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an operating agreement, and this chapter, and is subject to the restrictions and liabilities of a member under the articles of organization, an operating agreement, and this chapter.

(b) In addition to the liabilities imposed under (a) of this section, an assignee of a limited liability company interest who becomes a member of the company is liable for an obligation of the assignor to make a contribution under AS 10.50.280 that is not imposed by the articles of organization, an operating agreement, or otherwise by this chapter.

(c) Notwithstanding (a) and (b) of this section, an assignee who becomes a member is not liable for liabilities that are unknown to the assignee when the assignee becomes a member and that cannot be determined from the written records of the company maintained under AS 10.50.860.

Sec. 10.50.180. RIGHTS OF ASSIGNOR WHEN ASSIGNEE BECOMES A MEMBER. Unless otherwise provided in an operating agreement of the company, when an assignee of a member's limited liability company interest becomes a member of the company with respect to the assignor's entire interest, the assignor ceases to be a member or to have the power to exercise the rights of a member.

Sec. 10.50.185. VOLUNTARY TERMINATION OF MEMBERSHIP. (a) A person's membership in a limited liability company terminates if the person withdraws voluntarily from the company.

(b) Unless an operating agreement of the company provides that a member may not withdraw voluntarily from the company, a member of a limited liability company may withdraw as a member voluntarily at any time by giving 30 days' written notice to the other members, or by giving other notice that is established by an operating agreement of the company.

Sec. 10.50.190. WITHDRAWAL BEFORE END OF TERM OR UNDERTAKING. Unless otherwise provided in an operating agreement of the company, if a limited liability company has a definite term or particular undertaking, the withdrawal of a member of the company before the end of the term or the accomplishment of the undertaking is a breach of the operating agreement.

Sec. 10.50.195. REMEDIES FOR WRONGFUL WITHDRAWAL. (a) If the

voluntary withdrawal of a member with the power to withdraw from the company breaches an operating agreement of the company, or if the withdrawal occurs as a result of otherwise wrongful conduct of the member, a limited liability company may recover from the withdrawing member damages that are for the breach of the operating agreement or that result from the wrongful conduct, including the reasonable costs of obtaining replacement of any services the withdrawn member was obligated to perform.

(b) A limited liability company may offset the damages authorized under (a) of this section against the amount that is otherwise distributable to the withdrawing member, and may pursue other remedies allowed in an operating agreement of the company or otherwise available under applicable law.

Sec. 10.50.205. REMOVAL OF MEMBER. (a) A person's membership in a limited liability company may not be terminated except as provided by (b) or (c) of this section.

(b) Except as provided in (c) of this section, a person's membership in a limited liability company terminates if the person assigns all of the person's interest in the company and if a majority of the members who have not assigned their interests in the company authorize the removal of the person as a member.

(c) If an operating agreement of the company provides for the removal of a member with or without cause, a person's membership in a limited liability company terminates if the person is removed as a member in the manner and under the circumstances provided in the agreement.

Sec. 10.50.210. EFFECT OF DEATH OR INCOMPETENCY ON MEMBERSHIP. Unless otherwise provided in an operating agreement or by the written consent of all of the members at the time, the membership of a member of a limited liability company who is an individual terminates if the member dies, or if a court of competent jurisdiction enters an order adjudicating the member incompetent to manage the member's person or property.

Sec. 10.50.215. TERMINATION OF TRUST OR DISTRIBUTION OF INTEREST BY ESTATE MEMBERSHIP. (a) Unless otherwise provided in an operating agreement of the company or by the written consent of all of the members

of the company at the time, the limited liability company membership held by a trust or trustee terminates when the trust terminates. In this subsection, "terminates" does not include the substitution of a new trustee.

(b) Unless otherwise provided in an operating agreement of the company or by the written consent of all of the members of the company at the time, the limited liability company membership held by an estate terminates when the estate's entire limited liability company interest is distributed by the fiduciary of the estate.

Sec. 10.50.220. TERMINATION ON DISSOLUTION OF MEMBER. (a) Unless otherwise provided in an operating agreement of the company or by the written consent of all of the members of the company at the time, a limited liability company membership of a member that is a separate limited liability company terminates when the member dissolves and begins to wind up its affairs.

(b) Unless otherwise provided in an operating agreement of the company or by the written consent of all of the members of the company at the time, a limited liability company membership of a member that is a corporation terminates when the corporation is dissolved and 90 days lapse without reinstatement.

Sec. 10.50.240. EFFECT OF ELECTION. If an election to continue a limited liability company until a certain date or event is made under AS 10.50.085(a), 10.50.185 - 10.50.220 do not apply to the termination of the membership of a member unless the member is also a manager of the company.

ARTICLE 7. RELATIONSHIP TO THIRD PARTIES.

Sec. 10.50.250. AGENCY POWER OF MEMBERS AND MANAGERS. (a) Except as provided in (b) and (c) of this section, a member of a limited liability company is an agent of the company for the purpose of conducting the company's affairs. A member's act, including the execution of an instrument in the name of the company, that appears to be performed in the usual and customary way of conducting business, binds the company, unless the member does not in fact have the authority to act for the company in the particular matter and the person with whom the member is dealing knows that the member does not have the authority to act for the company in the particular matter.

(b) If a limited liability company is managed by a manager, a member is not,

solely by reason of being a member, an agent of the company.

(c) If a limited liability company is managed by a manager, a manager is an agent of a limited liability company for the purpose of conducting its affairs, and a manager's act, including the execution of an instrument in the name of the company, that appears to be performed in the usual and customary way of conducting business binds the company, unless the manager does not in fact have the authority to act for the company in the particular matter and the person with whom the manager is dealing knows that the manager does not have the authority to act for the company in the particular matter.

(d) A limited liability company manager's or member's act that does not appear to be performed in the usual and customary way of conducting business does not bind the company, unless the act is authorized by an operating agreement of the company when the act is performed or at another time.

(e) A limited liability company manager's or member's act that contravenes a restriction on the manager's or member's authority does not bind the company with regard to persons who know about the restriction.

Sec. 10.50.255. ADMISSIONS OF MEMBERS AND MANAGERS. (a) Except as provided in (b) of this section, an admission or representation made by a member of a limited liability company about the affairs of the company is evidence against the company if the admission or representation is within the scope of the member's authority under this chapter.

(b) If a limited liability company is managed by a manager, an admission or representation made by a

(1) manager about the affairs of the company is evidence against the company if the admission or representation is within the scope of the manager's authority under this chapter; and

(2) member, acting solely in the capacity of a member, is not evidence against the company.

Sec. 10.50.260. LIMITED LIABILITY COMPANY CHARGED WITH KNOWLEDGE OF OR NOTICE TO MEMBER OR MANAGER. (a) Except as provided in (b) and (c) of this section, and except for a fraud on the company

committed by or with the consent of the member who has the knowledge or receives the notice, the following operate as notice to or knowledge of a limited liability company:

(1) notice given to a company member of a matter relating to the affairs of the company;

(2) the knowledge of a company member acting in the particular matter, whether acquired while a member or known at the time of becoming a member; and

(3) the knowledge of a company member who reasonably could and should have communicated the knowledge to a member acting in the particular matter.

(b) If the company is managed by a manager, the following operate as notice to or knowledge of a limited liability company, except for a fraud on the company committed by or with the consent of the manager who has the knowledge or receives the notice:

(1) notice given to a manager of a matter relating to the business or affairs of the limited liability company;

(2) the knowledge of the manager acting in the particular matter, acquired while a manager or known at the time of becoming a manager; and

(3) the knowledge of a company manager who reasonably could and should have communicated the knowledge to the manager acting in the particular matter.

(c) If the company is managed by a manager, notice to, or the knowledge of, a member of a limited liability company while the member is acting solely in the capacity of a member does not operate as notice to or knowledge of the company.

Sec. 10.50.265. LIABILITY OF MEMBERS TO THIRD PARTIES. A person who is a member of a limited liability company is not liable, solely by reason of being a member, under a judgment, decree, or order of a court, or in another manner, for a liability of the company, whether the liability arises in contract, tort, or another form, or for the acts or omissions of another member, manager, agent, or employee of the company.

ARTICLE 8. CONTRIBUTIONS.

Sec. 10.50.275. CONSIDERATION FOR COMPANY INTERESTS. (a)

Except as provided in (b) of this section, an interest in a limited liability company may be issued for money, other tangible or intangible property, or labor or services actually performed for the company.

(b) An interest in a limited liability company may not be issued for a promissory note or future services.

Sec. 10.50.280. LIABILITY FOR CONTRIBUTIONS. (a) Notwithstanding AS 09.25.010 - 09.25.020, a promise by a member of a limited liability company to contribute property or services to the company is not enforceable unless the promise is stated in a writing signed by the member.

(b) Unless otherwise provided in an operating agreement of the company, a member of a limited liability company is liable for performing an enforceable promise made to the company to contribute property or services, even if the member is unable to perform because of death, disability, or another reason.

(c) If a member of a limited liability company does not make the member's required contribution of property or services, the member shall, at the option of the company, contribute cash equal to that portion of value of the required contribution that has not been made.

(d) Unless otherwise provided in an operating agreement of the company, an assignor of a limited liability company interest is not released from the assignor's liability to the company under this section, even if the assignee becomes a member with respect to the assigned interest.

Sec. 10.50.285. COMPROMISE OF CONTRIBUTION. Unless otherwise provided in an operating agreement of the company, the obligation of a member to make a contribution to a limited liability company may not be compromised, unless all of the other members consent to the compromise.

ARTICLE 9. DISTRIBUTIONS.

Sec. 10.50.290. SHARING OF PROFITS. Subject to AS 10.50.305 - 10.50.325, and unless otherwise provided in an operating agreement of the company, a member of a limited liability company shall be repaid the member's contribution to capital and shares equally in the profits and other assets of the company remaining after all liabilities, including liabilities to members, are satisfied.

Sec. 10.50.295. INTERIM DISTRIBUTIONS UNDER OPERATING AGREEMENT. Subject to AS 10.50.305 - 10.50.325, if a limited liability company makes an interim distribution of its assets to its members, the company shall make the distribution to the members in the manner provided in an operating agreement of the company. The operating agreement of the company may authorize different interim distributions for different classes of members.

Sec. 10.50.300. INTERIM DISTRIBUTIONS WITHOUT OPERATING AGREEMENT. Subject to AS 10.50.305 - 10.50.325, if an operating agreement of the company does not provide for the interim distribution of the assets of the company, when a limited liability company makes an interim distribution of its assets, the interim distributions to each member of the company shall be equal.

Sec. 10.50.305. DISTRIBUTIONS: CONDITIONS. (a) A limited liability company may not make a distribution to the company's members unless

(1) the amount of the retained earnings of the company immediately before the distribution equals or exceeds the amount of the proposed distribution; or

(2) immediately after giving effect to the distribution the

(A) sum of the assets of the company, exclusive of goodwill, capitalized research and development expenses, evidences of debts owing from a manager or managing member of the company or secured by the company's own limited liability company interests, and deferred charges, would be at least equal to one and one-fourth times its liabilities, not including deferred taxes, deferred income, and other deferred credits; and

(B) current assets of the company would be at least equal to its current liabilities or, if the average of the earnings of the company before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the interest expense of the company for those fiscal years, at least equal to one and one-fourth its current liabilities.

(b) For the purposes of this section,

(1) in determining the amount of the assets of the company, profits derived from an exchange of assets may not be included unless the assets received are currently realizable in cash;

(2) "current assets" may include net amounts determined in good faith by the manager, or by the members, if the company is not managed by a manager, that may reasonably be expected to be received from customers during the 12-month period used in calculating current liabilities under existing contractual relationships obligating the customers to make fixed or periodic payments during the term of the contracts after in each case giving effect to future costs not then included in current liabilities but reasonably expected to be incurred by the company in performing the contracts.

(c) For the purposes of this section, the amount of a distribution payable in property shall be determined on the basis of the value at which the property is carried on the company's financial statements in accordance with this section.

(d) Only a company that classifies its assets as current assets and fixed assets in accordance with this section is governed by (a)(2)(B) of this section.

(e) For the purposes of this section, a determination that a distribution is not prohibited may be based either on financial statements prepared in accordance with generally accepted accounting principles or on the basis of accounting practices and principles that are fair and reasonable in the circumstances.

(f) Financial statements and determinations prepared or arrived at in accordance with generally accepted accounting principles are fair and reasonable. The fair and reasonable quality of statements and determinations prepared under other practices and principles shall be proved by the company.

Sec. 10.50.308. PROHIBITED DISTRIBUTION: INABILITY TO MEET MATURING DEBTS AND LIABILITIES. A limited liability company may not make a distribution to the company's members if the company is, or as a result of the distribution would be, likely to be unable to meet its liabilities as they mature.

Sec. 10.50.310. PROHIBITED DISTRIBUTION ON JUNIOR INTERESTS; LIQUIDATION PREFERENCE. A limited liability company may not make a distribution to the company's members on any limited liability company interests of a class or series that are junior to outstanding limited liability company interests of another class or series with respect to distribution of assets on liquidation if, after giving effect to the distribution, the excess of its assets, exclusive of goodwill, capitalized research, and development expenses, evidences of debts owing from a

manager or managing member or secured by the company's own limited liability company interests, and deferred charges, over its liabilities, not including deferred taxes, deferred income and other deferred credits, would be less than the liquidation preference of all limited liability company interests having a preference on liquidation over the class or series to which the distribution is made.

Sec. 10.50.315. ADDITIONAL RESTRICTIONS IN ARTICLES OR OPERATING AGREEMENT. Nothing in this chapter prohibits additional restrictions upon the purchase or redemption of a company's own limited liability company interests by provision in the articles of organization or operating agreement of the limited liability company or in another agreement entered into by the company.

Sec. 10.50.320. LIABILITY OF MEMBERS RECEIVING PROHIBITED DISTRIBUTIONS; SUIT AGAINST MEMBERS. (a) A member of a limited liability company who receives a distribution prohibited by this chapter with knowledge of facts indicating the impropriety of the distribution is liable to the company for the benefit of all of the creditors or members entitled to institute an action under (b) of this section for the amount received by the member with interest at the legal rate on judgments until paid. The liability of the member under this subsection may not exceed the liabilities of the company owed to nonconsenting creditors at the time of the violation and the injury suffered by nonconsenting members.

(b) Suit may be brought in the name of the company to enforce the liability to

(1) creditors arising under (a) of this section for a violation of AS 10.50.305 or 10.50.308 against any or all members liable by any one or more creditors of the corporation whose debts or claims arose before the time of the distribution to members and who have not consented to the distribution, whether or not they have reduced their claims to judgment; or

(2) members arising under (a) of this section for a violation of AS 10.50.305 against any or all members liable by any one or more members holding preferred limited liability company interests outstanding at the time of the distribution who have not consented to the distribution, without regard to the provisions of AS 10.50.735.

(c) A member sued under this section may compel contribution from all other members liable under this section.

(d) This section does not affect the liability that a member may have under other applicable law.

Sec. 10.50.325. IDENTIFICATION OF DISTRIBUTION IN NOTICE TO MEMBERS. A distribution other than one chargeable to retained earnings shall be identified in a notice to members as being made from a source other than retained earnings, and shall include a statement of the accounting treatment of the distribution. The notice must accompany the distribution or shall be given within three months after the end of the fiscal year in which the distribution is paid.

Sec. 10.50.330. TIME FOR INTERIM DISTRIBUTIONS. A member of a limited liability company is entitled to receive interim distributions under AS 10.50.295 - 10.50.300 at the times or upon the happening of the events specified in an operating agreement of the company, or at the times determined by the members or managers under AS 10.50.150.

Sec. 10.50.335. DISTRIBUTIONS WHEN A PERSON CEASES TO BE A MEMBER. (a) Except for termination under AS 10.50.205, when the limited liability company membership of a person terminates and the termination does not cause dissolution of the company, the company shall distribute to the person any distribution that the person was entitled to receive before the person's membership terminated.

(b) In addition to a distribution made under (a) of this section, a limited liability company shall distribute to a terminating member the amount of the member's limited liability company interest. If an operating agreement of the company does not provide the amount of the distribution or a method for determining the amount of the distribution, the company shall make the distribution within a reasonable time after termination and the amount of the distribution is the fair value of the member's limited liability company interest as of the date of termination based on the member's right to share in distributions from the company.

(c) If an election to continue a limited liability company until a certain date or event is in effect under AS 10.50.085, then (a) and (b) of this section do not apply to the termination of the membership of a member unless the member is also a

manager of the company.

Sec. 10.50.340. DISTRIBUTION IN KIND. (a) Unless otherwise provided in an operating agreement of the company, a member, regardless of the nature of the member's contribution, may not demand and receive a distribution from a limited liability company in a form other than cash.

(b) Unless otherwise provided in an operating agreement of the company, a limited liability company may not compel a member of the company to accept from the company a distribution of a company asset in a form other than cash to the extent that the percentage of the asset distributed to the member exceeds the percentage that the member would have shared in a cash distribution equal to the value of the asset at the time of distribution.

Sec. 10.50.345. RIGHT TO DISTRIBUTION. When a member of a limited liability company is entitled to receive a distribution from the company, the member is a creditor of the company with respect to the distribution, and is entitled to all remedies available to a creditor of the company.

Sec. 10.50.348. INAPPLICABILITY TO WINDING UP AND INVOLUNTARY OR VOLUNTARY DISSOLUTION. AS 10.50.290 - 10.50.340 do not apply in a proceeding for winding up and dissolution of a limited liability company.

ARTICLE 10. OWNERSHIP AND TRANSFER OF PROPERTY.

Sec. 10.50.350. OWNERSHIP OF COMPANY PROPERTY. (a) Property transferred to or otherwise acquired by a limited liability company is the property of the company and is not the property of the members individually.

(b) A limited liability company may acquire, hold, and convey property, including real property, in the name of the company. If a limited liability company acquires an interest in property, the company shall acquire the interest in the name of the company. If a limited liability company acquires an interest in property, the company holds the title to the interest and not the members individually.

Sec. 10.50.355. TRANSFER OF PROPERTY. (a) Except as provided in (b) of this section, a limited liability company may transfer the property of the company if the company uses an instrument of transfer signed by a member of the company in

the name of the company.

(b) If the company is managed by a manager,

(1) title to limited liability company property may be transferred by an instrument of transfer signed by a manager of the company in the name of the company; and

(2) a member, solely by reason of being a member, does not have the authority to transfer the property of the company.

Sec. 10.50.360. RECOVERY OF PROPERTY. A limited liability company may recover property transferred under AS 10.50.355 if the company proves that the execution of the instrument of transfer did not bind the company under AS 10.50.250, unless the property has been transferred by the initial transferee, or by a person claiming through the initial transferee, to a subsequent transferee who gives value without having notice that the person who signed the instrument of initial transfer lacked authority to bind the company.

Sec. 10.50.370. NATURE OF INTEREST IN COMPANY. A limited liability company interest is personal property.

Sec. 10.50.375. ASSIGNMENT OF INTEREST IN COMPANY. (a) A person may assign a limited liability company interest in whole or in part.

(b) The assignment of a limited liability company interest entitles the assignee to receive, to the extent assigned, only the distributions to which the assignor is entitled.

(c) The assignment of a limited liability company interest does not dissolve the company or entitle the assignee to participate in the management and affairs of the company, to become a member, or to exercise the rights of a member. Unless the assignee of the interest becomes a member with respect to the interest, the assignor continues to be a member and may exercise the rights of a member, subject to the members' right to remove the assignor under AS 10.50.205.

(d) Unless the assignee becomes a member, an assignee of a limited liability company interest is not liable as a member solely as a result of the assignment.

(e) The assignor of a limited liability company interest is not released, solely as a result of the assignment, from the assignor's liability as a member.

(f) An operating agreement may establish terms different from those in (a) - (e) of this section.

(g) Unless otherwise provided in an operating agreement of the company, the pledge of, or granting of a security interest, lien, or other encumbrance in or against, a part or all of a member's limited liability company interest is not an assignment under this section and does not terminate the membership or the rights and powers of the member.

Sec. 10.50.380. RIGHTS OF JUDGMENT CREDITORS. (a) If a judgment creditor of a limited liability company member applies to a court of competent jurisdiction, the court may charge the member's limited liability company interest for payment of the unsatisfied amount of the judgment.

(b) To the extent a limited liability company interest is charged under (a) of this section, the judgment creditor has only the rights of an assignee of the member's interest.

Sec. 10.50.385. POWERS OF ESTATE OF A DECEASED OR INCOMPETENT MEMBER. If a member who is an individual dies or if a court of competent jurisdiction determines the member to be incompetent to manage the member's person or property, the member's executor, administrator, guardian, conservator, or other legal representative has the rights of an assignee of the member's interest.

Sec. 10.50.390. POWERS OF DISSOLVED OR TERMINATED ENTITY. If a member who is not an individual terminates or is dissolved, the member's legal representative or successor has the rights of an assignee of the member's interest.

ARTICLE 11. DISSOLUTION.

Sec. 10.50.400. DISSOLUTION. A limited liability company is dissolved and its affairs shall be wound up if

(1) an event occurs that is identified in the articles of organization or an operating agreement as causing dissolution; if an election under AS 10.50.085(a) is in effect, the event does not cause dissolution unless the event is identified in the articles or operating agreement before or at the same time the election is stated in the articles;

(2) all of the members of the company consent in writing unless an election under AS 10.50.085(a) is in effect;

(3) a person's membership in the company terminates, unless

(A) the business of the company is continued by the consent of all of the remaining members on or before the 90th day following the termination of the membership;

(B) an operating agreement provides otherwise; or

(C) an election under AS 10.50.085(a) is in effect and

(i) the election provides that the termination does not cause the company to dissolve; or

(ii) the person whose membership terminates is not a manager of the company; or

(4) the superior court enters a decree for judicial dissolution of the company under AS 10.50.405.

Sec. 10.50.405. DISSOLUTION BY COURT. On application by or for a member of a limited liability company, the superior court may order the company dissolved if the court determines that it is not reasonably practicable for the company to conduct its affairs in conformity with an operating agreement of the company.

Sec. 10.50.410. AUTHORITY TO WIND UP. Unless otherwise provided in an operating agreement, the affairs of a limited liability company may be wound up by the

(1) members or managers who have authority under AS 10.50.110 to manage the company before dissolution; or

(2) superior court on the application of a member of the company or the member's legal representative or assignee if

(A) a member or manager identified in (1) of this subsection has engaged in wrongful conduct; or

(B) other cause is shown.

Sec. 10.50.415. ACTS OF WINDING UP. Unless otherwise provided in an operating agreement of the company, a person winding up the affairs of a limited liability company may, in the name of, and for and on behalf of, the company,

(1) prosecute and defend court actions;

(2) settle and close the affairs of the company;

(3) dispose of and transfer the property of the company;

(4) discharge the liabilities of the company; and

(5) distribute to the members the assets of the company.

Sec. 10.50.420. AGENCY POWER OF MANAGER OR MEMBER AFTER DISSOLUTION. (a) Except as provided in (b) - (d) of this section, after dissolution of a limited liability company, a member having authority to wind up the company's affairs can bind the company by an act that

(1) is appropriate for winding up the company's affairs or completing transactions unfinished at dissolution; or

(2) would have bound the company if the company had not been dissolved, if the other party to the transaction does not have notice of the dissolution; in this paragraph, filing the articles of dissolution is presumed to constitute notice of the dissolution.

(b) A member's act that is not binding on the limited liability company under (a) of this section binds the company if the act is otherwise authorized by the company.

(c) A member's act that violates a restriction on the member's authority does not bind the member's limited liability company with regard to a person who knows about the restriction, even if the member's act would otherwise be binding under (a) of this section or is otherwise authorized.

(d) If the company is managed by a manager, a member does not have the authority to bind the company if the member is acting solely in the capacity of a member, and a manager of the company can bind the company by an act that

(1) is appropriate for winding up the company's affairs or completing transactions unfinished at dissolution; or

(2) would have bound the company if the company had not been dissolved if the other party to the transaction does not have notice of the dissolution; in this paragraph, filing the articles of dissolution is presumed to constitute notice of the dissolution.

Sec. 10.50.425. DISTRIBUTION OF ASSETS. Upon the winding up of a limited liability company, the assets of the company shall be distributed in the following manner and order of priority:

(1) payment, or adequate provision for payment, to creditors, including, to the extent permitted by law, members who are creditors and not covered by (2) of this section, in satisfaction of the liabilities of the company;

(2) unless otherwise provided in an operating agreement of the company, payment to members or former members in satisfaction of the company's liabilities for distributions under AS 10.50.295 - 10.50.335;

(3) unless otherwise provided in an operating agreement of the company, to members and former members in the following order of priority:

(A) for the return of their contributions; and

(B) in proportion to the members' respective rights to share in distributions from the company before dissolution.

Sec. 10.50.430. ARTICLES OF DISSOLUTION. After the dissolution of a limited liability company under AS 10.50.400, the limited liability company may file articles of dissolution with the department. The articles must state

(1) the name of the company;

(2) the date of filing of the company's articles of organization and of any amendments to the articles of organization;

(3) the reason for filing the articles of dissolution;

(4) the effective date, which must be a specific date, of the articles of dissolution if the articles of dissolution are not to be effective when filed; and

(5) other information determined appropriate by the members or managers filing the articles.

Sec. 10.50.435. KNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY. (a) Upon dissolution, a limited liability company may dispose of the known claims against it by filing articles of dissolution under AS 10.50.430 and following the procedures described in this section.

(b) A dissolved limited liability company shall notify its known claimants in writing of the dissolution at any time after the effective date of dissolution. The

written notice must

(1) describe the information that must be included in the claim;

(2) provide a mailing address where the claim may be sent;

(3) state the deadline, which may not be fewer than 120 days after the later of the date of the written notice or the filing of articles of dissolution under AS 10.50.430, for the company to receive the claim; and

(4) state that the claim is barred if it is not received by the company by the deadline.

(c) A claim against a limited liability company is barred if a claimant

(1) who was given written notice under (b) of this section does not deliver the claim to the company by the deadline; or

(2) whose claim is rejected by the company does not begin a proceeding to enforce the claim within 90 days after the date of the rejection notice.

(d) In this section, "claim" does not include a contingent liability or a claim based on an event occurring after the effective date of dissolution.

Sec. 10.50.440. UNKNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY. (a) If a limited liability company publishes a newspaper notice in accordance with (b) of this section and files articles of dissolution under AS 10.50.430, the following claims are barred unless the claimant commences a proceeding to enforce the claim against the company within three years after the later of the publication date of the newspaper notice or the filing of the articles of dissolution:

(1) a claim by a claimant who did not receive written notice under AS 10.50.435;

(2) a claim sent within the time allowed if the company does not act on the claim;

(3) a claim that is contingent or based on an event occurring after the effective date of dissolution.

(b) The notice published under (a) of this section shall be published once in a newspaper of general circulation in the judicial district where the company's principal office, or its registered office if it does not have a principal office in this

state, is located in this state, and must

(1) describe the information that must be included in a claim;

(2) provide a mailing address where the claim may be sent;

(3) state that a claim against the company is barred unless a proceeding to enforce the claim is begun within three years after the publication of the notice; and

(4) request that persons with claims against the company present them in writing to the company as provided in the notice.

(c) A claim may be enforced under this section

(1) against the company to the extent of the company's undistributed assets; or

(2) if the company's assets have been distributed in liquidation, against a member of the company to the extent of the member's pro rata share of the claim or of the assets of the company distributed to the member in liquidation, whichever is less; a member's total liability for all claims under this section may not exceed the total amount of assets of the company that are distributed to the member.

ARTICLE 12. MERGER AND CONSOLIDATION.

Sec. 10.50.500. AUTHORITY FOR MERGER OR CONSOLIDATION. Unless otherwise provided in an operating agreement of the company, and subject to the law applicable to the other limited liability company, a limited liability company may merge or consolidate with or into a limited liability company or a foreign limited liability company.

Sec. 10.50.505. CONVERSION OF RIGHTS AND INTERESTS. The rights of or interests in a limited liability company that is a party to a merger or consolidation may be exchanged for or converted into cash, property, obligations, rights or interests in the surviving or resulting limited liability company.

Sec. 10.50.510. APPROVAL OF MERGER OR CONSOLIDATION. (a) Unless otherwise provided in an operating agreement of the company, a limited liability company may not approve a proposed merger or consolidation unless the merger or consolidation is approved by all of the members of the company.

(b) A foreign limited liability company that is a party to a proposed merger or consolidation may not approve the merger or consolidation unless the merger or

written notice must

(1) describe the information that must be included in the claim;

(2) provide a mailing address where the claim may be sent;

(3) state the deadline, which may not be fewer than 120 days after the later of the date of the written notice or the filing of articles of dissolution under AS 10.50.430, for the company to receive the claim; and

(4) state that the claim is barred if it is not received by the company by the deadline.

(c) A claim against a limited liability company is barred if a claimant

(1) who was given written notice under (b) of this section does not deliver the claim to the company by the deadline; or

(2) whose claim is rejected by the company does not begin a proceeding to enforce the claim within 90 days after the date of the rejection notice.

(d) In this section, "claim" does not include a contingent liability or a claim based on an event occurring after the effective date of dissolution.

Sec. 10.50.440. UNKNOWN CLAIMS AGAINST DISSOLVED LIMITED LIABILITY COMPANY. (a) If a limited liability company publishes a newspaper notice in accordance with (b) of this section and files articles of dissolution under AS 10.50.430, the following claims are barred unless the claimant commences a proceeding to enforce the claim against the company within three years after the later of the publication date of the newspaper notice or the filing of the articles of dissolution:

(1) a claim by a claimant who did not receive written notice under AS 10.50.435;

(2) a claim sent within the time allowed if the company does not act on the claim;

(3) a claim that is contingent or based on an event occurring after the effective date of dissolution.

(b) The notice published under (a) of this section shall be published once in a newspaper of general circulation in the judicial district where the company's principal office, or its registered office if it does not have a principal office in this

consolidation is approved in the manner and by the vote required by the law applicable to the foreign limited liability company.

(c) A party to a merger or consolidation under this chapter may abandon the merger or consolidation as provided in the merger or consolidation agreement.

Sec. 10.50.515. DELIVERY OF ARTICLES OF MERGER OR CONSOLIDATION. The limited liability company that survives or results from a merger or consolidation under this chapter shall file with the department articles of merger or consolidation signed by each limited liability company that is a party to the merger or consolidation.

Sec. 10.50.520. CONTENTS OF ARTICLES OF MERGER OR CONSOLIDATION. The articles of merger or consolidation required by AS 10.50.515 must state

(1) the name of each limited liability company that is a party to the merger or consolidation;

(2) the jurisdiction where each limited liability company that is a party to the merger or consolidation was organized;

(3) that an agreement of merger or consolidation has been approved and signed by each limited liability company that is a party to the merger or consolidation;

(4) the name of the surviving or resulting limited liability company;

(5) the future effective date, which must be a specific date, of the merger or consolidation if the merger or consolidation is not effective when the articles are filed;

(6) that the agreement of merger or consolidation is on file at a place of business of the surviving or resulting limited liability company and the address of its place of business;

(7) that a copy of the agreement of merger or consolidation will be furnished by the surviving or resulting limited liability company on request and without cost to a person holding an interest in a limited liability company that is a party to the merger or consolidation;

(8) if the surviving or resulting limited liability company is not organized under the laws of this state, a statement that the surviving or resulting

limited liability company

(A) agrees that it may be served with process in this state in a proceeding to enforce an obligation of a company that is a party to the merger or consolidation and that was organized under the laws of this state, and to enforce an obligation of the surviving or resulting company;

(B) appoints the department as its agent for service of process in an enforcement proceeding under (A) of this paragraph; and

(C) the address to which a copy of the process may be mailed to the surviving or resulting company by the department.

Sec. 10.50.525. EXECUTION OF ARTICLES OF MERGER OR CONSOLIDATION. Articles of merger or consolidation shall be signed by a limited liability company that is a party to the merger or consolidation.

Sec. 10.50.530. EQUIVALENT TO ARTICLES OF DISSOLUTION. Articles of merger or consolidation constitute articles of dissolution for a limited liability company that is not the surviving or resulting limited liability company in the merger or consolidation.

Sec. 10.50.535. EFFECTIVE DATE OF MERGER OR CONSOLIDATION. A merger or consolidation under AS 10.50.500 - 10.50.565 takes effect upon the later of the effective date of the filing of the articles of merger or consolidation or an effective date stated in the articles of merger or consolidation.

Sec. 10.50.540. USE OF MERGER OR CONSOLIDATION AGREEMENT TO AMEND OR ADOPT OPERATING AGREEMENT. (a) An agreement of merger or consolidation approved under AS 10.50.510 may amend an operating agreement of a limited liability company or adopt a new operating agreement for the company if the company is the surviving or resulting limited liability company in the merger or consolidation.

(b) An approved agreement of merger or consolidation may provide that the operating agreement of a limited liability company that is a party to the merger or consolidation, including a limited liability company organized for the purpose of consummating a merger or consolidation, is the operating agreement of a limited liability company that is the surviving or resulting limited liability company.

(c) An amendment to an operating agreement or the adoption of a new operating agreement under this section is effective when the merger or consolidation is effective.

(d) This subsection is not intended to limit the accomplishment of a merger or of a matter referred to in this section by other means provided for in an operating agreement or in another agreement or as otherwise permitted by law.

Sec. 10.50.545. GENERAL EFFECTS OF MERGER OR CONSOLIDATION. (a) When a merger or consolidation becomes effective, the limited liability companies that are parties to a merger or consolidation agreement become a single limited liability company that, in the case of a merger, is the limited liability company named in the plan of merger as the surviving limited liability company, and, in the case of a consolidation, is the limited liability company named in the plan of consolidation as the resulting limited liability company.

(b) When a merger or consolidation becomes effective, a limited liability company that is a party to the merger or consolidation agreement and that is not the surviving or resulting limited liability company ceases to exist.

(c) The surviving limited liability company of a merger or the limited liability company resulting from a consolidation possesses all the rights, privileges, immunities, and powers of each limited liability company that is a party to the merger or consolidation agreement and is subject to all the restrictions, disabilities, and duties of each limited liability company that is a party to the merger or consolidation to the extent the rights, privileges, immunities, powers, franchises, restrictions, disabilities, and duties apply to the type of limited liability company that is the surviving limited liability company or the resulting limited liability company.

Sec. 10.50.550. EFFECT OF MERGER OR CONSOLIDATION ON PROPERTY OF COMPANIES. The real and personal property, the debts due, including promises to make capital contributions and subscriptions for shares, other choses in action, and the other interests of the limited liability companies that are parties to a merger or consolidation belong to the surviving or resulting limited liability company without further action by the companies.

Sec. 10.50.555. EFFECT OF MERGER OR CONSOLIDATION ON

LIABILITIES. (a) The surviving or resulting limited liability company in a merger or consolidation is liable for the liabilities of the limited liability companies that are parties to the merger or consolidation.

(b) A claim, action, or other proceeding that exists at the time of the merger or consolidation and that is pending by or against a limited liability company that is a party to a merger or consolidation may be pursued as if the merger or consolidation had not taken place, or the surviving or resulting limited liability company may be substituted in the claim, action, or other proceeding.

Sec. 10.50.560. RIGHTS OF CREDITORS. The rights of creditors and liens on the property of a limited liability company that is a party to a merger or consolidation are not impaired by the merger or consolidation.

Sec. 10.50.565. CONVERSION AT MERGER OR CONSOLIDATION. (a) Upon a merger or consolidation, the limited liability company interests that are to be converted or exchanged into interests, cash, obligations, or other property under the terms of a merger or consolidation agreement are converted as provided by the merger or consolidation agreement.

(b) Upon a merger or consolidation, the former holders of interests converted under (a) of this section have the rights provided in the merger or consolidation agreement or otherwise provided by law.

Sec. 10.50.590. DEFINITION. In AS 10.50.500 - 10.50.590, "limited liability company" means a limited liability company organized under this chapter or a foreign limited liability company.

ARTICLE 13. FOREIGN LIMITED LIABILITY COMPANIES.

Sec. 10.50.600. GOVERNING LAW. (a) Subject to the constitution of this state, the law of the state or other jurisdiction under which a foreign limited liability company is organized governs the organization and internal affairs of the company and the liability and authority of its managers and members.

(b) The department may not deny registration to a foreign limited liability company because of differences between the law of this state and the law of the state or other jurisdiction under which the foreign limited liability company is organized.

Sec. 10.50.605. REGISTRATION REQUIRED. Before conducting affairs in

this state, a foreign limited liability company shall register with the department. To register, the company shall deliver to the department an application for registration as a foreign limited liability company.

Sec. 10.50.610. EXECUTION OF REGISTRATION APPLICATION. An application for registration filed by a foreign limited liability company under AS 10.50.605 shall be signed by a person who is authorized by the law of the state or other jurisdiction where the company was organized to sign the application.

Sec. 10.50.615. CONTENTS OF REGISTRATION APPLICATION. (a) An application for the registration of a foreign limited liability company must state

(1) the name of the foreign limited liability company and, if different, the name the company proposes to use in this state;

(2) the state or other jurisdiction where the company was organized, and date of its organization;

(3) the name and address of the company's registered agent;

(4) that the department is appointed the agent of the company for service of process if the foreign limited liability company fails to appoint or maintain a registered agent under AS 10.50.635;

(5) the address of the office required by the state or other jurisdiction of the company's organization to be maintained in that state or other jurisdiction, or, if the state or other jurisdiction does not require an office to be maintained in that state or other jurisdiction, the principal office of the company;

(6) the purpose the company proposes to pursue in the conduct of its affairs in this state and the codes from the identification code established under AS 10.06.870 that most closely describe the activities in which the company will engage in this state;

(7) the names and addresses of the managers of the company, or, if the company is not managed by a manager, the names and addresses of the members of the company;

(8) the name and address of each person owning at least a five percent interest in the company and the percentage of interest owned by that person in the company; and

(9) that the company is a foreign limited liability company.

(b) In addition to the information required by (a) of this section, an application must include a certificate from the jurisdiction where the company was organized that indicates that the company is in good standing in that jurisdiction.

Sec. 10.50.620. NAME. The department may not file the application for registration of a foreign limited liability company unless the name of the company satisfies the requirements of AS 10.50.020 - 10.50.025. If the name under which a foreign limited liability is organized in the state or other jurisdiction of its organization does not satisfy the requirements of AS 10.50.020 - 10.50.025, the company may register under AS 10.50.605 if the company uses an assumed name that is available to the company under this chapter and that satisfies the requirements of AS 10.50.020 - 10.50.025.

Sec. 10.50.623. CHANGE OF NAME. If a foreign limited liability company that is registered under this chapter changes its name to one under which it may not register under this chapter, the registration of the company is suspended and the company may not conduct affairs in this state until it has changed its name to a name available to it under the laws of this state.

Sec. 10.50.625. AMENDMENT OF REGISTRATION. A foreign limited liability company may amend its registration by filing articles of amendment with the department that are signed by a person who has the authority to sign them under the law of the state or other jurisdiction of the company's organization.

Sec. 10.50.630. CONTENTS OF ARTICLES OF AMENDMENT. (a) The articles of amendment filed by a foreign limited liability company must state the

(1) name of the company;

(2) date the original application for registration was filed; and

(3) amendment.

(b) The application for registration may be amended in any way if the application for registration as amended contains only provisions that this chapter allows to be contained in an application for registration at the time of amendment.

Sec. 10.50.635. REGISTERED OFFICE AND REGISTERED AGENT OF FOREIGN COMPANY. A foreign limited liability company registered under this

chapter shall have and continuously maintain in the state a registered

(1) office that may be, but need not be, the same as its place of business in this state; and

(2) agent, who may be either an individual resident in this state whose business office is identical to the registered office, a corporation organized under AS 10.06, or a foreign corporation authorized to transact business in this state, that has a business office identical to the registered office.

Sec. 10.50.637. CHANGE OF REGISTERED OFFICE OR REGISTERED AGENT OF FOREIGN COMPANY. A foreign limited liability company registered under this chapter may change its registered office or change its registered agent, or both, upon filing with the department a signed statement setting out

(1) the name of the company;

(2) the address of its registered office;

(3) the address of the new registered office if the address of its registered office is to be changed;

(4) the name of its registered agent;

(5) the name of its new registered agent if its registered agent is to be changed;

(6) that the address of its registered office and the address of the business office of its registered agent, as changed, will be identical; and

(7) that the change is authorized by the company.

Sec. 10.50.638. FILING OF STATEMENT OF CHANGE. If the department finds that the statement conforms to the provisions of this chapter, the department shall file the statement, and upon the filing, the change of address of the registered office, or the appointment of a new registered agent, or both, as the case may be, becomes effective.

Sec. 10.50.640. SERVICE OF PROCESS ON FOREIGN COMPANY. The registered agent appointed by a foreign limited liability company registered under this chapter shall be an agent of the company upon whom process, notice, or demand required or permitted by law to be served upon the company may be served.

Sec. 10.50.645. SERVICE ON COMMISSIONER. When a foreign limited

liability company that is registered under this chapter, or that conducts affairs in this state without being registered under this chapter, fails to appoint or maintain a registered agent in this state, when a registered agent cannot with reasonable diligence be found at the registered office, or when the registration of a foreign company is suspended or revoked, the commissioner is an agent upon whom process, notice, or demand may be served. Service is made upon the commissioner as provided in AS 10.50.065(b).

Sec. 10.50.655. AUTHORITY TO CANCEL REGISTRATION. A foreign limited liability company registered in this state may cancel its registration by filing an application for cancellation with the department.

Sec. 10.50.660. CONTENTS OF APPLICATION FOR CANCELLATION. An application for cancellation filed by a foreign limited liability company must state

(1) the name of the company and the state or other jurisdiction where the company was organized;

(2) that the company is not conducting affairs in this state;

(3) that the company cancels its registration in this state;

(4) that the company revokes the authority of its registered agent for service of process in this state and consents that service of process may subsequently be made on the company by service on the commissioner for a cause of action arising in this state during the time the company was registered in this state; and

(5) an address for mailing a copy of a process to the company.

Sec. 10.50.665. FORM, MANNER, AND EXECUTION OF APPLICATION FOR CANCELLATION. The application for cancellation must be in the form and manner designated by the department and shall be signed on behalf of the foreign limited liability company by

(1) a person with authority to sign the application under the law of the state or other jurisdiction of its organization; or

(2) if the company is controlled by a receiver, trustee, or other court-appointed fiduciary, by the receiver, trustee, or other fiduciary.

Sec. 10.50.670. EFFECT OF CANCELLATION OF REGISTRATION. The cancellation of a registration under this chapter does not terminate the authority of the

commissioner to accept service of process on the foreign limited liability company with respect to causes of action arising out of the company's conduct of affairs in this state.

Sec. 10.50.675. CONDUCTING AFFAIRS WITHOUT REGISTRATION. (a) A foreign limited liability company conducting affairs in this state may not maintain an action or other proceeding in a court of this state until it has registered in this state.

(b) The failure of a foreign limited liability company to register in this state does not

(1) impair the validity of a contract or act of the company;

(2) affect the right of another party to a contract of the company to maintain an action or proceeding on the contract; or

(3) prevent the company from defending an action or other proceeding in a court of this state.

Sec. 10.50.690. LIABILITY FOR FEES AND PENALTIES. A foreign limited liability company that conducts affairs in this state without registration is liable to the department for the following fees and penalties for the full or partial years when it conducts affairs in this state without registration:

(1) the fees that would have been imposed by this chapter on the company if the company had been registered under this chapter; or

(2) the penalties imposed by this chapter.

Sec. 10.50.700. CIVIL PENALTY. (a) A foreign limited liability company that conducts affairs in this state without registration is subject to a civil penalty payable to the state not to exceed $10,000 for each calendar year, including a partial year, the company conducts affairs in this state without being registered under this chapter.

(b) The civil penalty imposed in (a) of this section may be recovered in an action brought in the superior court by the attorney general.

Sec. 10.50.710. INJUNCTIVE RELIEF. (a) Upon application to the court, if a court finds that a foreign limited liability company has conducted affairs in this state in violation of this chapter, the court may issue, in addition to imposing a civil penalty, an injunction restraining the company from conducting further affairs in this

state and from further exercising the company's rights and privileges in this state.

(b) An injunction issued under (a) of this section may continue until the civil penalties, interest, and court costs assessed by the court have been paid and until the foreign limited liability company otherwise complies with this chapter.

Sec. 10.50.715. NONLIABILITY OF MEMBER OR MANAGER. A member or manager of a foreign limited liability company is not liable for the debts and obligations of the company solely because the company conducts affairs in this state without registration.

Sec. 10.50.720. TRANSACTIONS NOT CONSTITUTING CONDUCTING AFFAIRS. The activities of a foreign limited liability company that are not considered to be conducting affairs in this state for the purposes of AS 10.50.600 - 10.50.720 include

(1) maintaining, defending, or settling a court action or other proceeding or a claim;

(2) holding meetings of the members or managers of the company;

(3) maintaining bank accounts;

(4) selling through independent contractors;

(5) soliciting or procuring orders by mail, through employees, agents, or otherwise, if the orders require acceptance outside the state before becoming binding contracts;

(6) creating as borrower or lender, or acquiring, indebtedness or mortgages or other security interests in real or personal property;

(7) securing or collecting debts, or enforcing rights in property securing debts;

(8) conducting an isolated transaction that is completed within 30 days and that is not part of a course of repeated transactions of a similar nature; or

(9) conducting affairs in interstate commerce.

ARTICLE 14. SUITS BY AND AGAINST LIMITED LIABILITY COMPANIES.

Sec. 10.50.730. ACTIONS AGAINST COMPANIES. A court action may be brought by or against a limited liability company. The court action may be brought

in the name of the company.

Sec. 10.50.735. AUTHORITY TO SUE ON BEHALF OF COMPANY. (a) Except as provided in AS 10.50.320, and unless otherwise provided in an operating agreement of the company, a person may not bring a court action on behalf of a limited liability company in the name of the company unless the person is authorized under (b) or (c) or this section to bring the action.

(b) Whether or not the company is managed by a manager, a member of a limited liability company may bring a court action on behalf of the company in the name of the company if the member is authorized to bring the action by more than one-half of all of the members of the company who are eligible to consent to the authorization, unless a larger number of the members are required under AS 10.50.145(c) for the authorization. When determining whether the required number of members consents under AS 10.50.145, the total number of all members does not include a member who has an interest in the outcome of the action that is adverse to the interest of the company and the member with the adverse interest is excluded from determining the authorization.

(c) A manager of a limited liability company may bring a court action on behalf of the company in the name of the company if the manager is authorized to bring the action by the consent required under AS 10.50.145 of the members eligible to consent to the authorization. When determining the number of managers required to consent under AS 10.50.145, the number does not include a manager who has an interest in the outcome of the action that is adverse to the interest of the company and the manager with the adverse interest is excluded from determining the authorization.

ARTICLE 15. BIENNIAL REPORT.

Sec. 10.50.750. BIENNIAL REPORT REQUIRED. A limited liability company and a foreign limited liability company conducting affairs in this state shall file a biennial report within the time established by this chapter.

Sec. 10.50.755. CONTENTS OF BIENNIAL REPORT. A biennial report must set out

(1) the name of the company and the state or country where it is organized;

(2) the address of the registered office of the company in this state, and the name of its registered agent in this state at that address, and, in the case of a foreign limited liability company, the address of its principal office in the state or country where it is organized;

(3) the names and addresses of the managers of the company, or, if the company is not managed by a manager, the names and addresses of the members of the company.

Sec. 10.50.760. FILING OF BIENNIAL REPORT. (a) A biennial report required by AS 10.50.750 shall be filed with the department and is due before January 2 of the filing year. A limited liability company filing articles of organization and a foreign limited liability company registering during an even-numbered year shall file the biennial report each even-numbered year. A limited liability company filing articles of organization and a foreign limited liability company registering during an odd-numbered year shall file the biennial report each odd-numbered year. The biennial report is delinquent if not filed before February 1 of each odd- or even-numbered year as provided in this section.

(b) Proof to the satisfaction of the department that on or before February 1 the report was deposited in the United States mail in a sealed envelope, properly addressed with postage prepaid, is compliance with (a) of this section.

(c) The department shall file the report if it conforms to the requirements of this chapter. If the department finds that the report does not conform to the requirements of this chapter, the report shall promptly be returned to the company for necessary corrections.

(d) Upon receipt of a form from the department, a limited liability company or a foreign limited liability company shall file a biennial report within six months after original incorporation or authorization to transact business in this state.

Sec. 10.50.765. FILING NOTICE OF CHANGE OF MANAGERS OR MANAGING MEMBERS. (a) In the event of a change of the manager of a limited liability company or of a foreign limited liability company registered under this chapter, or of a member of the company, if the members manage the company, during the first year of the biennial reporting period, the company shall file a notice of change

amending the biennial report of the company before the following January 2.

(b) The notice shall be filed with the department and shall state the name and current mailing address of the manager or member not included in the company's last filed biennial report, and the name of the person replaced and the office held.

ARTICLE 16. MISCELLANEOUS PROVISIONS.

Sec. 10.50.800. COMPANY CERTIFICATES. An operating agreement of a limited liability company may authorize the company to issue a certificate as evidence of a limited liability company interest. An operating agreement may also authorize and provide for the assignment or transfer of the interest represented by the certificate.

Sec. 10.50.810. SUBMISSION OF DOCUMENTS TO DEPARTMENT. When a document is required or allowed to be delivered to or filed with the department under this chapter, the person delivering the document shall deliver to the department the required fee, the original signed document, and an exact copy of the document.

Sec. 10.50.820. FILING OF DOCUMENTS BY DEPARTMENT. (a) If the department determines that a document filed under this chapter conforms to the filing requirements of this chapter, the department shall

(1) mark on the original signed document and on the exact copy the word "filed" and the date and time of the document's acceptance for filing;

(2) retain the original signed document in the department's files; and

(3) return the exact copy to the person who filed the document or to the person's representative.

(b) The department may not file a document if the requirements of this section are not met.

Sec. 10.50.830. DISAPPROVAL OF WRITING BY DEPARTMENT; APPEAL. If the department fails to approve articles of organization, amendment, merger, consolidation, or dissolution, or any other document required by this chapter to be approved by the department, the department shall, within 10 days after the delivery of the document to the department, give written notice of disapproval to the person, limited liability company, or foreign limited liability company, delivering the document, and specifying the reasons for disapproval. The person or company may

appeal the disapproval to the superior court.

Sec. 10.50.840. EXECUTION OF DOCUMENTS. (a) Unless otherwise provided in this chapter, a document required by this chapter to be filed with the department by or for a limited liability company shall be signed by

(1) a manager of the company if the company is managed by a manager;

(2) a member of the company if the articles of organization do not provide that the company is managed by a manager;

(3) a person organizing the company if the company is not organized;

(4) the fiduciary if the company is controlled by a receiver, trustee, or other court-appointed fiduciary.

(b) A person signing a document filed with the department under this chapter shall state beneath or opposite the signature the person's name and the capacity in which the person signs.

(c) A person signing a document filed with the department under this chapter may sign as an attorney-in-fact, but is not required to provide or file with the department a document authorizing the person to act as attorney-in-fact for the signing of a document.

Sec. 10.50.850. FILING AND OTHER FEES. The department shall charge fees established by the department by regulation adopted under AS 44.62 (Administrative Procedure Act) for

(1) filing the original articles of organization;

(2) filing articles of amendment;

(3) filing articles of merger or consolidation;

(4) filing articles of dissolution;

(5) issuing a document not otherwise covered by this section;

(6) furnishing a copy of a document;

(7) accepting an application for reservation of a name, or filing a notice of the transfer or cancellation of a name reservation;

(8) filing a statement of change of address for a registered office or registered agent;

(9) accepting service of a notice, demand, or process upon the department;

(10) filing the application for registration of a foreign limited liability company;

(11) registering a name, reserving a name, or renewing a name registration under this chapter; or

(12) filing another document allowed or required under this chapter.

Sec. 10.50.860. MAINTENANCE OF RECORDS. Unless otherwise provided in an operating agreement, a limited liability company shall keep at its principal place of business

(1) current and past lists that state in alphabetical order the full name and last known mailing address of every member and manager of the company;

(2) a copy of the company's articles of organization and amendments to the articles, including a signed copy of a power of attorney used by a person who signed articles of amendment for the company;

(3) a copy of the company's federal, state, and local income tax returns and financial statements, if any, for the three most recent years or, if the returns and statements are not prepared, a copy of the information and statements provided to, or that should have been provided to, the members to enable the members to prepare their federal, state, and local tax returns for the three-year period;

(4) a copy of any effective operating agreement of the company, amendments to the agreement, and former operating agreements;

(5) unless contained in an operating agreement,

(A) a document stating the amount of cash contributed by a member of the company, the agreed value of other property or services contributed by a member, and when a member is to make additional contributions;

(B) a document stating the events, if any, that cause the company to be dissolved and its affairs wound up; and

(C) other documents that an operating agreement requires the company to prepare.

Sec. 10.50.870. INSPECTION OF RECORDS. (a) A limited liability company shall make its books and records of account, or certified copies of them, reasonably available for inspection and copying at the registered office, principal office, or principal place of business in the state by a member of the company. Member inspection shall be upon written demand stating with reasonable particularity the purpose of the inspection. The inspection may be in person or by agent or attorney, at a reasonable time and for a proper purpose. Only books and records of account, minutes, and the record of members directly connected to the stated purpose of the inspection may be inspected or copied.

(b) A manager, or, if the company is not managed by a manager, a member, who, or a limited liability company that, refuses to allow a member, or the agent or attorney of the member, to examine and make copies from its books and records of account, minutes, and record of members, for a proper purpose, is liable to the member for a penalty in the amount of 10 percent of the value of the limited liability company interests owned by the member or $5,000, whichever is greater, in addition to other damages or remedy given the member by law. It is a defense to an action for penalties under this section that the person suing has within two years sold or offered for sale a list of members of the company or any other limited liability company or has aided or abetted a person in procuring a list of members for this purpose, or has improperly used information secured through a prior examination of the books and records of account, minutes, or record of members of the company or any other limited liability company, or was not acting in good faith or for a proper purpose in making the person's demand.

(c) Nothing in this chapter impairs the power of a court, upon proof by a member of a demand properly made and for a proper purpose, to compel the production for examination by the member of the books and records of account, minutes, and record of members of a limited liability company.

Sec. 10.50.880. DISCLOSURE OF INFORMATION. The members of a limited liability company, if the articles of organization do not provide that the company is managed by a manager, or the manager of the company, if the articles of organization provide that the company is managed by a manager, shall provide, to the

extent just and reasonable under the circumstances, true and full information of all matters that affect the members of a company to a member or to the legal representative of a deceased member or a member under a legal disability.

Sec. 10.50.890. WAIVER OF NOTICE. If notice is required to be given to a member or manager of a limited liability company under the provisions of this chapter or under the provisions of the articles of organization or an operating agreement of the company, a waiver of the notice in writing signed by the person entitled to notice, whether before or after the time stated for notice, is equivalent to the giving of notice.

ARTICLE 17. GENERAL PROVISIONS.

Sec. 10.50.900. REGULATIONS. In addition to the regulations the department is required to adopt under this chapter, the department may adopt other regulations under AS 44.62 (Administrative Procedure Act) to implement this chapter.

Sec. 10.50.910. INTERSTATE APPLICATION. A limited liability company that is organized and existing under this chapter may conduct its affairs and exercise the powers granted by this chapter in another jurisdiction, subject to the laws of that jurisdiction.

Sec. 10.50.990. DEFINITIONS. In this chapter, unless the context indicates otherwise,

(1) "articles of organization" means the articles of organization filed under AS 10.50.070 and the articles as amended or restated;

(2) "commissioner" means the commissioner of commerce and economic development;

(3) "corporation" means a corporation organized under the laws of this or another state, or of this or another country;

(4) "department" means the Department of Commerce and Economic Development;

(5) "filed," unless expressly provided otherwise, means filed with the department;

(6) "foreign limited liability company" means an organization that is

(A) not incorporated;

(B) organized under the law of a state other than this state, or under the law of a foreign country;

(C) organized under a statute that affords to each of its members limited liability regarding the liabilities of the organization; and

(D) not required to be registered under a statute of this state other than this chapter;

(7) "interim distribution" means a distribution of the assets of a limited liability company to the company's members, except as provided under AS 10.50.335 and 10.50.425;

(8) "know" means to have actual knowledge or to know other facts that demonstrate bad faith in the circumstances; this definition applies also to the derivatives of "know," including "known," "unknown," and "knowledge";

(9) "limited liability company" or "domestic limited liability company" means an organization organized under this chapter;

(10) "limited liability company interest" means an interest in a limited liability company issued under AS 10.50.275;

(11) "limited partnership" means a limited partnership organized under AS 32.11 or under the law of another state or a foreign country;

(12) "manager" means a person who manages a limited liability company, if the articles of organization provide that the company is managed by a manager;

(13) "managing member" means a member of a limited liability company if the company's articles of organization do not provide that the company is managed by a manager;

(14) "member" means a person who has been admitted to membership in a limited liability company under AS 10.50.155 - 10.50.160 and whose membership has not terminated under AS 10.50.180 - 10.50.185 or 10.50.205 - 10.50.220;

(15) "operating agreement" means a written agreement among all of the members of a limited liability company about conducting the affairs of the company;

(16) "property" includes cash;

(17) "state" means a state, territory, or possession of the United States,

and includes the District of Columbia, the Commonwealth of Puerto Rico, the Northern Mariana Islands, Guam, the Virgin Islands, American Samoa, and the Trust Territory of the Pacific Islands.

Sec. 10.50.995. SHORT TITLE. This chapter may be cited as the Alaska Limited Liability Act.

* Sec. 2. AS 10.06.105(c) is amended to read:

(c) A person may not adopt a name that contains the word "corporation", "incorporated", or "limited", or an abbreviation of one of these words, unless the person has been issued a certificate of incorporation, or, in the case of a foreign corporation, a certificate of authority, by the commissioner. This subsection does not prohibit **a limited liability company or** a limited partnership from using the word "limited" or an abbreviation of "limited" in its name.

* Sec. 3. AS 45.55.130(12) is amended to read:

(12) "security" means a note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; **a limited liability company interest under AS 10.50;** collateral-trust certificates; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; a certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under the title or lease or in any sale of or indenture or bond or contract for the conveyance of land or any interest in land; an option on a contract for the future delivery of agricultural or mineral commodities or any other commodity offered or sold to the public and not regulated by the Commodity Futures Trading Commission; however, the contract or option is not subject to the provisions of AS 45.55.070 if it is sold or purchased on the floor of a bona fide exchange or board of trade and offered or sold to the public by a broker-dealer or agent registered under this chapter; investment of money or money's worth including goods furnished or services performed in the risk capital of a venture with the expectation of some benefit to the investor where the investor has no direct control over the investment or policy decision of the venture; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim

certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing; "security" does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or for some other specified period;

* Sec. 4. This Act takes effect January 1, 1995.

[redacted]OUSE COMMITTEE REP[redacted]

(7)
Date Referred: March 9, 1994 FURTHER REFERRALS: State Affairs

Date of Committee Action: 3/31/94

The JUDICIARY Committee considered: SSHB 420

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 420 LIMITED LIABILITY COMPANIES

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

RECOMMENDATIONS: [ ] the same title
be replaced with CS HB 420 (JUD) [✓] a new title
[ ] have attached amendments(s)
(4) [✓] do pass
[ ] do not pass
(1) [✓] no recommendations
[ ] individual recommendations
[ ] additional referral to the _____ Committee

ADOPTS: _____ letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept) APPROVES PREVIOUS: (Dept/Date)

[ ] fiscal impact _____ [ ] fiscal note(s) _____

[✓] zero fiscal note Commerce & Ec. Developmt [ ] zero fiscal note(s) _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
[signature]	—	[signature]		✓	
[signature]	✓				
[signature]	✓				
[signature]	✓				
		JUD Committee Report			

FISCAL NOTE

STATE OF ALASKA **BILL NO. HB 420**

1994 LEGISLATIVE SESSION

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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CED FISCAL NOTE

REPRESENTATIVE
JEANNETTE JAMES
P.O. Box 56522
North Pole, Alaska 99705
(907) 488-1546
FAX (907) 488-9006
House District 34

Alaska State Legislature

House of Representatives

While in Juneau
State Capitol
Juneau, Alaska
99801-1182
(907) 465-3743
FAX (907) 465-2381

DATE: March 30, 1994

TO: Representative Brian Porter, Chair
House Judiciary Committee

FROM: Judiciary Sub-Committee on House Bill 420:
Representative Jeannette James, Chair

Extensive teleconferences were held on March 25 and 26 to hear and discuss concerns regarding the formation of Limited Liability Companies in Alaska. In attendance were:

Mike Monagle, Dep't of Commerce and Econ Development
Brian Durrell, Bogle & Gates
Terry Bannister, Div. of Legal Services
Wes Coyner, Alaska Bankers Ass'n
Craig Ingham, Alaska Bankers Ass'n, by teleconference from Fairbanks
Walt Wilcox, Rep. James staff
Barbara Cotting, Rep. James staff
Kim Metcalf Helmar, Rep. Davidson staff
George Dozier, Rep. Kott staff
Wilda Whittaker, Rep. Therriault staff

I believe the proposed committee substitute effectively addresses these concerns and should be adopted.

DESCRIPTION OF CHANGES

Daniella - I delivered to all members of the committee - I'll have some spare copies on hand tomorrow. Wilda

Revised 3/30

Sub-Committee changes to CSSSHB 420 (new version K)

Page 1

Title: Amends to reflect deletion of Art. 15 Sec. 10.50.810, "Members as Parties to Actions," and Sec. 3, "Amendment of Court Rules." The bill no longer amends civil rules.

Page 3, Line 2, through Page 7, Line 2

Adds new sections to conform more closely with corporate codes and department of commerce practices.

Page 7

Line 4: Amends to read that two or more persons, rather than just one, may organize a limited liability company.
Line 12: Adds new subsection (2) to conform to corporate code.
Line 19 through 23: Adds new subsections (5) and (6). Added to require public disclosure of manager vs. member-managed LLC's, and to require public disclosure of any limits on member's authority to manage.
Line 24-26: Clarifies that inclusion of provisions is elective.
Line 28: Changes to add the phrase "that conform to the filing requirements of this chapter."

Page 8

Deletes Article 3, Sec. 10.50.080 (b) (version J: page 6, line 5). Avoids problems associated with temporary organization where articles do not conform to law.

Line 16: Adds Sec. 10.50.095, "Operating Agreement" to clarify that an operating agreement is optional.

Page 9

Line 9: Changes "by this chapter" to "the company's articles of organization."
Line 10: Second sentence of former 10.50.110 (a) moved to 075 (6).
Line 21: Clarifies that an LLC may have more than one manager.
Line 27: Adds new section (b) to provide a procedure for managers to resign.

Page 10, Line 8 through Page 15, Line 11

Adds new sections to more closely reflect corporate code governing fiduciary responsibility, conflicts of interest, insider loans and indemnification.

Page 15

Line 22-23: Changes language to allow flexibility to set different approval levels.

Line 24: Changes "all members" to "two-thirds" members for amending articles of organization or operating agreement.

Line 31: Adds subsection (d) to limit the approval level that may be set.

Page 18, Section 10.50.205

Adds subsection (a) to limit membership terminations to (b) and (c).

(c) Clarifies that a member can be removed with or without cause if so stated in the operating agreement.

Page 19

Deletes Article 6, Sec. 10.50.225, "Other Events Terminating Membership" to make it consistent with bankruptcy code.

Line 26: Changes to "usual and customary way of doing business." (Same change made **Page 20, lines 5 and 11**).

Line 31, and Page 20, Lines 2 and 22: Changes "If the articles of organization of a limited liability company name a manager for the company," to "If a limited liability company is managed by a manager." (This change was made throughout the bill).

Page 22

Line 2-3: Changes to conform to corporation code.

Line 4: Adds (b) to clarify that an interest in a limited liability company may not be issued for a promissory note or future services.

Page 23, Line 12 through Page 26, Line 10

Adds new sections on distribution of assets to more closely mirror corporate code. (sections 305-325).

Page 27

Line 16: Adds Section 10.50.348 to conform to corporate code.

Line 25: Changes wording to prohibit property of an LLC being held in the name of anyone other than the LLC.

Page 28

Deletes Sec. 10.50.355 (b) from version J.

Deletes Sec. 10.50.365 "Transfer Free of Company Claims" from version J.

These are to conform to change made in section 350.

Page 29

Deletes Sec. 10.50.380 (c) (version J) to avoid confusion with Alaska and federal exemption laws.

Page 37

Deletes Sec. 10.50.550 (b) (version J) to conform to change in 350.

Page 39

Lines 22 through 31: Adds sections (6), (7) and (8) to conform to corporation practice.

Page 40

Line 2: Adds section (b)
Line 10: Changes term "designated name" to "assumed name."
Line 13: Adds Sec. 10.50.623
Line 30: Adds Sec. 10.50.635

All were made to conform to corporation code.

Page 41, Lines 8 through Page 42, Line 7

Adds sections 10.50.637 through 10.50.645 to conform to corporation code.

Page 43

Line 13: Deletes sections 10.50.680 and 10.50.685 because of changes made to conform to corporate code. (685 is replaced by 645; and 680 is replaced by 615 (a) (4)).

Page 44

Line 18: (5) Changes wording slightly to mirror corporate code 10.06.718 (6).

Page 45

Line 3: Adds "Except as provided in AS 10.50.320" to avoid conflicts between 320 and 735.

Line 11: Changes from "unless all of the members are required under" to "unless a larger number of the members are required under."

Deletes Sec. 10.50.740 (version J), "Effect of Lack of Authority to Sue" to avoid confusion with effect of section 735.

Line 24: Adds Article 15, requiring a Biennial Report. This was to conform to department of commerce practices and to require public disclosure of managers and members.

Page 47, Miscellaneous Provisions

Deletes Sec. 10.50.800 and 10.50.805 (version J), "Liability of Managers and Members," and "Indemnification of Members and Managers." These were replaced by earlier sections: 800 was replaced by other sections, including 135; and 805 by 148.

Deletes Sec. 10.50.810 (version J) to avoid amending civil rules.

Line 23: Deletes Sec. 10.50.840 (b) to conform to department of commerce practices and changes made in section 080.

Line 25: Adds Sec. 10.50.830 to conform to corporate practice and to provide a mechanism to provide organizer with notice of defective filing.

Page 48

Line 7: Changes "operating agreement" to "articles of organization."

Deletes Section 10.50.855 (version J) to avoid implication that the court otherwise did not have that power.

Page 49

Line 5: Adds (11) to conform to earlier changes.

Page 50

Line 1: Changes Sec. 10.50.870 to provide members a right to inspect records consistent with the right a shareholder would have in a corporation.

Page 51

Line 4: Adds "Waiver of Notice."

Deletes Sec. 10.50.920 (version J), "Rules of Construction" because they are confusing and subject to inconsistent interpretation.

Page 52

Lines 19 through 24: Changes (12) to conform to changes in the bill and (13) to define managing member.

Line 28: Deletes "or oral" to clarify that the agreement must be in writing.

Line 13: Adds Section 3 to clarify that LLC interest is subject to Alaska Blue Sky Laws.

Changes were made throughout to clarify that agreements must be made in writing; and to reflect that articles of organization, not an operating agreement, determine whether the company is managed by a manager or by the members.

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

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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 the same 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		

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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. 70-[illegible]*[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. 7-80-101, *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).

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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] 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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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, 10-1049) 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

See Limited Liability Companies, Page 14.

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

Limited Liability Companies, from Page 13.

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.

ARTHUR GOULD, ESQ., is a Partner in Mayer, Brown & Platt in Chicago, Illinois. He is a frequent lecturer at tax institutes and is the author of several tax articles. ALAN VAN DYKE, ESQ., is an Associate at the same law firm.

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

HAMILTON BROTHERS OIL COMPANY
1560 BROADWAY, P.O. BOX 5870
DENVER, COLORADO 80217
303-863-3000

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 Ruiings [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

[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.

(1992)[16], Iowa (1992)[17], Oklahoma (1992)[18], Minnesota (1992)[19] and Illinois[20] have enacted limited liability acts. Indiana in 1990 and Georgia in 1992 have enacted legislation permitting the registration of foreign limited liability companies.[21]

The Wyoming Act and its Revenue Ruling have become the focal point from which all states have premised their legislation. Section 7701 of the IRS Code and its accompanying regulations not only light the path for legislation in this area but warn legislators that to vary significantly may result in lost federal tax benefits. **Compliance with the state act does not assure the desired tax treatment.**

Unfortunately, the Wyoming Act still uses the old corporate act language. This has caused most other states to venture into drafting exercises of their own, sometimes onto thin ice. Care must be taken to comply with the IRS guidelines (14.100) even though state statutes may offer greater latitude. Wyoming limited liability companies are created when two or more persons file duplicate original verified Articles of Organization with the Secretary of State. W.S. § 17-15-106. A "person" is defined as

> . . . individuals, general partnerships, limited partnerships, limited liability companies, corporations, trusts, business trusts, real estate investment trusts, estates and other associations. W.S. § 17-15-102 (a)(iv).

In some states the statutory definition of "person" encompasses more. (4.600).

Limited liability companies have several useful advantages over their nearest relative, the **S corporation.** (2.153.) Limited liability companies have (1) no citizenship requirements, (2) no limitation on the size or number of members, (3) no limitation of one class of shares, (4) no limitation on ownership of other corporations, and, (5) usually, no tax penalties on liquidation, and (6) it can avail itself of § 754 code elections.

Limited liability companies have significant benefits over **limited partnerships (2.151) by allowing** limited liability to all members, including those who participate in management. Wyoming Statute § 17-15-113 provides that: Neither the members of a limited liability company nor the managers of a limited liability company managed by a manager or managers are liable under a judgment, decree or order of a court, or in

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[16] MD Code Ann. §§ 4A-101 et seq.

[17] 1992 Iowa Stat. § 490A.125.

[18] Oklahoma Title 18-2000.

[19] Minnestota Limited Liability Company Act, Chapter 322B.

[20] Illinois Limited Liability Company Act, § 5-45.

[21] Ind. Code §§ 23-16-10.1-1 et seq.

any other manner, for a debt, obligation or liability of the limited liability company. All states have similar provisions.

The main disadvantage is the restriction on transferability of the full rights of membership. Yet, a minority shareholder in a corporation is also without a meaningful right to participate in the management of that entity. Unlike the S corporation, the LLC can have broad based ownership, including corporations and trusts.

The limited liability company is a new statutory entity in its own right, separate from the corporation or the partnership. Yet, some states have restricted its potential by grafting unnecessary corporate or partnership language into their limited liability statute. Perhaps the promised model act will not restrict the LLC potential. (16.100).

CAVEAT

WARNING! Blind use of these forms can be dangerous to your legal health. Prior to drafting Articles of Organization for the client, careful attention must be given to the entity being created, as it affects the desires and needs of the participants. Information along the lines of the "Client Questionnaire" and "Formation Checklist" found at page 2.300 of this book should be obtained. Once obtained, this material needs to be analyzed and discussed with the representatives of the proposed entity. A perfect world probabiy would contain a detailed Pre-formation Agreement which participants would sign acknowledging full disclosure by the attorney of all "opt in" features and default rules contained in the Limited Liability Company Act, and affirming that the Articles of Organization and Operating Agreement or other internal regulations contain those, and only those, features desired. The adopted Articles and Operating Agreement or other regulation amount to a contract of parties, whose interests, in certain details, may well differ.

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Daily Market Record. Daily.
Statistical Annual: Grains, Options on Agricultural Futures. Chicago Board of Trade. Annual.
United States Census of Agriculture. Bureau of the Census. Quinquennial. Most recent: 1982.

CORNER "Control or monopoly over a commodity or security to get control of or to dictate prices" (S. S. Pratt, "Work of Wall Street"). Technically, a corner occurs on a stock exchange when shorts cannot borrow stock, i.e., have sold more stock than the floating supply makes available for purchase. Those who have a corner can dominate the situation and dictate price terms to their unfortunate victims—the shorts who are forced to settle at artificially dictated prices, thereby incurring heavy losses. The two important corners in stocks were the Northern Pacific corner (1901) and the Stutz corner (1920).

Corners have been more frequent in grain than in stock speculation and in most cases have proved disastrous for their promoters. The three great corners on the Chicago Board of Trade are known as the Hutchinson corner (1888), the Leiter corner (1898), and the Patten corner (1909). An attempt to corner silver occurred in the 1980s.

A corner has been declared to be illegal by the courts for two reasons: it is a gambling transaction and contracts thereunder are therefore unenforceable, it is in restraint of trade.

Under the COMMODITY EXCHANGE ACT and its successor the Commodity Futures Trading Commission Act of 1974, the Commodity Futures Trading Commission can set limitations both upon the amount of speculative trading done daily by any one individual and upon the speculative net position, long or short, of any speculative account at any one time, and requires the reporting to it of any holdings in excess of certain amounts. Under the Securities Exchange Act of 1934, operations of the stock exchanges and their members, and of security brokers and dealers generally, are subjected to regulation of the Securities and Exchange Commission.

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CORN-HOG RATIO The number of bushels of corn equal in value to 100 pounds of hog, liveweight, which indicates at market prices the relative attractiveness to farmers of selling their corn or feeding it to their hogs for hog marketing.

In addition to the corn-hog ratio, the Department of Agriculture also regularly compiles other local market commodity-feed price ratios, such as the egg-feed ratio (pounds of laying feed equal in value to one dozen eggs), broiler-feed ratio (pounds of broiler grower equal in value to one pound of broiler, liveweight), turkey-feed ratio (pounds of turkey grower equal in value to one pound of turkey, liveweight), and milk-feed ratio (pounds of concentrate ration equal in value to one pound of whole milk).

CORN PIT *See* PIT.

CORPORATE AGENT A person or firm empowered to act for another. Banks serve as corporate agents for a fee in various capacities for corporations, state and local governments, municipalities, and persons, including the following:

1. **Stock transfer agent.** Banks maintain stock transfer books and shareholders' ledger when retained by a corporate client.
2. **Stock registrar.** Banks serve as stock registrars who countersign stock certificates and ensure that each certificate is properly issued.
3. **Coupon and bond paying agent.** Banks and trust companies occasionally pay maturing coupons and principal of corporate clients. Paid coupons and bonds are cremated and either a cremation certificate or the paid coupons and bonds are returned to the principal.
4. **Dividends disbursing agent.** Banks pay dividends to stockholders of record and provide a report to the corporation of such disbursements when retained to do so.
5. **Fiscal agent.** Banks serve as fiscal agent for a government, especially for taxes withheld that are deposited with it for the account of the government.

CORPORATE RECORDS Those records of a CORPORATION required by incorporation laws and pertaining to its corporate character. Among these are the certificate of incorporation, bylaws, book of minutes of the board of directors, stock book, stock transfer book, etc. Section 10 of the New York Stock Corporation Law requires that every stock corporation keep at its office correct books of account of all its business and transactions and a stock book showing the names of all persons, alphabetically arranged, who are stockholders of the corporation, their addresses, number of shares of stock held, the time when they became stockholders, and the amount paid thereon.

CORPORATE STOCK In municipal financing, sometimes used as the title for bonds of long-term maturity, with sinking fund retirement and other characteristics of bonds.

See MUNICIPAL BONDS.

CORPORATE TRUSTS *See* TRUST.

CORPORATION **The corporate form of business organization is dominant in the U.S. in manufacturing and wholesale trade both in number of firms and in operating terms (sales, employees). In retail trade and the service industries, corporations are in the minority numerically but account for more sales** and employment than unincorporated firms (U.S. Bureau of the Census, U.S. Census of Business). This dominant position of the corporation as to size of operations underscores the major financial and managerial advantages of the corporate form. Financially, the corporate form structurally facilitates more extensive financing for a firm for the following reasons.

1. **Limited liability.** When stockholders become investors in a corporation they can foretell the limits of maximum loss (the extent of the investment), without personal liability for debts of the firm, unlike the case for the proprietorship and the general partnership.
2. **Separability of investor and managerial motivations.** The investor who is not interested in active participation in management may invest in nonvoting stock or, where he invests in voting stock, may by proxy designate persons to vote for him in his name, place, and stead, in elections of directors and on other corporate matters. In either case, management may be delegated to others (the directors, who in turn appoint the officers). If the stockholder is so motivated, he may participate actively in election of directors or become a member of the board of directors and/or member of the officers to the extent that his voting power and qualifications justify. The corporation's capitalization may be appropriately proportioned as to debt, nonvoting stocks, and voting stocks.
3. **Divisibility and transferability of ownership.** The corporation's total ownership is divisible into an appropriate number of units (shares of stock) by the device of par value (or if no par value stock is issued, by number of shares with suitable stated value per share). Such conveniently sized units of ownership may be sold to a larger number of investors, as contrasted to total lump sum proprietorship interest or proportionate interests of partners. Further, a fundamental right of stockholders is to receive certificates of ownership, which may be readily assigned to new owners and/or transferred, heightening marketability.
4. **The absence of "delectus personae" among stockholders** (the personal right of general partners to choose their associates as partners). Each and every stockholder of a particular class of stock is entitled to all the rights and privileges applicable to all other holders of that class of stock. Existing stockholders cannot refuse to admit new stockholders to full status as such.
5. **Separate legal existence of the corporation as an entity, apart from its owners, creditors, and agents** (directors, officers, employees, etc.). Because the corporation may own, buy, and sell property in its own name; make contracts; sue and be sued in its own name; exercise all its express, implied, and incidental authorized powers, it may continue its separate existence, with its own financial integrity, apart from turnover of such individuals, pursuant to its charter. Such durability of existence facilitates long-term financing.

A *de jure* corporation is one formed in compliance with the pro-

visions of an incorporation statute. A *de facto* corporation is one formed without full compliance with all material, mandatory provisions of an incorporation statute.

Corporations are also classified as public or private. Private corporations may be stock or nonstock corporations. Stock companies normally operate for profit, while nonstock corporations such as certain hospitals and churches usually are not-for-profit organizations. Corporations also can be classified as follows:

1. Public corporations are government-owned entities such as the Federal Deposit Insurance Corporation.
2. Open corporations are private stock corporations whose stock is available to the public and is usually traded on a stock exchange (a listed corporation) or in the over-the-counter market (unlisted).
3. Closed corporations are private corporations whose stock is not offered for sale to the general public but is usually held by a few individuals.
4. Domestic corporations are incorporated in a particular state. Foreign corporations operate in a state other than the one in which they are incorporated.

Managerially, the corporate form, aside from its general advantage of assembling skills, money, and property, especially facilitates use of the line and line and staff types of internal organization for large-scale operations, making possible functionalization and decentralization of operations with centralization of responsibility and accountability maintained.

The rise of the corporation as the most important form of business organization was especially facilitated in the latter part of the last century by enactment of general incorporation statutes among the states, making it possible for any group of incorporators complying with the objective statute's requirements to form corporations freely. By contrast, the previous system of special acts of the legislatures for chartering corporations inhibited new incorporations by making it possible for existing corporate interests to block the new charters by political pressure.

The corporation is a creature of statute, both as to procedure for formation and subsequent exercise of permissible powers, but the corporation is legally protected against arbitrary impairment of charter powers by the sovereign, the state, because the corporate charter is a contract that the state of incorporation may not impair (*Dartmouth College* v. *Woodward*, 4 Wheat. 518 [1819]). The corporation, although a legal entity, has no freedom of movement, as natural persons have, to do business in any state; as a foreign corporation seeking to do business in other states, it may validly be required to be licensed and designate agent therein for service of process in case of litigation. As a creature of statute, the corporation may be subjected to nonarbitrary or discriminatory regulation, especially in such fields as banking, insurance, and other regulated lines of activity.

Since the corporation is a separate legal entity, it is itself the legitimate object of taxation, both federal and state, both organizational taxes (incorporation fees, annual franchise taxes) and operational taxes (income, property, and excise taxes). This leads to the disadvantage for stockholders of double taxation (the corporation pays taxes and stockholders pay income taxes on dividends declared and distributed). To the extent of properly retained earnings, the corporation may legitimately avoid such double taxation. Intercorporate dividends are taxed only at their tax rate on only 15% of the dollar amount, so that, for example, at a 46% tax bracket for the corporation, the net tax is 6.9%, which constitutes welcome relief from the double taxation. The giant corporation of modern times is likely to be either purely or partly a HOLDING COMPANY, owning interests in other corporations.

The growth of giant corporations led some early observers (e.g., A. A. Berle, Jr., and G. C. Means, *The Modern Corporation and Private Property*, 1933) to view with alarm the concentration of industry in relatively few corporations and, projecting such growth, to conclude that the giant corporation was a threat to government itself. Other observers viewed with misgivings the impersonal natute of the corporation, hiding its principals behind its corporate veil and giving rise to a new professional class—the managers—normally insulated against effective accountability to independent stockholders because of massive proxy voting. The dire projections of concentration, however, have been modified by growth of the economy as a whole. Proxy battles for control indicate the vulnerability of arbitrary managements; the emphasis by giant corporations upon stockholder relations and public relations indicates responsibility as compared with the predatory irresponsibility of the latter part of the nineteenth century. And government, with its proliferations of laws and administrative agencies in regulation of business, has not been taken over by the corporation.

See PARENT COMPANY.

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CORPORATION BONDS Obligations of a business corporation as distinguished from civil bonds, obligations of a governmentality (federal, state, or municipal government).

The soundness of corporation bonds depends upon many factors including the character of collateral offered, the character of the issuer, the nature of the industry, and the stability of its earnings. The market value of corporation bonds is primarily influenced by money rates in the case of highest grade obligations, and business activity and conditions in the case of lower grade issues, while civil bonds of fiscally sound public bodies are primarily influenced by the level of money rates.

See BOND, INDUSTRIAL BONDS, INVESTMENT, PUBLIC UTILITY BONDS, RAILROAD BONDS.

CORPORATION FINANCE The division of finance that deals with the promotion, organization, capitalization, financing, reorganization, and financial conduct of business corporations. "Corporation finance aims to explain and illustrate the methods employed in the promotion, capitalization, financial management, consolidation, and reorganization of business corporations" (S. E. Mead, *Corporation Finance*, 1910). The descriptive approach of pioneer texts, emphasizing legal and accounting aspects of the subject, continues to be fundamental in modern works, but added thereto has been more emphasis on theory and decision-making, particularly from case materials, accentuating the managerial approach.

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CORPORATION PAPER Notes, acceptances, and bills of exchange issued by corporations, as distinguished from paper issued by individuals and copartnerships.

CORPORATION: TAX FORMULA The computation of the federal income tax liability for a corporation is presented here.

Sample Certificate of Participation

No. _____

$ _____

CERTIFICATE OF PARTICIPATION
issued by
Blank National Bank of New York

has allotted to _____ Bank
in participation of _____
in a note for $ _____
made by _____
dated _____
with interest at _____ % per annum.

PARTICULAR AVERAGE In marine insurance, insurance with particular AVERAGE, without limitation of percentage, covers any partial loss resulting from marine perils.

PARTIES The parties to a check are the drawer, payee, drawee, and endorsers; to a draft or bill of exchange, the DRAWER, DRAWEE (called acceptor after he accepts it), payee (often the same party as the drawer), and endorsers; to a note, the MAKER, PAYEE, and endorsers.

PARTNER'S CAPITAL The amount of money contributed by the partners of a firm for investment in the partnership business. This term is also sometimes applied to the capital contributed by the stockholders of a corporation, presumably represented by the aggregate amount of preferred and common stock outstanding, as distinguished from the amount of capital represented by bonds and other forms of fixed indebtedness. Stocks are sometimes referred to as share capital, while bonds, notes, mortgages, debentures, equipment trust certificates, etc., are called loan capital.

PARTNERSHIP A general partnership is a form of business organization in which two or more persons (no limit as to the number) are associated as coowners for the purposes of business or professional activities for private pecuniary gain. Each general partner is a general agent for the others and may bind the partnership for acts within the scope of the partnership's business. It is a contractual relationship needing no written partnership agreement to arise. It is preferable, however to prepare written articles of copartnership, especially in order to define the duties of each partner and respective authorities which will be binding as among the partners and to specify the agreed sharing of profits and losses which otherwise in the absence of specification will be implied to be equal.

As distinguished from the corporation, the general partnership requires no formal legal proceedings in the form of charter or franchise from the state, although legal incidents of the general partnership have been enacted by all states except Georgia and Louisiana by their versions of the Uniform Partnership Law, declaratory of common law principles which will otherwise prevail in other jurisdictions which have not enacted statutes. Moreover, the general partnership has no separate legal existence apart from the partners, and so is not taxed as a firm for income tax purposes as is the corporation. Because of such lack of legal entity, however, the general partnership is subject to unlimited personal liability by the general partners for any of the partnership debts, each general partner being jointly and severally liable for the firm debts. In recovering from personal assets of the partners, however, firm creditors are subject to the rule of marshaling of assets, pursuant to which personal creditors have first claim upon personal assets in the event of conflict as to priorities. In turn, personal creditors are subject to the firm creditors' first claim upon firm assets. In addition, because of the lack of legal entity for the general partnership as a firm, the firm's existence is very fragile, being subject to *dissolution* (not necessarily *liquidation* in each case) by reason of the death, withdrawal, bankruptcy, or legal disability of any of the general partners. Usually such lack of permanence of duration of the firm is a disadvantage insofar as long-term firm financing is concerned. This factor, as well as the divisibility of ownership into conveniently sized units (shares) enjoying limited liability and transferring readily without legal difficulty, makes the corporation the feasible form of business organization where substantial external financing is required for a firm.

Unlike the general partnership, the limited partnership is purely statutory and will arise by implication and without written articles of copartnership. A limited partnership is formed by express written agreement, pursuant to statute of the home state, between one or more general partners and one or more limited partners. The limited liability feature applies only to the limited partners, provided they are merely investors in the firm and actually do not have a voice in the management. The general partners in the limited partnership are subject to all the legal incidents of general partnership law. Most states have enacted their versions of the Uniform Limited Partnership Act. A limited partnership, like the corporation and unlike the general partnership, has no freedom of movement and will be simply a general partnership in any jurisdiction other than the home state of creation. State procedural requirements for the creation of the limited partnership, including the filing of a certificate or articles of partnership and publication thereof, are not onerous. Specific compliance, however, is necessary in order to achieve limited liability for the limited partners. Moreover, the limited partners' claims as to withdrawal of capital investment, sharing in profits, or withdrawal of loans to the firm must not impair the ability of the firm to provide for firm creditors. As investor-partners, however, limited partners enhance the financial resources of a partnership, the usual motivation for such form of organization. The disadvantage of impermanence of the firm because of the dissolution incidents of the general partnership will also apply to the limited partnership insofar as the general partners are concerned. As far as the limited partners are concerned, their withdrawal pursuant to agreement or transfer of their interest will not work dissolution of the firm. A limited partner may legally demand a dissolution, however, if after notice and without injury to the claims of creditors, the return of his investment is not forthcoming.

Other forms of partnership are the following:

1. The joint venture modified as to (a) limitation of existence for a single undertaking or specified period, and (b) centralized authority in the manager.
2. The mining partnership modified as to (a) coownership only as to profits, tenancy in common of the individuals as to the mine, (b) possibility of issuance of stock for transferable ownership interests in the mine; (c) no general agency authority in each of the partners to bind the partnership within the scope of the business, a manager usually having limited authority for necessary labor, supplies, etc.; and (d) personal liability of partners for firm debts incurred while they were owners or until notice of retirement is given to creditors.
3. The limited partnership association modified as to (a) formal organizational procedure, akin to that of the corporation, including organization tax; (b) legal entity for the firm so that limited liability applies; (c) division of the capital into shares of stock; (d) election by the shareholders of a board of managers or directors akin to that of the corporation; (e) transferability of stock subject to the requirement that new shareholders must be accepted by a majority of the existing stockholders in order to vote. Should the new shareholder be denied election, he may, pursuant to law, demand the purchase of his shares by the association, either by negotiations or pursuant to appraisal by court-appointed appraiser. This requirement for cash might prove embarrassing to the liquidity of the firm. Like the limited partnership and corporation, the limited partnership association is a creature of statute of the home state and will not have freedom of movement as such into other states. Only four states provide for this variation of the partnership, with their own variations of the form in each case.

Partnerships are treated as separate accounting entities from the partners. A partner's capital interest in a partnership is a claim against the net assets of the partnership as reflected in the partner's capital account. A partner's interest in profit and loss determines how the partner's capital interest changes as a result of subsequent operations.

Advantages associated with the partnership form of business organization include the ease of formation and dissolution, its ability to pool capital and personal talents and skills, its nontaxable status for income tax purposes, and the relative freedom and flexibility partners enjoy in business matters. Disadvantages of

partnerships include their limited life, the ability of a partner to commit the partnership in contractual matters, the unlimited personal liability of partners, and the difficulties of raising large sums of capital and of transferring ownership interests as contrasted with the corporate form of business organization.

A person may become a partner in an existing partnership by purchasing an interest from one or more of the existing partners and by investing cash or noncash assets in the partnership. A person can be admitted to a partnership only with the consent of all continuing partners in the new partnership enterprise.

The tax bases for assets contributed by the partners to the partnership are the same tax bases that applied to the individual partner making the contribution. The tax basis of a partner's interest in capital of a partnership is the sum of the tax bases of the assets contributed by the partner, increased by the personal liabilities of other partners which the partner assumes, and decreased by the partner's personal liabilities assumed by other partners. The sum of the tax bases of the partnership assets equals the sum of the tax bases of the partners' separate interests in capital.

Summary. Numerically, business firm population in the United States is about 80% simple proprietorships, with 10% partnerships and 10% corporations. Corporations account for the bulk of business assets, sales, and employment in the aggregate. This reflects their advantages for assembling large aggregations of capital. The partnership form is required in some states for firms involved with professional responsibility of a personal nature to clients. Law and accounting firms are often formed as partnerships.

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PAR VALUE Face value or nominal value.

Bonds. The PAR or face value of a bond is the principal amount (DENOMINATION) at which the obligor (issuing corporation) contracts to redeem the bond at maturity. It is also the basis upon which the cash interest rate on the bond is computed. Although bonds are usually originally issued at an interest rate sufficiently attractive to assure their sale approximately at par or at slight discount, they will subsequently fluctuate in accordance with the trend of money rates and yields (if high-grade) and general business conditions (if second-grade or speculative) and earnings available for charges of the issuer. Whether a bond commands an open market premium or discount, the closer it approaches maturity, the closer the market value should approximate the par value, unless there is serious question about the ability to repay or refund by the issuer. At the date of maturity, it should be worth precisely par, since that is its redemption value. In the United States, business corporation bonds are usually issued in denominations of $1,000, although $500 and $100 denominations are not infrequent. Higher denominations such as $5,000 and $10,000 occur in relatively fewer instances, designed for institutional investors.

Stocks. The par or face value of shares of stock is not uniform, although $100 was formerly the most common par value. Shares may be given any specified par value, e.g., $50, $25, $10, and even smaller or odder denominations especially as the result of split-ups. In speculative enterprises, such as in the oil and mining industries, the par value of shares is usually small, and in turn the number of shares on a given dollar amount of capital is large. This is done in order to attract a wider market than would be possible if shares were of higher par value and hence there were fewer shares on a given dollar amount of capital, resulting in higher per-share figures for earnings, asset value, dividend (if any), and market price. In many states shares may be issued without par value, in which cases the shares are assigned a stated or declared value for purposes of the capital stock account. In relatively rarer cases, par value of business corporations may be a multiple of $100, e.g., $500, $1,000, etc.; this may be done by privately owned or closely held corporations to restrict the number of holders. The significance of par value is that it must be fully paid (in the case of business corporations, issuable for cash, property, or services) in order that the stock may attain nonassessable status (limited liability). In the case of no par value shares, the subscription price must similarly be fully paid, even though the stated or declared value may be a fraction of the subscription price. But the subscription price on subsequent issues may be varied flexibly in line with market conditions as compared with the rigid par value requirement in the case of par value shares.

The treasury stock device in connection with the promotion of new speculative enterprises has been rendered obsolete by no par value shares and by fractional par values (something less than $100). That device would call for issuance of stock to the promoter for his services (subject to a test of reasonableness of the value thereof) at full par value. Next, the promoter would then donate back to the corporation a portion of his holdings, allowing the corporation thereafter to sell the treasury stock thus donated at any price to investors in the speculative venture, such resold treasury stock being entitled to fully paid and nonassessable status (having been originally issued at full par value). Thus the new corporation would be able to raise cash needed for the venture.

See WITHOUT PAR VALUE STOCK.

PASS A DIVIDEND When a board of directors omits to declare a regular or expected dividend, it is said to pass a dividend.

PASSBOOK A bank book; a book in which deposits, or deposits and withdrawals, are recorded. Passbooks are provided for both commercial and savings accounts. In commercial checking accounts the passbook is merely a memorandum of deposits. It is neither a book of original entry nor a statement of account. The DEPOSIT SLIP is the original entry and the important record from a legal point of view. Unlike the savings bank passbook, the nonsavings account passbook is not a contract. Entries should not be considered as absolute receipts admissible as court records, but rather as acknowledgments of receipts of deposits corresponding in amount to the footing of the accompanying deposit slips. It is not necessary to present a passbook when making deposits in a commercial checking account. It is only necessary to fill out a deposit slip, a duplicate being rendered if desired. The acceptance of a deposit for absolute receipt and credit, except for cash, is usually conditional upon the collection and payment of such deposit. Deposits of checks, in other words, are subject to final payment and therefore to cancellation of credit for such portions as may be returned unpaid.

In order that commercial depositors may understand the purpose of a passbook and the conditions under which deposits are accepted, a notation such as the following should be imprinted on the flyleaf.

> This passbook is issued for the convenience of customers and is intended for a record of deposits only. It is not a book of original entry, nor a statement of account. Statements of account will be rendered monthly.
>
> All items, other than money, are subject to cancellation of credit if not paid on presentation. It must be understood that the liability of the bank is limited to the observance of due diligence in selecting its immediate correspondents for the presentation and collection of items in this city and elsewhere and that the endorsement "Pay to any bank or banker," or its equivalent, shall not exceed such liability, and this bank will not be responsible for loss of any kind due to the acts of negligence of such correspondents in the selection of subagents for presentation and collection, etc., or for loss in or through the mails, or for any failure to present, demand, or collect on any Saturday or holiday.

The status of a savings account passbook is legally very different from that issued for a checking account. In savings bank practice, it is used as a voucher or receipt, both for money deposited and for money withdrawn. It must be presented whenever a deposit or withdrawal is made, and periodically for the credit of interest