely transferable interests" is, in reality, a misnomer. The federal classification regulations are really referring, as a practical matter, to the transferability of the rights

of ownership *other than* the rights to share in profits/losses and assets upon dissolution, e.g., the right to manage the business and the right to vote. Consequently, even if ownership interests in an entity can be transferred freely, the entity will not be characterized as having the corporate characteristic of freely transferable interests if there are certain limitations on the transfer of these *other* rights and attributes of ownership.

19. COLO. REV. STAT. 7-80-702; FLA. STAT. ANN. 608.432; KAN. STAT. ANN. 17-7617; NEV. REV. STAT. 86.351; VA. CODE 13.1-1039; W. VA. CODE 31-1A-34(c)(1); and WYO. STAT. 17-15-122.
20. *Rev. Rul. 88-76.*
21. Iowa Act 490A.903.1; Maryland Act 4A-601(B)(1); TEX. CORPS. & ASS'NS. CODE ANN. art. 4.07.
22. UTAH CODE ANN. 48-2b-131.
23. Arizona Act 29-731.B.2.
24. Minnesota Act 322B.313, Subd. 2.
25. *See, e.g., Ltr. Rul. 9219022*, holding that Utah's majority consent requirement was sufficient to avoid a free transferability of interests characterization. Two Service private letter rulings involving Texas LLCs have reached the same conclusion. In *Ltr. Rul. 9210019*, a Texas LLC's regulations provided as follows: interests could be transferred subject only to the consent of the LLC manager unless the manager was the transferor or was not a member of the LLC (in which case majority consent was required). In addition, no consent to a transfer of interests was required if the transfer was incident to the death, dissolution, divorce, liquidation, merger, or termination of the transferor and the transferee member constituted a "permitted transferee" under the LLC's regulations. The Service held that the LLC lacked freely transferable interests. In *Ltr. Rul. 9218078*, a Texas LLC's regulations conditioned the transfer of an interest on two-third's (2/3rds) consent of the "outstanding units." The Service held that the LLC lacked freely transferable interests. The Service's interpretation of the freely transferable interests characteristic in *Ltr. Rul. 9210019* also appears to permit Arizona and Minnesota LLCs to use their respective election provisions without being characterized as possessing freely transferable interests.
26. Treas. Reg. 301.7701-2(b)(1). These occurrences are hereinafter collectively referred to as "dissolution events."
27. Treas. Reg. 301.7701-2(b)(2). A partnership or LLC dissolution is not the same as a "termination." A termination has independent tax significance under Code 708. A partnership terminates for federal tax purposes (and State tax purposes if a State conforms to Code 708) if the partnership business, financial operation, or venture fails to be carried on by the partnership or its partners or if, in any twelve month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. Code 708(b)(1)(A) and (B).
28. Treas. Reg. 301.7701-2(b)(2).
29. Arizona Act 29-781.A.3.
30. FLA. STAT. ANN. 608.441(c) (Emphasis added).
31. KAN. STAT. ANN. 17-7622(a)(3).
32. UTAH CODE ANN. 48-2b-137(3) (Emphasis added).
33. TEX. CORPS. & ASS'NS. CODE ANN. art. 6.01(4). This article provides, in pertinent part: "... and the business of the limited liability company is continued by the consent *of the number of members or class thereof stated in the articles of organization or regulations* of the limited liability company or if not so stated, by all remaining members." (Emphasis added).
34. *See also Ltr. Rul. 9030013*, wherein the Service ruled that a Florida LLC lacked continuity of life because the LLC did not elect to use the Florida alternative, but, rather, required unanimous consent to continuation of the LLC following a dissolution event.
35. There is some authority in the federal classification regulations for the position that requiring unanimous consent from one particular class of interest is sufficient to avoid continuity of life. Treas. Reg. 301.7701-2(b)(1) provides, in pertinent part: "If the retirement, death, or insanity of a *general partner* of a *limited partnership* causes a dissolution of the partnership, unless the remaining *general partners* agree to continue the partnership or unless all remaining members agree to continue the partnership, continuity of life does not exist." (Emphasis added). A general partner interest is a different class of partnership interest from a limited partner interest. Consequently, use of the Texas alternative may not result in continuity of life if (1) the class that must consent to continuation is the class whose member has been affected by the dissolution event and (2) the Texas LLC is treated as a limited partnership for federal tax purposes. An LLC likely will be treated as a "limited partnership" by the Service, at least for letter ruling purposes. *Rev. Proc. 89-12*, 1.02, 1989-1 C.B. 798 (1.02 provides that "a 'limited partnership' includes an organization formed under a law that limits the liability of any member for the organization's debts and other obligations to a determinable fixed amount.")
36. *See, e.g.*, 6110(j)(3) of the Code and *Rev. Proc. 92-1*, 11.02, 1992 I.R.B. 9.
37. *See also Ltr. Rul. 9210019* and *Ltr. Rul. 9218078, supra* note 25. In both of these private letter rulings there was no continuity of life issue because the LLCs' operating agreements required unanimous consent of members to continuation of the LLC following a dissolution event.
38. Proposed regulations applicable to limited partnerships that the Service has recently issued may render these issues moot. These proposed regulations permit a "majority in interest of the remaining partners" to agree to continue a limited partnership upon the occurrence of any event causing the withdrawal of a general partner and still avoid being characterized as possessing continuity of life (Prop. Treas. Reg. 301.7701-2(b)(1), 57 Fed. Reg. 32473 (July 22, 1992) (PS-7-92)). Rev. Proc. 92-35, 1992-18 I.R.B. 21, also permits majority consent to continuation of a limited partnership but only if the dissolution event is the general partner's bankruptcy or removal. Consequently, for LLCs treated for federal purposes as limited partnerships, the questions surrounding continuity of life and majority consent to continuation after a dissolution event may be resolved in favor of partnership tax classification. In accordance with Rev. Proc. 89-12, *supra* note 35, an LLC should be treated as a limited partnership for federal tax purposes.
39. Treas. Reg. 301.7701-2(d)(1).
40. Arizona Act 29-651 (Arizona extends limited liability to employees, agents, officers, and non-member managers); Colo. Rev. Stat. 7-80-705; Fla. Stat. Ann. 608.436; Iowa Act 490A.601; Kan. Stat. Ann. 17-7620; Maryland Act 4A-301; Minnesota Act 322B.303., Subd. 1 (includes agents); Nev. Rev. Stat. 86.371; Tex. Corps. & Ass'ns. Code Ann. art. 4.03; Utah Code Ann. 48-2b-109 (Utah extends limited liability to employees); Va. Code 13.1-1019; W. Va. Code 31-1A-33; and Wyo. Stat. 17-15-113.
41. Treas. Reg. 301.7701-2(d)(2). LLCs eliminate any partnership-existence controversy with respect to the "limited liability" factor of the

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Limited Liability Companies, from Page 11.

federal classification regulations. Arguably, this treatment is different from what putative state law limited partnerships receive. At least one federal circuit court of appeals has suggested that the characteristic of limited liability is the most substantive factor that distinguishes corporations from partnerships. *Kurzner v. United States*, 413 F. 2d 97 (5th Cir. 1969).

42. Indeed, the Service issued proposed regulations in 1980 treating any entity vesting limited liability in all members as an association taxable as a corporation. Prop. Reg. 301.7701-2(a)(2), (g) Example (1). 45 Fed Reg. 75,709 (1980). This can be taken as a previous Service position that overall limited liability is so indicative of the corporate form that this single factor required federal tax classification as a corporation. These proposed regulations were later withdrawn. *I.R.S. Announcement 83-4*, 1983-2 C.B. 31. Moreover, the U.S. Treasury Department has in the past proposed treating limited partnerships as corporations if they had more than 35 limited partners. *See, e.g.*, U.S. Department of the Treasury, 2 *Tax Reform for Fairness, Simplification and Economic Growth–General Explanation of the Treasury Department's Proposals*, 146-150 (1984). Because of strong criticism, this proposal was never included in any tax reform package.
43. The issue of whether non-LLC states will recognize the limited liability of LLC members is also an issue which may present itself if LLCs begin operating to a substantial degree in interstate commerce. *See Keatinge, supra*, note 4 at 442-456.
44. Code 704(d). A net operating loss of a corporation can be carried forward 15 years or carried back 3 years. Code 172(b)(1)(A) and (B). A capital loss of a corporation can be carried forward 5 years and carried back 3 years. Code 1212(a)(1)(A) and (B). Taxpayers, other than corporations, may carry capital losses forward only to the next succeeding taxable year. Code 1212(b).
45. Code 441. A personal service corporation generally must select a calendar year tax accounting period. Code 441(i).
46. Under Code 706(b)(1)(B), a partnership's tax accounting period is, in order of priority: (1) the "majority interest taxable year" (*i.e.*, the taxable year of one or more partners having an aggregate interest in partnership profits and capital of more than 50 percent. Code 706(b)(4)(A)(i)); (2) the taxable year of the partnership's "principal partners" (*i.e.*, a partner having an interest in partnership profits or capital of 5 percent or more. Code 706(b)(3)); or (3) the calendar year. Partnerships may also be capable of using a "business purpose" tax accounting period under Code 706(b)(1)(C) (*i.e.*, when the partnership is engaged in a business having a "natural business year." Treas. Reg. 1.706-1(b)(4)(iii)). If the partnership cannot use the "majority interest taxable year" or the "principal partners" taxable year, the tax accounting period selected must provide for the "least aggregate deferral of income for the partners." Treas. Reg. 1.706-1T(a)(1).
47. Code 741 and 751(a).
48. *Supra*, p. 5.
49. For example, the REV. MODEL BUSINESS CORPORATION ACT requires a corporation to file articles of incorporation (2.01), hold an organizational meeting (2.05), adopt bylaws (2.06), issue shares (6.21), hold shareholder meetings (7.01), maintain a registered office and agent (5.01), appoint officers (8.40), hold board of directors meetings (8.20), and file annual reports (16.22). On the other hand, most of the LLC States require LLCs to file articles of organization, maintain a registered office and agent, file annual reports, and, if the LLC is to be managed by managers, appoint managers.
50. *See* Lederman, *Miami Device: The Florida Limited Liability Company*, 67 TAXES 339, 345 (1989). It should be noted, however, that the validity of the Service's "no separate interests" theory has not been tested by the courts. The only time a court was presented with this theory (in a case involving an unincorporated foreign business organization), it sidestepped the issue. *See MCA, Inc. v. United States*, 685 F. 2d 1099 (9th Cir. 1982).
51. 1976-2 C.B. 490.
52. *See also Rev. Proc. 89-6*, 1989-1 C.B. 776, 3.014 (Service will not rule on whether a non-U.S. LLC is a partnership if (1) the taxpayer seeking the ruling is a corporation and less than 20% of the LLC's interests are held by unrelated parties; or (2) unrelated parties hold only a nominal interest in the LLC regardless of whether the taxpayer is a corporation).
53. 1993-3 I.R.B. __ (Jan. 19, 1993). "GmbH" is the abbreviation for *Gesellschaft mit beschrankter Haftung*. *Rev. Rul. 93-4* modifies and supercedes *Rev. Rul. 77-214*, 1977-1 C.B. 408, which held that a GmbH consisting of two wholly-owned U.S. subsidiaries of the same U.S. parent possessed freely transferrable interest *and* continuity of life. *Rev. Rul. 93-4* held that the GmbH *lacked* continuity of life and provided that the presence or absence of separate interests is irrelevant to the determination of whether an entity possesses continuity of life.
54. *Supra*, note 35. The same requirement was also set forth in *Ltr. Rul. 9218078, supra* note 25, and *Ltr. Rul. 9147017* (August 21, 1991). This requirement has not been explicitly imposed in all private letter rulings concerning LLCs.
55. The Service should treat LLC managing members as general partners for letter ruling purposes. According to *Rev. Proc. 89-12*, 1.02, "[r]eferences to 'general partners' and 'limited partners' apply also to comparable members of an organization not designated as a partnership under controlling law and documents; the 'general partners' of such an organization will ordinarily be those with significant management authority relative to the other members."
56. The substantial interest requirement is not necessary for establishing a tax return position nor can it be applied on audit. *See Rev. Proc. 89-12*, 1.03.
57. *Ltr. Rul. 9030013.*
58. *Ltr. Rul. 9227033.*
59. *See* note 64, *infra*.
60. Wyoming and Nevada have not found it necessary to classify LLCs for tax purposes because neither state imposes a corporate or personal income tax. Wyoming does, however, impose a graduated annual fee on LLCs based on the amount of LLC capital. WYO. STAT. 17-15-132.
61. FLA. STAT. ANN. 608.471(2) and 608.426. House Bill 633, considered in the Florida legislature in 1989, would have exempted a Florida LLC from Florida's corporate income tax if it was classified as a partnership for federal tax purposes. The bill did not pass. *See* also FLA. STAT. ANN. 220.13(j) defining LLC "taxable income."
62. TEX. TAX CODE ANN. 171.001(a)(2) and (b)(1).
63. COLO. REV. STAT. 39-22-205(1) and 39-22-201.5. Recall from the previous analysis that the provisions of Colorado's statute prevent a Colorado LLC from ever possessing continuity of life or free transferability of interests.
64. Arizona Act, 29-857; Maryland Act, Title 10, 10-104(9) and 10-819(B); Minnesota Act 211B.15, Subd. 3b. Maryland characterizes

an LLC as an "unincorporated business organization." Maryland Act 4A-101(L). Maryland requires an LLC to pay a personal income tax on behalf of its non-resident members. Maryland Act 10-102.1(b).

65. *See, e.g.*, VA. CODE 58.1-301.A.; VA. INC. TAX REG. 630-3-302.15. Virginia characterizes an LLC as an "unincorporated association" for non-tax purposes. VA. CODE 13.1-1002.
66. *See, e.g.*, UTAH CODE ANN. 59-10-103(i). Code 761 defines a "partnership" for federal tax purposes in accordance with the federal classification regulations. Treas. Reg. 1.761-1(a). It also defines other terms such as "partner," "partnership agreement," and "liquidation of partnership interest." Code 761 also provides an election for certain partnerships to be excluded from partnership tax treatment under Subchapter K (*i.e.*, investment partnerships not engaged in an active trade or business, organizations availed of for the joint production, extraction, or use of property, but not availed of to sell services or property produced or extracted, and organizations engaged in the short-term selling of securities for the purpose of underwriting, selling, or distributing a particular issue of securities). *See, e.g.*, Treas. Reg. 1.761-1(a).
67. IOWA ADMIN. CODE 45.1(422).
68. KAN. STAT. ANN. 79-32,109(a). In addition, KAN. ADMIN. REGS. 92-12-8 conforms to the federal definition of "corporation." Moreover, KAN. STAT. ANN. 17-7603(b) characterizes an LLC for non-tax purposes and provides that "a limited liability company formed under this act shall be a separate legal entity and shall not be construed as a corporation." Kansas imposes an annual entity level franchise tax payable when the LLC files its Kansas report. KAN. STAT. ANN. 17-7647(c). Kansas also imposes an annual entity level franchise tax on limited partnerships. KAN. STAT. ANN. 56-1a606(d) and 56-1a607(d). The Kansas franchise tax is paid to the secretary of state and is based on an amount equal to $1.00 for each $1,000.00 of the "net capital accounts located in or used in this state at the end of the preceding taxable year as required to be reported on the federal partnership return of income." KAN. STAT. ANN. 17-7647(c). *See also* KAN. STAT. ANN. 17-7647(b)(2) which requires a Kansas LLC to provide a reconciliation of the capital accounts in the same manner that is required on the federal partnership return of income. This is further evidence that Kansas will treat LLCs the same as limited partnerships for tax purposes.
69. W. VA. CODE 31-1A-2(8).
70. W. VA. CODE 11-23-3(b)(17). West Virginia generally conforms with the Internal Revenue Code's definitions. W. VA. CODE 11-23-3a.
71. Arizona Act 29-801; COLO. REV. STAT. 7-80-901 to 7-80-913; Iowa Act 490A.1402; KAN. STAT. ANN. 17-7636 to 17-7645, and 17-7648; Maryland Act 4A-1001 to 4A-1011; Minnesota Act 322B.905; NEV. REV. STAT. 86.551; TEX. CORPS. & ASS'NS. CODE ANN. arts. 7.01 to 7.13; UTAH CODE ANN. 48-2b-143 to 48-2b-148; VA. CODE 13.1-1051 to 13.1-1060; and W. VA. CODE 31-1A-49. The twelfth state is Florida, which recognizes foreign LLCs for tax purposes. FLA. STAT. ANN. 220.13(j).
72. It should be noted that a State is not obligated to conform to the federal tax classification of an organization. *See, e.g., Commonwealth v. N.I., Inc.*, 31 Pa. Commw. 235, 375 A. 2d 898 (1977), *aff'd.*, 482 Pa. 261, 393 A. 2d 653 (1978) (Pennsylvania's non-recognition of federal S corporation status was held not to constitute a violation of the Supremacy Clause). *See also Garlin v. Murphy*, 42 A.D. 2d 30, 344 N.Y.S. 2d 402 (1973), *aff'd.*, 34 N.Y. 2d 921, 359 N.Y.S. 2d 552 (1974) (New York's non-recognition of federal S corporation status held not to constitute a violation of the Fourteenth Amendment).
73. *Supra*, notes 61 and 62.
74. *Supra*, note 63.
75. Table, *supra*, p. 7.
76. *See FTB Notice 92-5* (August 21, 1992). California's entity tax classification regulations substantially conform to the federal classification regulations. *See* CAL. ADMIN. CODE 23038(b).
77. Indiana has announced that it will classify LLCs for Indiana tax purposes in the same manner as an LLC is classified for federal tax purposes. *See Indiana Tax Policy Directive #2*, Limited Liability Companies (Ind. Dept. of Revenue, May 1992), 1992 Ind. St. Tax Rep. (CCH), 89-952. Earlier, Indiana had recognized foreign LLCs as limited partnerships for non-tax purposes. IND. CODE ANN. 23-16-10.1-1 through -4.
78. Letter dated September 20, 1991, from Myron C. Banks, Deputy Secretary, North Carolina Department of Revenue, to Dorothy Cramer (on file with the Deputy Secretary). The North Carolina Attorney General has also indicated that foreign LLCs can register to do business in the state as a limited partnership. *See*, Letter dated October 16, 1991, from Richard H. Carlton, Chief Deputy Secretary of State of North Carolina to Mr. Frank R. Liggett III, Esq., LeBoeuf, Lamb, Leiby & MacRae, Raleigh, NC (on file with the Chief Deputy Secretary).
79. *See, e.g.*, DEL. CODE ANN. tit. 30, 1901; N.J. ADMIN. CODE tit. 18, 7-1.4; N.Y. PERS. INC. TAX REG. 100.15(c).
80. *See* 1 CAVITCH, BUSINESS ORGANIZATIONS 12.01 (Matthew Bender & Co., Inc. 1988); *Klein v. Weiss*, 284 Md. 36, 395 A. 2d 126 (1978).
81. *See* 2 CAVITCH, BUSINESS ORGANIZATIONS 39.05[1] (Matthew Bender & Co., Inc. 1988); *Dwinell's Central Neon v. Cosmopolitan Chinook Hotel*, 21 Wash. App. 929, 587 P. 2d 191 (Wash. Ct. App. 1978); *Klein v. Weiss*, *supra*, note 80.
82. The Indiana and North Carolina attorneys general have ruled that an LLC will be treated as a limited partnership in those States. *Supra*, notes 77 and 78.
83. California *FTB Notice 92-5*, *supra*, note 76, does not indicate whether LLCs will be treated as limited or general partnerships. Characterization as a limited or general partnership has tax consequences in California because a limited partnership doing business in California is required to file a partnership information return under CAL. REV. & TAX CODE 17932 and pays a minimum tax of $800. CAL. REV. & TAX CODE 23081.

Other States may treat limited partnerships (or limited partnerships not electing particular tax treatment) as corporations for tax purposes. *See, e.g.*, ARK. ADMIN. REG. Art. 4.84-2002(7); N.J. DEPT. OF TREAS.–TAXATION REG. 18:7-1.5; and PENN. DEPT. OF REV. REGS. 153.1(a)(3), (9), and (b)(3). A number of states impose entity level income or franchise taxes generally on unincorporated business associations. *See, e.g.*, D.C. CODE ANN. 47-1808.3 (unincorporated business franchise tax); HAWAII REV. STAT. 237-1 (gross income tax on partnerships doing business in Hawaii); ILL. REV. STAT. ch. 120, 2-205(b) (personal property replacement tax on the net income of all business organizations with activities in Illinois); MICH. COMP. LAWS 208.6(1) ("single business tax" on all business organizations with Michigan business activities); N.H. REV. STAT. ANN. 77:14 (business profits tax

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ALASKA CORPORATION NET INCOME TAX

-- WHO MUST FILE --

--CORPORATIONS. A corporation or a partnership with a corporate partner must file an Alaska income tax return if it has a business activity or a taxable nexus with the State that is not protected under Public Law 86-272. Taxable nexus may include:

a. Owning or using property in the State including leased or mobile property;
b. Presence of employees in the State for business purposes;
c. Making sales into the State, or making sales from the State where the seller is not taxable at the destination of the buyer; or,
d. Generation of income from sources within the State without regard to whether there is a physical presence in the State.

--ELECTING SMALL BUSINESS CORPORATION (S CORPORATION). Alaska adopts Subchapter S (IRC Sec. 1361 - 1379) under AS 43.20.021(a), including the pass-through nature of an S Corporation. While an S Corporation may have no Alaska tax liability for the tax year, it is still required by AS 43.20.030(a)-(d) to file an Alaska Corporation Net Income Tax return and a complete copy of its federal form 1120S.

--LIMITED LIABILITY COMPANIES (LLC'S). Alaska does not recognize limited liability corporations organized in other states. An LLC engaged in business in Alaska, regardless of characterization as a partnership for federal and other state tax purposes, is treated as a corporation and must file a corporation net income tax return reporting the income of the corporation under the federal corporation income tax provisions as incorporated into Alaska law.

--INACTIVE CORPORATIONS. If a corporation had no business activities in Alaska and no income from Alaska sources during the tax year, only Page 1 of form 04-611 should be filed with the "INACTIVE" block checked. No other attachments are required.

--EXEMPT ORGANIZATION. An exempt organization includes those entities that are required to file a federal form 990 or 990-PF. An exempt organization is subject to the Alaska tax to the same extent as the organization is subject to federal tax. These organizations must file with the Alaska return a copy of the federal form 990 or 900-PF, as well as a copy of other federal forms that were filed such as 990-T and 1120-POL.

Please detach this portion and return to the Alaska Department of Revenue; P.O. Box 110420; Juneau, AK 99811-0420

Please answer the following questions to register with Revenue-Income & Excise Audit:

1. Name of corporation: _____
   Mailing address: _____
   City, State, ZIP: _____
2. Provide your federal Employer Identification Number (EIN/FIN): _____
3. What year did you begin doing business in Alaska? _____
4. Do you operate on a fiscal or calendar year end? Fiscal ☐ Calendar ☐
   Provide your tax year ending date: _____
5. Did you file your federal return on a consolidated basis? Yes ☐ No ☐
   If yes, provide the name of the parent corporation: _____
   Parent's EIN/FIN: _____
6. Do you have a valid Alaska Business License? Yes ☐ No ☐
   If yes, provide the Alaska Business License number: _____

If you need Alaska Corporation Net Income Tax Booklet forms, please call the following numbers:

Juli at (907)465-4988 or Rita at (907)465-3774 (Please note: these numbers are for FORMS ONLY)

Our fax number is: (907)465-2375

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imposed on partnerships equal to the aggregate percentage interests of the resident partners); and TENN. CODE ANN. 67-2-102 (bond interest and stock dividends received by partnerships taxed at partnership level).

The possible liability of LLCs for entity-level taxes raises the interesting issue of whether the limited liability of the members extends to State tax claims in the event that the LLC fails to remit tax and its assets are insufficient to pay a tax judgment. Although limited liability from an LLC's business debts or claims should probably not extend to unsatisfied state tax obligations of the LLC, States may have to enact specific "responsible party" legislation requiring LLC members to pay unsatisfied entity level state tax obligations of the LLC.

84. Precisely for this reason, tax practitioners are beginning to develop and to call for the enactment of uniform state LLC legislation that includes an explicit statement of partnership tax treatment. *See*, Hubbard, *Practitioner Calls for Uniform State Legislation on Limited Liability Companies*, 57 TAX NOTES 1629 (December 21, 1992).
84. Slow penetration of the LLC form into the business world may also give States time in which to consider the revenue implications of authorizing LLCs, about which there is growing concern. *See*, Carson, *Tax Revenues Will Suffer, But LLCs May Be Here to Stay*, 3 STATE TAX NOTES 802 (November 30, 1992); Sheppard, *New York Contemplates Cost of Partnership Treatment for LLCs*, 3 STATE TAX NOTES 887 (December 14, 1992).

Summary Of Multistate Tax Commission Actions On Policy Issues 1991 And 1992 Annual Meetings

At its August 2, 1991 Annual Meeting in Vail, Colorado, the Multistate Tax Commission:

- Adopted as a uniformity recommendation to the States the American Bar Association's Model S Corporation Income Tax Act ("MoSCITA") together with Six Proposed Modifications. The Proposed Modifications were not recommended by the Commission, but rather intended only as proposed language that will modify MoSCITA to conform it to an adopting State's existing state tax policy. (The Six Proposed Modifications, as adopted, were published and discussed in the March 1991 issue of the *REVIEW*.)
- Adopted a policy resolution endorsing S. 1564, "The Property Tax Fairness and Community and School Fiscal Stability Act of 1991" sponsored by Senator Kent Conrad of North Dakota. The bill would amend the 4-R Act to limit the railroads' privileged access to the federal courts by requiring them to exhaust all available state or local judicial and administrative remedies prior to review by the federal courts; repeal the "any other tax" provision; and clarify that federal courts do not have the authority to review railroad valuations determined by state and local assessors. (The history of 4-R Act related litigation is discussed in a cover story of the March 1991 issue of the *REVIEW*). It is anticipated that Senator Conrad will re-introduce this bill in the upcoming session of Congress.

At its July 24, 1992 Annual Meeting in Kansas City, Missouri, the Multistate Tax Commission:

- Adopted a policy resolution "urg[ing] the federal government to study and to consider seriously adopting formula apportionment-based methods for determining U.S. source income of multinational enterprises as a substitute for the theoretically-flawed and unadministrable system of attempting to determine 'arms-length' transfer prices under Section 482 of the Internal Revenue Code."
- Adopted a policy resolution that while acknowledging that "there is disagreement among Multistate Tax Commission States as to whether the state of residency or source of pension income should be able to tax pension income", urges that "Congress refrain from any legislation preempting States' rights to apply the source principal of taxation." The resolution notes that MTC States "agree that conflicts between States should be resolved by States, not Congress, and that "States have legitimate concerns that Federal preemption of a narrow issue of taxing pension income of non-residents may burgeon into broad restrictions on state tax practices."
- Adopted a policy resolution endorsing congressional enactment of S.2080/H.R. 4613, the "Preemption Clarification and Information Act of 1991." Introduced by Senators Carl Levin and David Durenberger, and Representative Craig Thomas, the bills would establish a rule of federal statutory construction that "No statute, or rule promulgated under such statute, shall preempt, in whole or in part, any State or local government law, ordinance, or regulation, unless the statute explicitly states that such preemption is intended or unless there is a direct conflict between such statute and a State or local law, ordinance, or regulation so that the two cannot be reconciled or consistently stand together." The bills would also require the Congressional Research Service to prepare an annual report to the President and the Congress spelling out all preemptive federal legislation and recent court cases with preemptive results. Because much of the States' problems with federal legislation preempting their taxing powers arises from legislation that was clearly intended to be preemptive (and thus not covered by the bills' rule of construction), the Commission also recommended that Congress take additional steps to address these problems, e.g., inclusion of a five-year "sunset" in all federal legislation preempting state taxing authority.

Copies of all the policy resolutions summarized are available by writing to the Commission at the address listed on the front cover of the *REVIEW*.

Property ownership: Key considerations in choice of entity

Example of structure Re. Land ownership

Choosing the most efficient form of ownership of real property can be complicated by various tax and nontax factors. Determining what form is most efficient — partnership, REIT, S corporation, C corporation, or another form — requires careful planning.

by Arthur Gould, Esq., and Alan Van Dyke, Esq.

In most cases, a complex set of tax and nontax factors must be weighed in choosing the form of ownership of real property. Important nontax goals include the limitation of personal liability that could arise as a result of owning the real property and the acquisition or maintenance of control over the management of the property. Important tax concerns include whether tax benefits, such as net losses and credits, can be realized directly by the owners, whether the income and gain generated by the property will be subject to multiple levels of taxation, and whether ownership of the real property will have an impact on the tax status or character of the owner of the property (e.g., whether ownership would affect the status of the owner as a tax-exempt entity).

The most tax-efficient form of ownership depends on such factors as the number of owners, the types of owners (e.g., individuals, taxable entities, tax-exempt entities, or foreign owners), the nature of the property, the expected economic performance of the property, and other goals of the parties. This article reviews the various tax and nontax factors that need to be considered before choosing a form of ownership for real estate. The types of entities discussed include partnerships, real estate investment trusts, S corporations, C corporations, and Wyoming limited liability corporations. Special considerations for tax-exempt entities are also examined.

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Partnerships

A partnership offers great flexibility as a form of ownership of real property. It also provides the ability to limit exposure to liabilities if it constitutes a limited partnership and no entity-level tax is imposed.

General nontax considerations. Unlike S corporations, real estate investment trusts (REITs), and the various vehicles available only to certain types of tax-exempt organizations, partnerships have no limitation on the number or type of investors, and multiple classes of interests can be used. A partnership can be structured so that the sharing ratios for cash distributions and the ratios for allocating taxable income or loss can shift over time or upon the occurrence of specified events. However, the pass-through character of partnerships can be a disadvantage for tax-exempt partners if the partnership generates unrelated

business taxable income. Foreign investors may also be disadvantaged if the tax rates in their country of residence are substantially higher than U.S. tax rates and partnerships are treated as pass-through entities for purposes of their local taxing jurisdiction.

A general partnership offers its partners no protection from partnership liabilities. Limited partners in a limited partnership are protected from partnership liabilities except to the extent that they are obligated to make additional capital contributions to the partnership. However, protection from partnership liabilities is lost if they become actively involved in the partnership's day-to-day management. A general partner of a limited partnership has unlimited exposure to the liabilities of the partnership.

Partnership classification for federal income tax purposes. An unincorporated organization, such as a partnership, will be treated as an association that is taxable as a corporation for federal income tax purposes if it has more than two of four corporate characteristics:

- Continuity of life;
- Centralization of management;
- Limited liability (liability for debts limited to the assets of the organization); and
- Free transferability of interests.[1]

Continuity of life. An organization has continuity of life "if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution of the organization."[2] Continuity of life does not exist if the occurrence of any of these events with respect to any member will cause a dissolution of the organization. A limited partnership organized under a statute corresponding to the Uniform Limited Partnership Act (ULPA) will not possess continuity of life because the bankruptcy of the general partner will result in technical dissolution under local law.[3]

Centralized management. An organization has centralized management if a person or group of persons that does not include all members and is not acting solely at the direction of the members has exclusive authority to make management decisions for the organization. Generally, a limited partnership formed under a statute corresponding to the ULPA does not have centralized management unless substantially all the interests are owned by the limited partners.[4]

Limited liability. The classification regulations provide that an organization possesses the corporate characteristic of limited liability "if under local law there is no member who is personally liable for the debts of or claims against the organization."[5] In the case of a general partnership subject to a statute corresponding to the UPA, personal liability exists with respect to each general partner.

A partnership provides great flexibility as a form of ownership of real property. It also provides the ability to limit exposure to liabilities if it constitutes a limited partnership and no entity-level tax is imposed.

Because general partners in a limited partnership are subject to personal liability under the ULPA, the regulations provide that "in the case of a limited partnership subject to a statute corresponding to the [ULPA], personal liability exists with respect to each general partner" unless the general partner "has no substantial assets (other than his interest in the partnership) which could be reached by a creditor of the organization and when he is merely a 'dummy' acting as the agent of the

[1] Reg. § 301.7701-2(a).
[2] Reg. § 301.7701-2(b)(1).
[3] Reg. § 301.7701-2(b)(3); see also Larson v. Comm'r, 66 T.C. 159 (1976), *acq.*, 1979-1 C.B. 1.
[4] Reg. § 301.7701-2(c)(4).
[5] Reg. § 301.7701-2(d)(1).

limited partners."[6] The Internal Revenue Service ruled that a Wyoming limited liability company that lacked continuity of life and free transferability of interests was classified as a partnership for federal income tax purposes even though it had limited liability.[7]

Free transferability of interests. An organization has free transferability of interests if each member can, without the consent of other members, confer on another person who is not a member of the organization all the attributes of his interest in the organization.[8] If a partner cannot substitute his assignee for himself in the organization without the consent of a general partner or the consent of all the partners, free transferability does not exist even if he may assign his income and distribution rights.

Publicly traded partnerships. Section 7704[9] provides that a "publicly traded partnership" shall be treated as a corporation for federal income tax purposes and defines "publicly traded partnership" as any partnership in which interests are traded on an established securities market or are readily tradable on a secondary market or the substantial equivalent thereof. However, a publicly traded partnership will not be treated as a corporation for a taxable year if the partnership met certain gross income requirements for the taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence.

Those gross income requirements are generally satisfied if 90 percent or more of the gross income of the partnership consists of the following:

- Interest not dependent on income or profits;
- Dividends;
- Real property rents not dependent on income or profits and not received from affiliates;
- Gain from the sale or other disposition of real property;
- Certain oil- or mineral-related income and gain; and
- Gain from the sale or other disposition of a capital asset or property described in Section 1231(b) (i.e., real property and depreciable assets used in a trade or business and held more than one year) that were held for the production of the types of income previously described.

Certain safe harbors are provided for that, if met, would ensure that interests in a partnership would not be considered to be "readily tradable on a secondary market or the substantial equivalent thereof."[10]

Taxation of profits and losses. Section 701 provides that no federal income tax is paid by a partnership as an entity. In determining his income tax, each partner takes into account separately his allocable share of the partnership's income, gains, losses, deductions, and credits, whether or not any actual cash distribution is made to the partner during his taxable year.

Subject to the at-risk limitations,[11] the passive activity loss limitations,[12] and certain other limitations, a partner in a partnership is generally entitled to deduct on his income tax return his allocable share of the partnership's losses, if any, to the extent of the tax basis of his partnership interest at the end of the partnership year in which the losses occur. To the extent that a partner's share of partnership losses exceeds the basis of his partnership interest at the end of the taxable year in which the losses occur, those excess losses cannot be utilized in that year by the partner for any purpose. However, the losses may be utilized as a deduction (subject to the limitations referred to previously) in the first succeeding year in which and to the extent that there is an increase in the basis of the partner's partnership interest.

[6] Reg. § 301.7701-2(d)(2).
[7] Rev. Rul. 88-76, 1988-2 C.B. 360.
[8] Reg. § 301.7701-2(e)(1).
[9] All section references are to the Internal Revenue Code of 1986, *as amended* (the Code) unless otherwise noted.
[10] Notice 88-75, 1988-2 C.B. 386
[11] I.R.C. § 465.
[12] I.R.C. § 469.

Basis rules and treatment of cash distributions. A partner's basis in his partnership interest is relevant, among other things, for determining his ability to deduct losses from the partnership (subject to other applicable limitations) and for determining gain or loss on a sale or other disposition of his interest in the partnership and on receipt of certain partnership distributions. Generally, the tax basis of any partner's interest in a partnership is equal to its cost[13] reduced (but not below zero) by the partner's share of partnership distributions and losses and increased by the partner's share of partnership income.[14] A partner's basis in his partnership interest also includes his proportionate share of partnership liabilities as determined under the regulations promulgated under Section 752.

Cash distributions from a partnership do not generally constitute taxable income for federal income tax purposes.[15] If the cash distributions in any year (including a reduction in the partner's share of the partnership's liabilities) exceed the partner's share of the partnership's taxable income for that year, the excess will constitute a return of capital to the partner to the extent of the partner's basis in his interest. A return of capital will not be reportable as taxable income by a recipient for federal income tax purposes but will reduce the tax basis of the recipient's partnership interest (but not below zero). If a partner's tax basis should be reduced to zero, his share of any subsequent cash distributions for any year[16] in excess of his share of taxable income will be taxable to the partner as though the excess were a gain on the sale or exchange of his interest.

REITs

REITs are another form of real estate ownership to consider.

General tax characteristics. Like partnerships and S corporations, REITs and their owners generally are subject to only a single level of tax on the earnings of the REIT. However, unlike partnerships and S corporations, a REIT is not a "pass through" entity whose owners are treated for tax purposes as directly receiving the taxable income or loss of the entity. Rather, distributions from REITs are taxed as ordinary dividend income to their shareholders (except in the case of capital gain dividends), and the REIT-level tax is avoided by means of a dividends-paid deduction. Therefore, REITs cannot "pass through" losses or credits to their shareholders. REITs have less flexibility than partnerships because a REIT must have at least a certain number of shareholders and must also meet certain asset and income tests. However, all REIT shareholders have protection from the liabilities of the REIT. In addition, a REIT is the most practical vehicle if an entity with publicly traded interests is desired.

REIT organizational requirements. A REIT must meet certain organizational requirements, among which are the following:

- The REIT must be managed by one or more "trustees or directors"[17];
- Beneficial ownership must be evidenced by transferable shares or transferable certificates of beneficial interest[18];
- The REIT must be taxable as a domestic corporation but for the REIT provisions[19];
- The REIT may not be either a financial institution referred to in Section 582(c)(5) or an insurance company taxed under subchapter L of the Code[20];
- During at least 335 days of a 12-month taxable year or a proportionate part of a short taxable year (other than during the first taxable year of a REIT's existence), the benefi-

[13] The tax basis of an interest received in exchange for property is equal to the basis of the property. I.R.C. § 722.

[14] I.R.C. § 705. The basis in the interest is reduced by losses whether or not these losses can be utilized on account of passive loss or other limitations.

[15] I.R.C. § 731.

[16] For this purpose, cash distributions include the partner's share of any reduction in the partnership's liabilities. I.R.C. § 752(b).

[17] I.R.C. § 856(a)(1).

[18] I.R.C. § 856(a)(2).

[19] I.R.C. § 856(a)(3).

[20] I.R.C. § 856(a)(4).

cial ownership of the REIT must be held by 100 or more persons[21];

- After application of the attribution rules of Section 544 (as modified by Section 856(h)(1)), five or fewer persons cannot own more than 50 percent of the stock of a REIT during the last half of a taxable year[22];
- A REIT must file an election to be taxed as a REIT[23]; and
- A REIT electing REIT status after 1976 must be a calendar-year taxpayer.[24]

Income and asset limitations. The income and asset limitations imposed on a REIT by Section 856(c) define the scope and character of permissible REIT activities as passive real estate investment. The five major limitations are as follows:

- Of the REIT's gross income, 75 percent must derive from rents from real property, gain from the sale of real property, interest from mortgages on real property, dividends from other REITs or gain from the sale of REIT stock, and other real estate activity;
- Of the REIT's gross income, 95 percent must derive the same sources as under the 75 percent test, with the addition of other (non-real estate) interest, dividends and gain from the sale of stock or securities;
- Less than 30 percent of the REIT's gross income must be derived from sales of stock held less than six months, sales of real property held as a dealer, or sales of real property held less than four years;
- Of the value of the REIT's assets, 75 percent must be represented by real estate assets, cash, and government securities; and
- Not more than 25 percent of the REIT's assets may be represented by nongovernment securities.

For purposes of these tests, the term "real estate assets" includes real property, interests in real property, interests in mortgages on real property, shares in qualified REITs, and stock or debt instruments representing the temporary investment of newly raised capital. Interests in foreign real estate also qualify.[25]

Dividends-paid deduction and distribution requirement. REITs are allowed the dividends paid deduction as defined in Section 561 for distributions made out of the REIT's current or accumulated earnings and profits.[26] A "preferential" dividend will not qualify for the dividends-paid deduction. A dividend is "preferential" under Section 562(c) if it is not pro rata to all shares of the same class or if a class of stock receives a preference over another class that is not provided for in its governing instruments.

In order to claim the benefit of the dividends-paid deduction and be taxed under the REIT rules, a REIT must distribute an amount equal to (with certain adjustments) 95 percent of its REIT taxable income before taking into account the dividends-paid deduction and excluding capital gains.[27] If certain conditions are met, a REIT can count distributions made after the close of a taxable year toward the 95 percent distribution requirement for that taxable year. Section 860 also provides a procedure for making deficiency distributions for taxable years for which the REIT's taxable income was adjusted as a result of an audit.

Taxation of REITs. A REIT computes its tax liability differently with respect to different categories of income. A REIT's taxable income is its regular corporate taxable income, computed and taxed in the same manner as a C corporation, with certain specified adjustments, the most important of which is the deduction for dividends paid. A REIT may designate all or a portion of its dividend distribution for a taxable year as a capital gain dividend up to the amount of the REIT's net capital gain for the taxable year.[28]

If a portion of REIT's net capital gain is retained (i.e., not distributed and designated as a capital gains dividend), it is subject to an alternative tax similar to that imposed by Sec-

[21] I.R.C. § 856(a)(5).
[22] I.R.C. § 856(a)(6).
[23] I.R.C. § 856(c)(1).
[24] I.R.C. § 859.
[25] Rev. Rul. 74-191, 1974-1 C.B. 170.
[26] I.R.C. § 857(b)(2)(B).
[27] I.R.C. § 857(a)(1).
[28] I.R.C. § 857(b)(3)(C).

tion 1201 on regulator corporations with net capital gains.[29] A REIT is also subject to a tax on certain prohibited transactions and on income from foreclosure property and is also subject to penalty taxes under certain circumstances.

Taxation of REIT shareholders. Distributions by a REIT not designated as a capital gain dividend in general are taxed under the same rules as distributions by ordinary C corporations. The distributions are treated as dividends to the extent of the current or accumulated earnings and profits of the REIT. Distributions in excess of earnings and profits are treated as a return of capital that reduces the adjusted basis of the shareholder's stock, and distributions in excess of basis are treated as gain from the sale or exchange of the stock. REIT dividends received by a corporate shareholder are not eligible for the 80 percent or 70 percent dividends-received deduction.[30] A capital gain dividend is reported as a long-term capital gain by the REIT shareholders, regardless of the shareholder's holding period for the stock.[31] However, if a REIT shareholder sells or exchanges shares with a holding period of less than six months after receipt of a capital gain dividend, then any loss on the sale of the shares is treated as a long-term capital loss up to the amount of the long-term capital gain recognized on receipt of the capital gain dividends.[32]

All REIT dividends are treated as portfolio income for purposes of the rules limiting the deductibility of losses from passive activities.

S corporations

Because S corporations are treated as pass-through entities for federal income tax purposes, their income and gain is generally subject only to tax at the shareholder level, and there is some ability to pass losses through to their shareholders. However, because of restrictions on the number and identity of shareholders and on the capital structure of the corporations, S corporations offer far less flexibility than partnerships. In addition, although a partner in a partnership includes in the basis of its partnership interest its share of partnership liabilities, a shareholder in an S corporation cannot include in the basis of his stock any amount of the S corporation's debt.[33] However, unlike REITs, S corporations are not subject to limitations on the type of assets that they may hold or the type of income that they may receive.[34]

Qualifications. To be eligible to make an election to be taxed as an S corporation, a corporation may have no more than thirty-five shareholders (all of whom are individuals — other than nonresident aliens), estates, or certain types of trusts), and it may have no more than one class of stock.[35] A member of an affiliated group of corporations (i.e., the owner of more than 80 percent of the stock of another corporation) is not eligible to elect S corporation status, and certain other types of corporations are also ineligible.[36] An election to be taxed as an S corporation may be made as follows:

- On or before the fifteenth day of the third month of the taxable year for either the current year or the next taxable year; or
- At any other time, for the next taxable year.[37]

Taxation of the S corporation. Although an S corporation is not subject to the corporate income tax, an S corporation that was formerly a C corporation is subject to tax on capital gain realized during a ten-year period beginning with the first day of the first taxable year for which the corporation was an S corporation. The tax is applied to the amount of

[29] I.R.C. § 857(b)(3)(A).
[30] I.R.C. §§ 243(d)(3), 857(c).
[31] I.R.C. § 857(b)(3)(B).
[32] I.R.C. § 857(b)(7).
[33] A shareholder can take into account the basis of debt of the S corporation owed to the shareholder in determining the limitation on the deduction of losses from the S corporation.
[34] The rules governing S corporations are found in I.R.C. §§ 1361–1379.
[35] However, there may be differences in voting rights among the shares.
[36] Section 1361(b).
[37] I.R.C. § 1362(b).

gain that is due to appreciation during years in which the corporation was a C corporation. An S corporation that has earnings and profits that were derived in years when it (or a corporation of which it is a successor) was a C corporation is taxed on passive investment income and on certain other items. An S corporation can also incur a corporate-level tax with respect to property acquired from a C corporation in a tax-free transaction. In addition, recent legislation added a provision requiring LIFO recapture by a C corporation in the last taxable year prior to its conversion to an S corporation. The tax imposed on the LIFO recapture is payable in four equal annual installments.

Taxation of S corporation shareholders. A shareholder includes his portion of an S corporation's income and loss on his return for the year in which the S corporation's taxable year ends.[38] The shareholder's portion of any item is computed on a daily basis in proportion to the number of shares of stock held by the shareholder on each day.

A shareholder cannot deduct losses from an S corporation in an amount exceeding the sum of the shareholder's basis in his stock and his basis in the corporation's indebtedness to him; however, disallowed losses can be carried over indefinitely for the life of the S corporation.[39] A shareholder is also subject to the at-risk limitation and the limitation on deductibility of losses from passive activities with respect to his share of losses from the S corporation.

Distributions. In the case of an S corporation that has no earnings and profits, the distribution will be tax free to the extent of the shareholder's basis in his stock. To the extent the amount of the distribution exceeds stock basis, the excess will be treated as gain from the sale or exchange of his stock.[40] If an S corporation has earnings and profits (carried over, for example, from a year in which it was a C corporation), more complicated rules apply, and a portion of a distribution may constitute a dividend.[41]

Other Forms of Ownership

C corporations. C corporations are generally not regarded as a tax-efficient form of ownership of investment real property. They are subject to an entity-level tax at a 34 percent rate on all income and gain, including gain realized upon the distribution of appreciated property. Also, all distributions from the corporation and gain from the sale of stock of the corporation are subject to an additional tax at the shareholder level. Furthermore, a C corporation is subject to the adjusted current earnings (ACE) adjustment[42] under the corporate alternative minimum tax and is also subject to other provisions, such as the personal holding company tax, collapsible corporation treatment, and the prohibition on paying unreasonable compensation. Such treatment does not present serious problems now but may become a disadvantage again if a lower capital gains tax rate is enacted.

Despite these disadvantages, foreign investors may find it desirable to invest in real property through a domestic C corporation in certain circumstances. Although the corporation would be subject to full U.S. corporate-level taxation, the foreign investors may pay little or no shareholder-level tax on the investment as a result of the following:

- The effect of tax treaties;
- Creditability of U.S. taxes against the foreign country taxes;
- The consequences of the relationship between U.S. corporate tax rates and tax rates in the investor's country; and
- Possible favorable treatment of dividends under the foreign tax laws in question.

Wyoming limited liability companies. A Wyoming limited liability company provides a vehicle that is taxed as a pass-through entity, insulates its owners from personal liability, and is not subject to the restrictions imposed

[38] I.R.C. § 1366.
[39] I.R.C. § 1366(d).
[40] I.R.C. § 1368(b).
[41] I.R.C. § 1368(c).
[42] I.R.C. § 56(g).

on S corporations. The pass-through nature of the entity is based on a ruling[43] that held that a Wyoming limited liability company that did not have the corporate characteristics of continuity of life or free transferability of interests was classified as a partnership, rather than an association taxable as a corporation, even though none of the members or designated managers had unlimited liability for the liabilities of the company.

However, because of the need for the entity to lack either centralized management or free transferability of interests, this vehicle may not be practical for real property investments with a large number of investors. Florida recently enacted a similar statute for limited liability companies. One issue confronting limited liability companies is their acceptance in states other than Florida and Wyoming, particularly as to the personal liability of its members.

Tax-exempt entities: Special considerations

There are some special issues to which tax-exempt entities should pay close attention. Tax-exempt entities, including group trusts, need to consider the potential for unrelated business taxable income. In addition, the key characteristics of qualifying as a Section 501(c)(25) tax-exempt organization is a special issue that corporations and trusts should not overlook. These topics are discussed next.

UBTI. Tax-exempt entities are generally subject to tax on their unrelated business taxable income (UBTI), which generally includes the following:

- Income derived from certain exempt organizations from a trade or business, except for certain permissible forms of passive income[44];
- Income derived by other exempt organizations from a trade or business when the conduct of such entities is not substantially related to the organization's exempt purpose;
- Income derived from "debt-financed property"; and
- Income from a publicly traded partnership.[45]

Subject to certain exceptions, "debt-financed property" is generally any property that is held to produce income and with respect to which there is "acquisition indebtedness" at any time during the taxable year, or, if the property was disposed of during the taxable year, at any time during the twelve months preceding the date of disposition.[46] Acquisition indebtedness is generally indebtedness incurred by a tax-exempt entity directly or through a partnership as follows:

- In acquiring or improving a property;
- Before acquiring or improving a property if the indebtedness would not have been incurred but for such acquisition or improvement; or
- After acquiring or improving a property if the indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of the acquisition or improvement.[47]

Under Section 514(c)(9), in the case of plans qualified under Section 401(a) and certain other tax-exempt organizations ("qualified organizations"), under certain circumstances,

Consider the particular circumstances of each potential purchaser or developer of real property to choose the form of ownership most suitable in that situation.

[43] Rev. Rul. 88-76, 188-2 C.B. 360.

[44] Permissible forms of passive income include (in the case of property that is not "debt-financed property") interest, dividends, royalties, real property rents, not dependent on income or profits, and gains from disposition of noninventory property.

[45] I.R.C. § 512.

[46] I.R.C. § 514(b).

[47] I.R.C. § 514(c)(1).

indebtedness incurred in acquiring or improving real property will not be treated as acquisition indebtedness.

Investment through a group trust. A group trust is an entity that is itself tax-exempt and is subject to tax on its UBTI. Distributions from the group trust to its owners do not constitute UBTI unless the participant borrows to acquire its interest. Ownership of interests in group trusts is limited to qualified pension plans, and its operation is subject to the Employee Retirement Income Security Act of 1974 and other rules relating to pension plans as well as special rules for group trusts.

Section 501(c)(25) companies. A corporation or trust qualifies as an exempt organization if it has the following characteristics[48]:

- Has no more than thirty-five shareholders or beneficiaries;
- Includes only one class of stock or beneficial interest; and
- Is organized for the exclusive purpose of acquiring real property,[49] holding title to and collecting income from the property, and remitting all income, less expense, to its shareholders or beneficiaries.

All of an exempt organization's shareholders or beneficiaries must be the following:

- Qualified plans that meet the requirements of Section 401(a);
- Government plans as defined in Section 414(d);
- Plans of the United States or any political subdivision, agency, or instrumentality; or
- Any organization described in Section 501(c)(3).

The shareholders or beneficiaries must have the right to dismiss the investment advisor by majority vote and must have the right to have their interests redeemed or transferred to another permitted owner (so long as the transfer does not violate the thirty-five-owner limitation). The organization may not hold an "indirect interest" in real property, nor may it hold an interest as a tenant in common, but it may use a wholly owned subsidiary to hold real property.

Conclusion

A partnership is often the most efficient type of entity for the ownership of real property because of its flexibility, its ability to limit exposure to liabilities if organized and operated as a limited partnership, and the avoidance of an entity-level tax. However, in many cases, another form of ownership may be more desirable. Therefore, consider the particular circumstances of each potential purchaser or developer of real property to choose the form of ownership most suitable in that situation. ■

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[48] I.R.C. § 501(c)(25).

[49] For this purpose, real property may include incidental personal property as long as rent attributable thereto does not constitute more than 15 percent of total rent from the property in any taxable year.

From Desk Manual
"The Limited Liability Company
The Better Alternative"

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FORWARD

In 1977, during my third term as a member of the Wyoming House of Representatives, a request was made for me to assist as a House floor manager for the enactment of Senate File 218--the Wyoming Limited Liability Company authorization statute. The Senate sponsor of SF 218 was State Senator Neil Stafford who had strong business connections in the oil and gas industry.

The source of the bill was not then clear to me and what was known has since been forgotten along with loss of notes and references. The proposal was well supported by efficient lobbyists and passed without particular objection. It was assumed that a major Wyoming business was directly interested in the alternative business entity opportunity for the transaction of oil and gas development activities.

Immediately following the 1977 enactment, as a lawyer active in participation and organization of small business development and in predating IRS formal approval decision by about a decade, I organized the first and several of the early Wyoming limited liability companies. The very first, Cheyenne Downtown Limited Liability Co. was established to promote a core city redevelopment-regional shopping center in the center of the downtown area of the city. Governing body shortsightedness and their economic stupidity denied required support for the redevelopment directed downtown business district maintenance challenge and the first Wyoming limited liability company faded into history from the results of city government frustration of its intended purpose. My interest in these succeeding years in the validity of the limited liability company has not diminished, although the first effort had come to no avail.

Other limited liability company filings by many attorneys did follow with more success and today the Wyoming state government and practicing bar is at the forefront in recognition of the advantages to be obtained through the limited liability business entity structure.

The enthusiasm and scholarship of William D. Bagley and Philip P. Whynott, authors of this first treatise on the limited liability company subject is truly to be commended. This publication should support understanding and utilization of this business entity not only in Wyoming, but the other seven states that have followed with comparable legislation. The universe that awaits with this new concept is competently and comprehensively recognized by this Wyoming publication endeavor. The favorable business oriented climate provided for Wyoming and other progressive jurisdictions is clearly authenticated in the text of this book.

January 13, 1992.

Walter Urbigkit

WALTER URBIGKIT
CHIEF JUSTICE,
WYOMING SUPREME COURT

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June 5, 1992

Mr. Walter Urbigkit
Chief Justice
Wyoming Supreme Court
P.O. Box 388
Cheyenne, Wyoming 82003

Dear Justice Urbigkit:

I recently had an opportunity to read your forward to "The Better Alternative: The Limited Liability Company" by William D. Bagley and Philip D. Whynott. I thought you might appreciate my recollections of the background behind the Wyoming Limited Liability Company statute.

Our company was involved in international oil and gas exploration through Panamanian limited liability companies in the early 1970's. We had reviewed the available alternatives to provide limited liability to individual partners and retain flow-through of U.S. tax benefits for all partners, and decided that the Panamanian entities were the most practical. We received rulings from the IRS that these entities would be treated as partnerships for federal income tax purposes, and we conducted oil and gas exploration through these entities in the United Kingdom Sector of the North Sea and other parts of the world.

In the mid 1970's, we decided to try to get a similar entity created in the United States that would provide more flexibility from a business standpoint and would retain the favorable characteristics of limited liability and flow-through of tax benefits. My recollection is that we originally considered Colorado and Wyoming as states in which such organizations might be formed, but decided that Wyoming would be more conducive to business interests.

Frank Burke, a tax partner with Peat, Marwick, Mitchell & Co. in Dallas, Texas, drafted the terms of the original proposal. He and Richard W. Coates, our chief counsel, then worked with Hugh Duncan of Casper, Wyoming to have the proposed legislation considered by the Wyoming legislature.

We formed our first Wyoming limited liability company on May 16, 1977, following the enactment of the legislation on March 4, 1977, and immediately filed a ruling request with the Internal Revenue Service requesting that this entity be treated as a partnership for federal income tax purposes. Three and one-half years later, on November 18, 1980, the IRS issued a favorable ruling on this entity. However, the IRS had proposed regulations the previous day that treated all entities with limited liability as associations taxable as corporations, irrespective of their other characteristics. Existing limited liability companies that had begun business before November 17, 1980 were given a grace period until December 31, 1982 before the proposed regulations would be effective.

Because of the proposed regulations, we never used our original Wyoming limited liability company, as the flow-through of tax benefits was critical to its operation. However, we did use another Wyoming limited liability company formed in 1977 for oil and gas operations in the United Kingdom Sector of the North Sea. By the time the IRS regulations were proposed in 1980, this entity had become a wholly-owned subsidiary of a U.S. corporation, so that the flow-through of tax benefits was of less importance, and we continued its operations until a few years ago.

Otherwise, limited liability companies were not considered a practical alternative for our purposes until the IRS issued Revenue Ruling 88-76 on September 2, 1988, agreeing that a Wyoming liability company would be treated as a partnership for federal income tax purposes. This was more than eleven years after enactment of the Wyoming legislation and almost eight years after having proposed regulations to the contrary!

Its good to see limited liability company statutes being enacted in other states and these entities being accepted as a practical way of doing business throughout the United States. I have always felt that the limited liability company entity should be helpful in capital formation endeavors in the United States. As stated by Messrs. Bagley and Whynott, these are certainly a better alternative than S corporations, general partnerships and limited partnerships for many types of businesses.

Sincerely,

A. J. Miller
Executive Vice President
and Chief Financial Officer

cc: Frank M. Burke, Jr.
Richard W. Coates

INTRODUCTION

The "Wyoming Limited Liability Company Act" was adopted in 1977. In 1988 a company formed under the Wyoming Act was finally approved by the Internal Revenue Service for partnership tax treatment. **The result is a flexible new business entity combining the advantage of corporate limited liability with IRS approved pass-through tax treatment of a partnership. This new entity should surpass corporations and partnerships in use and popularity.** By November 1991, eight states adopted limited liability company acts. Other states have legislation in process and there is now a move to draft a model or uniform act.

Because of the advantages of (1) flow-through tax treatment, (2) the operational flexibility of a partnership and (3) limited liability, the Limited Liability Company ("LLC") should replace the general partnership, the limited partnership, the joint venture, the S corporation, and closely held corporations as **the better alternative.**

This book titled ***The Limited Liability Company: The Better Alternative- Forms and Materials*** contains the historical background relating to this law; the relevant Internal Revenue Service rulings; a comparison of the limited liability company with other business entities; a discussion of ethics in the commercial law practice; the state by state analysis of limited liability company statutes and practices, including attorney general or advisory opinions that have been issued on this topic; and forms, including state mandatory and example forms to help the attorney in formation and post-formation matters.

This book covers the following topics:

I Introduction. A discussion of historical background of the limited liability company origins in the German company entity known as the Gesellschaft mit beschrankter Haftung [GmbH].

II A discussion of Wyoming Limited Liability Law adopted in 1977, and the 1988 Internal Revenue Service Rulings [Rev. Rul. 88-76, 1988 2 C.B. 360] which give Wyoming limited liability companies partnership tax treatment although the owners (members) and managers are not personally liable for the debts.

III A comparison of the limited liability company with (a) partnerships, (b) limited partnerships, (c) S corporations, (e) regular corporations, and (f) unstructured business entities.

IV A discussion of ethics in the commercial law practice addressing (a) conflicts of interest concerning former clients, (b) client identity, (c) privileged and confidential matters, (d) management misconduct, and (e) multiple representation.

V A state-by-state analysis of the limited liability acts adopted and proposed, setting out the statutes and the attorney general, advisory and court opinions that have been issued on this topic in each of the states.

VI A limited liability checklist designed to assist the attorney in identifying his client's desires, and to make a record to protect the drafter from future malpractice claims, along with "Preformation Agreements".

VII "Articles of Organization" forms which include provisions for control by strong management, or by strong equity holders, and variations in between. Additionally, we propose numerous clauses to implement the type of organization desired.

VIII "Operating Agreement" forms which contain clauses, provisions, and completed agreements relating to the daily management of the limited liability company.

IX A discussion of the operating and acceptance of limited liability companies in jurisdictions not having limited liability acts.

X A discussion of post formation considerations, powers and duties. Included here are matters relating to (a) meetings of members, (b) elections, (c) amendments of Articles of Organization and Operating Agreements, (d) considerations concerning merger, exchanges and consolidation; records and reports, and (f) dissolution of sale of assets.

Besides the advantages of flexibility, the limited liability companies have significant benefits over limited partnerships by allowing limited liability to all owners. Also, they do not contain the restrictions and limitations of an S corporation.

By June of 1992, Colorado, Kansas, Utah, Texas, Nevada, Virginia, West Virginia, Maryland, Iowa, Oklahoma, Illinois and Minnesota had joined Wyoming and Florida in enacting statutes recognizing this new entity. However, only the Wyoming Act has been blessed by an Internal Revenue Service ruling. (14.100).

HISTORICAL BACKGROUND

The limited liability firm is a triumph of comparative law in action. The origin of this relatively new institution is generally attributed to the German law of 1892, authorizing the Gesellschaft mit beschränkter Haftung.... While drawing some inspiration from the English practice of the private limited company, it was nevertheless an original creation. However, the claim that it was without precedent is negatived by the fact that the State of Pennsylvania had enacted a law in 1874 authorizing the limited partnership association, which was extensively used. This

form of business organization, as we shall note later, bears a striking resemblance to the limited liability firm current today in Europe and Latin America. Eder, "Limited Liability Firms Abroad", 13 Univ. of Pitt L. Rev 193 (1952).

Limited liability companies are neither new nor strange to businessmen in the civil law countries of Europe and Latin America. These business forms have their origin in the 1892 German company law known as Gesellschaft mit beschränkter Haftung (GmbH).[1] Germany not only was the first civil code country to enact this legislation but Germany's enactment became the discussional focal point for the countries which subsequently adopted this commercial enterprise.[2]

Once established in Germany the concept of the limited liability company had a very active and fast growth.[3] Success in Germany soon caused the German model act to become the focal point of extensive debate. Within a short period of time after enactment in Germany the following countries joined the limited liability bandwagon: Portugal(1901) known as the "sociedade por quotas de responsabilidade limitada", Panama (1917), Brazil (1919), Chile (1923), France (1925), Turkey (1926), Cuba (1929), Argentina (1932), Uruguay (1933), Mexico (1934), Belgium (1935), Switzerland (1936), Italy (1936), Peru (1936), Columbia (1937), Costa Rica (1942), Guatemala (1942), and Honduras (1950).[4] In France by the late 1940's the limited liability entity known as "societes de responsabilite limitee" was more popular than the more traditional stock corporation[5] and comprised approximately one-third of all French societes.

The limited liability company laws of each of the above countries all have in addition to limited liability **four basic characteristics** which distinguish this entity from other business forms. (1) All require some use of the word "limited" in the entity's name; (2) the entity is given full juristic personality; (3) the partnership concept of "delectus personae" which permits a member to control admission of new members to the entity; and (4) the codes provide that limited liability firms are dissolved by death of a

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[1] For additional information on foreign limited liability companies see: DeVries & Juenger, "Limited Liability Contract: The GmbH", 64 Colum L. Rev. 866 (1964); Eder, "Limited Liability Firms Abroad", 13 U. Pitt L. Rev. 193 (1952); and Vagts, "Reforming the 'Modern' Corporation: Perspectives from the German", 80 Harv. L. Rev. 23 (1980).

[2] Molitor, Die Auslandische Regelung der G.m.b.H. und die deutsch Reform (1927) and Hallstein, "Die Gessellschaft mit berschrankter Haftung in den Auslandsrechten", 12 Zeitscrift fur auslandisches und internationales Privatrecht 341 (1938).

[3] Ibid.

[4] Ibid. pp 197-202.

[5] Ibid. p 197.

member, unless expressly stated in the articles of association and some provide for probate or sale of a deceased's share.[6]

In the United States several states passed legislation creating entities similar to the limited liability company entity. Pennsylvania, Virginia, New Jersey, Michigan and Ohio in the last quarter of the Nineteenth Century enacted legislation permitting "limited partnership associations" or "partnership associations". These associations were created to provide a form of limited liability coupled with some the beneficial characteristics of the partnership association. The IRS has granted these partnership associations pass-through partnership tax status.[7] The enabling legislation for these associations requires either the principal office or place of business be located in the enacting state. As a consequence of this enabling legislation these associations were not attractive to many entities active outside of these localities. Accordingly, they have not been extensively used.

Wyoming in 1977 became the first American state to enact a true limited liability company act modeled after the 1892 German GmbH Code. (17.6000) and the Panamanian limited liability companies. (1.451). The Wyoming Limited Liability Act permits the formation of limited liability companies organized for any lawful purpose except the business of banking and insurance. W.S. § 17-15-103. Essentially, a Wyoming limited liability company is a conventional non-corporate business entity that has filed Articles of Organization with the Secretary of State. Once filed it secures a notice to third parties that the individual members of the company are not personally liable for debt, obligations, acts, or liability of the company. While the legislative history for the Wyoming legislation is essentially non-existent the statute parallels the four characteristics of the European and Latin American Acts. The Wyoming Act has, besides limited liability, the same four basic characteristics of the European and Latin American Codes which distinguish this entity. **First,** Wyoming requires some use of the word "limited" in the entity's name. **Second,** the entity is given full juristic personality. **Third,** the partnership concept of "delectus or intuitus personae" is present that permits a partner to control admission of new partners to the partnership. **Fourth,** Wyoming's act provides that limited liability firms have to be dissolved by death of a member and provides for probate or sale of a deceased's share.

Florida, in 1982, adopted the act in an attempt to stimulate economic development and compete with the flow of investment money to the Central and South American countries:

> The purpose behind the legislation's enactment [limited liability company act] was to lure capital to the state in order to add to the economic base of Florida. In committee hearings it was disclosed that a motivating factor was to provide a

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[6] Ibid. pp 202-203.

[7] Burke and Sessions, "The Wyoming limited liability company: An alternative to Sub S and limited partnerships", 54 J. Tax 232, 233 (1981).

business vehicle to accommodate international investments from Central and South America.... It was thought that having a familiar business organization would attract foreign investment. Besides attracting international investment, it was also thought that the combination of limited liability and federal taxation as a partnership would encourage businesses to move to Florida. The committee reports were very optimistic as to the impact which the new entity would have on the business community.[8]

Private Letter Ruling 81-06082 (November 18, 1980) recognized a Wyoming limited liability company as a partnership for federal income tax purposes. Yet, it was not until 1988 that this entity came to adult life in the American states. Effective September 19, 1988, the United States Internal Revenue Service, after extensive study, issued a formal opinion on Wyoming's Limited Liability Company Act (Rev.Rul. 88-76, 1988 2 C.B. 360). This ruling dealt with classification of organizations for tax treatment. The IRS concluded that this limited liability company formed under the Wyoming act would be classified for federal tax purposes as a partnership. Partnership classification was given even though none of the members or managers were personally liable for any debts of the company.

Though the LLC may be in good standing under the state act, this IRS ruling sets forth the test with which it must comply to obtain the non-corporate tax treatment.

To retain the federal tax advantages of being classified or recognized for partnership tax treatment, rather than as a corporation, the IRS ruled that a limited liability company must avoid at least two of the four corporate characteristics identified in Treasury Regulation §301.7701-2. (See detailed discussion at 14.100.) **If more than two of these four characteristics are present in the entity, it will not receive partnership pass-through benefits.** The four IRS entity characteristics mandated by the IRS are:

1. **Continuity of Life.** A typical corporate characteristic is that the entity is perpetual or has continuity of life. Under most limited liability company acts, the limited liability company has a life of no more than thirty (30) years. Under all limited liability company acts, the company dissolves upon the death, retirement, resignation,expulsion, or other event that cancels the continued membership of a member. Revenue Ruling 88-76 (14.300) found the latter restriction sufficient, though the remaining members may agree to continue the business. It appears that the arbitrary 30 year limit is an unnecessary state restriction. The Virginia and the West Virginia Acts do not include this limitation. (17.5600).

2. **Centralization of Management.** A characteristic of a corporation is that the owners (shareholders) usually do not manage the corporation. Management vests in the Board of Directors and professional management hired by the Board of Directors. Absent other provisions in the statute or articles of a limited liability company, management shall be reserved to the members in proportion to their ownership interests. If all members retain management, the corporate characteristic

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[8] Johnson, "The Limited Liability Company Act", 11 Fla. S.L. Rev. 387 (1983-1984).

of centralization of management is avoided. If members manage the company, individual members (with or without actually authority) may contract debts and incur liabilities for the limited liability company without being personally liable, except, possibly to the LLC or the other members if that member acts in excess of actual authority. However, under the statutes, other management may be established in the Articles, but if management consists of less than all members, the corporate characteristics of centralization of management will be found by the IRS. (14.102).

3. **Limited Liability.** This characteristic is to be found in all limited liability companies.

4. **Free Transferability of Ownership Interest.** The corporate characteristic of free transferability of ownership interest is not present under Wyoming's or most states' Acts, where a member can assign only the right to share in the profits of the limited liability company:

> . . . if all of the other members of the limited liability company other than the member proposing to dispose of his or its interest do not approve of the proposed transfer or assignment by unanimous written consent, the transferee of the member's interest shall have no right to participate in the management of the business and affairs of the limited liability company or to become a member. The transferee shall only be entitled to receive the share of profits or other compensation by way of income. . . . W.S. § 17-15-122.

The Internal Revenue Service found this language sufficient to avoid the corporate characteristic of free transferability of ownership interest and all other state acts have similar language.

Issuance of the 1988 IRS ruling blessing Wyoming's Limited Liability Act caused many states to become actively interested in this commercial form. Florida (1982), Colorado (April, 1990),[9] Kansas (July, 1990),[10] Nevada (October, 1991),[11] Texas (1991),[12] Utah (July, 1991)[13] Virginia (1991)[14], West Virginia (1992)[15], Maryland

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[9] Colo. Rev. Stat. §§ 7-80-101 et seq.

[10] K.S.A. §§ 17-7601 et seq.

[11] 1991 Nev. Stat. 442.

[12] 1991 Tex. Gen Laws 901.

[13] Utah Code Ass. §§ 48-2b-101 et seq.

[14] Va. Code Ann. §§ 13.1-1000 et seq.

[15] W.Va. Code Ann. §§ 31-1A-1 et seq.