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Assessing the Limited Liability Company

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The limited liability company is one of the newest forms of business organization. This form combines the limited liability of a corporation with the tax benefits normally associated with a partnership. The authors examine various implications and ramifications of this organizational form.

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INTRODUCTION

IN 1977 THE Wyoming legislature authorized the creation of a new form of business organization known as the limited liability company ("LLC").[1] Florida subsequently adopted the LLC with legislation patterned after Wyoming's statute.[2] The LLC legislation in each state combined limited partnership and corporate provisions drawn primarily from the Uniform Limited Partnership Act ("ULPA")[3] and the Model Business Corporation Act ("MBCA").[4]

From a business planning standpoint, the LLC was created to secure both the federal income tax advantages associated with partnership status[5] and state law limited liability for all participants in the venture.[6] These advantages indirectly presented potential benefits to states permitting the organization of LLCs. The Wyoming legislators were reportedly interested in pioneering the new investment vehicle to lure business to their state. In addition, Wyoming hoped to reap associated benefits from acting as the national haven for "tramp" LLCs that would bring their activities, or at least their organizational activities, to Wyoming in order to avail themselves of the LLC statute.[7] The Florida statute was sim-

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1. *See* WYO. STAT. §§ 17-15-101 to -136 (1977).
2. *See* FLA. STAT. §§ 608.401-471 (Supp. 1989).
3. UNIF. LTD. PARTNERSHIP ACT, 6 U.L.A. 561 (1916).
4. MODEL BUSINESS CORP. ACT (1969) (the 1969 version of the MBCA is cited where the MBCA is compared with the Wyoming LLC since the 1969 version was in effect when Wyoming drafted its LLC statute).
5. *See infra* text accompanying notes 349-56.
6. *See infra* text accompanying notes 61-78.
7. The Wyoming statute requires LLCs to maintain a registered office and registered agent in the state. *See* WYO. STAT. § 17-15-110 (1977). The registered office "may be, but need not be, the same as its place of business." *Id.* The Wyoming statute also requires that the articles of organization list "[t]he address of its principal place of business in the state and the name and address of its registered agent in the state " *Id.* § 17-15-107(a)(iv). While operations need not be conducted in Wyoming, a place of business must be maintained:

> Since the Act does not require that operations be conducted within the State of Wyoming (the Act merely provides that a place of business and a registered agent be maintained in the State) it was anticipated that interest in this form of entity would be generated in all parts of the U.S. as occurred in response to the attractiveness of the corporation laws of Delaware or Nevada for the organization of corporate enterprises. The state would benefit through the generation of revenues from the modest filing fees provided in the Act and the additional business activity which would be generated through the organization of companies under the Act and maintenance of nominal places of business and registered agents in the state by such companies.

Burke & Sessions, *The Wyoming Limited Liability Company: An Alternative to Sub S*

ilarly intended to attract business investment, especially from Latin America.[8]

The Treasury Department frustrated the realization of these anticipated benefits by its inconsistent treatment of the partnership tax classification issue as it applied to the LLC.[9] This inconsistency yielded uncertainty, and consequently few LLCs were formed, leaving Wyoming and Florida as the sole sponsor states.[10]

In 1988, however, the Internal Revenue Service ("I.R.S.") issued Revenue Ruling 88-76, favorably classifying a Wyoming LLC as a partnership for federal income tax purposes.[11] This pronouncement has renewed interest in the LLC.[12] In addition, Colorado and Kansas have recently enacted statutes authorizing the creation of LLCs,[13] and Indiana has provided for the registration of LLCs from other jurisdictions.[14] Like all tax conduit entities,

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and Limited Partnerships?, 54 J. TAX'N 232, 235 (1981).

Section 12(a) of the MBCA also provides that the registered office "may be, but need not be, the same as its place of business." MODEL BUSINESS CORP. ACT § 12(a) (1979). The confusion created by Wyoming's statute is avoided because the articles of incorporation are not required to set forth the corporation's place of business. Only the address of its initial registered office is required. *See id.* § 54(i). An LLC statute enacted in Colorado, for example, requires only that the articles of organization state "if known, [the LLC's] principal place of business." COLO. REV. STAT. § 7-80-204(1)(a) (Supp. 1990).

8. Comment, *The Limited Liability Company Act*, 11 FLA. ST. U.L. REV. 387, 387 (1983) ("The LLC is similar to a business organization called the *limitada* which exists in [Latin America]. It was thought that having a familiar business organization would attract foreign investment." (footnote omitted)).

9. For an account of the Treasury's treatment of the LLC, see *infra* text accompanying notes 301-48.

10. Two LLCs were reportedly formed under Florida law in the year following adoption of the enabling legislation. *See* Comment, *supra* note 8, at 388. As of February 22, 1988, only 26 Wyoming LLCs had been formed. *See* Comment, *The Wyoming Limited Liability Company: A Viable Alternative to the S Corporation and the Limited Partnership?*, 23 LAND & WATER L. REV. 523, 523 (1988) (discussing the tax status and liability protection aspects of the LLC form as adopted in Wyoming).

11. *See* Rev. Rul. 88-76, 1988-2 C.B. 360.

12. *See, e.g.*, August & Shaw, *The Limited Liability Company - A New Tax Refuge?* 7 J. TAX'N INVESTMENTS 179 (1990) (discussing the history, structure, and tax implications of the LLC as an organizational form); Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 FLA. L. REV. 721 (1989) (discussing settlement of the tax status of an LLC following the categorization of the entity as a partnership in Revenue Ruling 88-76); Lederman, *Miami Device: The Florida Limited Liability Company*, 67 TAXES 339 (1989) (discussing the ease with which an LLC could be classified as a partnership under Revenue Ruling 88-76).

13. *See* Colorado Limited Liability Company Act, COLO. REV. STAT. § 7-80-101 (Supp. 1990); Kansas Limited Liability Company Act, KAN. STAT. ANN. § 17-7601 (Supp. 1990). LLC legislation has also been introduced in Michigan, House Bill No. 5464, 85th Leg., 2d Sess. (1990), *reprinted in* 22 Sec. Reg. & L. Rep. (BNA) 401 (March 16, 1990).

14. *See* IND. CODE ANN. §§ 23-16-10.1-1 to -10.1-4 (Burns Supp. 1990).

the LLC indirectly benefitted from the Tax Reform Act of 1986, which significantly increased the income tax cost of doing business as a regular corporation.[15] As discussed later in this article, the federal income tax advantages of the LLC, coupled with limited liability for all participants, may render the LLC the most desirable tax conduit entity.[16] The LLC may be viewed as a survivor of the continuing controversy over the appropriate classification of entities for federal income tax purposes.

Characterization as a partnership, for federal tax purposes, is not a goal shared by all taxpayers. At first blush, the largely income tax driven, state level motivation for the enactment of LLC legislation and its utilization over a thirteen year period invites comparison to the development of the professional corporation ("PC"). With respect to the PC, the taxpayer's primary objective was corporate classification. After almost twenty years of controversy, the I.R.S. finally capitulated and every state now has some form of legislation permitting PCs. The policy considerations underlying PCs and LLCs, however, differ significantly Hence, the LLC may not follow the PC's course.[17] Ironically, after favorable

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15. *See* Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified as amended in scattered sections of 26 U.S.C.). For example, this act eliminated the so-called "General Utilities" exemption for gains realized on the sale of corporate assets, strengthened the corporate alternative minimum tax, phased out the long-term capital gains tax preference, and prescribed corporate tax rates that, at their highest point, exceeded the highest individual tax rates, even before consideration of the established regime of "double taxation" of corporate income. For a discussion of the technical aspects of the changes, see Friedrich, *The Unincorporation of America?*, 14 J. CORP. TAX'N 3 (1987) (explaining how changes wrought by the Tax Reform Act of 1986 have made the regular corporation an endangered form). For a discussion of the policy implications of this penalty on regular corporations, see Zolt, *Corporate Taxation After the Tax Reform Act of 1986: A State of Disequilibrium*, 66 N.C.L. REV. 839 (1988) (contending that the changes imposed on corporations upset the balance between the individual and corporate tax systems and that the resulting "disequilibrium" has produced many unexpected and undesirable consequences for corporations).

16. *See infra* text accompanying notes 385-405.

17. Traditionally, licensed professions were limited to the sole proprietor and partnership forms and prohibited from incorporating. However, the corporate form offered certain tax advantages, particularly in the area of employee benefits. The states responded with legislation permitting the formation of professional corporations and associations. The I.R.S. opposed attempts to utilize these state laws for the purposes of federal tax characterization. After several courts rejected its position, the I.R.S. recanted and approved the state classification of professional corporations. *See* Philipps, McNider & Riley, *Origins of Tax Law: The History of the Personal Service Corporation*, 40 WASH. & LEE L. REV. 433, 441 (1983) (discussing the various disputes between the I.R.S. and taxpayers seeking PC status ultimately resulting in the taxpayers' victory). For a summary of the tax advantages and disadvantages of professional corporations, see Dodd, *Professional Corporations: Planning Problems*, 6 GONZ. L. REV. 1 (1970); Malone, *Professional Corporations - A Current Ap-*

classification of PCs, many of the anticipated benefits were lost in subsequent amendments to the Internal Revenue Code.[18] State law issues aside, the degree of tax advantage it will provide, as compared with regular corporations, will determine the viability of the LLC as an organizational form.

This article seeks to:

1. examine certain significant state law issues concerning the structure and operation of the LLC as organized in Wyoming, Florida, Colorado, and Kansas;

2. discuss briefly the federal income tax classification of the LLC;

3. examine the overall advantages and drawbacks of the LLC in order to evaluate the prospects for widespread adoption of this form of doing business; and

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praisal, 23 ARK. L. REV. 215 (1969).

Not all the benefits of PC status are related to taxation. In Colorado, for example, attorney shareholders are not vicariously liable for the legal malpractice of their fellow shareholders as long as prescribed professional liability insurance is maintained. *See* COLO. SUP. CT. R. 265, *reprinted in* COLO. REV. STAT. ch. 22 (1973) (establishing the guidelines within which lawyers may form and operate a professional service corporation). LLCs present different considerations from those of the professional corporation. For example, regulation of licensed professionals is a fundamental prerogative of the state in which the professional practices. Multijurisdictional effects are secondary, and a state can take action without cooperation from other states. As discussed in this article, questions about the status of the LLC in jurisdictions outside its state of formation may initially impede its use in foreign jurisdictions until more states enact legislation expressly addressing the LLC. *See infra* text accompanying notes 218-64. Moreover, allowing highly regulated individuals circumscribed flexibility in choosing their organizational form has only a limited impact on persons outside the profession. By contrast, the LLC carries broad implications as a new limited liability vehicle available to all who actively conduct, or wish to organize, a business, supplanting longstanding forms of business organization such as the S corporation and the limited partnership.

18. The Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982) (codified as amended in scattered sections of 26 U.S.C.) [hereinafter "TEFRA"], eliminated much of the disparity between corporate employee plans and self-employed plans. Philipps, McNider & Riley, *supra* note 17, at 435-36. In addition, TEFRA enacted I.R.C. § 269A, which further limits the tax avoidance potential of personal services corporations. *Id.* at 454-56 (outlining the provisions in the Internal Revenue Code that give the I.R.S. flexibility in determining how income and deductions are allocated in order to prevent tax avoidance by PCs); *see* Halliday, *The Advantages and Disadvantages of Professional Corporations and Partnerships After TEFRA*, 8 REV. OF TAX'N OF INDIVIDUALS 23 (1984) (discussing the advantages and disadvantages of PC and partnership status and exploring various alternatives available if a PC chooses to liquidate). The Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified as amended in scattered sections of 26 U.S.C.), changed matters further by (1) establishing a maximum individual income tax rate that was less than the highest corporate rate; (2) taxing personal services corporations at only the highest corporate rates without benefit of the lower bracket rates; and (3) requiring the use of the calendar year as the taxable year in most cases.

4. consider some problems and unanswered questions presented by the application of traditional federal partnership income tax principles to an LLC.

I. STRUCTURE AND OPERATION

A. The Partnership Association — Precursor to the LLC

The limited partnership association is the LLC's predecessor in the United States.[19] In 1874 Pennsylvania[20] took the lead, which Michigan,[21] New Jersey,[22] and Ohio[23] followed several years later, in creating the "limited partnership association," or "partnership association," an entity roughly equivalent to a general partnership with limited liability for all members.

The United States had no federal income tax at the time these statutes were enacted.[24] Thus, unlike the LLC, the partnership association was not created for tax advantages. One purpose of the limited partnership association was to create a simpler alternative to the corporation.[25] Another motive was avoidance of restrictive corporate shareholder liability requirements.[26]

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19. For a detailed history of the limited partnership association, see Schwartz, *The Limited Partnership Association - An Alternative to the Corporation for the Small Business with "Control" Problems?*, 20 RUTGERS L. REV. 29 (1965). Virginia enacted partnership association legislation in 1874 only to repeal it in 1918. *Id.* at 29 n.3.

20. The Pennsylvania statute was repealed in 1970. *See* PA. STAT. ANN. tit. 59, § 341 (Purdon 1964), *repealed by* Act of Dec. 21, 1988, Pub. L. 1444, No. 177, § 302(e)(1) (effective Oct. 1, 1989).

21. *See* MICH. COMP. LAWS § 449.301 (1979).

22. *See* N.J. STAT. ANN. § 42:3-1 (West 1940 & Supp. 1990). As of September 21, 1988, no new limited partnership associations may be formed in New Jersey. *Id.* § 42:3-1.

23. *See* OHIO REV. CODE ANN. § 1783.01 (Anderson 1985).

24. The Pennsylvania statute was enacted in 1874, the Michigan statute in 1877, the New Jersey statute in 1880, and the Ohio statute in 1881. Schwartz, *supra* note 19, at 30-31. These enactments fell between the Civil War income tax, which was repealed in 1872, and the 1894 income tax. *See, e.g.*, S. SURREY, P. MCDANIEL, H. AULT & S. KOPPELMAN, FEDERAL INCOME TAXATION 1-17 (1986) (historical account of the development of federal income tax).

25. *See* Schwartz, *supra* note 19, at 31 (indicating that the primary motive for enacting New Jersey's statute was dissatisfaction with the complicated requirements for forming a corporation).

26. *Id.* at 32. Pennsylvania's legislature passed a corporation statute and a separate partnership association statute in 1874. The corporation statute subjected shareholders to personal liability (in an additional amount equal to their stock subscriptions) for all labor and materials furnished to carry on the operations of the corporation. The double liability aspects of the corporation statute reportedly reflected the views of anticorporation legislators. These legislators, however, were rebuffed by the partnership association statute which limited personal liability to the share subscription amount. *See* E. WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION 508-14 (1929).

After the income tax became a consideration, the I.R.S. classified limited partnership associations created under Ohio[27] and Pennsylvania[28] law as associations taxable as corporations. However, a limited partnership association formed under the Michigan law was accorded partnership status.[29] Aside from its uncertain classification for income tax purposes, the partnership association suffered from state law restrictions, such as a limitation on the number of members and the effective confinement of its principal business activities to the state of formation.[30] In any event, the limited partnership association withered in the United States after being specifically prohibited by law in Pennsylvania and New Jersey,[31] while the concept of an unincorporated limited liability association continued to develop abroad.[32]

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27. *See* Rev. Rul. 71-434, 1971-2 C.B. 430, 431-32 (if an association has the corporate characteristics of continuity of life, limited liability, and centralized management, it has sufficient corporate characteristics to justify classification as a corporation for federal income tax purposes). In Giant Auto Parts, Ltd. v. Commissioner, 13 T.C. 307 (1949), the Tax Court held that a limited partnership association formed under Ohio law was to be taxed as a corporation because the organization provided limited liability to participants, free transferability of interests subject to a first right of refusal, and centralized management. The treasury regulations recognize partnership associations and state that such associations will be treated as corporations if they more nearly resemble a corporation. Treas. Reg. § 301.7701-3(c) (1960).

28. *See* Rev. Rul. 71-277, 1971-1 C.B. 422, 423 (if an association has the corporate characteristics of centralized management and free transferability of interests, it has sufficient corporate characteristics to be taxed as a corporation for federal income tax purposes).

29. *See* Priv. Ltr. Rul. 75-05-290-310A (May 29, 1975).

30. Under all of the partnership association statutes, the association had to maintain its principal place of business in the state of creation. *See* MICH. COMP. LAWS § 449.301 (1979); N.J. STAT. ANN. § 42:3-1 (West 1940 & Supp. 1990); OHIO REV. CODE ANN. § 1783.01 (Anderson 1985); PA. STAT. ANN. tit. 59, § 341 (Purdon 1964), *repealed by* Dec. 21, 1988, P.L. 1444, No. 177, § 302(e)(1) (effective Oct. 1, 1989). Under the Ohio statute, membership was not permitted to number less than three or more than twenty-five persons. *See* OHIO REV. CODE ANN. § 1783.01. One commentator concluded that:

> the limited partnership association affords a promising vehicle for the small, relatively localized business having few active participants, each of whom desires the type of control usually available only through the partnership form. For [these] persons engaging in substantial multi-state transactions, the uncertainties as to how such partnership associations will be treated by out-of-state courts and regulatory agencies unfamiliar with this statutory form of doing business may militate against its use.

Schwartz, *supra* note 19, at 88.

31. *See supra* notes 20 & 22. "[The limited partnership association's] importance to the field of partnership, never decisive, may be expected to continue to decline." H. REUSCHLEIN & W GREGORY, THE LAW OF AGENCY AND PARTNERSHIP § 265 (2d ed. 1990).

32. The aspect of limited liability for all members of an association is found in a number of foreign organizations, including the Latin American *limitada* and the German

B. The LLC Statutory Schemes

Wyoming enacted the nation's first LLC legislation.[33] Although drawn primarily from the ULPA and the MBCA, Wyoming's statute also contains several provisions apparently adapted from the partnership association statutes.[34] Florida's statute, for the most part, closely follows the Wyoming model. Kansas's statute in turn resembles Florida's statute with some modifications.[35]

Gesellschaft mit beschrenkter Haftung (GmbH). For a discussion and comparison of Central American forms of business entities, including the *limitada*, see Gordon, *Joint Business Ventures in the Central American Common Market*, 21 VAND. L. REV. 315 (1968).

The I.R.S. has held that local law of the foreign jurisdiction is to be applied in determining the legal relationship of the members of an organization, among themselves, and with the public at large, as well as the interests of the members of the organization in its assets. Rev. Rul. 73-254, 1973-1 C.B. 613. Moreover, an entity organized under foreign law is classified for federal tax purposes solely on the basis of the characteristics set forth in section 301.7701-2 of the regulations. Rev. Rul. 88-8, 1988-1 C.B. 403.

The tax entity classification of a *limitada* utilized by U.S. taxpayers for a cotton farming operation in Mexico was at issue in Elot H. Rafferty Farms, Inc. v. United States, 511 F.2d 1234 (8th Cir. 1975) (*limitada* treated as a corporation). The *limitada* and *GmbH* have been found taxable as partnerships in several private letter rulings, except where multiple interests in the entity are held by related parties. *See* Rev. Rul. 77-214, 1977-1 C.B. 408 (*GmbH* classified as an association taxable as a corporation because sole interest holders were wholly owned subsidiaries of a common parent); Priv. Ltr. Rul. 90-10-028 (Dec. 7, 1989) (*GmbH* classified as a partnership); Priv. Ltr. Rul. 90-01-018 (Oct. 6, 1989) (*GmbH* classified as a partnership); Priv. Ltr. Rul. 80-03-072 (Oct. 25, 1979) (Brazilian *limitada* classified as a partnership); Priv. Ltr. Rul. 78-41-042 (July 14, 1978) (Brazilian *limitada* classified as a partnership); Tech. Adv. Mem. 84-01-001 (June 16, 1983) (Brazilian *limitada* classified as an association taxable as a corporation because sole interest holders were wholly owned subsidiaries of a common parent). *But see* MCA, Inc. v. United States, 685 F.2d 1099 (9th Cir. 1982) (an entity owned by a subsidiary corporation and a related employee trust for the benefit of the subsidiary's top directors found not to be an association); Priv. Ltr. Rul. 82-43-193 (July 29, 1982) (participants under common control issue not raised in context of entity comprised of two wholly owned subsidiaries of a U.S. parent company).

33. *See supra* text accompanying note 1.

34. Some of the Wyoming LLC name provisions were apparently drawn from the partnership association statutes. For a detailed history of the LLC statutes, refer to the comparative chart of LLC statutes set forth as an appendix to this article. *See infra* pp. 472-501.

35. Kansas's statute made several improvements to Florida's statute. It permits the use of names that would otherwise be deceptive, with distinguishing alterations, provided that the written consent of the other corporation, limited partnership, or LLC is obtained. *See* KAN. STAT. ANN. § 17-7606 (Supp. 1990). A minimum of 10 days' written notice of member meetings is required. *See id.* § 17-7613(b). The procedure for calling special meetings of members is specified, member actions by writing without a meeting are expressly recognized, written proxies are recognized, and the offices of president and secretary are required. *See id.* Certificates that are required to be filed, such as articles of organization and amendments, may be executed by an attorney-in-fact, and execution constitutes an oath, under penalties of perjury, that the facts stated in the certificates are true and that any power of attorney is in proper form and substance. *See id.* § 17-7634. Restated and

Colorado's statute represents the greatest departure from Wyoming's legislation, adopting a number of procedural refinements. As additional states adopt LLC statutes, such statutes will likely continue to follow the fundamental provisions of Wyoming's statute in order to align themselves with Revenue Ruling 88-76, which classified an LLC formed under Wyoming law as a partnership.[36] On the other hand, procedural requirements need not be slavishly duplicated by other jurisdictions because they are not critical to the federal income tax classification of the LLC entity A chart comparing the significant differences between the statutory provisions currently in effect in Wyoming, Florida, and Colorado is set forth as an appendix to this article.[37] The Kansas statute is omitted for the sake of brevity and because it closely resembles Florida's LLC law The appendix provides a detailed outline of the statutory requirements for an LLC, including such matters as formation, operation, dissolution, and the apparent origin of the provisions. Consequently, the following discussion focuses on the substantive aspects of selected provisions of the state statutes and will not repeat the information set forth in the appendix.

1. Formation

In Wyoming two or more persons must sign and deliver articles of organization to the Secretary of State to form an LLC.[38] This requirement differs from the MBCA which requires only "one or more" incorporators.[39] Wyoming's corporation statute, in effect at the time of enactment of the LLC legislation, also required only one incorporator.[40] A comparison of the Wyoming

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amended articles of organization are expressly recognized. *See id.* § 17-7635. Finally, registration of foreign LLCs is permitted, *see id.* §§ 17-7636 to -7644, annual LLC reports are required, *see id.* §§ 17-7647 to -7649, and the merger of LLCs is permitted, *see id.* § 17-7650.

36. *See infra* text accompanying notes 313-33 (discussing Rev. Rul. 88-76).

37. *See infra* pp. 472-501.

38. "Two (2) or more persons may form a limited liability company by signing, verifying and delivering in duplicate to the secretary of state articles of organization for such limited liability company." WYO. STAT. § 17-15-106 (1977). The Florida and Kansas provisions are nearly identical. *See* FLA. STAT. § 608.405 (Supp. 1989); KAN. STAT. ANN. § 17-7605 (Supp. 1990). The term "person" includes individuals, general and limited partnerships, LLCs, corporations, trusts, business trusts, real estate investment trusts, estates, and other associations. *See* WYO. STAT. § 17-15-102(a)(iv).

39. MODEL BUSINESS CORP. ACT § 53 (1969).

40. WYO. STAT. § 17-1-201 (repealed 1989).

corporation and LLC statutory requirements suggests that inclusion of the multiple organizer requirement for the LLC was therefore purposeful and not a return to early corporation statutes, which often required three or more incorporators for a single shareholder corporation.[41] Such corporate statutes which imposed a multiple organizer requirement were frequently circumvented through the use of "dummy" incorporators who had no function other than satisfying the statutorily imposed formalities.[42] Although Wyoming's legislature acted purposefully in adopting a multiple organizer requirement for its LLC statute, the LLC formation requirement could nevertheless be avoided, like its corporate ancestor, if the LLC statute did not require the existence of two or more members at all times. While the term "members" is used elsewhere in Wyoming's statute, there is no express requirement that an LLC have two or more members, except to comply with the formation requirement. The Florida and Kansas statutes suffer from the same uncertainty

This is a significant issue. The corporate multiple organizer requirement, which did not impede single shareholder corporations, is unlike the Uniform Partnership Act ("UPA"),[43] which defines a partnership as "an association of two or more persons."[44] If the LLC formation requirement serves a purpose similar to the UPA definition, requiring at least two members at all times, rather than serving the formalistic multiple organizer purposes of outdated corporate law, a partnership flavor is created that differentiates the LLC from corporations, which can have a sole shareholder[45] and, in some cases, a sole director.[46]

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41. *See, e.g.*, MODEL BUSINESS CORP. ACT § 47 (1960) ("Three or more natural persons of the age of twenty-one years or more, may act as incorporators of a corporation "). By 1960 only eight jurisdictions permitted incorporation by less than three incorporators. *See* MODEL BUSINESS CORP. ACT ANN. ¶ 2.02(1) (1960).

42. "Dummy" incorporators promoted the interests of individuals wishing to incorporate their business and existing corporations seeking to form a subsidiary. This charade was possible since the incorporator served only a ritualistic purpose having no significant or lasting effect upon the entity created. *See* MODEL BUSINESS CORP. ACT ANN. § 53 ¶ 2 comment (2d ed. 1971); H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS § 135 (1983). Pennsylvania's partnership association requirement of at least three members was held to be mandatory, prohibiting the use of dummy members. *See* Sturgeon v. Apollo Oil & Gas Co., 203 Pa. 369, 53 A. 189 (1902).

43. UNIF. PARTNERSHIP ACT, 6 U.L.A. 1 (1914).

44. *Id.* § 6(1).

45. *See, e.g.*, REVISED MODEL BUSINESS CORP. ACT § 1.42 (1984).

46. *See id.* § 8.03(a) ("A board of directors must consist of one or more individuals ").

Colorado's LLC statute permits "one or more" natural persons, eighteen years of age or older, to organize an LLC by executing and filing the articles of organization.[47] In effect, this requirement adopts the corporate distinction between nonshareholder incorporators and shareholders, since LLC organizers need not be "members" of the LLC after formation.[48] However, a Colorado LLC is required to "have two or more members at the time of its formation,"[49] and the context of the statute as a whole suggests that there must be at least two members at all times.[50]

The requirement of two or more members prevents the use of the LLC by sole proprietors seeking limited liability without the complications presented by token co-owners or tiered ownership structures.[51] Although no I.R.S. pronouncement addresses this consideration, the LLC requirement of two or more participants was probably intended to support classification of the LLC as a partnership for federal tax purposes.[52]

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47. *See* COLO. REV. STAT. § 7-80-203(1) (Supp. 1990) (formation requirement); *id.* § 7-80-205 (execution and filing of articles of organization). The other LLC statutes refer to "persons" who may organize an LLC but do not expressly limit organizers to "natural" persons. *See infra* note 153 (comparison of the statutory definitions of the term "person").

48. *See* COLO. REV. STAT. § 7-80-203(1). Colorado's statute borrows from the REVISED UNIF. LTD. PARTNERSHIP ACT § 204(c), 6 U.L.A. 291 (1985), in stating that the execution of the articles of organization constitutes an affirmation of the signatory, under penalty of perjury, that the facts stated therein are true. *See* COLO. REV. STAT. § 7-80-203(1). Drawing from RULPA § 204(b), the statute also permits execution of the articles of organization under a written power of attorney. *See id.* § 7-80-203(1).

49. COLO. REV. STAT. § 7-80-203(2).

50. The two member requirement derives from considering together the requirement that there be two or more members upon formation, *see* COLO. REV. STAT. § 7-80-203(2), and the provision that dissolution occurs upon a member's death, bankruptcy, expulsion, or resignation, unless there are at least two remaining members and all members consent to continue the LLC, *see id.* § 7-80-801(1)(c). *Compare* Treas. Reg. § 1.708-1(b)(1)(i)(a) (1956) (providing that termination of a two person partnership does not occur upon the death of one partner until the deceased partner's interest is liquidated).

51. For example, a sole proprietor could possibly create an entity to hold one of the two required LLC interests. Even assuming that the additional expense associated with multiple entities can be justified, such a course would draw the income tax classification of the LLC into question. *See infra* note 344 and accompanying text (discussing the single economic interest theory).

52. "The term 'partnership' is broader in scope than the common law meaning of partnership and may include groups not commonly called partnerships." Treas. Reg. § 301.7701-3(a) (1967). The use of the term "group" seems to indicate multiple participants. *Compare* Treas. Reg. § 1.708-1(b)(1)(i)(a) (suggesting that, for tax purposes, except for a suspended period for liquidation of a deceased partner's interest, the two person partnership terminates upon the death of one partner). Although two or more participants may be required for tax partnership status, the number of participants has little apparent effect on

2. Stated Period of Duration

All four LLC statutes provide that an LLC cannot endure for a greater period than thirty years,[53] as opposed to the MBCA, which allows perpetual corporate existence.[54] The ULPA certificate is required to state "[t]he term for which the partnership is to exist."[55] The RULPA prescribes no set term for limited partnership duration but instead refers to that date chosen by the partners as the "latest date upon which the limited partnership is to dissolve."[56] The limitation of the duration of an LLC to a term of thirty years could reduce its appeal to the participants of a long-term business undertaking. Although LLC members would arguably not be precluded from agreeing to reform an expiring LLC,[57] the uncertainty attending the statutory limitation on LLC

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an association's status. *See infra* text accompanying notes 276-345. If there are two or more participants, there are "associates," but that factor is common to both partnerships and corporations and would not be determinative of corporate or partnership status. *See* Treas. Reg. § 301.7701-2(a)(2) (1983) (defining a business as including corporations and partnerships for tax purposes). If there were only one participant, the same regulation would still find "associates" due to a parenthetical reference to the "so-called one-man corporation and the sole proprietorship." *Id.* The courts have generally found that one person corporations meet this test. *See* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS § 2.02 n.13 (5th ed. 1987 & Supp. 1989). The statute may also reflect the partnership association's ancestry, which required multiple participants. *See, e.g.*, OHIO REV. CODE ANN. § 1783.01 (Anderson 1985) (requiring at least three members in a partnership association).

53. *See* COLO. REV. STAT. § 7-80-204(1)(b) (Supp. 1990); FLA. STAT. § 608.407(1)(b) (Supp. 1989); KAN. STAT. ANN. § 17-7607(A)(2) (Supp. 1990); WYO. STAT. § 17-15-107(a)(ii) (1977).

54. *See* MODEL BUSINESS CORP. ACT § 54(b) (1969) (allowing the articles of incorporation to designate the corporation's period of duration as perpetual).

55. UNIF. LTD. PARTNERSHIP ACT § 2(1)(a)V (1916).

56. REVISED UNIF. LTD. PARTNERSHIP ACT § 201(a)(4) (1985); *see id.* § 801 (setting forth the events of dissolution, one of which is the passage of "the time specified in the certificate of limited partnership.").

57. All four LLC statutes provide that the period of duration may not exceed 30 years from the date of filing the articles of organization. *See supra* note 53. Because the duration is linked to the filing of the original articles of organization, LLC participants can not subsequently amend the articles to further extend the period of duration. However, it would apparently not violate the letter of the statutes if the members of an expiring LLC agree to formally dissolve the LLC, agreeing, however, to immediately thereafter organize a new LLC to continue the business of the predecessor LLC. The line could be even further blurred in a state like Kansas, which permits mergers of LLCs, *see supra* note 34, because an expiring LLC can be merged into a newly formed LLC, with the latter as the surviving entity. A merger would minimize complications presented by the mechanics of dissolving and reorganizing the LLC, such as asset transfers and liability assumptions. For partnership income tax purposes, a merger of partnerships with identical ownership, but with the older LLC/partnership providing the bulk of the combined assets, would result in a continuation of the older LLC. *See* Treas. Reg. § 1.708-1(b)(2)(i) (1956).

duration represents a disadvantage when compared with the competing corporate or limited partnership alternatives, which are not similarly restricted.[58]

The origin of the LLC's limited duration might lie in the limited partnership association statutes of Michigan, New Jersey, and Ohio, which contained twenty year limitations.[59] The thirty year limitation should be eliminated if it is based on the precedent of limited partnership associations or on misplaced fears of adverse federal income tax entity classification.[60]

3. Liability of Members

a. Broad Exculpation

All four LLC statutes use similar language providing broad liability exculpation to LLC members and managers.[61] The LLC

The phrase "letter of the statutes" warrants emphasis. For partnership income tax purposes, the merger approach will be construed as a continuation of the old LLC. Similarly, the liquidation and immediate reincorporation of a corporate enterprise will often be viewed in substance as a continuation of the liquidated corporation in the nature of a "D" reorganization. For a discussion of the federal income tax of the liquidation reincorporation device, see B. BITTKER & J. EUSTICE, *supra* note 52, § 14.54. It is uncertain whether the income tax concepts would be extended to the LLC state law context to invalidate the successor LLC as a continuation of the dissolving predecessor LLC. For state tort law purposes, a form of continuity of corporate enterprise has been reflected in decisions that hold a successor corporation liable for the product liability of a predecessor's products. *See, e.g.*, Ray v. Alad Corp. 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977) (purchaser of manufacturing assets held liable for product liability claims of predecessor corporation). For a discussion of this issue and extensive citations to authority, see H. HENN & J. ALEXANDER, *supra* note 42, at 967 (a significant factor in liability is whether "the successor is a mere continuation of the predecessor (same shareholders, directors, and officers)").

58. The uncertainty of a future agreement to extend the duration of the LLC could be reduced if, for example, the LLC is comprised solely of limited partnerships. A unanimous vote on this matter would not be required at the limited partnership level, although the limited partnerships would need to unanimously agree on continuation as LLC members. However, tiered ownership structures present some income tax classification uncertainties. *See infra* text accompanying notes 336-45.

59. *See* MICH. COMP. LAWS § 449.301 (1979); N.J. REV. STAT. ANN. § 42:3-2.a.VII (West 1940 & Supp. 1990)); OHIO REV. CODE ANN. § 1783.01 (Anderson 1985). Initially, corporations had limited lives, expiring after 20 years. *See* Weidner, *A Perspective to Reconsider Partnership Law*, 16 FLA. ST. U.L. REV. 1, 28-29 (1988); *see also* Liggett Co. v. Lee, 288 U.S. 517, 548 n.3 (1933) (Brandeis, J., dissenting) (noting that limited 20, 30, or 50 year periods of duration were imposed on corporations in their early stages of development).

60. *See infra* text accompanying notes 334-35.

61. "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 any other manner, for a debt, obligation, or liability of the limited liability company." FLA. STAT. § 608.436 (Supp. 1989). Wyoming's statutory lan-

statutory language is clearer than the exemption expressed in the MBCA[62] and broader than the RMBCA.[63] A corporate shareholder, however, may be subject to personal liability if a court decides to "pierce the corporate veil."[64]

b. Piercing the Corporate Veil Doctrine — LLC Applications

A limited partner is not liable to creditors unless the limited partner takes part in the management or control of the business.[65] Under the RULPA, a limited partner can engage in specified activities without incurring personal liability for partnership obligations.[66] An individual seeking active participation[67] in a new busi-

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guage is identical. *See* WYO. STAT. § 17-15-113 (1977). The Kansas statute is identical except that it also refers to officers of the LLC. *See* KAN. STAT. ANN. § 17-7620 (Supp. 1990). Colorado's statute varies slightly due to a difference in the authority of managers. *See* COLO. REV. STAT. § 7-80-705 (Supp. 1990) (containing language similar to the Wyoming and Florida statutes, deleting only the phrase "managed by a manager or managers").

62. *See* MODEL BUSINESS CORP. ACT § 25 (1969). Some of the LLC statutes also provide for member liability with respect to unpaid capital contributions and returns of capital. *See* FLA. STAT. § 608.435 (Supp. 1989); WYO. STAT. § 17-15-121 (1977).

63. *See* REVISED MODEL BUSINESS CORP. ACT § 6.22(b) (1984) (potential liability by reason of a shareholder's own acts or conduct).

64. For some of the cases and literature on this doctrine, see Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371 (1981); Hackney & Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837 (1982); Krendl & Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DEN. L.J. 1 (1978).

65. UNIF. LTD. PARTNERSHIP ACT § 7 (1916); REVISED UNIF. LTD. PARTNERSHIP ACT § 303 (1985).

66. *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 303(b).

67. The degree of activity of corporate shareholders is a factor in disregarding the corporate form and assessing personal liability. "The courts have refused to impose personal liability under a veil-piercing theory upon inactive shareholders." L. RIBSTEIN, BUSINESS ASSOCIATIONS § 2.04, at 2-64 (1983) (citing Krivo Indus. Supply Co. v. National Distillers & Chem. Corp., 483 F.2d 1098 (5th Cir. 1973), *modified*, 490 F.2d 916 (5th Cir. 1974); Fisser v. International Bank, 282 F.2d 231 (2d Cir. 1960)). In environmental liability cases, courts have held active shareholders and directors liable in order to achieve some control over a polluting corporation. *See, e.g.*, United States v. Northeastern Pharmaceutical & Chem. Co., 810 F.2d 726 (8th Cir. 1986) (officers of chemical manufacturer found liable for cleanup costs of hazardous waste site), *cert. denied*, 484 U.S. 848 (1987); New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985) (property owner and officer held individually liable for cleanup of hazardous waste disposal site); Comment, *Corporate Officer Liability for Hazardous Waste Disposal: What Are the Consequences?* 38 MERCER L. REV. 677 (1987) (discussing ramifications of corporate officer liability under hazardous waste laws).

Support for the proposition that only those shareholders actively involved in management will be personally liable has been referred to as "dicta in a few cases." *See* Barber, *supra* note 66, at 373. Justice Traynor suggested that, in cases involving inadequately capitalized corporations, liability rests on shareholders that actively participate in the conduct

ness may, nevertheless, prefer the corporate form to a limited partnership. The corporation, even subject to potential disregard of the corporate entity, affords greater certainty of protection than the RULPA guidelines, the parameters of which are not clearly defined.[68] An important issue, therefore, is whether the equitable doctrine of piercing the corporate veil will apply to the LLC.

The limited partnership association and corporation are similar to an LLC because all participants enjoy limited liability The veil-piercing doctrine does not appear to extend to limited partnership associations in those states permitting such organizations absent such factors as fraudulent promoter representations in the sale of interests or defective formation.[69] The rationale underlying limited liability for limited partners and corporate shareholders is similar: parties should be permitted to invest in enterprises without risking their personal assets.[70] The doctrine of piercing the limited liability shield, however, generally has not been extended to limited partners.[71] This inconsistency may result from the es-

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of corporate affairs. Minton v. Cavaney, 56 Cal. 2d 576, 579, 364 P.2d 473, 475, 15 Cal. Rptr. 641, 643 (1961); *see* Pearl v. Shore, 17 Cal. App. 3d 608, 95 Cal. Rptr. 157 (1971) (dismissal of alter ego liability claim filed against inactive investor of adequately capitalized corporation); Slusarski v. American Confinement Sys., 218 Neb. 576, 357 N.W.2d 450 (1984) (no liability for directors not actively involved in fraudulent activities). *But see* Briggs Transp. Co. v. Starr Sales Co., 262 N.W.2d 805 (Iowa 1978) (inactive shareholder found liable for disregarding corporation's inadequate capitalization and failure to maintain corporate books).

68. The 1985 RULPA amendments to section 303 clarified matters but questions remain. Under section 303(a), a limited partner is not liable for the obligations of the partnership unless he participates in the control of the business. Section 303(b) provides a list of activities that do not necessarily constitute control for purposes of section 303(a). *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 303. For a detailed analysis of the effects of the 1985 amendments to § 303, see Basile, *Limited Liability for Limited Partners: An Argument for the Abolition of the Control Rule*, 38 VAND. L. REV. 1199, 1214-17 (1985).

69. Two early decisions applied the statutory limited liability standard. *See* Staver & Abbott Mfg. Co. v. Blake, 111 Mich. 282, 69 N.W 508 (1896) (no member liability on a contract); Whitney v. Backus, 149 Pa. 29, *reported sub nom.* Whitney v. Short, 24 A. 51 (1892) (no member liability for a tort). A later case held association members liable for return of membership subscriptions because of fraudulent representations in the sale of association interests. *See* Macomber v. Endion Grape Juice Co., 160 Mich. 54, 125 N.W 26 (1910). Of course, members could be personally liable if the association were improperly formed. *See, e.g.*, Nichols v. Buell, 157 Mich. 609, 122 N.W 217 (1909) (promoters of partnership association found liable because partnership association was never recorded as required by law).

70. *See generally* Lewis, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715 (1917) (discussing history of and purposes for the ULPA).

71. One court found limited partner officers of the corporate general partner liable because they were engaged in indirect control. *See* Delaney v. Fidelity Lease, Ltd., 526 S.W.2d 543 (Tex. 1975). Two other courts rejected this position, refusing to impose per-

tablished approach of determining potential limited partner liability from the degree of participation in the control of a partnership's business, thereby forestalling reliance on the corporate piercing doctrine.[72]

This dichotomy may also result from an important structural distinction between a corporation and a limited partnership: while all corporate shareholders seek limited liability, a limited partnership has at least one general partner with unlimited liability The creditor's remedy is to pursue the general partner.[73] Based on this latter distinction, the LLC more closely resembles a corporation. Therefore, the most consistent position is that, in appropriate circumstances, claimants may pierce the LLC's veil. In fact, Colorado's statute expressly applies this doctrine to LLCs.[74] Furthermore, in prescribing formalities such as notices, meetings, records, and reports, Colorado's LLC statute, to some extent, sets the stage for a piercing of an LLC's protective veil if members ignore such formalities.[75]

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sonal liability upon the limited partner regardless of control. *See* Western Camps, Inc. v. Riverway Ranch Enter., 70 Cal. App. 3d 714, 138 Cal. Rptr. 918 (1977) (control test rejected by court); Frigidaire Sales Corp. v. Union Properties, Inc., 88 Wash. 2d 400, 562 P.2d 244 (1977) (rejecting personal liability for limited partner although corporate general partner held liable). The RULPA has codified this latter position. *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 303(b)(1) (1985). A limited partner does not participate in control of the partnership by "being an officer, director, or shareholder of a general partner that is a corporation." *Id.* However, such participants remain subject to attempts to pierce the corporate general partner.

72. One commentator has argued:

> Neither the ULPA nor the RULPA as presently written contains any provision imposing personal liability on the limited partners of undercapitalized limited partnerships, provided that the limited partners do not take part in the control of the business. The control rule is not, and was not intended to be, an effective prophylactic against the possible formation of thinly capitalized limited partnerships.

Basile, *supra* note 68, at 1230-31.

73. The liability of an individual general partner could be reduced, of course, if a corporation were interposed as the general partner. One commentator has suggested that the legislators who enacted the early limited partnership statutes probably did not contemplate the use of a corporate general partner. *See* O'Neal, *Comments on Recent Developments in Limited Partnership Law*, 1978 WASH. U.L.Q. 669, 683-84. The persons controlling the corporate general partner might be subject to liability upon a decision to pierce the corporate veil or upon the theory that they engaged in indirect control of the limited partnership. *See supra* note 71.

74. *See* COLO. REV. STAT. § 7-80-107 (Supp. 1990).

75. *See, e.g., id.* § 7-80-303 (outlining required reports). The failure to respect corporate formalities such as minutes of shareholder meetings and maintenance of corporate records have been factors referred to by courts in permitting a disregard of the corporate entity. *See, e.g.*, Barber, *supra* note 64, at 374 (noting that not following corporate formali-

c. Liability for Acting Without Proper Formation

The Wyoming, Florida, and Kansas statutes provide that "[a]ll persons who assume to act as a limited liability company without authority to do so shall be jointly and severally liable for all debts and liabilities."[76] This provision is patterned after section 146 of the MBCA except that the MBCA adds the qualifying phrase "incurred or arising as a result thereof" after the word "liabilities."[77] Colorado's statute supplies a similar sanction but requires lack of authority and lack of "good faith belief that [the participants] have such authority" before personal liability is imposed.[78]

4. Capital Contributions

The Wyoming and Florida statutes permit capital contributions of cash or other property, but not services.[79] This language is very similar to section 4 of the ULPA[80] and could be modified to allow contributions of services in the manner permitted under the RULPA.[81] For example, the Colorado statute adopted the

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ties has influenced courts' decisions to pierce the corporate veil); Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 990 (1971) (summarizing the rule from numerous Texas cases).

76. FLA. STAT. § 608.437 (Supp. 1989); KAN. STAT. ANN. § 17-7621 (Supp. 1990); WYO. STAT. § 17-15-133 (1977).

77. *See* MODEL BUSINESS CORP. ACT § 146 (1969).

78. *See* COLO. REV. STAT. § 7-80-105. RMBCA § 2.04 differs from MBCA § 146 in requiring "know[ledge that] there was no incorporation under this Act." The Official Comment to RMBCA § 2.04 suggests that this would immunize participants who "honestly and reasonably but erroneously believed the articles had been filed." REVISED MODEL BUSINESS CORP. ACT § 2.04 comment 1 (1984). UNIF. LTD. PARTNERSHIP ACT § 11 (1916) contains a similar exculpation for erroneous belief, as does REVISED UNIF. LTD. PARTNERSHIP ACT § 304 (1985), which speaks to erroneous, "good faith" belief.

79. *See* FLA. STAT. § 608.4211; WYO. STAT. § 17-15-115. Kansas's statute omits language specifically addressing capital contributions other than the general language requiring a description in the articles of organization of cash and property other than cash contributed to the LLC. *See* KAN. STAT. ANN. § 17-7607(5).

80. "The contributions of a limited partner may be cash or other property, but not services." UNIF. LTD. PARTNERSHIP ACT § 4 (1916).

81. "The contribution of a partner may be in cash, property, or services rendered, or a promissory note or other obligation to contribute cash or property or to perform services." REVISED UNIF. LTD. PARTNERSHIP ACT § 501 (1985). A services partner may be taxed on the value of the partnership interest received. *See* Campbell v. Commissioner, 59 T.C.M. (CCH) 236 (1990) (an organizer of hotel syndications was required to include in income the value of partnership interests he received in exchange for his services); Diamond v. Commissioner, 56 T.C. 530 (1971), *aff'd*, 492 F.2d 286 (7th Cir. 1974) (plaintiff taxed for partnership interest he received in exchange for services).

RULPA language permitting contributions of services rendered or to be rendered.[82]

5. Management

a. Managers

Unless otherwise stated in the articles of organization, management of the LLC is vested in its members in proportion to their capital contributions as adjusted from time to time to reflect contributions or withdrawals.[83] If provision is made in the articles of organization, management of the LLC may be undertaken by managers elected annually by the members. The manner of election, offices, and responsibilities are to be established in the operating agreement.[84] The Colorado statute reverses this rule and vests management in the managers, creating a structure clearly resembling a board of directors or general partners of a limited partnership.[85]

The simpler Wyoming, Florida, and Kansas statutes leave open a number of questions. For example, in requiring that elections be held "annually,"[86] the statutes might preclude staggered terms for directors.[87] The statutes do not expressly require that managers also be members of the LLC or residents of the state of

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82. *See* COLO. REV. STAT. § 7-80-501 (Supp. 1990) (allowing contributions of cash, property, services rendered, or a promissory note or other obligation to contribute cash or property or to perform services).

83. *See* FLA. STAT. § 608.422 (Supp. 1989); KAN. STAT. ANN. § 17-7612 (Supp. 1990); WYO. STAT. § 17-15-116 (1977). This provision is operative only in the absence of agreement, but its application is unclear. For example, if the LLC property appreciates, the original LLC members' capital contributions will not reflect the unrealized appreciation, while the capital contributions of incoming members may in part be based on the new values. Without adjustment, management would gravitate to newer members.

The Kansas statute creates a mixed management structure. Even if no managers are elected, the LLC must select a president and secretary. Thus, if managers are elected, the LLC will have the equivalent of a board of directors as well as corporate officers. *See* KAN. STAT. ANN. § 17-7613(b).

84. *See* FLA. STAT. § 608.422; KAN. STAT. ANN. § 17-7612; WYO. STAT. § 17-15-116.

85. *See* COLO. REV. STAT. § 7-80-401(1) (management and voting power shall be vested in the managers).

86. *See* FLA. STAT. § 608.422; KAN. STAT. ANN. § 17-7612; WYO. STAT. § 17-15-116.

87. On the other hand, they could require an annual vote, but not with respect to all directors at the time of each vote. By comparison, the Michigan limited partnership association statute is clear. "All such partnership associations shall elect their managers annually, and the entire number of managers shall be balloted for at one and the same time and not separately." MICH. COMP. LAWS § 449.301 (1979).

formation.[88] The Colorado statute, by comparison, fills in a number of details through the adoption of corporate style governance provisions. Managers must be natural persons who are 18 years of age or older but need not be residents of Colorado, unless required by the articles of organization or the operating agreement.[89] The Colorado statute also addresses the election and term of managers,[90] classification of managers,[91] manager vacancies,[92] and removal of managers.[93] In a drafting inconsistency, the Colorado statute does not expressly permit action by the managers without a meeting.[94] In addition, the Colorado LLC statute adopts the corporate prudent manager rule of the MBCA[95] and the extensive indemnification provisions of the RMBCA.[96] However, the statute rejects the corporate model when dealing with managerial conflicts of interest in favor of a liberal RULPA approach, permitting

88. In comparison the MBCA states, in part, "Directors need not be residents of this State or shareholders of the corporation unless the articles of incorporation or by-laws so require." MODEL BUSINESS CORP. ACT § 35 (1979). However, some states have construed the limited partnership association to require member-managers. *See, e.g.*, R.F Roof, Ltd. v. Sommers, 75 Ohio App. 511, 517, 62 N.E.2d 647, 649, *appeal dismissed*, 143 Ohio St. 311, 64 N.E.2d 957 (1944).

89. *See* COLO. REV. STAT. § 7-80-401(2) (Supp. 1990).

90. *See id.* § 7-80-402 (providing that the number of managers be set forth in the articles of organization and that they hold office until the next annual meeting when their successors take office). This provision resembles the MBCA § 36, which provides for the same terms regarding election and term of managers. MODEL BUSINESS CORP. ACT § 36 (1979).

91. *See* COLO. REV. STAT. § 7-80-403 (providing that when there are six or more managers, they shall be divided into two or three classes whose terms rotate). This provision resembles the MBCA with the exception that nine members trigger the classification requirement. MODEL BUSINESS CORP. ACT § 37.

92. *See* COLO. REV. STAT. § 7-80-404 (providing that vacancies be filled by a written agreement of a majority of the remaining managers and that the successor serve until the predecessor's term expires). This provision resembles the MBCA, which states that a vacancy should be filled by a majority vote of the remaining directors and, like the Colorado statute, the successor should serve the unexpired term of the predecessor. MODEL BUSINESS CORP. ACT § 38.

93. *See* COLO. REV. STAT. § 7-80-405 (requiring that a meeting be called for that purpose only, at which time managers may be removed in the manner set forth in the operating agreement). The MBCA includes provisions similar to the Colorado statute but contains additional provisions regarding cumulative voting and separate classes of shareholders. MODEL BUSINESS CORP. ACT § 39.

94. *See infra* note 122 and accompanying text.

95. *See* COLO. REV. STAT. § 7-80-406 (Supp. 1990). *Compare* MODEL BUSINESS CORP. ACT § 35 (1979) (manager must act in good faith, must reasonably believe conduct to be in the interest of the corporation, and must act with the care of a reasonably prudent person).

96. *See* COLO. REV. STAT. § 7-80-410. *Compare* REVISED MODEL BUSINESS CORP. ACT §§ 8.50-.58 (1984) (nearly identical provision).

loans to and transaction of business with managers.[97]

b. Authority of Managers

If authority is not restricted to managers, any member of a Wyoming or Florida LLC can bind the LLC for debts and liabilities[98] as well as acquire and dispose of property.[99] This broad grant of authority is not tempered by the express limitations of apparent authority that would apply to general partners of a conventional partnership[100] or officers of a corporation.[101] If managers are appointed, the power to contract, acquire, or dispose is held by one or more managers.[102] This cloaks every manager with authority greater than that of a general partner, given that, unlike general partners, members of an LLC are not personally liable for the entity's obligations, contractual or otherwise.[103] It is unclear whether the authority of one or more managers to act could be limited by language in the operating agreement prescribing, for example, unanimous action by managers for all or selected transactions.

The Colorado statute follows the Wyoming, Florida, and Kansas statutes in not limiting the actual authority of a manager

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97. *See* COLO. REV. STAT. § 7-80-409. *Compare* REVISED UNIF. LTD. PARTNERSHIP ACT § 107 (1985) (specifying legitimate transactions between a partner and the limited partnership) *with* MODEL BUSINESS CORP. ACT § 41 (setting forth disclosure requirements for director conflicts of interest) *and* REVISED MODEL BUSINESS CORP. ACT §§ 8.31-.32 (defining the effect of director conflict of interest on corporate transactions and permitting loans to or guarantees of obligations on behalf of directors, with board of directors' approval or a determination by the board of directors that the transaction benefits the corporation).

98. *See* FLA. STAT. § 608.424 (Supp. 1989); WYO. STAT. § 17-15-117 (1977). The Kansas statute takes a different approach. All written contracts are to be signed by the president and secretary of the LLC or by any other person designated at a member meeting. KAN. STAT. ANN. § 17-7613(b) (Supp. 1990). The acquisition, mortgage, or disposition of property, however, is subject to the general scheme of the Wyoming and Florida statutes. *See id.*

99. *See* FLA. STAT. § 608.425; WYO. STAT. § 17-15-118.

100. *See, e.g.*, UNIF. PARTNERSHIP ACT §§ 9-10 (1914). Courts recognize apparent authority only in cases where a partner has acted beyond the limits of express authority but within the scope of the partnership's business. *See, e.g.*, Bamford v. Cope, 31 Colo. App. 161, 499 P.2d 639 (1972); RESTATEMENT (SECOND) OF AGENCY §§ 8, 159, 161, 166 (1958).

101. *See, e.g.*, MODEL BUSINESS CORP. ACT § 50 (1979).

102. *See* FLA. STAT. §§ 608.424-425; KAN. STAT. ANN. § 17-7614; WYO. STAT. §§ 17-15-117 to -118.

103. *See supra* note 61 and accompanying text (discussing LLC member limited liability).

with respect to LLC property [104] However, with respect to contracting for LLC debts, which would likely encompass a greater number of transactions, a manager's authority is subject to the articles of organization, or the operating agreement.[105] The Colorado statute states further that managers have apparent authority for "carrying on in the usual way the business of the limited liability company,"[106] unless the act is in contravention of the articles of organization or operating agreement or the manager lacks actual authority "and the person with whom he is dealing has knowledge of the fact that he has no such authority "[107]

The potential for acts to contravene the articles of organization is great because the Colorado statute enlarges the scope of notice provision found in the RULPA[108] and makes the filed articles of organization "notice of all other facts set forth therein which are required to be set forth in the articles of organization."[109] Although the list of "required" facts is otherwise abbreviated,[110] it is couched in mandatory language with respect to all provisions that the members elect to include.[111]

6. Operating Agreement and Members

The Wyoming and Florida statutes are largely silent on the rights and duties of members, leaving such matters to the articles of organization and operating agreement. The term "operating agreement" is referred to in the Wyoming statute but never de-

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104. *See* COLO. REV. STAT. § 7-80-408 (Supp. 1990).

105. *See id.* § 7-80-407.

106. *Id.* § 7-80-406(4).

107. *Id.*

108. "The fact that a certificate of limited partnership is on file in the office of the Secretary of State is notice that the partnership is a limited partnership and the persons designated therein as general partners are general partners, but it is not notice of any other fact." REVISED UNIF. LTD. PARTNERSHIP ACT § 208 (1985).

109. COLO. REV. STAT. § 7-80-208 (Supp. 1990).

110. Colorado's requirements for LLC articles of organization are patterned after the abbreviated certificate requirements introduced by the 1985 amendments to the RULPA. *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 201. The articles must specify: (a) the LLC's name and, if known, principal place of business; (b) the LLC's duration, not to exceed 30 years; (c) the name and business address of the LLC's registered agent; (d) the names and business addresses of initial managers; and (e) any other provision, not inconsistent with law, by which the members choose to regulate the LLC's internal affairs. *See* COLO. REV. STAT. § 7-80-204.

111. "The articles of organization shall set forth [a]ny other provision, not inconsistent with law, which the members elect to set out in the articles of organization " COLO. REV. STAT. § 7-80-204(1)(e).

fined. The context suggests an agreement resembling a partnership agreement or the bylaws of a corporation. The Florida statute also refers to an operating agreement, without defining it, and to "regulations," for which a definition is provided.[112] The Kansas statute refers to an operating agreement and to "bylaws" of the LLC.[113] The Colorado statute defines the operating agreement as a written agreement of the members concerning the affairs of an LLC and the conduct of its business.[114] The exclusion of oral agreements has created some drafting inconsistencies in adopting the RULPA provisions, which were structured to accommodate written or oral agreements.[115]

Colorado's statute supplies a number of governance refinements. Unless the articles of organization require consent by a unanimous or majority vote, the operating agreement can grant to all or specified groups of members the right to consent, vote, or agree, on a per capita or other basis, upon any matter.[116] "Unless the operating agreement provides otherwise, any member may vote in person or by proxy"[117] The Colorado statute draws from

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112. "The regulations may contain any provisions for the regulation and management of the affairs of the limited liability company not inconsistent with law or the articles of organization." FLA. STAT. § 608.423 (Supp. 1989).

113. Kansas's statute follows the Florida pattern, referring both to the operating agreement, *see, e.g.*, KAN. STAT. ANN. § 17-7612 (Supp. 1990), and the bylaws, *see id.* §§ 17-7612 to -7613. The "bylaws" language was generally substituted for the term "regulations" as it had been used in the Florida statute.

114. *See* COLO. REV. STAT. § 7-80-102(11) (Supp. 1990). *Compare* REVISED UNIF. LTD. PARTNERSHIP ACT § 101(9) (1985) (defining the partnership agreement, in part, as "any valid agreement, written or oral ") *and* Treas. Reg. § 1.761-1(c) (1972) ("Such [partnership] agreement or modifications can be oral or written.").

115. The RULPA includes written and oral agreements in its definition of the term "partnership agreement" In situations where a writing is considered necessary, the RULPA expressly requires it. For example, section 603 states: "A limited partner may withdraw at the time or upon the events specified in writing in the partnership agreement." REVISED UNIF. LTD. PARTNERSHIP ACT § 603. The Official Comment confirms this special treatment stating, "[t]his section additionally reflects the policy determination, also embodied in certain other sections of the 1985 Act, that to avoid fraud, agreements concerning certain matters of substantial importance to the partners will be enforceable only if in writing." *Id.* § 603 official comment. The Colorado statute retains this requirement in the RULPA provisions. *See, e.g.*, COLO. REV. STAT. § 7-80-411(1)(d), (f) (referring to written operating agreements); *Id.* §§ 7-80-503, -504, -604 (referring to provisions expressed in writing in the operating agreement).

116. COLO. REV. STAT. § 7-80-706(1). *Compare* REVISED UNIF. LTD. PARTNERSHIP ACT §§ 302, 405 (section 302 states that "the partnership agreement may grant to all or a specified group of limited partners the right to vote (on a per capita or other basis) upon any matter," while section 405 provides that the partnership agreement may grant voting powers to all or some general partners on a per capita or other basis).

117. COLO. REV. STAT. § 7-80-706(2). The MBCA would require the proxy to be

the MBCA in specifying guidelines for member meetings,[118] notice of member meetings,[119] meeting quorum requirements,[120] waiver of notice,[121] and action by members without a meeting.[122] The quorum provision was not adopted verbatim from the MBCA and might be read to require a majority per capita vote on all member decisions, rather than a vote by reference to classes, percentage interests, or some other basis.[123] The Kansas statute strikes a balance between the extremes of the Wyoming and Colorado statutes by concisely addressing times for annual meetings, notice of meetings, special meetings, actions taken in writing without a meeting, proxies, required officers, and quorum requirements.[124]

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written and limited in duration: "A shareholder may vote either in person or by proxy executed in writing by the shareholder or by his duly authorized attorney-in-fact. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy." MODEL BUSINESS CORP. ACT § 33 (1979). This, of course, could be done in the operating agreement. The Kansas statute permits written proxies to remain valid for three years unless the proxy provides otherwise. *See* KAN. STAT. ANN. § 17-7613.

118. *See* COLO. REV. STAT. § 7-80-707. *Compare* MODEL BUSINESS CORP. ACT § 28. The RMBCA also provides for court ordered meetings. REVISED MODEL BUSINESS CORP. ACT § 7.03 (1984).

119. *See* COLO. REV. STAT. § 7-80-709 (Supp. 1990). *Compare* MODEL BUSINESS CORP. ACT § 29. The Kansas statute also requires meetings to be held at the times designated in the bylaws or upon a minimum 10 days written notice and establishes the formalities for calling special meetings. *See* KAN. STAT. ANN. § 17-7613(b) (Supp. 1990).

120. *See* COLO. REV. STAT. § 7-80-708 (defining a quorum as a "majority of the members entitled to vote"). *Compare* MODEL BUSINESS CORP. ACT § 32. Kansas's statute also requires that a majority of the company's voting interests be present to establish a quorum. *See* KAN. STAT. ANN. § 17-7613(b).

121. *See* COLO. REV. STAT. § 7-80-710(1). *Compare* MODEL BUSINESS CORP. ACT § 144. The Wyoming, Florida, and Kansas statutes contain similar provisions. *See* FLA. STAT. § 608.455; KAN. STAT. ANN. § 17-7630; WYO. STAT. § 17-15-131 (1977).

122. *See* COLO. REV. STAT. § 7-80-711. *Compare* MODEL BUSINESS CORP. ACT § 145 (1979). Kansas's statute also permits member action without a meeting. *See* KAN. STAT. ANN. § 17-7613(b) (Supp. 1990). In a drafting inconsistency, the Colorado and Kansas statutes do not permit action by the managers without a meeting. The MBCA, however, permits director action without a meeting. *See* MODEL BUSINESS CORP. ACT § 44.

123. The overall voting requirement which permits voting on any basis is "[s]ubject to the provisions of this article which require majority or unanimous consent " COLO. REV. STAT. § 7-80-706(1). The quorum provision states, however, "[i]f a quorum is present, the affirmative vote of the majority of the members shall be the act of the members, unless the vote of a greater proportion or number or voting by classes is required by this article, the articles of organization, or the operating agreement." *Id.* § 7-80-708. The roots of this problem are found in the almost verbatim adoption of section 32 of the MBCA. Drafters of the Colorado quorum provision substituted "members" in a provision which is tied to number of "shares." *See* MODEL BUSINESS CORP. ACT § 32.

124. *See* KAN. STAT. ANN. § 17-7613 (Supp. 1990).

INTRODUCTION

IN 1977 THE Wyoming legislature authorized the creation of a new form of business organization known as the limited liability company ("LLC").[1] Florida subsequently adopted the LLC with legislation patterned after Wyoming's statute.[2] The LLC legislation in each state combined limited partnership and corporate provisions drawn primarily from the Uniform Limited Partnership Act ("ULPA")[3] and the Model Business Corporation Act ("MBCA").[4]

From a business planning standpoint, the LLC was created to secure both the federal income tax advantages associated with partnership status[5] and state law limited liability for all participants in the venture.[6] These advantages indirectly presented potential benefits to states permitting the organization of LLCs. The Wyoming legislators were reportedly interested in pioneering the new investment vehicle to lure business to their state. In addition, Wyoming hoped to reap associated benefits from acting as the national haven for "tramp" LLCs that would bring their activities, or at least their organizational activities, to Wyoming in order to avail themselves of the LLC statute.[7] The Florida statute was sim-

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1. *See* WYO. STAT. §§ 17-15-101 to -136 (1977).
2. *See* FLA. STAT. §§ 608.401-471 (Supp. 1989).
3. UNIF. LTD. PARTNERSHIP ACT, 6 U.L.A. 561 (1916).
4. MODEL BUSINESS CORP. ACT (1969) (the 1969 version of the MBCA is cited where the MBCA is compared with the Wyoming LLC since the 1969 version was in effect when Wyoming drafted its LLC statute).
5. *See infra* text accompanying notes 349-56.
6. *See infra* text accompanying notes 61-78.
7. The Wyoming statute requires LLCs to maintain a registered office and registered agent in the state. *See* WYO. STAT. § 17-15-110 (1977). The registered office "may be, but need not be, the same as its place of business." *Id.* The Wyoming statute also requires that the articles of organization list "[t]he address of its principal place of business in the state and the name and address of its registered agent in the state " *Id.* § 17-15-107(a)(iv). While operations need not be conducted in Wyoming, a place of business must be maintained:

> Since the Act does not require that operations be conducted within the State of Wyoming (the Act merely provides that a place of business and a registered agent be maintained in the State) it was anticipated that interest in this form of entity would be generated in all parts of the U.S. as occurred in response to the attractiveness of the corporation laws of Delaware or Nevada for the organization of corporate enterprises. The state would benefit through the generation of revenues from the modest filing fees provided in the Act and the additional business activity which would be generated through the organization of companies under the Act and maintenance of nominal places of business and registered agents in the state by such companies.

Burke & Sessions, *The Wyoming Limited Liability Company: An Alternative to Sub S*

ilarly intended to attract business investment, especially from Latin America.[8]

The Treasury Department frustrated the realization of these anticipated benefits by its inconsistent treatment of the partnership tax classification issue as it applied to the LLC.[9] This inconsistency yielded uncertainty, and consequently few LLCs were formed, leaving Wyoming and Florida as the sole sponsor states.[10]

In 1988, however, the Internal Revenue Service ("I.R.S.") issued Revenue Ruling 88-76, favorably classifying a Wyoming LLC as a partnership for federal income tax purposes.[11] This pronouncement has renewed interest in the LLC.[12] In addition, Colorado and Kansas have recently enacted statutes authorizing the creation of LLCs,[13] and Indiana has provided for the registration of LLCs from other jurisdictions.[14] Like all tax conduit entities,

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and Limited Partnerships?, 54 J. TAX'N 232, 235 (1981).

Section 12(a) of the MBCA also provides that the registered office "may be, but need not be, the same as its place of business." MODEL BUSINESS CORP. ACT § 12(a) (1979). The confusion created by Wyoming's statute is avoided because the articles of incorporation are not required to set forth the corporation's place of business. Only the address of its initial registered office is required. *See id.* § 54(i). An LLC statute enacted in Colorado, for example, requires only that the articles of organization state "if known, [the LLC's] principal place of business." COLO. REV. STAT. § 7-80-204(1)(a) (Supp. 1990).

8. Comment, *The Limited Liability Company Act*, 11 FLA. ST. U.L. REV. 387, 387 (1983) ("The LLC is similar to a business organization called the *limitada* which exists in [Latin America]. It was thought that having a familiar business organization would attract foreign investment." (footnote omitted)).

9. For an account of the Treasury's treatment of the LLC, see *infra* text accompanying notes 301-48.

10. Two LLCs were reportedly formed under Florida law in the year following adoption of the enabling legislation. *See* Comment, *supra* note 8, at 388. As of February 22, 1988, only 26 Wyoming LLCs had been formed. *See* Comment, *The Wyoming Limited Liability Company: A Viable Alternative to the S Corporation and the Limited Partnership?*, 23 LAND & WATER L. REV. 523, 523 (1988) (discussing the tax status and liability protection aspects of the LLC form as adopted in Wyoming).

11. *See* Rev. Rul. 88-76, 1988-2 C.B. 360.

12. *See, e.g.*, August & Shaw, *The Limited Liability Company - A New Tax Refuge?* 7 J. TAX'N INVESTMENTS 179 (1990) (discussing the history, structure, and tax implications of the LLC as an organizational form); Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 FLA. L. REV. 721 (1989) (discussing settlement of the tax status of an LLC following the categorization of the entity as a partnership in Revenue Ruling 88-76); Lederman, *Miami Device: The Florida Limited Liability Company*, 67 TAXES 339 (1989) (discussing the ease with which an LLC could be classified as a partnership under Revenue Ruling 88-76).

13. *See* Colorado Limited Liability Company Act, COLO. REV. STAT. § 7-80-101 (Supp. 1990); Kansas Limited Liability Company Act, KAN. STAT. ANN. § 17-7601 (Supp. 1990). LLC legislation has also been introduced in Michigan, House Bill No. 5464, 85th Leg., 2d Sess. (1990), *reprinted in* 22 Sec. Reg. & L. Rep. (BNA) 401 (March 16, 1990).

14. *See* IND. CODE ANN. §§ 23-16-10.1-1 to -10.1-4 (Burns Supp. 1990).

alert to all of the relevant facts.[230]

However, this article has suggested reasons beyond the exchange-promise dichotomy for recognizing a category of fiduciary relationships and especially for setting a limit on that concept. Contracts will be made for fiduciary responsibilities by parties until the costs of full disclosure to the fiduciary exceed the benefits of receiving all the relevant information.[231] Costs of disclosure will tend to exceed these benefits where the relationship offers opportunities to appropriate the social efficiencies of nondisclosure. Even if those transactions, considered individually, conferred a $1000 benefit on one party at the expense of a $500 loss to the other, the losing party would have an incentive to make those transactions a part of the compensation package of the benefiting party Removal of the fiduciary relationship would allow an arrangement of the transactions that creates mutual benefit out of transactions that, individually, were only Kaldor-Hicks efficient.

Beyond the narrow realm of fiduciary relationships, the law of nondisclosure often refers to the customary morality of the commercial community[232] For example, the *Restatement (Second) of Torts* requires one to disclose information "basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts."[233]

"Reasonable expectations" is always a slippery concept, especially since the expectations of commercial parties are often a

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230. *See* Levmore, *supra* note 150, at 135 (noting the problem that effort is wasted learning information for one's own protection that someone else already possesses).

231. *See* Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 436 (7th Cir. 1987) (noting that, to a certain extent, parties may define their obligation to disclose information), *cert. dismissed*, 485 U.S. 901 (1988).

232. Consider, for example, the following:

> The continuing development of modern business ethics has, however, limited to some extent this privilege to take advantage of ignorance It is extremely difficult to be specific as to the factors that give rise to this known, and reasonable, expectation of disclosure. In general, the cases in which the rule stated in Clause (e) has been applied have been those in which the advantage taken of the plaintiff's ignorance is so shocking to the ethical sense of the community, and is so extreme and unfair, as to amount to a form of swindling, in which the plaintiff is led by appearances into a bargain that is a trap, of whose essence and substance he is unaware.

RESTATEMENT (SECOND) OF TORTS § 551 comment 1 (1977).

233. *Id.* § 551(2)(e).

function of the governing legal rules. It is tempting to conclude that the "reasonable expectation" is the expectation that is in accordance with the better ethical view of a particular practice.[234] Such a conclusion, however, would miss the epistemological gain from deducing what pre-legal morality had actually evolved to govern particular types of transactions. The general acceptance of nondisclosure in a particular setting may be due to the presence of one or more efficiencies.[235] Regarding nondisclosure as unethical in another setting may result from an absence of opportunities for efficient transactions in that setting.

In short, while the Kaldor-Hicks benefits from nondisclosure practices will not always translate into mutual benefits, there is not as dramatic a gap between these two efficiency concepts as may at first appear Competition can convert Kaldor-Hicks efficiency into mutual benefit, as can packaging transactions as long term relationships. In contexts where nondisclosure appears likely to generate efficiency gains, one might wish to have clear evidence that the express terms or customary understandings of a particular trade called for full disclosure before declaring that the background rule permitting nondisclosure had been contractually varied.[236]

B. Summarizing the Rules of Nondisclosure

The focus of this article, which has been on the benefits of certain nondisclosure practices, should not be misinterpreted as a theory that nondisclosure is generally unobjectionable. Rather, the focus is a counterweight to a literature which is heavily oriented toward condemning nondisclosure as tantamount to fraud. Because of this emphasis, however, the reasons that nondisclosure is a highly suspect practice bear repeating.

Apart from its distributional effects, trading without disclosure is a source of stark inefficiencies. If a homeowner is aware of termite infestation or that a polluting factory will soon be operat-

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234. Consider the ambiguity between description and prescription in the *Restatement (Second) of Torts*. *See supra* note 232.

235. *See* R. SUGDEN, THE ECONOMICS OF RIGHTS, CO-OPERATION AND WELFARE 25-29 (1986) (arguing that existing rules of morality are based on efficient strategies).

236. The relationship between the underlying case for a particular background rule, or "default" rule, and the clarity of evidence that must be present to vary that rule is explored in Ayres & Gertner, *supra* note 177, at 123 (The courts should "establish 'safeharbors' of contractual language that will be sufficient to reach contractual outcomes.").

On the other hand, advance consent for the admission of general partners to a general partnership is enforceable.[147] The limited partnership provisions in question require written consent to or ratification of the "specific act"[148] or "specific written consent."[149] The general partnership provisions require only the "consent of all the partners."[150] The LLC statutes refer to "unanimous written consent," so that comparing only the language itself might lead to the conclusion that advance consent should be permitted. However, in the context of the general partnership provisions, the result is derived from the right of general partners to make agreements about such matters, rather than a close reading of the "consent of all partners" language.[151] ULPA analogies aside, the LLC statutes suggest a contemporaneous consent process by their use of such language as "the member proposing to dispose," and "do not approve of the proposed transfer or assignment," although the critical issue is still whether the consent requirement is subject to modification by agreement of the members.[152]

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narrow aspects of the advance consent. This advance consent restricted the identity of a new general partner to an officer or director of the retiring general partner's corporate affiliates. The new general partner was in fact such an officer. However, the general partner could also have been any fiduciary under the general partner's will or under a trust instrument or any other person receiving the consent of 60% of the Class A limited partner interests. *See* Basile, *supra*, at 247.

147. *See* Basile, *supra* note 146, at 239-40. The UPA provides that "subject to any agreement between them [n]o person can become a member of a partnership without the consent of all the partners." UNIF. PARTNERSHIP ACT § 18(g) (1914). Advance consent may not be as successful under a different reading of "consent of all the partners" as under the phrase "any agreement between them." *See* Weil v. Diversified Properties, 319 F Supp. 778 (D.D.C. 1970); Bricklin v. Stengol Corp., 1 Conn. App. 656, 667-68, 476 A.2d 584, 590 (1984) (holding that a new partner cannot be admitted to the partnership without consent of the other partners unless the partnership agreement so provides).

148. UNIF. LTD. PARTNERSHIP ACT § 9(1)(e); *see supra* note 146.

149. REVISED UNIF. LTD. PARTNERSHIP ACT § 401; *see supra* note 146.

150. UNIF. LTD. PARTNERSHIP ACT § 18(g) (1916).

151. *See supra* note 147.

152. For example, Wyoming's statute provides in part:

> The interest of all members in a limited liability company constitutes the personal estate of the member, and may be transferred or assigned as provided in the operating agreement. However, 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.

WYO. STAT. § 17-15-122 (1977). The first sentence permits the operating agreement to control such matters. It is unclear whether the second sentence overrides the first or if so, whether the first sentence enables the directive of unanimous consent through members'

Tiered ownership structures may mitigate problems with LLC transfer restrictions. All current LLC statutes permit entities such as partnerships, trusts, and corporations to function as LLC members.[153] The interests in an LLC may be held, for example, by two limited partnerships. A transfer of LLC interests would occur infrequently, if ever, while the interests in the member limited partnerships could be transferred under the more flexible limited partnership statutes. There are some drawbacks; for instance, this structure requires the formation, operation, and management of one or two other entities in addition to the LLC itself. Furthermore, the effect of this structure on the federal income tax classification of the LLC is uncertain.[154]

11. Admission of Additional Members

The Wyoming LLC statute does not address the issue of whether additional members can be admitted to an LLC, for example, to provide additional capital. Since assignees cannot be admitted without unanimous written consent, it follows that the admission of new members requires no less. However, this principle may be undermined if the operating agreement can be amended by a less than unanimous vote.[155] By comparison, the general part-

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advance agreements.

153. In describing permissible members, the LLC statutes refer to the term "person." The Wyoming statute defines "person" to include "individuals, general partnerships, limited partnerships, limited liability companies, corporations, trusts, business trusts, real estate investment trusts, estates and other associations." WYO. STAT. § 17-15-102(a)(iv). Kansas's definition of person is identical to the Wyoming statute but mentions only "trusts" and does not classify them as "business" or "real estate investment." *See* KAN. STAT. ANN. § 17-7602(d) (Supp. 1990). Colorado's definition of person is also identical to the Wyoming statute but omits real estate investment trusts and includes "government or governmental subdivision or agency" as well as the catchall category "other legal entity." *See* COLO. REV. STAT. §§ 2-4-401(8), 7-80-102(12) (Supp. 1990). Florida defines "person" to include "individuals, children, firms, associations, joint adventures, partnerships, estates, trusts, business trusts, syndicates, fiduciaries, corporations, and all other groups or combinations." FLA. STAT. § 1.01(3) (Supp. 1989). The LLC statute states that "person means any of those entities listed in s. 1.01(3)." *Id.* § 608.402(4). Together these two Florida provisions literally suggest the implausible result that only entities can form or be members of a Florida LLC, since the LLC statute only refers to the entities listed in the Florida code's definition of "person."

154. *See infra* text accompanying notes 336-45 (discussing various private letter rulings pertaining to the federal tax treatment of LLCs).

155. Both partnership agreements and LLC operating agreements are contracts. Therefore, all parties must agree to any amendment. However, unanimity is not required if the original agreement, to which all parties assented, provides for future amendments upon a vote of a majority or supermajority. While such provisions have been upheld in the part-

ners of a limited partnership can substitute or admit additional limited partners if the certificate permits such action.[156]

The Colorado LLC statute resolves this issue by prohibiting the admission of additional members except "upon the written consent of all members."[157] This requirement derives only in part from the RULPA, and it is unclear whether advance or contemporaneous consent is required.[158] The Florida and Kansas statutes offer the most flexible treatment by simply providing that the articles of organization must describe "[t]he right, if given, of the members to admit additional members and the terms and conditions of the admissions."[159]

Existing members might circumvent the restrictions on admission of new members through the use of tiered ownership structures. This approach is addressed in the transferability of interests discussion immediately preceding this section.[160] If, for example, a limited partnership were utilized as one of the LLC members, new limited partners could be admitted at that level without disturbing the composition of the LLC. The uncertainty

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nership context, they are subject to the interpretative problem of determining whether the transaction in question was contemplated by the language of the particular advance agreement. *See* Hooker, *The Power of Limited Partners to Remove and Replace the General Partner of a Limited Partnership*, 19 TEX. TECH L. REV. 1 (1988) (noting that the limited partners' ability to remove a general partner is a function of the limited partnership agreement, which can be amended to circumvent its undesirable limitations).

156. Reading sections 2(1)(a)(X)-(XI), 8, 9(1)(f), and 19(4) of the ULPA together, a general partner can admit additional limited partners if the certificate provides for this. UNIF. LTD. PARTNERSHIP ACT §§ 2(1)(a)(X)-(XI), 8, 9(1)(f), 19(4) (1916) (sections pertaining to the formation of a limited partnership; addition of limited partners; rights, powers, and liabilities of a general partner; and assignment of a limited partner's interest). Sections 301 and 704 of the RULPA also permit the admission of additional or substitute partners without the consent of all partners if the partnership agreement so permits. REVISED UNIF. LTD. PARTNERSHIP ACT §§ 301, 704 (1985).

157. COLO. REV. STAT. § 7-80-701.

158. The 1985 amendments to the RULPA eliminated the specific written consent language. *See supra* text accompanying notes 146-54. The model statute now provides that "additional general partners may be admitted as provided in writing in the partnership agreement or, if the partnership agreement does not provide in writing for the admission of additional general partners, with the written consent of all partners." REVISED UNIF. LTD. PARTNERSHIP ACT § 401 (1985). The official comment states that the "partnership agreement determines the procedure for authorizing the admission of additional partners, and that the written consent of all partners is required only when the partnership agreement fails to address the question." REVISED UNIF. LTD. PARTNERSHIP ACT § 401 official comment. The Colorado statute closely resembles the RULPA in providing only for unanimous written consent. *See* COLO. REV. STAT. § 7-80-701 (Supp. 1990).

159. FLA. STAT. § 608.407 (1)(g) (Supp. 1989); KAN. STAT. ANN. § 17-7607(A)(7) (Supp. 1990).

160. *See supra* text accompanying notes 153-54.

of the federal income tax treatment of tiered organizations is discussed later in this article.[161]

12. Dissolution

a. Events of Dissolution

Under the Wyoming statute, an LLC is dissolved:

> (i) When the period fixed for the duration of the limited liability company shall expire ["fixed duration"];
> (ii) By the unanimous written agreement of all members ["agreement"]; or
> (iii) Upon the death, retirement, resignation, expulsion, bankruptcy, dissolution of a member or occurrence of any other event which terminates the continued membership of a member in the limited liability company, unless the business of the limited liability company is continued by the consent of all the remaining members under a right to do so stated in the articles of organization of the limited liability company ["specified events"].[162]

The first provision's maximum time period for fixed duration of an LLC has been determined to be thirty years.[163] The second provision's meaning is clear. The third provision is the most critical because of its importance to the federal income tax classification of the entity The importance of this provision is a strong disincentive to experimentation. Thus, the events of dissolution set forth in all four LLC statutes are identical.[164] The described events expand on the events of dissolution enumerated in the ULPA,[165] and their scope approaches the number of general partner withdrawal events that prompt a dissolution under the RULPA,[166] but the partnership definition of the term "dissolution" is not included in any of the LLC statutes.[167]

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161. *See infra* text accompanying notes 336-45.

162. WYO. STAT. § 17-15-123(a) (1977). For federal income tax purposes, the partnership is not terminated until the partnership affairs are completely wound up. *See* Treas. Reg. § 1.708-1(b)(iii)(a) (1956).

163. *See supra* text accompanying notes 53-60 (discussing the duration of LLCs).

164. *See* COLO. REV. STAT. § 7-80-801(1) (Supp. 1990); FLA. STAT. § 608.441(1) (Supp. 1989); KAN. STAT. ANN. § 17-7622 (Supp. 1990); WYO. STAT. § 17-15-123(a); *see also infra* text accompanying notes 318-45.

165. *See* UNIF. LTD. PARTNERSHIP ACT §§ 9(1)(g), 20 (1916) (general partners may not continue the business on the death, retirement, or insanity of a general partner unless the right is granted in the certificate).

166. *See* REVISED UNIF. LTD. PARTNERSHIP ACT §§ 402, 801 (1985) (stating general conditions and circumstances under which one ceases to be a general partner).

167. The UPA defines the dissolution of a partnership as "the change in the relation

The LLC is subject to dissolution upon the occurrence of any of the specified events with respect to any of its members. By comparison, a limited partnership risks dissolution only for events concerning general partners. For example, the death or bankruptcy of a limited partner is of no consequence to the continued legal existence of the limited partnership.[168]

The resemblance of the LLC's dissolution provisions to those of the partnership acts results from the goal of achieving a partnership classification for federal income tax purposes. The Colorado LLC statute represents the most complete adoption of traditional partnership attributes, including the troublesome power of a general partner to withdraw at any time and cause a dissolution of the partnership. The Colorado statute permits any member to dissolve the LLC at any time by withdrawing from the LLC, but the withdrawing member may be liable for damages if the action violates the operating agreement.[169] The other LLC statutes refer to the "resignation" of members as an event triggering dissolution, but the power of withdrawal resembles the much narrower power accorded to limited partners, which can be restricted in the parties' agreement.[170] Many participants would probably not otherwise desire broad dissolubility of their business entity, and many of the legal principles underlying the fragile continuity of partnerships arguably do not apply to the LLC.[171]

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of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." UNIF. PARTNERSHIP ACT § 29 (1914). As demonstrated in the Appendix, *infra* p. 497-500, if dissolution occurs without a continuation of the LLC, a corporate style of dissolution patterned after the MBCA is followed. For example, a statement of intent to dissolve must be filed, followed by the articles of dissolution. The asset distribution scheme, however, is derived from the ULPA and the RULPA. *See* UNIF. LTD. PARTNERSHIP ACT § 23; REVISED UNIF. LTD. PARTNERSHIP ACT § 804.

168. *See* UNIF. LTD. PARTNERSHIP ACT §§ 20 (all events of dissolution refer only to general partners), 21 (on death of limited partner, the executor or administrator has all the rights of a limited partner); REVISED UNIF. LTD. PARTNERSHIP ACT § 801 (all events of withdrawal refer only to general partners).

169. *See* COLO. REV. STAT. § 7-80-602 (Supp. 1990). This Colorado provision is patterned after REVISED UNIF. LTD. PARTNERSHIP ACT § 602.

170. The Florida and Wyoming statutes, for example, adopt the provisions of UNIF. LTD. PARTNERSHIP ACT § 16 (1916) permitting a member to demand the return of his or her contribution after six months prior written notice where the time for the dissolution of the limited partnership is not specified. *See* FLA. STAT. § 608.427 (Supp. 1989); WYO. STAT. § 17-15-121 (1977).

171. Professor Hillman questions the validity of the commonly offered justifications for the free dissolubility of partnerships. *See* Hillman, *Indissoluble Partnerships*, 37 FLA. L. REV. 691 (1985). Free dissolubility draws support from characterizing partnerships as close, personal relationships that should not be maintained against the will of a partner.

b. Continuation of the LLC Business

An LLC's risk of dissolution for the broad range of events described above is potentially mitigated by the LLC statute's authorization of continuation provisions. The Wyoming statute described above requires the consent of all remaining members to continue under a continuation right stated in the articles of organization.[172] The Colorado statute differs slightly, requiring that any decision to continue be made within ninety days after the event of dissolution.[173] The Florida and Kansas statutes permit continuation upon the consent of all remaining members or under a continuation right stated in the articles of organization.[174] The latter alternative presents some tax entity classification issues.[175] Excluding the Florida and Kansas provisions, which permit continuation under a right stated in the articles of organization,[176] the LLC statutes all require the unanimous consent of the remaining members to continue.[177] This type of continuation provision would seem most appropriate for small, closely knit investor groups. The

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Free dissolubility also rests on the mutual agency aspects of partnerships that give a single partner the power to act on behalf of all partners, thus rendering other members jointly and severally liable. *Id.* at 699. Even assuming that this rationale is appropriate for partnerships, it does not necessarily apply to LLCs. While LLC members might share a close relationship, the agency aspects of an LLC are not as persuasive. Although Kansas, Florida, and Wyoming permit LLC members to act on behalf of the LLC, the members lose this authority if the managers are elected. *See* FLA. STAT. § 608.422; KAN. STAT. ANN. § 17-7612 (Supp. 1990); WYO. STAT. § 17-15-116. Moreover, in a Colorado LLC, the managers retain such authority in all events, while the members have no opportunity to exercise it. *See* COLO. REV. STAT. § 7-80-401(1). Finally, unlike members of a partnership who risk joint and several liability for partnership obligations, members of an LLC are not personally liable for entity obligations. *See id.* § 7-80-705; FLA. STAT. § 608.436; KAN. STAT. ANN. § 17-7619; WYO. STAT. § 17-15-113. Elsewhere Professor Hillman has argued that free dissolubility is inappropriate for a close corporation. *See* Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 87 (1982).

172. *See supra* note 162 and accompanying text.

173. *See* COLO. REV. STAT. § 7-80-801(1)(c). This 90 day requirement is patterned after the REVISED UNIF. LTD. PARTNERSHIP ACT § 801 (1985).

174. *See* FLA. STAT. § 608.441(1)(c); KAN. STAT. ANN. § 17-7622(A)(3).

175. The right to continue under the articles of organization resembles the authority that can be given to the general partner in the certificate of a partnership formed under the ULPA. *See* UNIF. LTD. PARTNERSHIP ACT § 9(1)(g) (1916). This provision probably bears adverse tax entity classification consequences. *See infra* text accompanying notes 318-45 (discussing the I.R.S.'s position on continuity of life).

176. *See supra* note 174.

177. COLO. REV. STAT. 7-80-801(c) (Supp. 1990); FLA. STAT. § 608.441(1)(c) (Supp. 1989); KAN. STAT. ANN. § 17-7622(A)(3) (Supp. 1990); WYO. STAT. § 17-15-123 (1977).

continuation provisions of the ULPA[178] and the RULPA,[179] by comparison, require the consent of all members only when no other general partners remain. A more feasible approach under the LLC statute would be to permit continuation after an event of dissolution based on the managers' discretion. However, this approach would require amendments to the LLC statute and might alter the federal income tax consequences associated with LLC statutes.[180]

Another issue requiring additional consideration is whether the risk of LLC dissolution can be limited further through advance consent or advance agreements to continue. The effect of such contractual continuation agreements on federal income tax entity characterization is discussed later in this article.[181] The immediate state law issue is whether such continuation or high continuity agreements are permissible under the LLC statute.

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178. UNIF. LTD. PARTNERSHIP ACT §§ 9(1)(g), 20.

179. REVISED UNIF. LTD. PARTNERSHIP ACT § 801 (1985).

180. In Rev. Proc. 89-12, 1989-1 C.B. 798, the I.R.S. announced its intention to rule that a partnership has continuity of life if less than a majority in interest of the limited partners can elect a new general partner to continue the partnership. Assuming that managers are analogous to general partners of a limited partnership the managers would need to represent at least a majority of member interests to satisfy this requirement. The I.R.S. appears to have encouraged this analogy: "References 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." *Id.* Moreover, Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989) and Priv. Ltr. Rul. 90-29-019 (April 19, 1990) establish that an LLC must satisfy the requirements of Rev. Proc. 89-12, specifically sections 4.01 and 4.03. Many of those requirements (excluding the limited liability guidelines, which do not apply to an LLC according to Gen. Couns. Mem. 39,798 (Oct. 24, 1989)) are based on distinctions between general and limited partners.

In Priv. Ltr. Rul. 90-30-013 (April 25, 1990), an LLC comprised of only two corporate members with shared management was excluded from section 4 of Rev. Proc. 89-12, which contains substantive requirements based on distinctions between general and limited partners. *See infra* note 312. In Rev. Rul. 88-79, 1988-2 C.B. 361, the I.R.S. classified a Missouri business trust as a partnership. The I.R.S. found that the trust did not have continuity of life even though continuation of the trust after dissolution required only a majority vote of its members and a unanimous vote of its remaining managers. Similarly, this ruling permitted the admission of transferees of trust interests as new beneficiaries with the consent of only the managers. *See supra* note 145. The holding of Priv. Ltr. Rul. 90-10-027 that a majority vote of members to continue results in continuity of life, creating adverse tax entity classification consequences, belies the analogy of member-managers to general partners suggested in these private letter rulings. Nevertheless, the result in Rev. Rul. 88-79 and the private letter rulings may be harmonized by noting that the member-managers in the private letter rulings did not retain the veto power over continuation wielded by the business trust managers in the revenue ruling.

181. *See infra* text accompanying notes 318-45.

It is well established that the partners of a general partnership can agree in advance that the business of the partnership will be continued after events that would otherwise dissolve and require the winding up and liquidation of the partnership.[182] The continuation language of the LLC statute is apparently a conjunction of the disjunctive language of ULPA § 20. Section 20 provides for the dissolution of a limited partnership upon the retirement, death, or insanity of a general partner "unless the business is continued by the remaining general partners (a) [u]nder a right to do so stated in the certificate, or (b) [w]ith the consent of all members."[183]

The RULPA continuation provision similarly emphasizes continuation by the general partners, and only when there is a default as to this provision is it necessary that "all partners agree in writing to continue the business of the limited partnership and to the appointment of one or more additional general partners if necessary or desired."[184] The RULPA provision prefaces the agreement by all partners with the phrase "if, within 90 days after the withdrawal,"[185] suggesting that the consent must follow the event of dissolution. The Colorado LLC statute also incorporates this language.[186]

Some commentators have implied that under the unanimous consent provisions of both the ULPA and the RULPA, a lone dissenter could prevent the continuation of the partnership.[187] However, this commentary does not consider the effect of advance consent or continuation agreements.[188] The failure to address this

182. *See generally* A. BROMBERG & L. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 7.13(i) (1988 & Supp. 1989) (continuation agreements may establish the price of an outgoing partner's interest); Bromberg, *Partnership Dissolution — Causes, Consequences, and Cures*, 43 TEX. L. REV. 631, 647-59 (1965) (discussing alternatives for dealing with the interest of the withdrawing member).

183. UNIF. LTD. PARTNERSHIP ACT § 20 (1916).

184. REVISED UNIF. LTD. PARTNERSHIP ACT § 801(3) (1985).

185. *Id.*

186. *See* COLO. REV. STAT. § 7-80-801(1)(c) (Supp. 1990).

187. *See, e.g.*, Hecker, *The Revised Uniform Limited Partnership Act: Provisions Governing Financial Affairs*, 46 MO. L. REV. 577, 611 (1981) ("The more serious problem that exists under the 1916 Act, the ability of a single dissenter to prevent continuation of the business unless there are both a remaining general partner and a right to continue stated in the certificate, is not rectified by the 1976 Act.").

188. *See, e.g.*, Kessler, *The New Uniform Limited Partnership Act: A Critique*, 48 FORDHAM L. REV. 159, 179 (1979) ("The dissolution article is not without problems, however. Section 801(3) provides for a ninety-day period after an event of withdrawal during which all partners may agree in writing to the continuation of the business. The effect of

issue may reflect the fact that, if continuation were addressed in writing in advance, it probably would be accomplished by empowering the general partners to continue the partnership in either the certificate or partnership agreement rather than by obtaining the advance consent of all partners.

The foregoing discussion is based on the interpretations of the partnership continuation provisions from which the LLC provisions were derived. The partnership analogy may be overstated due to the hybrid nature of the LLC, but the language of the LLC statute alone suggests that advance consent was not contemplated, except in the provisions of the Florida and Kansas statutes, which present tax entity classification difficulties.[189] The continuation of a Wyoming or Colorado LLC requires both a right to continue stated in the operating agreement and the consent of all remaining members.[190] The right to continue contained in the operating agreement must, of necessity, have been agreed to in advance, and the operating agreement must be signed by all members.[191] Thus, if the advance consent was also included in the operating agreement signed by all members, the requirement of unanimous consent to continue would be met. However, if the consent requirement is satisfied by inclusion in and integration with the operating agreement, the two requirements merge, rendering the consent requirement surplusage. In a departure from the RULPA and the ULPA, the consent of all members is not a fallback provision operating in the absence of a written agreement; there can be no continuation of the LLC unless the power to continue is provided in advance in the operating agreement.[192] A very strict construction of the LLC statute further suggests that if the consent cannot be part of the operating agreement, it cannot precede the event of dissolution or it would, by definition, become part of the operating agreement.[193]

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this section is to create an extended limbo period during which it is uncertain whether the partnership will continue."). Professor Basile also seems to imply that RULPA envisions contemporary consent. *See* Basile, *supra* note 146, at 243-44 (noting that the circumstances under which such consent is necessary are so remote that the requirement should never be a serious burden on a limited partnership).

189. *See supra* notes 174-75.

190. COLO. REV. STAT. § 7-80-801(c); WYO. STAT. § 17-15-123 (1977).

191. *See* COLO REV. STAT. § 7-80-203 (Supp. 1990) (formation); *Id.* § 7-80-204 (articles of organization); WYO. STAT. § 17-15-106 (formation); *Id.* § 17-15-107 (articles of organization).

192. *See supra* text accompanying note 190.

193. An operating agreement is defined as "any valid written agreement of the mem-

With the exception of the uncertain status of the LLC in nonadopting jurisdictions,[194] continuity of existence is the most significant LLC state law concern. The confusion seems to be the unintended result of adopting language drafted for limited partnerships, which are not entirely similar, rather than a clear legislative desire to preclude advance consent. By analogy to general partnership law, which permits advance continuation agreements,[195] there is a clear, practical need for advance agreements concerning continuation, and no apparent state law policy considerations to preclude such advance arrangements.[196] Nevertheless, since this particular aspect of the LLC is crucial to the determination of income tax classification, discussed in Part III of this article, the I.R.S.'s response to continuation agreements will shape these agreements far more than state law considerations.

c. Tiered Ownership Structures

As discussed above, tiered ownership structures can minimize the impact of the transfer and new member admission limitations of the LLC.[197] Tiered ownership can be still more effective in reducing the hazards of dissolution if the LLC members do not object to the difficulties attending the proliferation of multilayered entities.

For example, assume that two separate individual investor groups are assembled by two promoters. If all the investors become LLC members, the LLC will be dissolved upon the death or bankruptcy of any one of them. Moreover, the Colorado statute dissolves the LLC upon the resignation of any member.[198] If, how-

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bers as to the affairs of a limited liability company and the conduct of its business." COLO. REV. STAT. § 7-80-102(11).

194. *See infra* text accompanying notes 217-64.

195. *See supra* notes 182-83 and accompanying text.

196. The validity of an advance agreement may be subject to several exceptions. In Phillips v. Kula 200, 2 Haw. App. 206, 629 P.2d 119 (1981), the court rejected the general partners' contention that a provision permitting the amendment of the partnership agreement by a 75% vote of limited partner units could be utilized to cure a breach of fiduciary duty by the general partners. *Id.* at 210-11, 629 P.2d at 122-23. In Day v. Sidley & Austin, 394 F Supp. 986 (D.D.C. 1975), *aff'd sub. nom.* Day v. Avery, 548 F.2d 1018, 1028 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 908 (1977), a general partner unsuccessfully asserted that a less than majority amendment provision did not contemplate the action in question. The circumscribed events of dissolution to which the advance continuation agreements would apply did not suggest fiduciary duty, overbreadth, or frustration of general public policy considerations. 394 F Supp. at 993-94.

197. *See supra* text accompanying notes 153-54 & 160-61.

198. *See* COLO. REV. STAT. § 7-80-801(c) (Supp. 1990).

ever, each promoter forms a limited partnership comprised of his or her investor group, the only members of the LLC will be the two limited partnerships, allowing the two promoters to act as the managers of the LLC.[199] Only the dissolution of one of the limited partnerships will dissolve the LLC, with resignation or expulsion unlikely A limited partnership is generally unaffected by events occurring with respect to its limited partners, consequently, the occasions for dissolution are limited primarily to events pertaining to the general partners.[200]

Even if such events of dissolution occur, the remaining general partner(s) may continue the member limited partnership under the RULPA.[201] If a structure enlisting multiple general partners is not possible or practical, a single corporate general partner reduces the potential of dissolution by reason of death. However, if a corporate general partner is utilized, such that no partner is personally liable for the partnership's debts or obligations, the LLC is redundant, providing limited liability coextensive with that already in place. Consequently, the most plausible case of a tiered arrangement occurs where the promoter continues as an individual general partner of the member limited partnership. The risk of dissolution of the member limited partnership, and in turn the LLC, remains limited to events pertaining to the general partner or general partner group, and the individual general partners obtain limited liability through the LLC. The effect of such arrangements on the federal income tax classification of the LLC is unclear.[202]

Given the number of entities created under the tiered ownership structure, a limited partnership utilizing an LLC general partner might provide a simpler alternative. This structure would provide limited liability for all, while avoiding the state law disadvantages of the LLC with respect to the majority of investors who would be limited partners. However, in business endeavors involving only a limited number of investors, the state law burdens imposed through dissolution and transfer of interest restrictions may

199. Under Colorado's statute, which limits managers to natural persons, limited partnerships could not be the managers. *See id.* § 7-80-401(2). The Florida, Kansas, and Wyoming, statutes do not expressly limit management to natural persons. *See* FLA. STAT. § 608.422 (Supp. 1989); KAN. STAT. ANN. § 17-7612 (Supp. 1990); WYO. STAT. § 17-15-116 (1977).

200. *See supra* text accompanying notes 165-68.

201. REVISED UNIF. LTD. PARTNERSHIP ACT § 801(4) (1985).

202. *See infra* text accompanying notes 336-45.

not be sufficient to warrant the use of tiered or hybrid structures.[203]

13. Survival of Actions after Dissolution

The LLC statutes incorporate the language of MBCA § 93, which states that "the existence of the corporation shall cease, except for the purpose of suits, other proceedings and appropriate corporate action by shareholders, directors and officers as provided in this Act."[204] Section 93 refers to MBCA § 105, which provides for survival of remedies available to or against the corporation, its directors, officers, or shareholders if the action or proceeding is commenced within two years after dissolution.[205] The Colorado, Kansas, and Wyoming LLC statutes refer to "suits, other proceedings and appropriate action as provided in this act";[206] the Florida statute is similar but refers to "this chapter."[207] However, all the LLC statutes are deficient insofar as they copy the MBCA § 93 language referring to other operative provisions without including them.

14. Derivative Actions

The Florida, Kansas, and Wyoming statutes establish that a member of an LLC is not a proper party to a proceeding by or

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203. The LLC statutes impose several burdens. All four LLC statutes provide for the dissolution of the company upon the death, retirement, resignation, expulsion, or bankruptcy of any member, unless all the remaining members agree to continue the business. *See supra* notes 162-64 and accompanying text. Furthermore, if an LLC interest is transferred or assigned, the transferee does not have the right to participate in management or become a member unless all the other members, excluding the transferor, consent to the transfer. *See supra* notes 140-41 and accompanying text.

204. MODEL BUSINESS CORP. ACT § 93 (1979).

205. *See id.* § 105.

206. *See* COLO. REV. STAT. § 7-80-807(2) (Supp. 1990); KAN. STAT. ANN. § 17-7627(b) (Supp. 1990); WYO. STAT. § 17-15-128(b) (1977). The Wyoming statute specifies that upon the issuance of the certificate of dissolution:

> The existence of the company shall cease, except for the purpose of suits, other proceedings and appropriate action as provided in this act. The manager or managers in office at the time of dissolution, or the survivors of them, shall thereafter be trustees for the members and creditors of the dissolved limited liability company and as such shall have authority to distribute any company property discovered after dissolution, convey real estate and take such other action as may be necessary on behalf of and in the name of such dissolved limited liability company."

Id.

207. FLA. STAT. § 608.446(2) (Supp. 1989).

against an LLC, except in proceedings to enforce a member's rights against or liabilities to the LLC.[208] This provision follows ULPA § 26,[209] which some courts have interpreted as barring derivative suits by limited partners.[210] The Colorado LLC statute omits this provision as well as the express derivative action provisions introduced by the RULPA,[211] which leaves open the question of whether derivative action law suits are available in the LLC context.[212]

15. Foreign and Interstate Commerce

The Wyoming statute "shall apply to commerce with foreign nations and among the several states only as permitted by law "[213] This language derives from MBCA § 148, which refers to "the provisions of the Constitution of the United States,"[214] rather than "by law " The purpose of this provision is to make "it clear that the Model Act applies to interstate commerce so far as permitted by the Constitution of the United States."[215]

Recognition of the LLC outside its state of domicile is a greater concern, because of the limited number of states that recognize this organizational form. The uncertain status of entities in foreign jurisdictions is not unique to the LLC. It remains a fundamental issue for limited partnerships formed under the ULPA[216]

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208. *See id.* § 608.462; KAN. STAT. ANN. § 17-7631; WYO. STAT. § 17-15-130.

209. *See* UNIF. LTD. PARTNERSHIP ACT § 26 (1916) (identifying parties who may bring actions against the partnership). This language was one of many issues in the debate over whether derivative suits are permitted in a partnership formed under the ULPA. *See* Hecker, *Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act*, 33 VAND. L. REV. 343, 351-53 (1980) (discussing possible interpretations of section 26).

210. *See, e.g.*, Bedolla v. Logan & Frazier, 52 Cal. App. 3d 118, 128, 125 Cal. Rptr. 59, 66-67 (1975); Amster v. American Home Assurance Co., 348 So. 2d 68 (Fla. Dist. Ct. App.), *cert. denied*, 358 So. 2d 128 (Fla. 1977); Millard v. Newmark & Co., 24 A.D.2d 333, 336, 266 N.Y.S.2d 254, 259 (1966); Lieberman v. Atlantic Mut. Ins. Co., 62 Wash. 2d 922, 385 P.2d 53 (1963).

211. *See* REVISED UNIF. LTD. PARTNERSHIP ACT §§ 1001-04 (1985) (detailing requirements for derivative actions).

212. Colorado's statute permits the members to seek an accounting, which can achieve some of the same objectives as a derivative suit based on member or manager actions or omissions. *See* COLO. REV. STAT. § 7-80-712(c) (Supp. 1990).

213. WYO. STAT. § 17-15-135 (1977).

214. MODEL BUSINESS CORP. ACT § 148 (1969).

215. MODEL BUSINESS CORP. ACT ANN. § 148 ¶ 2 comment (2d ed. 1971).

216. This problem prompted amendments to the ULPA.

Article 9 of the 1976 & 1985 Acts deals with one of the thorniest questions for those who operate limited partnerships in more than one state, i.e., the status of

and for business trusts seeking to do business outside of Massachusetts.[217] The many aspects of this issue, as applied to the LLC, are discussed below

a. Registering the LLC in Foreign Jurisdictions

The Wyoming statute gives each LLC the authority to "conduct its business, carry on its operations and have and exercise the powers granted by this act in any state, territory, district or possession of the United States, or in any foreign country "[218] In order to do business in jurisdictions other than the state of formation, the LLC must first have authority from the state of formation. This requirement is met by a statutory enabling act, such as the Wyoming provision.[219] The presence of constitutional or statutory provisions permitting foreign entities to do business in the host or "forum" jurisdiction must also be examined when assessing an LLC's ability to do business outside its state of formation. In that regard, only the Colorado and Kansas LLC statutes, and a separate provision under Indiana law, provide express procedures for the registration of LLCs formed under the laws of other jurisdictions.[220] By comparison, the RULPA[221] and the MBCA[222]

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the partnership in a state other than the state of its organization. Neither case law under the 1916 Act nor administrative practice made it clear which state's law governed the partnership or whether, in that other state, the limited partners continued to possess limited liability.

REVISED UNIF. LTD. PARTNERSHIP ACT prefatory note at 229 (1985); O'Neal, *supra* note 75, at 690 (discussing the current legal approach to the issue of limited partnerships in states where the partnership was not organized). At least 44 states and the District of Columbia have enacted the 1976 version of the RULPA and many have also adopted the 1985 amendments as well. REVISED UNIF. LTD. PARTNERSHIP ACT, Table of Jurisdictions Wherein Act Has Been Adopted, 6 U.L.A. 226-27 (Supp. 1990).

217. *See* Note, *Conflict of Laws: Choice of Law and the Foreign Real Estate Investment Trust*, 26 OKLA. L. REV. 395 (1973) [hereinafter Note, *Conflict of Laws*] (examining the uncertainty of how business trusts are treated by foreign jurisdictions); Note, *The Real Estate Investment Trust in Multistate Activity*, 48 VA. L. REV. 1125 (1962) [hereinafter Note, *Multistate Activity*] (discussing difficulties business trusts encounter when trying to do business outside their home state).

218. WYO. STAT. § 17-15-104(a)(viii) (1977). The Colorado and Florida statutes contain similar provisions. *See* COLO. REV. STAT. § 7-80-104(h) (Supp. 1990); FLA. STAT. § 608.404(7) (Supp. 1989).

219. "It is elementary that a corporation is a creature of the law and that it has no authority to exercise in another state or country any powers which its charter does not confer upon it, either expressly or impliedly " 17 W FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8317 (rev. perm. ed. 1987).

220. *See* COLO. REV. STAT. §§ 7-80-901 to -913 (extensively outlining the requirements for foreign LLCs). Florida's statute implies that foreign LLCs will be admitted to Florida because the name restrictions apply to "a foreign limited liability company, author-

offer such provisions to foreign limited partnerships and foreign corporations, respectively In the absence of specific statutory acceptance by foreign jurisdictions, an LLC might attempt to register under foreign limited partnership or foreign corporation statutes. While meeting the foreign limited partnership definitions would be difficult,[223] an LLC might be able to register under state corporation statutes.[224]

The issuance of a certificate of authority memorializes successful registration in a foreign jurisdiction. With a certificate of authority, "the corporation shall be authorized to transact business in this State for those purposes set forth in its application."[225]

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ized to transact business in this state." FLA. STAT. § 608.406(1). Colorado's statute defines "[f]oreign limited liability company" as "a limited liability company formed under the laws of any jurisdiction other than this jurisdiction." COLO. REV. STAT. § 70-80-102(6). This provision is meaningless unless other states name these entities LLCs. Florida, Kansas, and Wyoming have named them LLCs, and other states are likely to do so as well. *See* FLA. STAT. § 608.401; KAN. STAT. ANN. § 17-7601 (Supp. 1990); WYO. STAT. § 17-15-101. However, it is unclear whether an examination of the substance of an entity with such a name is required. The Kansas statute permits the registration of a "foreign limited liability company" but fails to define the term. *See* KAN. STAT. ANN. §§ 17-7636 to -7644. Indiana is unique in that it permits foreign LLCs to register to do business in Indiana even though it does not itself allow the formation of LLCs. *See* IND. CODE §§ 23-16-10.1 to -10.1-4 (1990); *see also supra* note 14.

221. *See* REVISED UNIF. LTD. PARTNERSHIP ACT §§ 902-08 (1985).

222. *See* MODEL BUSINESS CORP. ACT §§ 106-24 (1979).

223. The RULPA defines the term "foreign limited partnership" as "a partnership formed under the laws of any state other than this State and having as partners one or more general partners and one or more limited partners." REVISED UNIF. LTD. PARTNERSHIP ACT § 101(4). An LLC does not have partners, or differentiated interests corresponding to general or limited partners. All members enjoy immunity from liability for the obligations of the entity. For federal income tax purposes, however, the management control exercised by member-managers may liken them to the general partners of a limited partnership. *See supra* note 180 and accompanying text.

224. The MBCA defines the term "foreign corporation" as "a corporation for profit organized under laws other than the laws of this State for a purpose or purposes for which a corporation may be organized under this Act." MODEL BUSINESS CORP. ACT § 2(b). The RMBCA is broader. " 'Foreign corporation' means a corporation for profit incorporated under a law other than the law of this state." REVISED MODEL BUSINESS CORP. ACT § 1.40(10) (1984). The definitions of corporation in both the 1969 and 1984 Model Business Corporation Acts are circular, defining a corporation to be a corporation. The authors have not exhaustively reviewed the corporation laws of all states. Other authors, dealing with proper names of foreign corporations for registration, suggest that the *GmbH*, the *limitada*, and other foreign entities, might be registered as foreign corporations. *See* H. HENN & J. ALEXANDER, *supra* note 42, § 136, at 321 n.8. The similarity of the LLC to those entities might provide some basis for registration. *See supra* note 218 and accompanying text. In some cases the unincorporated business trust was treated as a corporation. *See, e.g.*, State v. United Royalty Co., 188 Kan. 443, 460, 363 P.2d 397, 409 (1961) (foreign business trust treated as a corporation).

225. MODEL BUSINESS CORP. ACT § 112. This discussion assumes that the LLC has

Moreover, "[a] qualified foreign corporation usually enjoys in the jurisdiction where qualified such powers as are permitted by the laws of the jurisdiction of its incorporation but no greater powers than domestic corporations formed for the business set forth in the application."[226]

Registration of the LLC in a foreign jurisdiction may be advantageous for other reasons. It not only affords any protection of LLC status gained by registration but also helps to avoid the imposition of penalties if such registration is required. The RMBCA, for example, levies civil penalties and bars a foreign entity from maintaining civil actions if it does business without a certificate of authority [227]

b. Conflict of Laws in General

In the case of an LLC, a conflict might arise between a statute of the forum state prohibiting LLCs and the LLC enabling legislation of the state of formation. If no LLC statute exists in the forum state, then an examination of its public policy toward LLCs will be weighed against the enabling legislation of the state of formation. In the first situation, some suggest that states can

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interstate activities that subject it to regulation by the foreign jurisdiction. The constitutional aspects of doing business in a given jurisdiction, for purposes of personal jurisdiction, regulation, or taxation, are beyond the scope of this article. *See generally* H. HENN & J. ALEXANDER, *supra* note 42, §§ 96-101 (discussing constitutional aspects involved in the selection of jurisdiction).

226. H. HENN & J. ALEXANDER, *supra* note 42, § 136, at 323. This language finds its origin in REVISED MODEL BUSINESS CORP. ACT § 15.05(b). California and New York, however, apply provisions of their own corporate statutes to certain foreign corporations doing business in the respective states, extending to traditional internal affairs. *See* CAL. CORP. CODE § 2115 (West 1977 & Supp. 1990); N.Y. BUS. CORP. LAW §§ 1317-20 (McKinney 1986 & Supp. 1990); Halloran & Hammer, *Section 2115 of the New California General Corporation Law — The Application of California Corporation Law to Foreign Corporations*, 23 UCLA L. REV. 1282 (1976) (discussing application of California's law to foreign corporations); Oldham, *California Regulates Pseudo-Foreign Corporations — Trampling Upon the Tramp?*, 17 SANTA CLARA L. REV. 85 (1977) (discussing applicability and resulting hardship of California's law to foreign corporations); Comment, *California s Statutory Attempt to Regulate Foreign Corporations: Will It Survive the Commerce Clause?*, 16 SAN DIEGO L. REV. 943 (1979) (discussing constitutional limitations on the California law). For further discussion of these issues, including the constitutional aspects, see R. LEFLAR, L. MCDOUGAL & R. FELIX, AMERICAN CONFLICTS LAW, 707-13 (4th ed. 1986).

227. REVISED MODEL BUSINESS CORP. ACT § 15.02. *See generally* R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, § 254, at 703-05 (discussing the enforceability of these provisions).

absolutely prohibit the entry of foreign entities,[228] but once they are permitted to enter they are entitled to certain constitutional protections.[229] If the foreign entity engages solely in interstate commerce, then only reasonable restrictions in the exercise of the forum state's police power are constitutionally permissible.[230] In the absence of LLC legislation in the forum state, the question of the LLC's status would probably arise in the context of facts connected with the forum state, such as a debt, contract claim, or claim of liability arising from tortious conduct. In such an event, a court will base its choice of law on general conflict of laws principles.[231] A third party claimant who asserts that the LLC is invalid in the forum state therefore raises unsettled choice-of-law issues.

In dealing with foreign corporations, the *Restatement (Second) of Conflict of Laws* ("*Second Restatement*") provides that "[i]ncorporation by one state will be recognized by other states."[232] The *Second Restatement* further establishes that the law of the state of incorporation will be applied to "determine the existence and extent of a shareholder's liability to the corporation for assessments or contributions and to its creditors for corporate debts."[233] Other "internal affairs" of the corporation are governed by the law of the state of incorporation, unless another state has a more significant interest.[234] The relatively specific rules for corpo-

228. R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, § 251, at 696 n.6.

229. *Id.* at 709-13 (noting that these constitutional safeguards prevent a state from imposing substantial burdens on foreign corporations or excluding foreign corporations engaged in interstate commerce).

230. *Id.*

231. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 301 (1971) ("The rights and liabilities of a corporation with respect to a third person that arise from a corporate act of a sort that can likewise be done by an individual are determined by the same choice-of-law principles as are applicable to non-corporate parties.").

232. *Id.* § 297.

233. *Id.* § 307.

234. *Id.* § 302. This section establishes the general rule that the law of the state of incorporation will apply except where some other state has a more significant relationship to the occurrence and the parties. This would arise, for example, where a corporation incorporated in one state does a significant portion of its business in the forum state. "All the basic rights and duties of all the stockholders (or members) of any corporate entity, between themselves and toward the entity, ought to be governed by the same law, which has to be the law of the (or a) place in which the corporate existence was created and is centered." R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, § 60, at 181-82. The quoted passage refers to a qualifying footnote that states: "A difficulty exists as to corporations formally organized in one state, perhaps Delaware, but having their principal place of business and all of their major activities centered elsewhere. Probably as to these the state of 'commercial domicile' rather than that of incorporation should be looked to." R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, § 60, at 182 n.2 (citing Latty, *Pseudo-Foreign*

rations are, however, subject to general conflict-of-laws principles, including consideration of "the relevant policies of the forum ..."[235] This volatile public policy exception figures prominently in the application of comity discussed below.[236]

Even assuming, public policy aside, that a court would embrace all relevant directives of the *Second Restatement*, those directives apply only to corporations,

> [o]ther forms of organization are ignored because (1) to date, they have engaged the attention of the courts only rarely in the field of choice of law and (2) to the extent that they enjoy the same attributes as business corporations, the choice-of-law rules stated in this Chapter should usually be applicable to them.[237]

The *Second Restatement* discusses some commonly held attributes of corporations, most of which are satisfied by the LLC.[238] If the LLC were, on the other hand, considered a limited partnership, even more uncertain conflict-of-laws principles would be involved.[239] This traditional choice-of-law approach, however, does not necessarily apply to LLCs. All 50 states recognize the corporate form, and all but Louisiana recognize the limited partnership, so the conflict-of-laws analysis proceeds from that common ground to determine which jurisdiction's law applies. In contrast, only five states expressly recognize the LLC. Therefore, the inquiry will focus more on comity aspects of the conflict of laws.[240]

1. Comity Toward Foreign Entities

In the absence of a statute or a constitutional provision ad-

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Corporations, 65 Yale L.J. 137 (1955)).

235. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2)(b) (1971).

236. *See infra* notes 241-48 and accompanying text.

237. RESTATEMENT (SECOND) OF CONFLICT OF LAWS ch. 13 introductory note.

238. The corporate attributes are: (1) limited liability of shareholders for any act or omission of the corporation and (2) capacity: (a) to sue or be sued in the corporate name; (b) to have official representatives with exclusive power to enforce and protect common rights and interests direct its affairs; (c) to transact with respect to property, real or personal, in the corporate name; and (d) to endure for a term of years or in perpetuity. *See id.* The ready dissolubility of the LLC obviously detracts from the last attribute.

239. *See supra* note 216. As a hybrid entity, the LLC does not clearly fit as either a corporation or a limited partnership. For registration purposes, at least, the limited partnership characterization appears to be more strained due to the lack of clearly differentiated ownership classes corresponding to general and limited partners. *See supra* note 222.

240. *Cf.* Comment, *Limited Liability of Shareholders in Real Estate Investment Trusts and the Conflict of Laws*, 50 CALIF. L. REV. 696, 701 (1962) (discussing the rationale for establishing choice-of-law rules relating to foreign business trusts by analogy to similar rules for foreign corporations).

dressing the status of foreign entities, the right of a corporation to do business in a jurisdiction outside of its state of formation is said to be governed by the law of comity.[241] Comity is the principle that a forum state will enforce rights granted by a foreign state unless enforcement is "inconsistent with any statute or public policy of the [forum] state ."[242] In the context of corporations, it is widely held that "[c]omity is never extended to a foreign corporation where such corporation's existence in the state or the exercise of its powers there would be prejudicial to the state's interest or repugnant to its declared policy."[243]

The reception accorded the Massachusetts Business Trust in other states demonstrates the unpredictability of relying on principles of comity The Texas Supreme Court ruled that the business trust did not provide limited liability to its interest holders.[244] In the court's view, the business trust constituted an impermissible circumvention of the statutorily mandated vehicle for limited liability· the limited partnership.[245] Although several other courts reached the same conclusion, a number of jurisdictions "saw nothing contrary to public policy or legislative intention in permitting entrepreneurs to achieve freedom from personal liability without complying with either the corporation or the limited partnership statutes."[246]

From a state law perspective, the LLC is not analogous to a limited partnership because no member has even nominal liability to creditors. However, the LLC closely resembles a corporation, justifying a comparison between LLCs and foreign corporations

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241. *See generally* 17 W FLETCHER, *supra* note 219, §§ 8330-45 (discussing the scope of comity with respect to foreign corporations).

242. *Id.* § 8331.

243. *Id.* § 8334.

244. *See* Thompson v. Schmitt, 115 Tex. 53, 69-70, 274 S.W 554, 560 (1925).

245. "They attempted to secure such exemption without procuring anyone to join them as a general partner, and in fact without compliance with a single statutory requirement." *Id.* at 68, 274 S.W at 560.

246. G. BOGERT & G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 247(G), at 164 (2d ed. 1977) (discussing the controversy over recognition of the business trust). Most of the decisions predate amendments made in 1948 to the enabling legislation for the Full Faith and Credit Clause, which focused more attention on the constitutional implications of recognition of foreign public acts. *See generally infra* notes 249-53. The potential for nonrecognition of the foreign trust entity has remained an issue for commentators. *See generally* Note, *Conflict of Laws*, *supra* note 217 (examining problems of foreign trusts that are denied recognition and attendant conflict-of-laws issues); Note, *Multistate Activity*, *supra* note 217 (discussing difficulties posed by the varying treatment of business trusts).

seeking to do business in the forum jurisdiction.[247] The risks of nonrecognition can be mitigated through the use of clauses, commonly encountered in contracts between business trusts and creditors, releasing the members and managers from all personal liability Furthermore, choice-of-law provisions in contracts, stating that the law of the LLC's state of formation shall apply, also provide members and managers insulation from liability [248] Nevertheless, until more states adopt LLC statutes, or otherwise provide for their registration or recognition, their status will remain in doubt.

ii. Full Faith and Credit and Due Process

The Colorado statute contains a declaration of legislative intent that LLCs transacting business outside of Colorado "be granted the protection of full faith and credit under section 1 of Article IV of the Constitution of the United States."[249] The full faith and credit clause states: "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof."[250] Until 1948, the federal enabling statute referred to in the second sentence of the clause did not refer to "Acts,"[251] but the addition of this word may not have lent any additional force to the clause.[252] However,

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247. The policy comparison should focus on the LLC and any applicable corporation statutes. If the forum state has particularly stringent corporation requirements, they should not be compared with the LLC because these requirements could be avoided through incorporating in a much more flexible domicile, such as Delaware. These corporations would then be subject only to the forum's regulation of foreign corporation internal affairs. *See generally* sources cited *supra* note 226. It is difficult to see any significant circumvention of corporate policy by LLCs, particularly those formed under the Colorado statute. There might be some concern for the perceived oppression of dissension and the rights of minority members regarding dissenters' rights and approval of extraordinary transactions, where corporate law would require at least majority approval, appraisal rights, and other safeguards. However, part of the LLC's attractiveness is its avoidance of these rigid requirements. *See infra* text accompanying note 274.

248. "It is apparently everywhere admitted, however, that by agreement a creditor may be precluded from proceeding against the beneficiaries " G. BOGERT & G. BOGERT, *supra* note 246, § 247(J), at 173.

249. COLO. REV. STAT. § 7-80-106 (Supp. 1990).

250. U.S. CONST. art. IV, § 1.

251. The current version of the statute refers to acts. *See* 28 U.S.C. § 1738 (1988).

252. Professor Weintraub points to pre-1948 decisions of the Supreme Court holding that the clause refers to "public act[s]" and is self-executing. He suggests that "it is difficult to see how anything important turned upon the absence from the statute of the word

there is no question that the full faith and credit clause has placed a constitutional gloss on the common law principles of comity discussed above.[253]

The full faith and credit clause has been applied almost coextensively with the due process clause,[254] requiring a sufficient state interest by the forum state. The clause, as described by Justice Brennan in *Allstate Insurance Co. v Hague*, "has invalidated the choice of law of a State which has had no significant contact or significant aggregation of contacts, creating state interests, with the parties and the occurrence or transaction."[255] A forum state's application of its own law to a controversy will therefore be sustained under full faith and credit and due process if it has significant contacts with the proceeding, but "if a State has only an insignificant contact with the parties and the occurrence or transaction, application of its law is unconstitutional."[256]

In *Hague*, an accident occurred in Wisconsin involving three Wisconsin residents, two of whom were on their way to work in Minnesota. Despite all the factors pointing to application of Wisconsin law, the Court upheld the application of Minnesota law because the deceased, to whom the wrongful death action pertained, worked in Minnesota, commuted to work there, and his surviving spouse became a Minnesota resident subsequent to his death but before the action was commenced.[257] In most cases of a foreign LLC entering another state, the challenge to the status of the LLC would be precipitated by the LLC's business activities, ownership of property, or tortious conduct in the forum state. In the face of such significant contacts with the forum state, it appears that the forum state would not be constitutionally precluded from

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'acts' Nor should very much turn upon the word's subsequent inclusion." R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 567 (3d ed. 1986); *see* R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, at 218 n.5 (asserting that the addition of "Acts" had no impact).

253. "It substituted a command for the earlier principles of comity and thus basically altered the status of the States as independent sovereigns." Estin v. Estin, 334 U.S. 541, 546 (1948).

254. In Allstate Ins. Co. v. Hague, 449 U.S. 302, 308 n.10 (1981), Justice Brennan noted that the tests for full faith and credit and due process are almost always identical.

255. *Id.* at 308.

256. *Id.* at 310-11. The constitutional test resembles the application of common law choice-of-law principles. "A court may not apply the local law of its own state to determine a particular issue unless such application of this law would be reasonable in the light of the relationship of the state and of other states to the person, thing or occurrence involved." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 9 (1971).

257. *Hague*, 449 U.S. at 305.

looking to its statutes and public policy in deciding whether to recognize an LLC.

Application of the laws of the LLC's state of formation might be constitutionally required under precedent pre-dating the Court's decision in *Hague*. A line of decisions ending in 1947 involving fraternal beneficent societies, required application of the law of the state of incorporation under the full faith and credit clause to achieve national uniformity of result.[258] However, these cases may no longer be good law[259] at least in the insurance context.[260] These cases might also be distinguished on the grounds that they addressed transactions between the members and the fraternal society, matters similar to the "internal affairs" of a corporation and for which choice-of-laws rules mandate application of the law of the state of incorporation.[261] In contrast, an entity's dealings with third persons generally are governed by the law of the forum.[262] The issue of whether to recognize the entity's valid-

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258. *See, e.g.*, Order of United Commercial Travelers of Am. v. Wolfe, 331 U.S. 586, 606 (1947); Sovereign Camp of the Woodmen of the World v. Bolin, 305 U.S. 66, 74 (1938); Modern Woodmen of Am. v. Mixer, 267 U.S. 544, 550-51 (1925); Supreme Council of the Royal Arcanum v. Green, 237 U.S. 531, 540 (1915).

259. R. WEINTRAUB, *supra* note 252, at 522 n.86 (quoting Clay v. Sun Ins. Office, Ltd., 377 U.S. 179, 183 (1964) (declining to extend or apply the rule developed in the earlier fraternal society cases)).

260. "The analogy to the common interest of shareholders in a commercial corporation does not stand up. The analogy should be to choice-of-law rules applicable to insurance contracts generally, just as it would be to any independent contract between a stockholder and his corporation. The *Hague* formula governing legislative jurisdiction should control these contracts just as it controls other insurance contracts." R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, at 183.

261. *See supra* text accompanying notes 232-35; *see also* Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 446 (1968); Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958).

262. *See supra* text accompanying notes 228-31. In referring to the need for uniformity of treatment with respect to shareholders' rights to dividends, their right to participate in management by voting, their liability on unpaid subscriptions, their subjection to assessments or double liability, and the existence of preemptive rights, one leading commentary states:

> As to most or all of these, competing interests of third persons or of other states will seldom be involved. If no such outside interests are affected, the members of the corporate body ought all to have identical rights and duties, and a constitutional requirement that one law and one law only govern them is understandable. Any other rule would defeat the 'justifiable expectations' of the stockholders, 'unfairly surprise' them, operate 'unreasonably,' and constitute an 'arbitrary and capricious application of laws that have no fair or decent connection' with the real problem, which is uniformity of treatment.

R. LEFLAR, L. MCDOUGAL & R. FELIX, *supra* note 226, at 182.

ity implicates elements of each of these choice-of-law principles. On the one hand, the liability of shareholders might be considered an "internal affairs" matter governed by the laws of the state of incorporation.[263] On the other hand, the limited liability of members affects the remedies available to third parties; the courts of the forum state would probably be compelled to consider protecting the interests of citizens of the forum state,[264] in view of the alleged repugnancy of the LLC form to a perceived public policy of the forum state. However, neither inquiry raises constitutional questions beyond the due process analysis discussed above. At this point in the development of the law, recognition of the LLC in other jurisdictions does not appear to be constitutionally required and is subject to the unpredictable policy determinations of the forum state's courts.

C. Revising the LLC

We have already identified a number of areas requiring statutory revision.[265] Because many of the Wyoming statute's provisions were drawn from the ULPA and the MBCA, adapting the RULPA amendments to the LLC model affords a ready mechanism for effecting these revisions.[266] This is essentially the path

263. *See supra* text accompanying notes 228-40.

264. One author notes that cases considering the application of public policy to the business trust have produced conflicting results. In analyzing these cases, "it is apparent that the choice of law rested primarily on the result which best protected the forum's citizens. Furthermore, each court's notions of justice dictated the decisions rendered." Note, *Multistate Activity*, *supra* note 217, at 1143. However, this approach may frustrate other choice-of-law principles applied to LLC members, including "protection of justified expectations," RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6(2)(d) (1971), and "certainty, predictability and uniformity of result." *Id.* § 6(2)(f); *see supra* note 262 and accompanying text (discussing other choice-of-law principles). The rule of comity, discussed *supra* text accompanying notes 241-48, "is always subject to and must yield to considerations of public policy." 17 W FLETCHER, *supra* note 219, § 8334. Furthermore, public policy limitations on recognition of foreign public acts have been alluded to in some decisions. *See* Paulsen & Sovern, *"Public Policy" in the Conflict of Laws*, 56 COLUM. L. REV. 969, 972, 1010 (1956) (discussing cases involving public policy limitations on judicial recognition of foreign law).

265. *See supra* text accompanying notes 79-82 (allow contributions of services), 88-97 (state whether managers need to be members or residents), 129-35 (provide for allocations of losses), 136-38 (provide 1 and 6 year statutes of limitations on return of capital) & 213-27 (adopt provisions for admission of foreign LLCs).

266. These RULPA improvements permit an attorney-in-fact to sign articles of organization and amendments, REVISED UNIF. LTD. PARTNERSHIP ACT § 204(b) (1985); permit amendment or cancellation by judicial act, *Id.* § 205; consider reservations of LLC names, *Id.* § 103; consider abbreviated certificate disclosures, *Id.* § 201; require mainte-

that the Colorado legislature followed, and the result demonstrated by the appendix to this article[267] is striking when compared with the relatively simple structures of the Wyoming and Florida statutes. This assumes that the RULPA was an improvement over the ULPA. While this assumption is substantially justified, problems of interpretation and policy pervade some of the provisions.[268]

Colorado's statute added a number of technical and procedural refinements. However, a number of attributes traditionally associated with the corporate form were not included. Preemptive rights were not addressed[269] but need not be if approval of additional members requires unanimous consent[270] and if the operating agreement treats additional contributions from existing members. Voting trusts and member voting agreements were not addressed.[271] Derivative actions were also not mentioned.[272] Drafters of LLC statutes should consider whether to protect minority members by requiring a supermajority for transactions outside the ordinary course of business, whether to give dissenters appraisal rights,[273] and whether to permit mergers.[274] The challenge is drawing a line between the traditional detail of a corporation and the flexibility of a partnership. The Wyoming, Florida, and Kansas statutes are very flexible. The Colorado statute attempts to walk this line by making many of the prescribed statutory provisions applicable only in the absence of the members' express agreement. "Agreement" is the key that should not be lost, lest

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nance of certain books and records and ensure members' rights to inspect them, *Id.* §§ 105, 305; expressly address the rights of the estate of a deceased or incompetent partner, *Id.* § 705; permit judicial dissolution, *Id.* § 802 (Florida has incorporated this provision, FLA. STAT. § 608.448 (Supp. 1989)); consider the derivative action provisions, *Id.* §§ 1001-04; and consider a severability clause, *Id.* § 1103.

267. *See infra* pp. 472-501.

268. *See, e.g., supra* note 187 (discussing concern with the RULPA's continuation and dissolution aspects).

269. *Compare* MODEL BUSINESS CORP. ACT § 26 (1979) (no preemptive rights unless articles of incorporation provide otherwise).

270. *See supra* text accompanying notes 157-61.

271. *Compare* MODEL BUSINESS CORP. ACT § 34 (allowing voting trusts of up to ten years in duration).

272. *Compare id.* § 49 *and* REVISED UNIF. LTD. PARTNERSHIP ACT §§ 1001-04 (1985) (allowing limited partners to bring derivative suits and establishing procedures therefor).

273. *Compare* MODEL BUSINESS CORP. ACT §§ 79-81 (establishing dissenting shareholders' right to fair market value of their shares).

274. *Compare id.* §§ 71-77 (allowing mergers and establishing procedures). The Kansas statute permits mergers. *See* KAN. STAT. ANN. § 17-7650 (Supp. 1990).

the freedom of contract enjoyed by the general and limited partnership be swallowed up in the more unyielding structure of corporate law.[275] Although LLCs are not corporations, the courts may apply corporate principles in determining the relationship of their members. Such an approach would be unfortunate because the tax induced structural limitations on LLC duration and transferability will probably relegate the LLC to closely held operations for which partnership flexibility is more desirable.

II. Federal Income Tax Consequences

A. Classification of the LLC for Tax Purposes

1. State Law Treatment

Wyoming has no state income tax.[276] The Florida statute requires taxation of the LLC as a corporation for Florida state taxation purposes.[277] The Colorado statute taxes the LLC as a partnership.[278] As more states adopt LLC statutes, the tax characterizations of domestic LLCs, and perhaps foreign LLCs, may diverge from the desired federal tax results that originally motivated creation of the LLC.

2. Federal Tax Law Classification in General

Classification of the LLC as a partnership, rather than a cor-

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275. "Perhaps the most striking feature of a partnership is its basically contractual nature. Though there is a partnership statute, it is basically a 'default' or 'suppletory' law — one which, concerning the partners, inter se, will only apply when the parties have not agreed otherwise." Karjala, *A Second Look at Special Close Corporation Legislation*, 58 TEX. L. REV. 1207 (1980) (discussing the advantages and disadvantages of the MBCA and special state statutes dealing with close corporations); Kessler, *The ABA Close Corporation Statute*, 36 MERCER L. REV. 661, 663-64 (1985). Freedom of contract has been extended to close corporations through special statutes. *See* Fessler, *The Fate of Closely Held Business Associations: The Debatable Wisdom of "Incorporation,"* 13 U.C. DAVIS L. REV. 473, 486-95 (1980) (arguing that the freedom of contract granted to close corporations is contrary to the justifications underlying the corporate entity). In comparing the New Jersey corporate law to the New Jersey limited partnership association, at least one commentator has found more freedom in the limited partnership association provisions to fashion control mechanisms for the business. *See* Schwartz, *supra* note 19, at 77. The Michigan legislature, on the other hand, added cumulative voting for and reduction in the number of partnership association managers, voting by proxy, and prohibition of class voting for managers. *See* MICH. COMP. LAWS § 449.351 (1979).

276. An "annual tax" of $50.00 is, however, due and payable on January 2 of each year by each LLC. WYO. STAT. § 17-15-132(a)(vi) (1977).

277. *See* FLA. STAT. § 608.471 (Supp. 1989) (LLC regarded as an artificial entity).

278. *See* COLO. REV. STAT. § 39-22-205 (Supp. 1990).

poration, for federal income tax purposes is crucial to the viability of the LLC as an alternative form of business organization. The factors considered in the classification of an entity as a partnership have been discussed at length in a number of other publications and will therefore be dealt with briefly in this article.[279] The inquiry focuses on the existence of factors of corporate resemblance identified in the Supreme Court's 1935 decision in *Morrisey v Commissioner*[280] Although the decision in *Morrisey* established the guidelines, the Treasury's regulations and pronouncements have provided the operative details.

The current regulations governing entity characterization for federal income tax purposes identify six factors drawn from the *Morrisey* opinion: (1) associates; (2) an objective to carry on business and divide the gains therefrom; (3) continuity of life; (4) centralization of management; (5) liability for corporate debts limited to corporate property; and (6) free transferability of interests.[281] An unincorporated organization will not be classified as an association, which is taxable as a corporation, unless the organization has more corporate characteristics than noncorporate characteristics, not considering characteristics common to both the unincorporated organization and a corporation.[282] Since associates and an objective to carry on business and divide the gains therefrom are common to both corporations and partnerships, the four remaining factors are determinative of an entity's classification.[283] The factors are equally weighted; thus, if an unincorporated organization lacks any two, it generally will not be classified as an association taxable as a corporation, barring other considerations.[284]

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279. *See, e.g.*, August & Shaw, *supra* note 12.

280. 296 U.S. 344 (1935). The Court identified a number of corporate characteristics:

1. Associates in a joint enterprise;
2. A purpose to transact business and share its gains;
3. Title to property held by the enterprise as an entity;
4. Centralized management through representatives of the participants;
5. Entity existence unaffected by the death of participants;
6. Beneficial interests in the entity transferable by the participants without affecting the continuity of the enterprise;
7. The introduction of large numbers of participants; and
8. Liability of participants limited to their investment in the enterprise.

Id. at 356-59.

281. *See* Treas. Reg. § 301.7701-2(a)(1) (as amended in 1983).

282. Treas. Reg. § 301.7701-2(a)(3).

283. *See id.*

284. *See* Larson v. Commissioner, 66 T.C. 159 (1976) (entity that had corporate

a. Continuity of Life

If the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will cause a dissolution of the organization, the entity does not possess continuity of life.[285] An agreement providing that the remaining members will continue the business in the event of the death or withdrawal of a member does not engender continuity of life if, under local law, the death or withdrawal of any member causes a dissolution of the organization.[286] For a limited partnership to be classified as a partnership for federal income tax purposes, the partnership agreement must require at least a majority of the limited partners to elect a new general partner to continue the partnership in the event of the removal of a general partner.[287]

b. Centralization of Management

"An organization has [the corporate characteristic of] centralized management if any person (or any group of persons which does not include all the members) has continuing exclusive authority to make the management decisions necessary to the conduct of the business for which the organization was formed."[288] A limited partnership subject to a statute corresponding to the ULPA does not have centralized management unless substantially all the interests in the partnership are owned by the limited partners.[289] If all or a specified group of the limited partners may remove a general partner, all the facts and circumstances must be

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characteristics of centralized management and free transferability of interests but lacked continuity of life and limited liability, classified as a partnership for tax purposes). In noting the equal weight of the factors, the Tax Court stated: "This apparently mechanical approach may perhaps be explained as an attempt to impart a degree of certainty to a subject otherwise fraught with imponderables." *Id.* at 172. In addition to the four principal factors, the regulations leave open the possibility that other factors might influence the characterization issue. *See infra* text accompanying notes 297-300.

285. *See* Treas. Reg. § 301.7701-2(b)(1).

286. *See id.* § 301.7701-2(b)(2). The effect of continuation agreements is an important issue for the LLC because such agreements could reduce the difficulties posed by the numerous potential causes of dissolution. *See supra* text accompanying notes 162-96. For a discussion of the effect on tax classification, *see infra* text accompanying notes 318-45.

287. *See* Rev. Proc. 89-12, 1989-1 C.B. 798, 801. The authors of the American Law Institute Subchapter K project considered, but rejected, a revision to the continuity of life test that would require the consent of all members in the event of a technical dissolution under state law. AMERICAN LAW INSTITUTE, *supra* note 143, at 381.

288. Treas. Reg. § 301.7701-2(c)(1) (as amended in 1983).

289. *See id.* § 301.7701-2(c)(4).

examined to determine whether the partnership possesses centralized management.[290] However, the limited partners do have a "substantially restricted right" to remove the general partner if, for example, it is limited to the general partner's gross negligence, self-dealing, or embezzlement. The exercise of this right will not itself lead to a finding of centralized management.[291]

c. Limited Liability

An organization has the corporate characteristic of limited liability if, under local law, no member is personally liable for the debts of or claims against the organization.[292] By definition, LLCs will always have this corporate characteristic because LLC members are absolved from liability.[293]

d. Free Transferability of Interests

An organization possesses "free transferability of interests if each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same

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290. *Id.*

291. *Id.* For ruling purposes, the I.R.S. will find centralized management if limited partner interests, excluding those held by general partners, exceed 80% of the total interests in the partnership. In addition, the I.R.S. will consider all the facts and circumstances, including limited partner control of the general partners (whether direct or indirect) in determining whether the partnership possesses centralized management. *See* Rev. Proc. 89-12, 1989-1 C.B. 798, 801 (specifying the conditions that the I.R.S. will consider when classifying an organization as a partnership for tax purposes).

292. Treas. Reg. § 301.7701-2(d)(1) (as amended in 1983).

293. *See supra* note 61 and accompanying text. In a limited partnership, "personal liability does not exist with respect to a general partner when he 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 limited partners." Treas. Reg. § 301.7701-2(d)(2). A limited partnership with corporate general partners will generally be deemed to lack limited liability if the net worth of the corporate general partners, at the time of the ruling request, is equivalent to at least 10% of the total contributions to the limited partnership and is expected to continue to represent at least 10% of the total contributions throughout the life of the partnership. If the only general partners are corporations, and those general partners do not meet the 10% requirement, then it must be demonstrated that either a general partner has (or the general partners collectively have) substantial assets, other than the interest in the partnership, that partnership creditors might reach or that the general partners will act independently of the limited partners. *See* Rev. Proc. 89-12, 1989-1 C.B. 798, 801. The authors of the American Law Institute Subchapter K Project proposed elimination of the inquiry into a corporate general partner's financial holdings or its control by limited partners. AMERICAN LAW INSTITUTE, *supra* note 143, at 386-87.

organization a person who is not a member of the organization."[294] An interest is not freely transferable if each member can, without the consent of other members, assign only the right to share in profits but cannot also assign the right to participate in management.[295] An obligation to offer an interest to other members of the organization at its fair market value before transfer to a nonmember, known as a first right of refusal, is considered a modified form of free transferability but is accorded less weight than unmodified free transferability.[296]

e. Other Factors

The regulations provide that "other factors may be found in some cases which may be significant in classifying an organization as an association, a partnership, or a trust."[297] In Revenue Ruling 79-106,[298] the I.R.S. excluded a list of elements from consideration as "other factors," limiting their significance to establishing the presence of the six major corporate resemblance factors.[299] In that regard, Revenue Procedure 89-12 contributes to the level of complexity in gaining assurance that an entity will be treated as a partnership for federal income tax purposes. It prescribes general requirements for a favorable ruling, in addition to specific requirements for satisfying the four major determinative characteristics: continuity of life, centralized management, limited liability, and free transferability of interests.[300]

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294. Treas. Reg. § 301.7701-2(e)(1).

295. *Id.* If consent may not be unreasonably withheld, the interests are freely transferable. *See* Larson v. Commissioner, 66 T.C. 159, 183 (1976) (limited partners' income rights considered freely transferable despite a requirement of the general partner's consent, circumscribed by a standard of reasonableness).

296. *See* Treas. Reg. § 301.7701-2(e)(2).

297. *Id.* § 301.7701-2(a)(1).

298. 1979-1 C.B. 448.

299. *See id.* (stating that the I.R.S. will not consider the factors enumerated in *Larson* as "other factors" that have significance, other than their bearing on the six major corporate characteristics, with respect to the classification of an entity as a limited partnership).

300. *See* Rev. Proc. 89-12, 1989-1 C.B. 798, 800. Under this revenue procedure, general partners, as a group, are required to have at least 1% of each material item of partnership income, gain, loss, deduction, or credit at all times during the existence of the partnership. In addition, subject to certain qualifications, the general partners, taken together, must maintain the lesser of $500,000 or a minimum capital account balance equal to 1% of total positive capital account balances for the partnership. *Id.*

3. Federal Tax Law Classification of LLCs

a. The Troubled History

Until recently the I.R.S. vacillated in its application of the corporate resemblance test to LLCs. When the LLC was first conceived in 1977, the I.R.S. was still assessing its position in the wake of its defeat in *Larson v Commissioner*[301] In 1980 the I.R.S. issued proposed regulations that would deny partnership status if no member were liable for entity debts.[302] Because no member of an LLC is personally liable for the debts of the LLC, these proposed regulations would have precluded partnership tax classification. This approach, however, had been rejected in dictum by the Board of Tax Appeals in *Glensder Textile Co. v Commissioner*[303] The American Law Institute's *Federal Income Tax Project (Subchapter K)* also rejected the contention that limited liability of participants should result in classification as a corporation. The ALI report indicated that the limited liability of the participants was not relevant to the policy considerations underlying the establishment of pass-through partnership treatment.[304]

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301. 66 T.C. 159 (1976) (holding that a limited partnership whose general partner is a corporation is taxable as a partnership). In two memoranda, the I.R.S. studied whether an LLC should be classified as a corporation due to the presence of "other characteristics." *See* Gen. Couns. Mem. 38,281 (Feb. 15, 1980) (Wyoming LLC could not be classified outright as a corporation under Dartmouth College v. Woodward, 17 U.S. 518 (1819), because the LLC would dissolve upon the death or bankruptcy of a member); Gen. Couns. Mem. 38,036 (Aug. 7, 1979) (undisclosed membership of LLC members not more significant than the four principal factors).

302. 45 Fed. Reg. 75,709 (1980) (to be codified at 26 C.F.R. pt. 301) (proposed November 17, 1980) (proposing amendments including Prop. Treas. Reg. §§ 301.7701-2(a)(2), 301.7701-2(a)(3), 301.7701-2(a)(4)).

303. 46 B.T.A. 176 (1942). In discussing the structure and role of the limited partnership association, the precursor to the LLC, the *Glensder* court asserted that the absence of personal liability "cannot be taken as the sole touchstone of classification " *Id.* at 183.

304. "Of what importance is it to the fisc that the participant in a business venture has limited liability or that he does not participate in management?" AMERICAN LAW INSTITUTE, *supra* note 143, at 377. "[T]he conclusion was that the pass-through method of taxation permitted under Subchapter K is appropriate for the type of entity formed under limited-partnership statutes. It was noted there that the existence of limited liability, without more, does not seem sufficient reason for imposing a corporate-tax regimen on an entity." *Id.* at 386. However, in suggesting changes to the classification regulations, one commentator noted: "The characteristic of limited liability is so significant that, if all the members of an organization have limited liability, it is suggested that the organization be classified as an association taxable as a corporation regardless of the other characteristics." Peel, *Definition of a Partnership: New Suggestions on an Old Issue*, 1979 WIS. L. REV. 989, 1015.

In 1981 the I.R.S. issued a private letter ruling, dated November 18, 1980, classifying a Wyoming LLC as a partnership.[305] This ruling was a hollow victory for other taxpayers considering the formation of LLCs because it was made one day after the publication of the 1980 proposed regulations. In 1982 the I.R.S. withdrew the 1980 proposed regulations, promising a study of the entity classification rules.[306] In Private Letter Ruling 83-04-138 the I.R.S. reversed its course and held that an LLC should be classified as a corporation because it possesses limited liability, centralized management, and continuity of life.[307] The I.R.S. also announced that it was suspending the issuance of private letter rulings addressing the entity classification of LLCs.[308]

In 1988 the I.R.S. removed the classification of LLCs for federal income tax purposes from the list of issues on which private rulings would not be issued.[309] Shortly thereafter the I.R.S. ruled that a Wyoming LLC should be classified as a partnership.[310] Other developments have followed this ruling, including the extension of partnership classification to a Florida LLC,[311] and a favorable ruling on the conversion of an existing limited partnership to a Florida LLC.[312]

b. Revenue Ruling 88-76: A Simple Case

The facts in Revenue Ruling 88-76 describe a relatively simple Wyoming LLC. The LLC in question had 25 members including three member managers.[313] The structure of the LLC followed the basic statutory requirements that transferees of member interests not be admitted as members without the consent of all members and that the LLC be dissolved upon the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member, or

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305. *See* Priv. Ltr. Rul. 81-06-082 (Nov. 18, 1980).

306. *See* I.R.S. Announcement 83-4, 1983-2 I.R.B. 31 (discussing I.R.S. News Release IR-82-145 (Dec. 16, 1982)).

307. *See* Priv. Ltr. Rul. 83-04-138 (Oct. 29, 1982).

308. *See* Rev. Proc. 83-15, 1983-1 C.B. 676.

309. *See* Rev. Proc. 88-44, 1988-2 C.B. 634.

310. *See* Rev. Rul. 88-76, 1988-2 C.B. 360.

311. *See* Priv. Ltr. Rul. 89-37-010 (June 16, 1989).

312. *See* Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989); *see also* Priv. Ltr. Rul. 90-30-013 (April 25, 1990) (allowing a Florida LLC comprised of two corporate members to be classified as a partnership); Priv. Ltr. Rul. 90-29-019 (April 19, 1990) (allowing the conversion of a general partnership to a Florida LLC).

313. *See* Rev. Rul. 88-76, 1988-2 C.B. 360, 360. The ruling did not reveal the aggregate percentage ownership interest held by the three managers.

the occurrence of any other event that terminates the membership of a member, subject to an agreement by all members to continue the organization.[314] Not surprisingly, the I.R.S. held that the LLC possessed limited liability and, due to the selection of managers apparently holding less than twenty percent of the total LLC interests, centralized management.[315] The LLC did not, however, possess continuity of life or free transferability of interests.[316]

The taxpayer apparently could have avoided the attribution of centralized management by: (1) having all members manage; (2) having member managers own at least twenty percent of the member interests; or (3) empowering the managers to perform only ministerial acts at the direction of the members.[317] The efficacy of these alternatives depends upon factors such as the number of members and the type of management and control relation-

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314. *See id.*

315. *See id.* at 361. Treas. Reg. § 301.7701-2(c)(4) (as amended in 1983) states that "limited partnerships subject to a statute corresponding to the [ULPA], generally do not have centralized management, but centralized management ordinarily does exist if substantially all the interests in the partnership are owned by the limited partners." Rev. Proc. 89-12, 1989-1 C.B. 798, 801, provides that the I.R.S. will rule that the partnership has centralized management if the limited partner interests, excluding those held by general partners, exceed 80% of the total interests in the partnership. Application of the 80% guideline to LLCs rests on the analogy of general partners and limited partners of a limited partnership to the member-managers and nonmanaging members of an LLC. This analogy is suggested by several I.R.S. pronouncements. *See supra* note 180. Not all aspects of Rev. Proc. 89-12 apply to LLCs. In Priv. Ltr. Rul. 90-30-013 (April 25, 1990), the Florida LLC in question was comprised of only two corporate members, sharing equal management rights. On the basis of the LLC's limited management feature, the I.R.S held that section 4 of Rev. Proc. 89-12 did not apply to the LLC. Section 4 contains most of the substantive guidelines of Rev. Proc. 89-12, including the subsections distinguishing between general and limited partners. In Gen. Couns. Mem. 39,798 n.3 (Oct. 24, 1989), the I.R.S. stated that the limited liability net worth requirements of section 4.07 of Rev. Proc. 89-12, 1989-1 C.B., 798 do not apply to limited liability companies.

316. *See* Rev. Rul. 88-76, 1988-2 C.B. 360, 361.

317. Management by all members would be unwieldy in large organizations, but it did obviate centralized management from the two member LLC described in Priv. Ltr. Rul. 90-30-013. *See supra* note 315. The 20% guideline for the ownership of member-managers rests on an analogy between member-managers and general partners of a partnership. Even if that analogy is apt, an LLC could not rely on the percentage guideline without securing a private letter ruling. *See id.* The regulations state that an organization does not possess centralized management if the managers perform ministerial acts at the direction of the members. *See* Treas. Reg. § 301.7701-2(c)(3). The Colorado LLC statute, which vests management solely with the managers, would not readily permit this. Under the other statutes, the members could retain management authority, rather than delegating it to managers, appointing certain individuals for circumscribed operational tasks. For a more detailed discussion of the various statutes that govern the organization and delegation of management responsibilities, see *supra* text accompanying notes 83-124. In any event, such an arrangement would appear to be impractical for LLCs with large memberships.

ship desired for nonmanager members as opposed to the managers.

c. Continuity of Life: The Uncertain Consequences of Continuation Agreements

The emphasis on continuity of life is somewhat troublesome. As discussed earlier, state LLC statutes are unclear on whether an advance agreement to continue is permitted.[318] The Florida and Kansas statutes mitigate the risk of dissolution by permitting continuation "under a right to continue stated in the articles of organization of the limited liability company"[319] However, from a tax standpoint, the favorable private letter ruling issued in 1989 with respect to a Florida LLC expressly found that this provision was inoperative under the facts presented.[320]

The I.R.S. recently found that a Florida LLC possessed continuity of life because, under a right stated in the articles of incorporation, the members could agree to continue by only a majority vote, rather than the statutory alternative requiring a unanimous vote.[321] In effect, one-half of the members relinquished, in advance, their right to prevent the continuation of the LLC business.

Unlike the Florida and Kansas statutes, the Wyoming and Colorado statutes do not permit simplified continuation in the articles of organization. The Wyoming and Colorado statutes require the unanimous consent of all members but grant the right to consent in the articles of organization.[322] The Wyoming LLC described in Revenue Ruling 88-76 apparently was not subject to a continuation agreement. The validity of continuation agreements

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318. For a discussion of the implications of dissolution and continuity of the LLC under LLC statutes, see *supra* text accompanying notes 162-96.

319. FLA. STAT. § 608.441(1)(c) (Supp. 1989); KAN. STAT. ANN. § 17-7622(A)(3) (Supp. 1990).

320. *See* Priv. Ltr. Rul. 89-37-010 (June 16, 1989) (despite the fact that the firm allowed for the continuance of the LLC upon consent of all the members, the holding disregarded the provision because continuity was not assured). In a recent private ruling in which continuity of life was not found, the I.R.S. stated that "no right to continue the business of X upon a member ceasing to be a member of X is stated in the articles of organization or other documents submitted with the request apart from continuance of X's business upon the consent of all the remaining members." Priv. Ltr. Rul. 90-29-019 (April 19, 1990). In Priv. Ltr. Rul. 90-30-013 (April 25, 1990), also dealing with a Florida LLC, continuation similarly required the unanimous consent of both members.

321. *See* Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989).

322. *See* COLO. REV. STAT. § 7-80-801(1)(c) (Supp. 1990); WYO. STAT. § 17-15-123(a)(iii) (1977).

in the LLC context was not addressed. If valid under state law, a contractual agreement to continue could be imbedded in the operating agreement at the outset, and unanimous consent would be achieved because all members are signatories. The continuity of the LLC would be even more secure than that of the LLC in Private Letter Ruling 90-10-027 The unresolved issue is whether this private letter ruling suggests a prohibition on any advance agreement eroding the right of all members to participate in a contemporaneous vote to continue the LLC upon an event of dissolution.

The entity classification regulations permit the use of continuation agreements without creating continuity of life. An agreement to continue despite the death or withdrawal of a member does not create continuity of life if state law provides that death or withdrawal dissolves the organization.[323] Under this regulation, the continuation agreement at issue in Private Letter Ruling 90-10-027 arguably did not establish continuity of life.

The I.R.S.'s apparent unanimity requirement seems to ignore language in the regulations permitting continuation agreements, focusing instead on the regulations' conclusion that a limited partnership does not possess continuity of life if the withdrawal of a general partner causes a dissolution "unless the remaining general partners agree to continue the partnership or all remaining members agree to continue the partnership "[324] This regulation cites as authority the Board of Tax Appeals' decision in *Glensder Textile Co. v Commissioner*,[325] which found continuity lacking where continuation is contingent upon the agreement of the general partners. The Tax Court's predecessor referred to this principle as "contingent continuity of existence"[326] because "[c]ontinuance will be certain only if the remaining general partners agree to it "[327] *Glensder* and the portion of the regulation referring to continuation by general partners are arguably not applicable to LLCs unless member managers are substantially equivalent to general partners. Moreover, the state LLC statutory provisions do not obviously permit continuation by consent of the managers alone, unless managers may receive unanimous advance delegation of such authority as the equivalent of unanimous mem-

323. Treas. Reg. § 301.7701-2(b)(2) (as amended in 1983).
324. *Id.* § 301.7701-2(b)(1).
325. 46 B.T.A. 176 (1942).
326. *Id.* at 185.
327. *Id.*

ber consent.

Revenue Ruling 54-484[328] similarly failed to find continuity of life in an agreement "making it possible for the continuing members to continue the partnership if they choose."[329] Furthermore, in *Zuckman v United States*,[330] the partnership had agreed with a lender that it would not dissolve. Nevertheless, distinguishing between the power and the right to dissolve, the Court of Claims found that the limited partnership lacked continuity of life because a general partner could breach the agreement and dissolve the partnership.[331] Most of the LLC statutes, however, do not expressly empower a member to unilaterally withdraw and cause dissolution of the entity Only the Colorado statute permits any member to resign at any time, subject, however, to remedies of the other members for breach of the organization agreement.[332] The ability of a member to withdraw and cause dissolution obviates continuity of life under the regulations.[333] This is a significant advantage from an income tax standpoint, if the LLC can endure dissolubility at will.

The regulations and other authority addressing the effects of continuation agreements proceed from the rationales underlying partnerships and do not clearly apply to the LLC. In this environment, the LLC is hostage to the administrative posturing of the I.R.S. At present, the I.R.S. apparently views this factor very restrictively, and caution will probably prevail until an authoritative precedent is established. On the other hand, the small investor groups that may find the LLC particularly attractive may be more aggressive in testing the entity classification issue than was the limited partnership industry for which a favorable tax opinion let-

328. 1954-2 C.B. 242.

329. *Id.* at 243.

330. 524 F.2d 729 (Cl. Ct. 1975).

331. *See id.* at 735.

332. *See* COLO. REV. STAT. § 7-80-602 (Supp. 1990). The Wyoming, Florida, and Kansas statutes all refer to the "resignation" of a member as an event triggering dissolution, but none of those statutes expressly grants a member the unilateral authority to withdraw as if a general partner. *See supra* text accompanying notes 162-71.

333. *See* Treas. Reg. § 301.7701-2(b)(3) (as amended in 1983). In *Foster v. Commissioner*, a partnership agreement provided for continuation despite the occurrence of certain events, including the death of a partner. Thus, the general partner had the power to withdraw and dissolve the partnership, but not the right to do so. Nonetheless, the Tax Court held that the partnership did not possess continuity of life because "it is the power, not the right, to dissolve which is the touchstone of the regulation." 80 T.C. 34, 188 (1983). In so holding, the court gave effect to a prior analysis of tax classification. *See* Larson v. Commissioner, 66 T.C. 159, 173-74 (1976).

ter as to classification was an integral part of most offering materials.

d. The Thirty Year Limit on Duration

With the emphasis placed on events of dissolution occurring with respect to members, it appears that the thirty year limited life requirement of the LLC statutes was not determinative of tax classification. Under the regulations, a fixed period of existence, however abbreviated, does not vitiate continuity [334] This limitation might be eliminated to conform to the durational scheme utilized, for example, by the RULPA.[335]

e. Tiered Ownership Structures

Participants in an LLC may seek to avoid state law disadvantages through a tiered ownership structure.[336] Although authority exists that addresses general income tax consequences of tiered partnerships,[337] there is little authority suggesting the appropriate tax classification inquiry for LLCs involved in such tiered structures. While Revenue Ruling 88-76 addressed a twenty-five member LLC, the status of the members was not discussed. However, a recent private letter ruling classified an LLC with two corporate members as a partnership.[338] Nevertheless, no rulings have addressed the utilization of limited partnership members, particularly arrangements where a purpose of the tiered structure was the avoidance of the state law restrictions on the transfer of LLC interests and of the uncertainty of dissolution.

The entity classification test should be applied at each level,

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334. *See* Treas. Reg. § 301.7701-2(b)(3) (all agreements will be examined in light of local law and the pertinent partnership act, but should the agreement provide that the organization is to continue for a stated period, the organization has continuity of life if the effect of the agreement is that no member has the power to dissolve the organization in contravention of the agreement).

335. *See supra* text accompanying notes 53-60.

336. *See supra* notes 153-54, 160-61 & 197-203 and accompanying text.

337. *See, e.g.*, I.R.C. § 706(d)(3) (1988) (allowing items attributable to interest in lower tier partnership to be prorated over entire taxable year where there is a change in the partners' interests in the tiered partnership); Rev. Rul. 87-50, 1987-1 C.B. 157 (sale of an interest in an upper tier partnership is a sale of its interest in the lower tier partnership where the sale causes the termination of the upper tier partnership); Rev. Rul. 86-138, 1986-2 C.B. 84 (a subsidiary partnership must separately state items of income, gain, loss, deduction, and credit).

338. *See* Priv. Ltr. Rul. 90-30-013 (April 25, 1990) (involving an LLC organized under the Florida LLC Act); *see also supra* note 315.

rather than by collapsing the various layers together. In one ruling, the I.R.S. considered the classification of a limited partnership in which the sole general partner was another limited partnership.[339] The ruling's analysis is instructive. First, it did not address the classification of the general partner itself, that being a separate issue.[340] Second, the lower tier partnership was classified as a partnership because the general partner of the upper tier limited partnership had substantial assets, which avoided limited liability.[341] Moreover, the limited partnership lacked continuity of life because it was organized under a statute corresponding to the ULPA.[342] The ruling did not elaborate, but the partnership probably lacked continuity of life because a dissolution of the general partner would cause a dissolution of the limited partnership. Under all of the LLC statutes, the dissolution of a member causes a dissolution of the LLC.[343]

In the LLC context, overlapping ownership in the upper tier entities should be avoided to elude the single economic interest theory advanced in Revenue Ruling 77-214.[344] Beyond that, the I.R.S.'s response to aggressive tiered LLC arrangements is difficult to predict.[345]

f. Summary

Conservative taxpayers may have to live with some drawbacks in the areas of transferability of interests and continuity of life in exchange for some degree of certainty of tax result. In this

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339. *See* Priv. Ltr. Rul. 87-53-006 (Sept. 30, 1987).

340. *Id.*

341. *Id.*

342. *Id.*

343. *See supra* text accompanying notes 162-71.

344. 1977-1 C.B. 408. In this ruling, the two members of a German *GmbH* were the subsidiaries of a common parent. *See id.* The I.R.S. viewed the organization as enjoying free transferability of interests because, in substance, no adverse party held any management control. *See id.* at 409. One court has rejected this approach, and the I.R.S. has not followed it faithfully. *See supra* note 33.

345. In Rev. Rul. 77-220, 1977-1 C.B. 263, 264, the I.R.S. disregarded a partnership of three S corporations that had been formed to avoid the statutory limitation on the number of S corporation shareholders. The tiered LLC structure does not circumvent a provision of the Internal Revenue Code and can be distinguished on that basis; the tiered structure is a response to state law disadvantages. It also does not provide the participants with greater benefits with respect to the continuity of life and transferability of interests than could be achieved under limited partnerships formed under the ULPA or the RULPA, both of which would be accorded partnership status for income tax purposes. The tiered arrangement should, therefore, be respected.

regard, Private Letter Ruling 90-10-027[346] also complicates matters by implying that LLCs must comply with the minimum general partner percentage interest and capital account requirements of Revenue Procedure 89-12,[347] again suggesting an analogy between member-managers and the general partners of a limited partnership.[348]

The classification of LLCs as partnerships presently rests upon the limited acceptance by the I.R.S. of the vehicle and the continued abandonment of the position expressed in the 1980 proposed regulations that an entity for which no member has personal liability cannot be a partnership. Assuming that the current administrative posture is continued, qualification will require rigid adherence to clumsy transferability and continuation provisions that are less flexible and bear less predictable tax consequences than those permitted for limited partnerships.

B. The Promised Reward: Partnership Taxation Treatment

Partnership classification unlocks a number of tax advantages, a topic thoroughly discussed in numerous other articles.[349] Briefly, the partnership pays no entity level tax and items of income, gain, loss, deduction, or credit pass through to the partners,[350] avoiding the "double taxation" to which a corporation is subject. On the other hand, if the partnership incurs losses or is eligible for credits, the partners can utilize those items personally to shelter other income.[351] Moreover, income, losses, and credits

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346. Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989).

347. Rev. Proc. 89-12, 1989-1 C.B. 798.

348. *See supra* text accompanying notes 294-98; *see also supra* notes 180 (discussing the general partner/member-manager analogy) & 315 (discussing Priv. Ltr. Rul. 90-30-013 (April 25, 1990), which exempted a two member LLC from much of Rev. Proc. 89-12).

349. *See, e.g.*, Rabinowitz, *Realty Syndication: An Income Tax Primer for Investor and Promoter*, 29 J. TAX'N 92 (1968) (discussing advantages of a partnership form for a real estate "syndicate"); Robinson, *Setting up the Real Estate Venture: An Overview*, 3 J. REAL EST. TAX'N 28 (1975) (discussing tax implications of a real estate partnership); Williford, *The Unique Tax Characteristics of Partnerships*, 13 REAL EST. REV., Summer 1983, at 28 (discussing federal income tax treatment of partnerships).

350. *See* I.R.C. § 701 (1988) (partners are subject to tax, not the partnership).

351. This ability is not unqualified. For instance, the partner must have a sufficient basis from which to deduct the losses. *See id.* § 704(d). The partner also must have sufficient amounts at risk. *See id.* § 465; Moreover, the losses may be subject to the passive activity loss limitation. *See id.* § 469; *see also* Goldberg, *The Passive Activity Loss Rules: Planning Considerations, Techniques, and a Foray into Never-Never Land*, 15 J. REAL EST. TAX'N 3 (1987).

can be allocated disproportionately among partners so long as such allocations comply with the notorious requirement of "substantial economic effect."[352]

Formation of and property contributions to a partnership are relatively simple from an income tax standpoint, with no requirement that the transferor exercise control over the partnership.[353] Distributions from a partnership, whether nonliquidating or liquidating, generally do not generate a recognized gain or loss to the distributee or the other partners.[354] Upon the withdrawal of a partner, the remaining partners have broad discretion in arranging partially deductible or nondeductible purchases of the withdrawing partner's interest.[355] In addition, if a prospective partner purchases the partnership interest of a current partner or a partner dies and his or her estate succeeds to the decedent's partnership interest, the new partner may adjust a share of the inside basis of partnership assets to reflect any amount by which the purchase price (or fair market value as of the date of death or an alternate valuation date in the case of a decedent's estate) exceeds the partnership's adjusted tax basis in the partnership assets.[356]

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352. *See* I.R.C. § 704(b); Treas. Reg. § 1.704-1(b)(2) (1988) (discussing the determination of a partner's distributive share and the analysis for determining whether such allocation has substantial economic effect); Bailis & Hartung-Wendel, *Meeting the Economic Effect Test under Section 704(b) Regulations*, 3 J. PARTNERSHIP TAX'N 3 (1988) (although the methods for determining a partner's interest in the partnership are vague, allocations will be respected if the allocations meet the strictures of the substantial economic effect test); *infra* note 423 and accompanying text.

353. *See* I.R.C. § 721 (providing for nonrecognition of gain or loss upon contribution). By comparison, transfers of property to a corporation in exchange for stock constitute a taxable exchange unless the transferors are in control of the corporation after the exchange. *See id.* § 351(a). If the property is encumbered, the contributing partner may recognize gain from debt relief under I.R.C. § 752.

354. *See id.* § 731 subject, however, to I.R.C. § 751 (1988) (providing that certain distributions of partnership property receive sale or exchange treatment).

355. *See id.* § 736 (regarding "payments to a retiring partner or a deceased partner's successor in interest"); *see also* Cleveland, *Retirement Payments to Partners: Timing of Recognition of Income*, 57 J. TAX'N 86 (1982) (discussing the relationship of I.R.C. § 736 to recognition of a retiring partner's capital gain from a partnership distribution); Solomon, *How Use of Section 736 Enhances Planning in Liquidating Partnership Interests*, 51 J. TAX'N 347 (1979) (analyzing I.R.C. § 736 and discussing its adaptability to various financial circumstances).

356. *See* I.R.C. § 743 (1988) (permitting a transferee partner's share in the adjusted basis of partnership property to increase by the amount that such partner's basis in the partnership interest exceeds his or her share in the adjusted basis of the partnership property).

C. The Competing Entity: The S Corporation

If a taxpayer seeks conduit treatment for items of income, gain, loss, deduction, or credit, the S corporation offers a competing option. Generally, such items pass through to the individual shareholder.[357] Again, there is no "double taxation" of earnings, and the opportunity exists to pass through losses to the individual shareholders. However, the S corporation is not as flexible as a partnership in this regard. Special allocations of income or loss are not permitted, and a shareholder can receive only a pro rata share of such items based on their proportional ownership interest.[358] The amount of losses and deductions a shareholder is permitted to take in a given year is limited to the adjusted basis in the shareholder's stock plus the shareholder's adjusted basis of any indebtedness of the corporation to the shareholder.[359] If the entity level debts are incurred by a partnership, a partner is treated as having contributed money to the partnership. The partner's tax basis for the deduction of losses increases in the amount of the partner's share of liabilities.[360] This difference is probably the key factor in choosing between a partnership and an S corporation. Moreover, if the S corporation was previously a C corporation, the immunity from entity level taxation would be lost if the S corporation had built-in gains from a period in which it was not an S corporation.[361] The corporation could also be charged a pen-

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357. *See id.* § 1366 (allowing items of income, loss, deduction, and credit to 'pass through' to S corporation shareholders for the purpose of determining their individual tax liabilities).

358. *See id.* § 1377 (requiring that S corporation shareholders report items of income, loss, deduction, and credit in direct proportion to their respective interests in the corporation). This general rule might be softened through the use of several techniques. *See, e.g.*, J. EUSTICE & J. KUNTZ, FEDERAL INCOME TAXATION OF S CORPORATIONS § 6.04, at 6-21 to -22 (1985 & Supp. 1990) (suggesting the use of stock purchase options to produce sharing ratios that vary over time as the options are exercised and shift stock ownership); I. GRANT & W CHRISTIAN, SUBCHAPTER S TAXATION 3-4 (3d ed. 1990) (proposing the formation of several S corporations that in turn join in a partnership; the special allocations are made at the partnership level).

359. *See* I.R.C. § 1366(d) (1988). However, there is some controversy as to the basis treatment of entity level debt in very thinly capitalized corporations. *Compare* Selfe v. United States, 778 F.2d 769 (11th Cir. 1985) (third party loans, guaranteed by the shareholder, to a thinly capitalized corporation treated as shareholder loans to the corporation) *with* Harris v. United States, 902 F.2d 439 (5th Cir. 1990) (refusing to treat shareholder guarantee as a loan to the corporation) *and* Estate of Leavitt v. Commissioner, 90 T.C. 206 (1988) (rejecting *Selfe*), *aff'd*, 875 F.2d 420 (4th Cir. 1989).

360. *See* I.R.C. § 752(a) (When a partner's share of the partnership's liabilities increases, the increase in liability is treated as a contribution of money to the partnership).

361. *See id.* § 1374 (discussing qualifications for tax imposed on net built-in gains of

alty tax[362] and lose its S corporation status[363] if it receives significant amounts of passive income.

S corporations are subject to further requirements not applicable to partnerships. For instance, the formation of an S corporation and subsequent contributions of property in exchange for stock must satisfy the control requirements of I.R.C. § 351.[364] In addition, distributions of appreciated property from an S corporation yield taxable income.[365]

There are some advantages to the S corporation form. For state law purposes, the S corporation is a conventional corporation and, as such, provides limited liability to all participants. Upon the contribution of property with a fair market value that differs from its adjusted basis, there is no statutory requirement similar to I.R.C. § 704(c), requiring the allocation of built-in gain or loss to the contributing party.[366] Losses on the sale, exchange, or worthlessness of S corporation stock are eligible for ordinary loss treatment, while such transactions generally would be capital gain or loss transactions if a partnership were involved.[367]

Although the purchaser of S corporation stock cannot elect to increase the inside adjusted tax basis of his or her share of the corporation's assets, the sale of such stock has little effect on the corporation. By comparison, if, within a twelve month period, a partner sells or exchanges fifty percent or more of his or her total interest in capital and profits, the disposition causes a termination of the partnership for federal income tax purposes.[368] Finally, al-

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S corporations).

362. *See id.* § 1375 (discussing tax imposed on passive investment income of corporations that have subchapter C earnings and whose profits exceed 25% of gross receipts).

363. *See id.* § 1362(d)(3) (discussing termination where passive investment income exceeds 25% of gross receipts for three consecutive taxable years and corporation has subchapter C earnings and profits).

364. *See id.* § 351(a) (providing nonrecognition treatment where property is transferred to corporation controlled by transferor in exchange for stock).

365. *See id.* § 1374.

366. Shareholders report only their pro rata shares of income, loss, or credits. *See supra* note 358. The I.R.S., however, has a general power to reallocate income and deductions among family members in a manner resembling I.R.C. § 704(e), which applies to partnership allocations. *See* I.R.C. § 1366(e) (1988) (reallocation if shareholder of S corporation provides services or capital without receiving reasonable compensation).

367. *Compare* I.R.C. § 1244(a) (1988) (permitting ordinary loss treatment for small business stock) *with id.* § 741 (treating sales or exchanges of partnership interests as the sale or exchange of a capital asset, subject to I.R.C. § 751).

368. *See id.* § 708(b)(1)(B). The election to operate as an S corporation may be revoked only upon the consent of shareholders holding more than one-half of the shares of stock of the corporation on the day of revocation. *See id.* § 1362(d)(1)(B). Thus, a sale or

though the partnership contribution and distribution rules do not present many obstacles to reorganizations with other partnerships and unincorporated businesses, S corporations can also take advantage of the corporate reorganization provisions which provide access to reorganizations with larger, publicly traded pools of capital.[369]

One area in which partnerships enjoy a distinct advantage over S corporations is the formal qualifications for S corporation status. The S corporation may not have more than thirty-five shareholders;[370] nonresident aliens cannot be shareholders;[371] other than estates and certain trusts, only individuals can be shareholders;[372] an S corporation cannot own interests in corporate subsidiaries that would render it a member of an affiliated group;[373] and it cannot issue more than one class of stock.[374] This last provision precludes the shifting of risks that certain business arrangements require.

A number of articles have been devoted to comparing partnerships to S corporations.[375] Neither of these organizational forms is conclusively preferable to the other. The choice in any particular case rests on a number of specific factual concerns. If the entity will generate debt leveraged losses, then the shareholder

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exchange of S corporation stock will result in a termination of the S election only if the purchaser or transferee provides such consent and acquires, or combines with a class of similar shareholders, who hold more than one-half of the corporation's shares. *See id.* For a definition of an S corporation, see *id.* § 1361(b)(1).

369. *See, e.g., id.* §§ 368, 354, 356, 361.

370. *See id.* § 1361(b)(1)(A). Spouses are treated as one shareholder. *See id.* § 1361(c)(1).

371. *See id.* § 1361(b)(1)(C).

372. *See id.* § 1361(b)(1)(B).

373. *See id.* § 1361(b)(2)(A). An exception applies to ownership of stock in inactive corporations. *See id.* § 1361(c)(6). The I.R.S. has administratively excused transitory subsidiaries. *See, e.g.*, Rev. Rul. 73-496, 1973-2 C.B. 313 (existence of an active subsidiary for less than 30 days did not terminate the election).

374. *See* I.R.C. § 1361(b)(1)(D) (1988). However, differences between classes of stock based solely on voting rights will not constitute different classes of stock. *See id.* § 1361(c)(4).

375. *See, e.g.*, Kaplan & Ritter, *Partnership and S Corporations: Has the Tax Gap Been Bridged?*, 1 J. PARTNERSHIP TAX'N 3 (1984) (comparing tax features of S corporations and partnerships in the formation, operation, and liquidation phases and concluding that, as a result of the inherent flexibility of Subchapter K, partnership is preferable for the operation of most closely held businesses); Liveson, *Partnerships vs. S Corporations: A Comparative Analysis in Light of Legislative Developments*, 5 J. PARTNERSHIP TAX'N 142 (1988); Mullaney & Blau, *An Analytic Comparison of Partnerships and S Corps as Vehicles for Leveraged Investments*, 59 J. TAX'N 142 (1983) (explaining the major differences that exist between S corporations and partnerships with respect to debt treatment).

basis limitations of an S corporation render the partnership form preferable. If the entity will hold substantial property, the pliable partnership contribution and distribution sections will be attractive. Also, if an entity other than an individual seeks to participate in the business, the S corporation form may be unavailable. On the other hand, for transactions involving little property, but for which limited liability is desired, the S corporation is attractive because it involves only one entity A limited partnership with a corporate general partner, by comparison, requires two entities: the corporate general partner and the limited partnership. A limited partnership also presents uncertainty and complexity in achieving classification as a partnership under the corporate resemblance test. This expresses the essence of the LLC's allure: limited liability with only one entity and partnership tax treatment, while avoiding some of the tax entity classification concerns of the limited partnership and shortcomings of the S corporation election. On the other hand, a form of doing business which lacks both familiarity and an established body of precedent presents substantial uncertainty, at least over the short run.

D. Other Tax Considerations

1. Foreign Taxpayers

Nonresident aliens are unable to own S corporation stock[376] but may be members of an LLC. Also, the estate of a nonresident alien would be subject to federal estate tax for stock issued by a domestic corporation.[377] Although an LLC is not a corporation,[378] an LLC interest may be included in the value of an estate for tax purposes because it would be property "situated in the United States."[379]

A nonresident alien is not subject to a gift tax on the transfer of "intangible property "[380] Even if an LLC interest is an intangi-

376. *See* I.R.C. § 1361(b)(1)(C) (providing that "the term 'S corporation' means a small business corporation" that prohibits nonresident aliens from stock ownership).

377. *See id.* § 2104(a) (For purposes of the estate tax provision, stock held by a nonresident alien must have been issued by a domestic corporation to meet the definition of "property").

378. The definitions of "corporation" and "partnership" under I.R.C. §§ 7701(a)(3) and (a)(2), respectively, apply to all of Title 26 "where not otherwise distinctly expressed or manifestly incompatible with the intent thereof." *Id.* § 7701(a).

379. *Id.* § 2103 (Only the portion of the estate "situated in the United States" at the time of death is included in the value of the nonresident alien's estate.).

380. *Id.* § 2501(a)(2) ("Transfers of intangible property shall not apply to the

ble asset, a taxpayer would use a foreign corporation to avoid the broader sweep of the estate tax. With respect to the income taxation of nonresident aliens, "a nonresident alien individual or foreign corporation [would] be considered as being engaged in a trade or business within the United States if the partnership of which such individual or corporation is a member is so engaged ..."[381] An LLC would be a partnership for this purpose.[382]

2. State Taxation Considerations

Taxation in the state of formation may be another important factor in selecting an organizational form. Under Florida tax law, for example, ownership of LLC interests is treated differently than ownership of partnership interests for purposes of the intangible property tax.[383] The tax treatment of LLCs in states admitting them to do business will be an additional factor. For example, states might not agree that the LLC should be treated as a partnership for their state tax purposes. On the other hand, a jurisdiction that does not recognize the S corporation election for state or local tax purposes but would treat the LLC as a partnership extends a tax advantage to LLCs over S corporations.[384]

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transfer of intangible property by a nonresident not a citizen of the United States.").

381. *Id.* § 875(1). The I.R.S. has taken the position that a "permanent establishment" is imputed to a limited partner, as with a general partner, of a partnership for treaty purposes. *See* Rev. Rul. 85-60, 1985-1 C.B. 187, 187.

382. LLCs might present some advantages to foreign taxpayers owning interests in U.S. corporations. A foreign shareholder who is not present in the United States for 183 days or more will generally not pay U.S. tax on a sale of the corporate stock. *See* I.R.C. § 871(a)(2) (1988). The exclusion is couched in terms of "capital gains," so gains received upon the liquidation of a corporation would generally qualify. *See id.* § 331(a). A foreign taxpayer is still, therefore, extremely interested in the capital gains versus ordinary income distinction. *See* 1 J. ISENBERGH, INTERNATIONAL TAXATION: U.S. TAXATION OF FOREIGN TAXPAYERS AND FOREIGN INCOME § 8.7, at 242-43 (1990) (sale or exchange treatment, including the effects of liquidation-reincorporation transactions, remains a significant issue for foreign owners of U.S. corporations). The Tax Reform Act of 1986 rendered liquidation-reincorporation transactions less attractive because United States residents enjoy little benefit from the capital gains on the constructive sale of their stock upon a liquidation, while the corporation must pay a tax on the appreciation inherent in its assets. *See generally* B. BITTKER & J. EUSTICE, *supra* note 52, § 14.54. As discussed above, foreign shareholders still have a strong interest in seeking sale or exchange treatment in a liquidation-reincorporation, avoiding recharacterization as a "D" reorganization. One common structure to avoid such recharacterization is the placement of the assets of the liquidating corporation in a partnership. The LLC is well-suited for this duty because it is treated as a partnership for income tax purposes, but also provides a state law entity with limited liability for the continuation of the liquidated corporation's business.

383. *See* Lederman, *supra* note 12, at 349.

384. The following jurisdictions do not recognize S corporation status: Connecticut,

III. WEIGHING THE ADVANTAGES AND DISADVANTAGES

A. LLC Compared with S Corporation

If tax consequences were the sole consideration, the LLC would be preferable to the S corporation for those types of transactions in which the partnership taxation rules hold more benefits than the S corporation rules, including highly leveraged transactions, transactions with participants other than individuals, and transactions in which the number of participants exceeds thirty-five shareholders. From a strict tax standpoint, the LLC may suffer in the tax entity classification area. Revenue Ruling 88-76, the polestar of LLCs, dealt with highly stylized facts on the issues of continuity and transferability, yet it narrowly resulted in an even split between the corporate resemblance factors.[385] The tax consequences of any deviation from these facts are uncertain.

State law uncertainty is another matter. The S Corporation is a more established corporate form and benefits from years of practitioner experience. Corporations are recognized in every state, and, therefore, enjoy a familiar body of statutory law and judicial interpretation. The organizer of an LLC has a cleaner, if more uncertain, slate upon which to write, but that flexibility may be advantageous.[386] At this point, however, the lack of guidance as to recognition in foreign jurisdictions is troublesome. In addition, the LLC transfer and continuity of life provisions, drafted with an eye toward tax consequences, are awkward for transactions involving many participants. Tiered ownership structures combining limited partnerships with an LLC offer a solution to some of the state law transfer and dissolution concerns. However, the effect of this solution on tax classification is uncertain. Until a number of states accept LLCs and grant them extraterritorial recognition, the entity, like its ancestor the partnership association,

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the District of Columbia, Louisiana, Michigan, New Hampshire, New Jersey, New York City, and Tennessee. *See* State Tax Guide (CCH) ¶ 10-100 (March 1991). *See generally* Maule, *Effect of State Law on the Use of S Corporation*, 37 TAX LAW. 535, 536-41 (1984) (treatment of S corporations is complicated and inconsistent, indicating a need for reform).

385. *See* Rev. Rul. 88-76, 1988-2 C.B. 360, 360-61; *see also supra* text accompanying notes 313-16.

386. The uncluttered flexibility of the limited partnership association was a perceived advantage over the corporate form. *See supra* text accompanying notes 19-32. Those state corporation statutes that impose the fewest restrictions are generally viewed as the most advantageous under which to incorporate. Kaplan, *supra* note 261, at 436 (explaining the preference of organizations to incorporate in Delaware).

would seem to play a significant part only in highly leveraged, tax sensitive transactions involving relatively few participants and doing business in the state of formation.[387]

B. LLC Compared with General Partnership

The LLC and general partnership are on an equal footing with respect to tax consequences aside from the entity classification issue. However, the LLC is preferable to the general partnership in that it limits the liability of participants. With respect to other factors, the results are mixed. For instance, the transferability aspects of an LLC are more complicated than those of a general partnership.[388] On the other hand, while the apparent authority of nonmanaging LLC members is more circumscribed than that of nonmanaging general partners,[389] the apparent authority of LLC managers exceeds that of any general partner.[390] Furthermore, the limited number of participants and the consensus management style of many general partnerships are suited to the LLC format. With the exception of the Colorado statute, which permits members to withdraw at any time, the LLC is not dissoluble at will, unlike the general partnership.[391] The remaining problem is the possibility that a foreign jurisdiction will refuse to recognize the LLC as a legitimate business form. Should that occur, however, the participants are no worse off than if they had utilized the competing general partnership form. However, the mere fact that the LLC offers the tax advantages of a partnership coupled with the limited liability of a corporation does not make it universally preferable to the partnership as an organizational form.

C. LLC Compared with Limited Partnership

The LLC and the limited partnership with a corporate general partner are almost equivalent for federal income tax purposes. A disparity arises to the extent that profits and losses are allocated to the corporate general partner, which, as an S or C corporation, suffers from tax disadvantages compared with a

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387. *See supra* note 31 and accompanying text.

388. For example, general partners can agree in advance to admit certain classes of substitute general partners. Members of an LLC cannot. *See supra* text accompanying notes 157-59.

389. *See supra* text accompanying notes 98-111.

390. *See id.*

391. *See supra* text accompanying notes 169-71.

partnership.[392]

The inquiry into LLC entity classification is simpler than that required for a limited partnership. Under Revenue Ruling 88-76, the LLC only failed two of the four corporate resemblance tests.[393] In drafting a limited partnership agreement under the RULPA, it is easy to avoid two of the corporate resemblance factors, as well as the attribute of limited liability in larger transactions where a substantial general partner is present.[394]

For state law purposes, the transferability of interests[395] and continuity of life[396] provisions under an RULPA partnership are much more flexible than the LLC provisions. Furthermore, the limited partnership offers a significant advantage in its probability of extraterritorial recognition, particularly if the forum state is one of the majority of states that have adopted the RULPA.[397]

The limited partnership formed under the RULPA may also have an advantage in terms of limited liability of the participants because limited partners can engage in some activity without liability.[398] By comparison, an active LLC member may invite a court to pierce the corporate veil of the LLC.[399] The relative advantage may be slight and assumes a larger limited partnership arrangement where there are limited partner investors apart from the managing general partner group. Assuming that the LLC is better suited for smaller groups of participants that would otherwise use a general partnership or S corporation, the relevant comparison is with a limited partnership in which some of the limited

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392. Under the tax entity classification rules, all corporate general partners must maintain at least an aggregate one percent interest in the partnership. *See supra* note 300.

393. *See supra* text accompanying notes 314-16.

394. Some commentators contend:

> [T]he classification issue with regard to limited partnerships has become "much ado about nothing." Given the pro-partnership orientation of the Regulations, the equivalent weighting of all four factors and the recent interpretations placed upon the liability standard it is particularly difficult for entities formed under the RULPA or ULPA to be classified as an association unless they constitute publicly traded partnerships under [I.R.C.] § 7704.

1 A. WILLIS, J. PENNELL & P. POSTLEWAITE, PARTNERSHIP TAXATION § 34.11, at 34-27 to -28 (4th ed. 1989).

395. *See supra* text accompanying notes 140-52.

396. *See supra* text accompanying notes 162-96.

397. *See supra* note 216.

398. Piercing a thinly capitalized limited partnership has apparently not been a creditor remedy if the limited partner does not participate in the control of the partnership business. *See supra* text accompanying notes 71-72.

399. *See supra* text accompanying notes 65-75.

partners also control the corporate general partner In such a case, the limited partner shareholders may be subject to liability should a court decide to pierce the veil of the corporate general partner.[400]

The LLC may compare more favorably to a limited partnership organized in one of the few states that have not adopted the 1985 amendments to the RULPA. Inasmuch as the Wyoming LLC statute was patterned after the ULPA, an LLC formed under it will resemble limited partnerships in states which have not enacted the RULPA. Therefore, the technical improvements introduced by the RULPA will not place the LLC at a comparative disadvantage in non-RULPA states.

In some respects, the LLC is superior to both the ULPA and the RULPA. For example, LLC statutes do not require disclosure of the members' names in the articles of organization, while the ULPA[401] and the original version of the RULPA[402] require the certificate to disclose the names of the limited partners.

A limited partnership with an LLC general partner may represent a compromise structure that mitigates the perceived disadvantages of the LLC in the area of extraterritorial recognition and the general uncertainty regarding the legal aspects of its operation. This structure provides a degree of comfort to the limited partners concerning fundamental matters, such as their limited liability in a foreign jurisdiction, the legal aspects of the entity's operation and the rights of members,[403] and federal income tax aspects of the LLC that remain unsettled.[404] The remaining uncertainties would be limited to the LLC general partner and its members. The limited partnership can also facilitate the tiered ownership structure offered previously as a solution to the state law impediments to transfer of interests and dissolution.[405]

IV SOME ADDITIONAL UNANSWERED QUESTIONS AND OBSERVATIONS

In enacting its LLC statute, the Colorado legislature adopted

400. *See supra* note 73.

401. *See* UNIF. LTD. PARTNERSHIP ACT § 2(1)(a) IV (1916).

402. *See* REVISED UNIF. LTD. PARTNERSHIP ACT § 201(a)(4) (1976) (amended in 1985 to eliminate disclosure requirement).

403. *See supra* text accompanying notes 218-64.

404. *See infra* text accompanying notes 412-39.

405. *See supra* text accompanying notes 336-45.

numerous conforming amendments to other statutes. For example, the term "limited liability company" was added to statutes referring to "corporations" or "limited partnerships."[406] Such definitional changes will not clarify all matters. Unresolved, for instance, is the status of the LLC for federal diversity jurisdiction,[407] the classification of LLC interests as "securities" under security regulation laws,[408] the application of bankruptcy law to LLCs,[409] and the applicability of corporate usury exemp-

406. *See, e.g.*, COLO. REV. STAT. §§ 2-4-401, 7-3-106, 7-62-102 (Supp. 1990).

407. A corporation is treated as a citizen of its state of domicile, regardless of the citizenship of its individual shareholders, managers, or directors. 28 U.S.C. § 1332 (1988). However, an unincorporated association is deemed to be a citizen of every state in which one of its members is domiciled for the purposes of federal diversity jurisdiction. *See* Note, *Diversity of Citizenship of the Limited Partnership: A "Real Party" Rule as Federal Common Law*, 71 IOWA L. REV. 235, 235-36 (1985) (reviewing the contradictory rulings of several circuits in determining requirements for diversity jurisdiction over limited partnerships). The Supreme Court of the United States has recently addressed this issue in connection with limited partnerships, holding that the citizenship of both general and limited partners is determinative. *See* Carden v. Arkoma Assocs., 110 S. Ct. 1015, 1021 (1990). In Great S. Fire Proof Hotel Co. v. Jones, 177 U.S. 449, 457 (1900), the Court held that the citizenship of all members of a limited partnership association is to be considered for this purpose. For an analysis finding corporate characteristics in an unincorporated association, compare Puerto Rico v. Russell & Co., 288 U.S. 476 (1933) (holding that a Puerto Rican *sociedad en comandita* should be treated as a corporation, distinguishing the limited partnership associations as "partnerships"). *Id.* at 480-81. One distinction between the *sociedad en comandita* and the LLC is that "[w]here the articles so provide, the *sociedad* endures for a period prescribed by them regardless of the death or withdrawal of individual members." *Id.* at 481. Other factors discussed by the Court in support of corporate characterization are enjoyed by the LLC, including: the power to contract, to own property, and transact business and to sue and be sued in its own name and right; creation by articles of association filed as public records; powers of management that may be vested in managers; and members who are not primarily liable for its acts and debts. *See id.* The *Carden* Court distinguished the result in *Russell & Co.*, reasoning that the civil law origin of the *sociedad en comandita* virtually limited the case to its facts, thus the LLC is likely to be treated as a partnership for diversity jurisdiction purposes. *See Carden*, 110 S. Ct. at 1018.

408. Corporate stock is a "security" under a literal reading of the Securities Act of 1933. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681, 687-88 (1985). An interest in an LLC, if not stock, would probably be tested as an investment contract in the manner of partnership interests. *See, e.g.*, Note, *General Partnership Interests as Securities Under the Federal Securities Laws: Substance Over Form*, 54 FORDHAM L. REV. 303, 306-10 (1985).

409. *See* 11 U.S.C. § 109 (1988) (setting forth the debtors eligible for protection under Chapters 7 and 11). This statute refers to a "person." A " 'person' includes individual, partnership, and corporation " *Id.* § 101(35). A "corporation" includes a "partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association," *id.* § 101(8)(A)(ii); an "association having a power or privilege that a private corporation, but not an individual or a partnership, possesses," *id.* § 101(8)(A)(i); and an "unincorporated company or association " *Id.* § 101(8)(A)(iv). The term "corporation" expressly excludes a "limited partnership." *Id.* § 101(8)(B). An LLC would, therefore, appear to be a corporation for the purposes of the

tions to LLCs.[410] Some of the questions will turn upon whether the LLC is a corporate entity or a partnership aggregation of interests.[411]

These questions aside, the federal income tax aspects of the LLC are not altogether clear. Revenue Ruling 88-76 classified the LLC described in its simple facts as a partnership for federal tax purposes.[412] That designation, under I.R.C. § 7701(a)(2), controls the usage of the term "partnership" throughout Title 26, which includes income, gift, estate, generation skipping, withholding, employment, and excise taxes where "not otherwise distinctly expressed or manifestly incompatible with the intent thereof."[413] In addition, this designation most likely applies to the crucial partnership income tax provisions of Subchapter K.[414] However, the narrow holding of Revenue Ruling 88-76 might be overlooked. Definitional effects aside, partnership designation alone does not address the complex issues of taxation as applied to LLCs, such as

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bankruptcy code. This could create some inconsistencies in the application of the bankruptcy tax provisions of section 728, which prescribe marshalling rules for partnerships for purposes of state and local taxes. *Id.* § 728. The LLC might be a corporation for bankruptcy purposes, but it can be treated as a partnership for state or local taxation purposes.

410. *See, e.g.*, Leader v. Dinkler Management Corp., 20 N.Y.2d 393, 400-01, 230 N.E.2d 120, 123-24, 283 N.Y.S.2d 281, 286 (1967) (explaining the justification for the New York corporate borrower exception).

411. *See* Appendix, *infra* pp. 472-74 (illustrating the adoption of corporate powers, including, the power to sue or be sued in the LLC name and to borrow, lend, and deal with property in the LLC name); *see also supra* note 238 (the *Restatement (Second) of Conflict of Laws* listing of corporate characteristics). The aggregate versus entity controversy in partnerships raises such issues as the application of employment discrimination and workmen's compensation statutes to partners. *See* A. BROMBERG & L. RIBSTEIN, *supra* note 182, § 1.03.

412. *See supra* notes 313-16 and accompanying text.

413. I.R.C. § 7701(a)(2) (1988).

414. For example, "[a] partnership as such shall not be subject to the income tax imposed by this chapter." *Id.* § 701. Even though an organization is excluded from the application of Subchapter K, it is undetermined whether the balance of the Internal Revenue Code continues to apply. Treasury regulations provide: "Under conditions set forth in this section, an unincorporated organization may be excluded from the application of all or a part of the provisions of subchapter K of chapter 1 of the Code." Treas. Reg. § 1.76-2(A)(1) (1972); *see* Bryant v. Commissioner, 46 T.C. 848 (1966) (although petitioners made an election not to be treated as partners under subchapter K, they were still treated as partners for purposes of computing their investment credit), *aff'd*, 399 F.2d 800 (5th Cir. 1968). *But see* Rev. Rul. 83-129, 1983-2 C.B. 105 (partnership election to be excluded from the provisions of Subchapter K applies to other sections of the Code as well, allowing two partners to make different elections under section 616 rather than a single partnership election). For a discussion of the conflicting treatment of this issue and the I.R.S.'s attempt to resolve the conflict, see 1 A. WILLIS, J. PENNELL & P POSTLEWAITE, *supra* note 394, § 2.06, at 2-17 to -18.

basis computations involving partnership debt and allocations of items of partnership income, gain, loss, deduction, or credit. Revenue Ruling 88-76 did not effect a considered revision of the tax statutes and regulations and undoubtedly created inconsistencies. For example, a statute or regulation that distinguishes between limited and general partnerships and between limited and general partners must incorporate the LLC and its members into its framework. LLCs may present additional uncertainties regarding taxation. A discussion of these uncertainties follows.

A. Tax Matters Partner

The partnership audit sections provide for a tax matters partner who is "the general partner designated as the tax matters partner . . ."[415] There is no distinction between "general" and "limited" members of an LLC. However, insofar as the statutory general partner requirement is based on management control, the tax matters partner should be a member-manager.[416]

B. Partner Signatories

The income tax return for a corporation may be signed "by the president, vice-president, treasurer, assistant treasurer, chief accounting officer, or any other officer duly authorized to sign such returns."[417] However, only a partner may sign the partnership income tax return.[418] Therefore, nonmember-managers, who resemble corporate officers, apparently are not the proper persons to sign partnership income tax returns for the LLC.

C. Partnership Liabilities

Under section 752 of the Internal Revenue Code a partner's share, or assumption, of the partnership liabilities affects the tax basis of that partner's interest in the partnership. An increase in the partner's share, or assumed portion, of liabilities is treated as a contribution of capital to the partnership, and a decrease is

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415. I.R.C. § 6231(a)(7)(A).

416. I.R.C. § 6231(a)(7) also provides that if there is no general partner designated, and it is "impracticable to apply [I.R.C. § 6231(a)(7)(B)], the partner selected by the Secretary shall be treated as the tax matters partner." The Secretary may also appoint a limited partner. For a description of the I.R.S.'s procedures and criteria for the selection of a tax matters partner, see Rev. Proc. 88-16, 1988-1 C.B. 691.

417. Treas. Reg. § 1.6062-1(a)(1) (1973).

418. *Id.* § 1.6063-1(a).

treated as a distribution.[419] The temporary regulations interpreting section 752 generally apportion partnership debt to those partners who bear the economic risk of loss.[420]

Because no member of an LLC is liable for its debts, the economic risk of loss rules for recourse liabilities prevent members from adjusting their partnership basis for the LLC's liabilities.[421] Thus, where a member incurs personal liability on indebtedness encumbering property that is subsequently transferred to an LLC, the bases of the interests of nontransferor members will not receive any increase, even though the LLC will ultimately repay the debt. This rule encourages nontransferor members to enter into assumption of liability agreements or to convert the debt to a nonrecourse liability in order to fall within the special rules for nonrecourse liabilities.[422]

D Special Allocations

The allocations of profit and loss made in the LLC agreement must have "substantial economic effect" to be valid for federal income tax purposes.[423] The regulations generally require capital account accounting, liquidation distributions in accordance with capital accounts, and an unconditional obligation to restore deficit capital accounts.[424] The Wyoming, Florida, Colorado, and Kansas LLC provisions governing distributions are modeled after the ULPA and the RULPA distributions provision,[425] thus there is no structural impediment to capital account accounting.[426] No obligation to restore deficit capital accounts, which might be imposed by state law in the case of a general partner,[427] will apply to an

419. *See* I.R.C. § 752 (1988).

420. *See* Treas. Reg. § 1.752-1T(a) (1989).

421. *See id.* § 1.752-1T(a)(1).

422. *See id.* § 1.752-1T(a)(2).

423. *See* I.R.C. § 704(b)(2).

424. *See* Treas. Reg. § 1.704-1(b)(2) (1988) (these methodologies, which are used to determine economic effect, must be contained in the partnership agreement and must be in effect for the full term of the partnership).

425. *See supra* text accompanying notes 129-35.

426. The state law provisions themselves do not provide for the strict capital account accounting procedures that the regulations mandate. This places a premium on drafting the partnership agreement. The principal state law contribution is the subordination of the state's statutory scheme to the agreement of the parties. *See, e.g.*, COLO. REV. STAT. § 7-80-805(b) (Supp. 1990) ("[e]xcept as provided in the operating agreement"); FLA. STAT. § 608.444 (Supp. 1989) ("[s]ubject to any statement in the regulations"); WYO. STAT. § 17-15-126 (1977) ("[s]ubject to any statement in the operating agreement").

427. *See, e.g.*, Park Cities Corp. v. Byrd, 534 S.W.2d 668 (Tex. 1976); Gazur, *Part-*

LLC in the absence of express language in the operating agreement. However, no such provision is necessary if the qualified income offset provisions and the "minimum gain" rules for the allocation of deductions attributable to nonrecourse liabilities are applicable.[428]

E. Passive Activity Losses

Except as provided in regulations, the limitation on passive activity loss deductions precludes treating a limited partner's interest "as an interest with respect to which a taxpayer materially participates."[429] The regulations treat a partnership interest, thus limiting the deduction of losses, as a limited partnership interest if the interest is designated as such in the limited partnership agreement.[430] While this definition does not apply to LLCs, an alternative definition treats an interest as a limited partnership interest if the law of the state in which the partnership is organized provides that the holder's liability for partnership obligations is limited to a "determinable fixed amount."[431] An LLC interest probably satisfies this latter definition. Therefore, the LLC members will only be able to participate materially, and deduct all losses, if their level of activity meets the thresholds prescribed by the regulations.[432]

F Self-Employment Tax

For self-employment tax purposes, "the distributive share of any item of income or loss of a limited partner, as such, other

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ner Beware: Evaluating the Economic Risks Presented by an Obligation to Restore a Deficit Capital Account Balance, 3 TAX L.J. 179, 184-90 (1986) (asserting that the obligation to restore a deficit capital account is not without economic risk and, as each partnership is unique, the partners must carefully consider the facts and circumstances in order to determine whether such an obligation is warranted); Teitelbaum, *The Impact on Partners of Allocations That Have Substantial Economic Effect*, 4 J. PARTNERSHIP TAX'N 112 (1987). *But see* Hogan v. Commissioner, 59 T.C.M. (CCH) 870, 875 (1990) (the Pennsylvania Partnership Act does not require the restoration of deficit capital account balances upon liquidation); Goldfine v. Commissioner, 80 T.C. 843, 853 (1983) (finding no express deficit restoration obligation under the Illinois Uniform Partnership Act).

428. *See generally* Treas. Reg. § 1.704-1T(b) (1989) (nonrecourse deductions must be allocated in proportion to each partner's interest in the partnership).

429. I.R.C. § 469(h)(2) (1988), *amended by* Omnibus Budget Reconciliation Act of 1989, 26 U.S.C.A. § 469 (West Supp. 1990).

430. *See* Treas. Reg. § 1.469-5T(e)(3)(i)(A) (1989).

431. *Id.* § 1.469-5T(e)(3)(i)(B).

432. *See id.* § 1.469-5T(e)(2)-(3).

than guaranteed payments" is excludable from self-employment net earnings.[433] The purpose of such exclusion was to preclude investors performing no services from qualifying for social security benefits based on passive investment activity[434] Regulations addressing this issue are needed, particularly in the case of active member-managers.

G. Family Partnerships

The treasury regulations interpreting the family partnership provisions address the relationship of family members in a limited partnership.[435] In assessing the validity of profit and loss allocations, some weight is given to the fact that the general partner, usually the parent, risks his or her personal assets in the business.[436] In the absence of a contractual agreement to the contrary, the factor of personal liability will not apply to any LLC member.

H. Exempt Organizations

The I.R.S. scrutinizes exempt organizations acting as general partners and examines the liability to which the organization is subjected.[437] The LLC's limited liability and partnership tax sta-

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433. I.R.C. § 1402(a)(13) (1988), *amended by* Omnibus Budget Reconciliation Act of 1989, 26 U.S.C.A. §§ 1402, 3127 (West Supp. 1990).

434. As a House Report declared:

> Under present law each partner's share of partnership income is includable in his net earnings from self-employment for social security purposes, irrespective of the nature of his membership in the partnership. The bill would exclude from social security coverage, the distributive share of income or loss received by a limited partner from the trade or business of a limited partnership. This is to exclude for coverage purposes certain earnings which are basically of an investment nature.

H.R. REP. No. 702, 95th Cong., 1st Sess., pt. 1, at 11, *reprinted in* 1977 U.S. CODE CONG. & ADMIN. NEWS 4155, 4168.

435. *See* Treas. Reg. § 1.704-1(e)(2)(ix) (1988).

436. *See id.* § 1.704-1(e)(3)(ii)(c).

437. *See* Gen. Couns. Mem. 39,546 (Aug. 15, 1986) (stating the current position of the I.R.S. regarding situations in which exempt organizations can hold general partner status); *see also* Plumstead Theatre Soc'y, Inc. v. Commissioner, 74 T.C. 1324, 1333-34 (1980) (rejecting the I.R.S.'s former position that any non-profit corporation that acts as a general partner fails to meet exemption requirements), *aff'd*, 675 F.2d 244 (9th Cir. 1982). A general partner's liability is, however, only one of several factors considered in the treatment of the participation in partnerships by tax exempt entities. Many of the I.R.S.'s concerns would probably still apply to an exempt organization's status as a manager. *See generally* B. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 829-43 (5th ed. 1987) (discussing tax implications of exempt organizations engaging in an unrelated trade or business).

tus may promote its use by tax exempt organizations.

I. Estate Valuation Freezes

The limited partnership was one of the primary targets of the so-called "estate valuation freeze" legislation introduced under the Revenue Act of 1987 [438] The estate tax provisions would apply to LLCs in a similar fashion.[439]

CONCLUSION

The LLC is an entity in the development stage and thus continues to exhibit some contradictions in its focus. The LLC is noteworthy for its potential ability to avoid the thirty-five shareholder limitation of S corporations; however, some of its governance provisions make the vehicle most effective for organizations with far fewer than thirty-five participants. The LLC can offer tax advantages in leveraged, tax sensitive business arrangements, but questions regarding its status in other jurisdictions may confine it,

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438. *See* I.R.C. § 2036(c) (1988) (enacted by Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, §§ 10401, 10402, 101 Stat. 1330, 1330-430 to -432 (1987), *amended by* Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 3031, 102 Stat. 3342, 3634-3637 (1988)). *See generally* Bush, *Many Estate Planning Devices Affected by IRS Notice on Impact of Section 2036(c)*, 17 EST. PLAN. 66, 66-67 (1990) (Section 2036(c) includes in a transferor's estate property in which the transferor retains a substantial interest, including interest in the income of or rights in the enterprise); Gazur, *Congressional Diversions: Legislative Responses to the Estate Valuation Freeze*, 24 U.S.F. L. REV. 95 (1989) ("[R]etention of an interest by a person, typically an elder generation member, will be considered a retention of the enjoyment of an interest transferred to another person, typically a younger generation member, within the context of the Internal Revenue Code section 2036(a).").

439. On November 5, 1990, Congress passed the Omnibus Budge Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388. In part, the new legislation retroactively repealed the existing "anti-freeze" statute. *See id.* § 11601, repealing I.R.C. § 2036(c) (1988). Congress added several complex provisions focusing on the appropriate valuation of interests retained by the elder generation in corporate and partnership freeze arrangements, and the effect on valuation of transfers of interests in a trust, and restrictions such as options to purchase and the treatment of lapsing rights and restrictions. *Id.* § 11602 (to be codified at I.R.C. §§ 2701-04 (1988)). A discussion of the new law is beyond the scope of this article. Generally, the impact on the LLC appears to be mixed. The expansive statute that was repealed strictly limited the use of limited partnership, and consequently LLC, structures that were strongly disproportionate in transferring all appreciation elements to the younger generation; that regime has been eliminated. On the other hand, the new legislation critically addresses the effect of value depressing devices crucial to the success of many freeze structures, which will increase the gift tax stakes in transferring junior partnership and LLC interests to members of the younger generation. For a discussion of the new provisions, see Mezzullo, *New Estate Freeze Rules Replacing 2036(c) Expand Planning Potential*, 74 J. TAX'N 4 (1991).

for the present time, to its state of origin. Therefore, it will not be the entity of choice for any remaining tax shelter syndication activity Until more states adopt LLC legislation, the LLC will probably be confined to closely held intrastate transactions.

The emphasis on the uncertainty of recognition in foreign jurisdictions and the awkward governance aspects of the LLC may be, in the words of a well-worn phrase, "seeing the cup as half-empty instead of half-full." Granted, there should be reluctance to use this form for investments with numerous participants doing business outside of those states that expressly recognize LLCs. The limited partnership vehicle probably remains better suited for those purposes. A limited partnership with an LLC general partner may provide a compromise. Tiered ownership structures utilizing limited partnerships as LLC members may also solve some of the perceived state law shortcomings of the LLC, albeit at the price of multiple entities. Viewing this entity in proper perspective, as a substitute for the S Corporation, it represents a viable business planning option. The I.R.S. has, in effect, permitted the creation of a new limited liability entity that completes the unfinished job of placing S corporations on a par with partnerships.[440] However, this result carries the price of highly restrictive transfer and continuation provisions that may be intended, in part, to limit its utility to public tax shelter promoters or entities with many owners.[441]

The LLC holds great promise for estate planning purposes because there are no restrictions on membership and different classes of economic membership interest can be utilized. The S corporation election, by comparison, does not permit more than one economic class of stock, and only narrowly tailored trusts can qualify as shareholders. Estate planning aside, the LLC might be valuable for a number of family or closely held enterprises, such as farming, real estate, hotels, and restaurants, that hold signifi-

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440. *See* Coven, *Subchapter S Distributions and Pseudo Distributions: Proposals for Revising the Defective Blend of Entity and Conduit Concepts*, 42 TAX L. REV. 381 (1987) (discussing the continuing lack of parity between partnerships and S corporations).

441. The restrictions may also limit the use of the LLC for larger businesses that seek to escape the "prison" of Subchapter C but are unable to utilize the S corporation election because the number of participants exceeds the 35 shareholder limitation. At the extreme end of the pass-through entity continuum, where the master limited partnership lies, the publicly traded partnership limitations of I.R.C. § 7704 (1988) will be more of an impediment than the LLC restrictions. For discussion of the uneven sweep of Subchapter C as applied to businesses having few, as compared with many, participants see *supra* note 15.

cant assets but subject the owners to potential liability for breach of contract or tortious behavior.

The LLC, in the proper context, deserves the consideration of those seeking both limited liability and partnership tax classification. If a significant number of states recognize the LLC, it may eclipse the S corporation as the organizational form of choice in the future.

APPENDIX*
*COMPARATIVE CHART OF LLC PROVISIONS***

CATEGORY	*WYOMING*	*FLORIDA*	*COLORADO*
A *General*			
1 Nature of Business	Any lawful purpose except banking or insurance WYO STAT § 17-15-103 (Origin: MBCA § 3)	Any lawful purpose, except any special regulatory statutes shall control when in conflict FLA STAT § 608 403	Any business that a limited partnership may lawfully conduct COLO REV STAT § 7-80-103 (Origin: ULPA § 3; RULPA § 106)
2 Powers	Each LLC may: (a) sue and be sued, complain, and defend in its name; (b) purchase, lease, or otherwise deal in and with property; (c) sell, convey, or otherwise dispose of assets; (d) lend money to and otherwise assist its members; (e) purchase, use, and	FLA STAT § 608 404 is similar to the Wyo statute, except that there is: (a) no express power to lend money to members; (b) express power to transact business in aid of governmental policy; to make donations for the public welfare or for charitable, scientific, or	Similar to the Wyo statute COLO REV STAT § 7-80 104

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* This chart paraphrases the statutory language of the LLC provisions Kansas's LLC statute closely resembles Florida's and, therefore, is omitted for the sake of brevity

** Unless otherwise expressly noted, the abbreviated citation forms used in this chart refer to the following sources:
MBCA = MODEL BUSINESS CORP ACT (1969)
RMBCA = REVISED MODEL BUSINESS CORP ACT (1984)
UPA = UNIFORM PARTNERSHIP ACT (1914)
ULPA = UNIFORM LTD PARTNERSHIP ACT (1916)
RULPA = REVISED UNIFORM LTD PARTNERSHIP ACT (1985)
WYO STAT = WYO STAT (1977)
FLA STAT = FLA STAT (Supp 1989)
COL REV STAT = COL REV STAT (Supp 1990)
OHIO REV CODE ANN (Baldwin 1990)

CATEGORY	WYOMING	FLORIDA	COLORADO
2 Powers (continued)	deal in interests in or obligations of companies and governmental instrumentalities; (f) borrow money; (g) lend money; (h) conduct its business in any state, territory, district, or foreign country; (i) elect or appoint managers and agents; (j) make and alter operating agreements; (k) indemnify current and former managers and members; (l) cease its activities; (m) have and exercise all powers necessary or convenient; and (n) become a member of a general partnership, limited partnership, joint venture or similar association, or any other limited liability company WYO STAT § 17-15-104 (Origin: MBCA §§ 4(b), 4(d), 4(e), 4(f), 4(g), 4(h), 4(i), 4(j), 4(k), 4(l), 4(q) and 4(p))	educational purposes; and to pay pensions (Origin: MBCA §§ 4(n), 4(m), and 4(o), respectively)	
3 Unauthorized Assumption of Powers	Persons acting as an LLC without authority shall be jointly and severally liable for all debts and liabilities WYO STAT § 17-15-133 (Origin: MBCA § 146)	Identical to the Wyo statute FLA STAT § 608 437	Similar to the Wyo statute but persons must also act without good faith belief that they have authority COLO REV STAT § 7-80-105
4 Transaction of Business Outside State	An LLC has the power to transact business outside the state. WYO STAT § 17-15-104(a)(viii) (Origin: MBCA § 4(j))	Grant of power to transact business outside the state similar to the Wyo statute FLA STAT § 608 404(7)	Grant of power to transact business outside the state similar to the Wyo statute COLO REV STAT § 7-80-104(1)(h) The statute includes a declaration of intent that an LLC should be recognized outside of the state and should be granted protection under the full faith and credit clause COLO REV STAT § 7-80-106

CATEGORY	WYOMING	FLORIDA	COLORADO
4 Transaction of Business Outside State (continued)	Act applies to commerce with states and foreign nations only as permitted by law WYO STAT § 17-15-135 (Origin: MBCA § 148)	No provision	No provision
5 Piercing the LLC Veil	No provision	No provision	Corporate law of 'piercing the corporate veil" made expressly applicable to LLCs COLO REV STAT § 7-80 107
B *Formation*			
1 LLC Name	"Limited Liability Company" must be the last words of name The LLC may not imply that it is organized for a purpose other than that contained in its articles of organization and the LLC name may not be the same as or deceptively similar to the name of another LLC or corporation WYO STAT § 17-15-105(a) (Origin: MBCA § 8)	Similar to the Wyo statute, but requires only "Limited Company' or the abbreviation L C " as the last words of the LLC name FLA STAT § 608 406(1)	' Limited Liability Company ' shall be included in name (not necessarily at end) "Limited' may be abbreviated as "Ltd " and Company" as "Co " COLO REV STAT § 7-80-201(1) Name cannot be same as or deceptively similar to the names of other corporations, limited partnerships LLCs, or certain registered names COLO REV STAT § 7-80 201(3)-(4)
	Omission of word "Limited", or as abbreviated "Ltd ," in the use of the LLC name renders any person participating or knowingly acquiescing in the omission liable for damages or liability occasioned by the omission WYO STAT § 17-15-105(b) (Origin: OHIO REV CODE ANN § 1783 02)	Similar to the Wyo statute FLA STAT § 608 406(2)	No provision

CATEGORY	WYOMING	FLORIDA	COLORADO
1 LLC Name (continued)	"A Limited Liability Company" shall appear after the name of the LLC on all correspondence, stationery, checks, invoices, and any and all documents and papers executed by the LLC WYO STAT § 17-15-105(c) (Origin: OHIO REV CODE ANN § 1783 02)	No provision	No provision
	No provision	No provision	An otherwise deceptive name can be used with consent and alteration to make the name distinguishable or with a decree of court which establishes a prior right to use the name COLO REV STAT § 7-80-201(5) (Origin: MBCA § 8(c)) An otherwise deceptive name can also be used if the LLC acquired all or substantially all assets of another LLC, including its name, if the name is altered to make it distinguishable COLO REV STAT § 7-80-201(6) (Origin: MBCA § 8(c))
2 Name Selection and Reservation	No provision	No Provision	Reservations of name permitted for 120 days, plus renewals not to exceed 120 days COLO REV STAT § 7-80-202 (Origin: MBCA § 9; RULPA § 103(b))

	CATEGORY	WYOMING	FLORIDA	COLORADO
3	Who Can Form an LLC?	Two or more persons may form an LLC WYO STAT § 17-15-106 "Person" includes individuals, general and limited partnerships, LLCs, corporations, trusts, business trusts, real estate investment trusts, estates, and other associations WYO STAT § 17-15-102(a)(iv)	Similar to the Wyo statute FLA STAT § 608 405	One or more natural persons 18 years of age or older may form an LLC COLO REV STAT § 7-80-203(1) (Origin: MBCA § 53) Organizers need not be members of the LLC *Id* The execution of articles constitutes an affirmation under penalties of perjury that facts stated therein are true *Id* (Origin: RULPA § 204(c)) A person may sign articles of organization by an attorney-in-fact under a written power of attorney *Id* (Origin: RULPA § 204(b)) The LLC shall have two or more members at the time of formation COLO REV STAT § 7-80-203(2)
4	Articles of Organization	Articles shall set forth: (a) name; (b) period of duration, not to exceed 30 years; (c) purpose; (d) address of principal place of business in state and name and address of registered agent; (e) amount of contributions; (f) right to admit additional members; (g) right to continue business on dissolution; (h) names and addresses of managers or, if no managers, then names of members; and (i) any other provision not inconsistent with law WYO STAT § 17-15-107 (Origin: MBCA §§ 54(a), (b), (c), (i), (j), (h); ULPA §§ 2(1)(a) VI, VII, XI, XIII)	Almost identical to the Wyo statute FLA STAT § 608 407	Abbreviated format requiring only: (a) name and, if known, principal place of business; (b) period of duration, not to exceed 30 years; (c) name and business address of registered agent; (d) names and business addresses of initial managers; and (e) any other provision not inconsistent with law that the members set out in the articles of organization COLO REV STAT § 7-80-204(1) (Origin: RULPA § 201(a))

	CATEGORY	WYOMING	FLORIDA	COLORADO
5	Filing Articles of Organization	File duplicate originals with Secretary of State WYO STAT. § 17-15-108(a) (Origin: MBCA § 55)	Similar to the Wyo statute but does not require duplicates FLA STAT § 608 408	Similar to the Wyo. statute COLO REV STAT § 7-80-205(1)
		Secretary of State returns certificate of organization and duplicate original articles of organization to principal office of LLC or to its representative WYO STAT. § 17-15-108(b) (Origin: MBCA § 55)	Similar to the Wyo. statute FLA STAT § 608 408	An enclosed duplicate original of the articles is returned to the principal place of business of the LLC or to its representative and a copy is filed with the Secretary of State's office No certificate of organization is issued COLO. REV STAT § 7-80-205(2) (Origin: RULPA § 206(a)(3))
6	Appeal from Denied Filing	No provision	No provision	Appeal procedure for denied filing requires written notice of disapproval by Secretary of State, specifying the reasons for disapproval, within 10 days of delivery of the articles for filing COLO. REV STAT § 7-80-206(1) (Origin: RMBCA § 1 25(c)). Disapproval may be appealed to the courts COLO. REV STAT § 7-80-206(2) and (3) (Origin: RMBCA § 1 26)
7	Effect of Filing Articles	Upon issuance of a certificate of organization, an LLC is organized and the certificate is conclusive evidence that the LLC is legally organized WYO STAT. § 17-15-109(a) (Origin: MBCA § 56)	Similar to the Wyo statute FLA STAT § 608 409(1). However, the date of existence is the date of filing of articles except the date: (a) can be a date specified in the articles if subsequent to, but no later than, 90 days from the date of filing; or (b) can be the date of subscription and acknowledgment of the articles if filed within 5 days, exclusive of legal holidays, after such date FLA STAT § 608 408(3)	Similar to the Wyo statute, except that a delayed effective date, not later than 90 days after the date of filing, may be specified COLO. REV STAT § 7-80-207 (Origin: RMBCA § 1 23(b))

	CATEGORY	WYOMING	FLORIDA	COLORADO
7	Effect of Filing Articles (continued)	An LLC shall not transact business except that which is incidental to its organization or to obtaining subscriptions until the certificate is issued WYO STAT § 17-15-109(b)	Similar to the Wyo. statute FLA STAT § 608 409(2)	No provision
8	Notice of Limited Liability	No provision	No provision	Fact that articles are on file is notice that the LLC exists as such and notice of all other facts therein that are required to be included in the articles of organization COLO. REV STAT § 7-80-208 (Origin: RULPA § 208)
9	Amendment to Articles	Articles shall be amended when: (a) there is a change in the LLC name or amount or character of contributions; (b) there is a change in the character of business; (c) there is a false or erroneous statement in the articles; (d) there is a change in the time as stated in the articles for dissolution or, if a time is fixed for such dissolution, where none was previously stated; or (e) the members desire to make a change to accurately represent their agreement WYO STAT § 17-15-129(b) (Origin: ULPA § 24(2)(a), (f), (g), (h), (i), (j))	Almost identical to the Wyo statute FLA STAT § 608 411(1)	The articles shall be amended when: (a) there is a change in the LLC name; (b) there is a false or erroneous statement in the articles; (c) there is a change in the time stated for dissolution; or (d) the members desire to make a change to accurately represent their agreement COLO REV STAT § 7-80-209(1)
		The amendment shall be signed and sworn to by all members An amendment adding a new member must be signed by the new member. WYO STAT § 17-15-129(c) (Origin: ULPA § 25(1)(b))	Almost identical to the Wyo statute FLA STAT § 608 411(2)	The amendment shall be signed by a manager and may be signed by an attorney-in-fact The execution of an amendment constitutes an affirmation under penalties of perjury that the facts stated therein are true COLO. REV STAT § 7-80 209(2) (Origin: RULPA § 204)

CATEGORY	WYOMING	FLORIDA	COLORADO
C *Administrative Matters*			
1 Registered Agent	Registered office and registered agent must be maintained in the state of formation WYO STAT. § 17-15-110 (Origin: MBCA § 12)	Similar to the Wyo statute FLA STAT § 608 415(1)	No requirement of a registered office as such; only a registered agent for service of process must be maintained However, the statute refers to a registered office, defined as the business address of the registered agent COLO REV STAT § 7-80-301, -102(13)
2 Change of Name or Business Address of Registered Agent	A statement must be filed in the office of the Secretary of State if the registered office, registered agent, or both are changed WYO STAT. § 17-15-111(a) and (b) (Origin: MBCA § 13)	Similar to the Wyo. statute FLA STAT § 608 416(1) and (2)	Similar in purpose to the Wyo statute COLO REV STAT § 7-80-302
	A registered agent may resign by mailing a written notice to the Secretary of State, and the appointment terminates 30 days after receipt of such notice by the Secretary of State WYO STAT. § 17-15-111(c) (Origin: MBCA § 13)	Similar to the Wyo statute FLA STAT § 608 416(3)	Similar in purpose to the Wyo statute COLO REV STAT § 7-80-302(3)
3 LLC Reports	No provision	No provision, but see C.4 below for $50 00 annual fee pertaining to "an annual report"	Requires the filing of a report setting forth the: (a) name of the LLC and, if a foreign LLC, the state of organization; (b) name and business address of the registered agent; and (c) name and address of each manager COLO. REV. STAT. § § 7-80-303, -304 (Origin: MBCA §§ 125 and 126)

CATEGORY	WYOMING	FLORIDA	COLORADO
4 Fees	Filing fees for articles, amendments, statements of intent to dissolve, articles of dissolution, and change of registered office or agent are prescribed WYO STAT § 17-15-132(a)(i)-(v)	Similar filing fees are prescribed FLA STAT § 608 452(1)-(5)	Similar filing, service and copying fees are prescribed COLO REV STAT § 7-80-307
	The Secretary of State shall charge and collect $5 00 at the time of any service of process on him as a resident agent of an LLC WYO STAT § 17-15-134	Miscellaneous charges are assessed for certified copies of documents and for service of process on a registered agent FLA STAT § 608 453	(See above)
	An annual tax of $50 00 is due and payable on January 2 of each year WYO STAT § 17-15-132(a)(vi)	A fee of $50 00 is payable January 2 of each year for an annual report FLA STAT § 608 452(6)	An LLC is not subject to a tax, but its members are liable for taxes in their separate or individual capacities COLO REV STAT §§ 39-22-201 5, -205
	Wyoming has no income tax	An LLC is treated as a corporation subject to Florida state income tax FLA STAT § 608 471	Special entity level measures are prescribed to assure payment of state taxes on LLC income earned by non-residents COLO REV STAT § 39-22-601(4 5)(c)
5 Failure to Pay Fees, etc	An LLC that fails for 30 days to maintain a registered agent, fails for 30 days to file a required statement of change of registered agent or office, or fails to pay the annual $50 tax is deemed to be transacting business without authority and, unless there is compliance within 30 days of notice, shall be deemed defunct, subject to reinstatement if an application is made within one year after forfeiture WYO STAT § 17-15-112	An LLC may not maintain any action in any court until the LLC complies with the registered office and agent requirements and pays a penalty of the lesser of $1 per day of noncompliance or $250 FLA STAT § 608.415(4) An LLC may be involuntarily dissolved for failure to file reports or pay fees or failure to maintain a registered agent or file a statement of change for a change of registered office or agent within 30 days FLA STAT § 608 448(2)	A domestic LLC may be suspended for failure to pay fees or file required reports, subject to reinstatement The status of a suspended LLC is detailed COLO REV STAT § 7-80-305

CATEGORY	WYOMING	FLORIDA	COLORADO
6 Service of Process	The registered agent shall be the agent for service of process If the registered agent was not appointed or cannot be found, then the Secretary of State shall be the agent WYO STAT § 17-15-114 (Origin: MBCA § 14)	Similar in purpose to the Wyo statute Process may be served on the registered agent, a manager (if management is vested in a manager), a member (if management is vested in the members), or by mailing to the registered office FLA STAT § 608 463	Similar in purpose to the Wyo statute COLO REV STAT § 7-80-306
7 Forms	No Provision	All filings made by the Department of State shall be in accordance with the general filing duties prescribed by statute FLA STAT § 608 451	All filings and reports to be filed with the Secretary of State shall be typewritten on forms prescribed and furnished by the Secretary of State COLO REV STAT § 7-80-308 (Origin: MBCA § 142)
8 Power of Secretary of State	No provision	No provision	The Secretary of State shall have the power reasonably necessary to administer the statute and perform the duties imposed upon him COLO REV STAT § 7-80-309 (Origin: MBCA § 139)
D *Management*			
1 Managers	Management shall be vested in the members in proportion to their capital contributions, as adjusted from time to time to reflect additional capital contributions or withdrawals If provided for in the articles of organization, management may be vested in a manager or managers elected by members WYO STAT § 17-15-116	Similar to the Wyo statute FLA STAT § 608 422	Management shall be vested in a manager or managers The articles of organization or operating agreement may apportion management responsibility or voting power among the managers in any manner not inconsistent with the statute COLO REV STAT § 7-80-401(1)

CATEGORY	WYOMING	FLORIDA	COLORADO
1 Managers (continued)	No provision	No provision	Managers shall be natural persons 18 years of age or older but need not be residents of the state of formation or members, unless the articles of organization or operating agreements so provide. COLO. REV. STAT. § 7-80-401(2) (Origin: MBCA § 35 and RMBCA § 8 02)
2 Election and Term	Managers shall be elected annually by the members in a manner provided in the operating agreement WYO STAT § 17-15-116	Similar to the Wyo statute FLA STAT § 608 422	The number of managers shall be fixed in the articles of organization or operating agreement, except initial manager(s) shall be fixed in the articles of organization In the absence of an operating agreement provision for the number, the number shall be that in the articles of organization The number of managers may be increased or decreased as provided in the articles of organization or operating agreement, but no decrease shall shorten the term of any incumbent manager In the absence of an operating agreement provision, managers shall be elected by a majority vote of members COLO REV STAT § 7-80-402(1) At the first annual meeting of members and at each annual meeting thereafter, members shall elect managers Each manager shall hold office for the term for which he is elected and until his successor has been elected or qualified COLO. REV. STAT. § 7-80-402(2) (Origin: MBCA § 36)

CATEGORY	WYOMING	FLORIDA	COLORADO
3 Classification	Managers shall be elected annually by the members in a manner provided in the operating agreement WYO STAT § 17-15-116	Similar to the Wyo Statute FLA STAT § 608 422	If there are 6 or more managers, articles of organization may provide for the managers to be divided into 2 or 3 classes, as nearly equal in number as possible COLO REV STAT § 7-80-403 (Origin: MBCA § 37)
4 Vacancies	No provision	No provision	Vacancies in managers may be filled by written agreement of a majority of the remaining managers If vacancies are filled due to an increase in the number of managers, the vacancy shall be filled by written agreement of a majority of the managers then in office or by election at either an annual meeting or special meeting of members COLO REV STAT § 7-80-404 (Origin: MBCA § 38)
5 Removal	No provision	No provision	At a meeting called for the purpose of removal, all or a lesser number of managers may be removed with or without cause in the manner provided in the operating agreement If the operating agreement does not provide for removal, then a manager may be removed with or without cause by a vote of the majority of the members then entitled to vote at an election of managers COLO REV STAT § 7-80-405 (Origin: MBCA § 39)

CATEGORY	WYOMING	FLORIDA	COLORADO
6 Duties	The manager(s) shall hold the offices and have the responsibilities set out in the operating agreement WYO STAT § 17-15-116	Similar to the Wyo. statute FLA STAT § 608 422	Managers shall perform their duties in good faith and with such care as an ordinarily prudent person in a like position would use under similar circumstances COLO. REV STAT § 7-80-406(1) (Origin: RMBCA § 8 30(a))
	No provision	No provision	In performing his duties, a manager may generally rely on information from employees or other agents of the LLC, attorneys and other professionals, and committees upon which he does not serve COLO. REV. STAT. § 7-80-406(2) (Origin: MBCA § 35; RMBCA § 8 30(b) and (c))
	No provision	No provision	A manager shall not have authority to act in contravention of either the articles of organization or the operating agreement COLO. REV STAT § 7-80-406(3) (Origin: ULPA § 9(1)(a))
	No provision (However, see D 7 and D 8 below)	No provision (However, see D 7 and D 8 below)	Every manager is an agent of the LLC, and a manager's acts, including execution of instruments for apparently carrying on in the usual way the business of the LLC, bind the LLC unless the act is in contravention of the articles of organization or the operating agreement or the manager lacks authority and the person with whom he is dealing has knowledge that he has no such authority COLO. REV. STAT. § 7-80 406(4) (Origin: UPA § 9(1))

CATEGORY	WYOMING	FLORIDA	COLORADO
7 Contracting Debts	Except as otherwise provided in the Act, no debt shall be contracted nor liability incurred, except by one or more managers (if management is vested in managers) or by any member (if management is retained by members) WYO STAT § 17-15-117	Similar to the Wyo. statute FLA STAT § 608 424	Similar to the Wyo statute, except that only managers may incur such obligations, and the provision is also subject to the articles of organization or the operating agreement COLO REV STAT § 7-80-407
8 LLC Property	Property shall be held and conveyed in the LLC name Instruments for acquisition, mortgage, or disposition of property shall be binding upon the LLC if executed by one or more managers (if management is vested in managers) or one or more members (if management has been retained by the members) WYO STAT. § 17-15-118 (*compare* UPA § 10)	Similar to the Wyo. statute FLA STAT § 608 425	Similar to the Wyo statute, except that execution of documents shall be by one or more managers (members cannot act) COLO REV STAT § 7-80-408
9 Related Party Transactions	An LLC has the power to lend money to and otherwise assist its members WYO STAT. § 17-15-104(a)(iv) (Origin: MBCA § 4(f))	No provision	An LLC has the power to lend money to and otherwise assist its members and employees, except as otherwise provided in the operating agreement COLO REV STAT § 7-80-104(1)(d)
	No provision	No provision	Except as provided in the operating agreement, a member or manager may lend money to, act as surety for, and transact other business with the LLC Subject to other applicable law, a member or a manager has the same rights and obligations as a person not a member or manager COLO. REV STAT § 7-80-409 (Origin: RULPA § 107)

	CATEGORY	WYOMING	FLORIDA	COLORADO
10	Indemnification	An LLC has the power to: (a) indemnify a member, manager, or former member or manager against expenses incurred in connection with proceedings arising by reason of such person being or having been a member or manager, except if he be adjudged liable for negligence or misconduct in the performance of his duty; and (b) make other indemnification as authorized by the articles of organization, operating agreement, or a member resolution WYO STAT § 17-15-104(a)(xi)	An LLC has the power to indemnify to the same extent as a corporation would indemnify its directors, officers, employees, or agents FLA STAT § 608 404(11)	Extensive indemnification provisions COLO. REV STAT § 7-80-410 (Origin: RMBCA §§ 8 50 - 8 58)
11	Records	No provision	No provision	The following required records are to be maintained at an office specified in the operating agreement, or if none, at the registered office: (a) a list of the names and the addresses of past and present members and managers; (b) a copy of the articles of organization and all amendments, plus the power of attorney pursuant to which any amendment has been executed; (c) copies of federal, state, and local tax returns, for the three most recent years; (d) copies of the operating agreements in effect and the financial statements for the three most recent years; (e) minutes of meetings; (f) unless contained in the operating agreement or other writing, a statement describing capital contributions and rights to distributions upon member resignations; (g) any written consents of members to action without a meeting COLO. REV STAT § 7-80-411(1) (Origin: RULPA § 105(a))

	CATEGORY	WYOMING	FLORIDA	COLORADO
11	Records (continued)	No provision	No provision	Records are subject to inspection and copying upon a reasonable request, and at the expense of any member during ordinary business hours. COLO. REV STAT § 7-80-411(2) (Origin: RULPA § 105(b))
E	*Finance*			
1	Form of Contribution	Contributions may be in the form of cash or other property, but not services WYO STAT § 17-15-115 (Origin: ULPA§ 4)	Almost identical to the Wyo statute FLA STAT § 608 4211	Contributions may be in the form of cash, property, or services rendered or a promissory note or other obligation to contribute cash or property or to perform services COLO. REV STAT § 7-80-501 (Origin: RULPA § 501)
2	Liability for Contribution	Members are liable to the LLC for unpaid capital contributions WYO STAT § 17-15-121(a)(ii) (Origin: ULPA § 17(1))	Almost identical to the Wyo statute FLA STAT § 608 435(1)	Similar in purpose to the Wyo statute, but also addresses failure to perform an obligation to contribute services COLO. REV STAT § 7-80-502(1) (Origin: RULPA § 502)
		The liabilities of a member may be waived or compromised by consent of all members, but the rights of a creditor who extended credit or whose claim arose before the cancellation or amendment of the articles of organization are not affected WYO STAT § 17-15-121(c) (Origin: ULPA § 17(3))	Almost identical to the Wyo statute FLA STAT § 608 435(3)	Similar in purpose to the Wyo statute COLO. REV STAT § 7-80-502(2) (Origin: RULPA § 502(c))
		No provision	No provision	A promise by a member to contribute to the LLC is not enforceable unless set out in a writing signed by the member COLO. REV STAT § 7-80-502(3) (Origin: RULPA § 502(a))

	CATEGORY	WYOMING	FLORIDA	COLORADO
3	Sharing of Profits and Losses	Profits are divided and distributed upon the basis stipulated in the operating agreement Losses are not discussed WYO STAT § 17-15-119	Similar to the Wyo statute, but it does not mention "profits ' or "division;" speaks to "distribution [of] property" upon the basis stipulated in the regulations governing the LLC FLA STAT § 608 426	Profits and losses are allocated in the manner provided for in the operating agreement. If the operating agreement is silent, profits and losses shall be allocated on the basis of the value of member contributions COLO. REV STAT § 7-80-503 (Origin: RULPA § 503)
4	Sharing of Distributions	Distributions are shared upon the basis stipulated in the operating agreement WYO STAT § 17-15-119	Distributions are shared upon the basis stipulated in the regulations FLA STAT § 608 426	Distributions are shared in the manner provided for in the operating agreement, or, if it is silent, on the basis of the value of member contributions COLO. REV STAT § 7-80-504 (Origin: RULPA § 504)
F	*Distributions and Resignations*			
1	Interim Distributions	No provision	No provision	Interim distributions are permitted before dissolution and winding up at the times or upon the events specified in the operating agreement COLO. REV STAT § 7-80-601 (Origin: RULPA § 601)
2	Resignation of Member	A member may rightfully demand the return of his or its contribution on the dissolution of the LLC or after the member has given all other members 6 months prior written notice where no time is specified in the articles of organization WYO STAT § 17-15-120(b) (Origin: ULPA § 16(2))	Similar to the Wyo statute FLA STAT § 608 427(2)	A member may resign at any time by written notice to other members, but if the resignation violates the operating agreement, the LLC may recover damages for breach of the operating agreement and offset them against the amount otherwise distributable to him COLO. REV STAT § 7-80-602 (Origin: RULPA § 602)

	CATEGORY	WYOMING	FLORIDA	COLORADO
3	Distribution upon Resignation	No provision	No provision	A resigning member is entitled to receive any distribution to which he is entitled under the operating agreement If not otherwise provided for in the operating agreement, he is entitled to receive, within a reasonable time after his resignation, the fair value of his membership interest based upon his right to share in distributions COLO. REV STAT § 7-80-603 (Origin: RULPA § 604)
4	Distribution in Kind	In the absence of a statement in the articles of organization to the contrary or the consent of all members, a member has only the right to demand and receive cash in return for his or its contribution WYO STAT § 17-15-120(c) (Origin: ULPA § 16(3))	Identical to the Wyo. statute FLA STAT § 608 427(3)	Except as provided in the operating agreement, a member has no right to demand and receive a distribution in any form other than cash, regardless of the nature of his contribution Except as provided in writing in the operating agreement, a member may not be compelled to accept a distribution of any asset in kind to the extent that the percentage of the asset distributed to him exceeds the percentage in which he shares in distributions. COLO. REV STAT § 7-80 604 (Origin: RULPA § 605)
5	Right to Distribution	A member may have the LLC dissolved and wound-up when the member has rightfully but unsuccessfully demanded the return of his or its contribution or the other liabilities of the LLC have not been paid, or the LLC property is insufficient for their payment, and the member would otherwise be entitled to the return of his contribution WYO STAT § 17-15-120(d) (Origin: ULPA § 16(4))	Identical to the Wyo. statute FLA STAT § 608 427(4)	At the time a member becomes entitled to receive a distribution, he has the status and remedies of a creditor with respect to the distribution COLO. REV STAT § 7-80-605 (Origin: RULPA § 606)

CATEGORY	WYOMING	FLORIDA	COLORADO
6 Limitations on Distributions	After distribution is made, the assets of the LLC must exceed all liabilities of the LLC except liabilities to members on account of their contributions WYO STAT § 17-15-119 (Origin: ULPA § 15)	Amost identical to the Wyo statute FLA STAT § 608 426	Closely resembles the Wyo statute COLO REV STAT § 7-80-606 (Origin: RULPA § 607)
	A member shall not receive any part of his capital contribution until (a) all liabilities, except liabilities to members on account of contributions, have been paid or there remains property sufficient to pay them; (b) the consent of all members is had unless the return may be rightfully demanded; and (c) the articles of organization are cancelled or amended to set out the withdrawal or reduction WYO STAT § 17-15-120(a) (Origin: ULPA § 16(1))	Almost identical to the Wyo statute FLA STAT § 608 427(1)	(See COLO REV STAT 7-80-606 above)
7 Liability upon Return of Contribution	A member holds as trustee for the LLC: (a) specific property not contributed or property which was wrongfully and erroneously returned; and (b) money or other property wrongfully paid or conveyed to such member on account of his or its contribution WYO STAT § 17-15-121(b) (Origin: ULPA § 17(2))	Almost identical to the Wyo statute FLA STAT § 608 435(2)	If a member receives the return of any part of his contribution in violation of the operating agreement or law, he is liable to the LLC for a period of 6 years thereafter for the amount of the contribution wrongfully returned COLO REV STAT § 7-80-607(2) (Origin: RULPA § 608(b))

CATEGORY	WYOMING	FLORIDA	COLORADO
7 Liability upon Return of Contribution (continued)	When a member has rightfully received the return in whole or in part of his contribution, he is nevertheless liable for any sum, not to exceed the return plus interest, necessary to discharge the LLC's liability to creditors who extended credit or whose claims arose before the return WYO STAT § 17-15-121(d) (Origin: ULPA § 17(4))	Almost identical to the Wyo statute FLA STAT § 608 435(4)	If a member has received the return of any part of his contribution without violation of the operating agreement or the Act he is liable to the LLC for a period of 6 years thereafter for the amount of the returned contribution, but only to the extent necessary to discharge the LLC's liability to creditors who extended credit during the period the contribution was held by the LLC COLO REV. STAT § 7-80-607(1) (ORIGIN RUPLA § 608(A))
G *Members*			
1 Admission of Members	The articles of organization shall set forth the right, if given, of the members to admit additional members, and the terms and conditions of the admission WYO STAT § 17-15-107(a)(vii) (Origin: ULPA §§ 2(1)(a)(X and XI)	Almost identical to the Wyo statute FLA STAT § 608 407(1)(g)	After the filing of an LLC's original articles of organization, a person may be admitted as an additional member upon the written consent of all members COLO. REV STAT § 7-80-701 (Origin: RULPA § 401)
2 Transferability of Interests	The interest of all members in an LLC constitutes the personal estate of the member WYO STAT § 17-15-122	An interest of a member in an LLC is personal property FLA. STAT. § 608 431 (Origin: ULPA § 18)	The interest of each member in an LLC constitutes the personal property of the member COLO REV STAT § 7-80-702(1)
	The interest of a member may be transferred or assigned as provided in the operating agreement However, if the other members (other than the member proposing to dispose of his or its interest) fail to approve by unanimous written consent, the transferee shall have no right to participate in the management of the business and affairs of the LLC or to become a member WYO STAT §17-15-122	Almost identical to the Wyo statute FLA STAT § 608 432	Almost identical to the Wyo statute COLO REV STAT § 7-80-702(1)

CATEGORY	*WYOMING*	*FLORIDA*	*COLORADO*
2 Transferability of Interests (continued)	The transferee shall only be entitled to receive the share of profits or other compensation by way of income and the return of contributions to which that member would otherwise be entitled WYO STAT § 17-15-122 (Origin: ULPA § 19(3))	Almost identical to the Wyo statute FLA STAT § 608 432	Almost identical to the Wyo statute COLO REV STAT § 7-80-702(1)
	No provision	No provision	A substituted member is a person admitted to all rights of a member who has died or has assigned his interest in the LLC with the approval of all members The substituted member has all rights and powers and is subject to all the restrictions and liabilities of his assignor, except that the substitution of the assignee does not release the assignor from liability to the LLC for contributions COLO. REV STAT § 7-80-702(2) (Origin: ULPA § 19(6) - (7))
3 Rights of Creditor Against a Member	No provision	No provision	On application by a judgment creditor, a court may charge the membership interest of a member with payment of the unsatisfied amount of the judgment with interest To the extent so charged, the judgment creditor has only the rights of an assignee COLO. REV STAT § 7-80-703 (Origin: RULPA § 703)
4 Deceased or Incompetent Members Who Are Individuals; Dissolved or Terminated Members that Are Legal Entities	No provision	No provision	If a member who is an individual dies or is adjudged incompetent, the executor, conservator, or other legal representative may exercise all of the member's rights COLO. REV STAT § 7-80-704(1) (Origin: RULPA § 705)

	CATEGORY	WYOMING	FLORIDA	COLORADO
4	Deceased or Incompetent Members Who Are Individuals; Dissolved or Terminated Members that Are Legal Entities (continued)			If a member is a corporation, trust, or other entity that is dissolved or terminated, the powers of that member may be exercised by its legal representative or successor. COLO. REV STAT § 7-80-704(2) (Origin: RULPA § 705)
5	Liability of Members and Managers	Neither the members nor the managers of an LLC are liable under a judgment, decree, or order of a court, or in any other manner for a debt, obligation, or liability of the LLC. WYO STAT § 17-15-113	Identical to the Wyo. statute FLA STAT § 608 436	Closely resembles the Wyo. statute COLO REV STAT § 7-80-705 (See also A 5 above for application of the piercing the corporate veil doctrine)
6	Voting	No provision	No provision	Subject to provisions requiring majority or unanimous consent, the operating agreement may grant to all or a specified group of members, the right to consent, vote, or agree on a per capita or other basis, upon any matter COLO. REV STAT § 7-80-706(1) (Origin: RULPA § 302)
		No provision	No provision	Unless the operating agreement provides otherwise, any member may vote in person or by proxy COLO. REV. STAT. § 7-80-706(2) (Origin: MBCA § 33)
7	Meetings of Members	No provision	No provision	Meetings of members may be held at such place, within or without the state of formation, as may be stated in or fixed by the operating agreement If no other place is so stated or fixed, all meetings shall be held at the registered office of the LLC COLO. REV. STAT. § 7-80-707(1) (Origin: MBCA § 28)

	CATEGORY	WYOMING	FLORIDA	COLORADO
7	Meetings of Members (continued)	No provision	No provision	An annual meeting shall be held at such time as may be stated or fixed in the operating agreement. Failure to hold the annual meeting at the designated time shall not work a forfeiture or dissolution of the LLC COLO. REV. STAT. § 7-80-707(2) (Origin: MBCA § 28)
		No provision	No provision	Special meetings of the members may be called by any manager, by not less than 1/10 of the members entitled to vote at the meeting, or by such other persons as may be provided in the articles of organization or in the operating agreement COLO. REV. STAT. § 7-80-707(3) (Origin: MBCA § 28)
		No provision	No provision	Procedures are set forth for judicial orders that a meeting be held COLO. REV STAT § 7-80-707(4) (Origin: RMBCA § 7 03)
8	Quorum of Members; Vote Required	No provision	No provision	Unless otherwise provided in the articles of organization or operating agreement, a majority of members entitled to vote shall constitute a quorum If a quorum is present, the affirmative vote of the majority of members represented at the meeting and entitled to vote shall be the act of the members, unless the vote of a greater proportion or number or voting by classes is required by this article, the articles of organization, or the operating agreement If a quorum is not represented, such meeting may be adjourned for a period not to exceed 60 days COLO. REV. STAT. § 7-80-708 (Origin: MBCA § 32)

CATEGORY	WYOMING	FLORIDA	COLORADO
9 Notice of Members' Meetings	No provision	No provision	Written notice of meetings shall be delivered not less than 10 days, nor more than 50 days, before the meeting, either personally or by mail COLO. REV. STAT § 7-80-709(1) (Origin: MBCA § 29)
	No provision	No provision	Notice to members, if mailed, shall be deemed delivered when deposited in the U S mail, addressed to the member, postage prepaid Three successive letters returned as undeliverable obviate the need for further notice to the last address COLO. REV STAT § 7-80-709(2) (Origin: RMBCA § 1 41(c))
	No provision	No provision	Unless the operating agreement otherwise requires, notice need not be given of an adjourned meeting if the time and place are announced at the meeting at which adjournment is taken COLO REV STAT § 7-80-709(3) (Origin: RMBCA § 7 05(e))
10 Waiver of Notice	When, under the act, articles of organization or operating agreement, notice is required, a written waiver of notice, whether before or after the time stated in it, is equivalent to the giving of notice WYO STAT § 17-15-131 (Origin: MBCA § 144)	Almost identical to the Wyo statute FLA STAT § 608 455	Similar to the Wyo statute in purpose, but limited to notice to members and does not include notice to managers COLO. REV STAT § 7-80-710 (Origin: RMBCA § 7 06)

	CATEGORY	WYOMING	FLORIDA	COLORADO
11	Action by Members Without a Meeting	No provision	No provision	Unless articles of organization or operating agreement provide otherwise, action to be taken at a meeting of the members may be taken without a meeting if action is evidenced by written consent signed by each member entitled to vote Action is effective when all members have signed, unless the consent specifies a different effective date COLO REV STAT § 7-80-711 (Origin: MBCA § 145)
12	Information and Accounting	No provision	No provision	A member has the right to inspect and copy the LLC records required to be maintained by the LLC (See D 11 above) and obtain from the managers, subject to such reasonable standards as set forth in the operating agreement or otherwise established by the managers, upon reasonable demand for any purpose reasonably related to the member's interest: (a) information regarding LLC affairs; and (b) a copy of federal, state, and local income tax returns COLO REV STAT § 7-80-712(1)(a) and (b) (Origin: RULPA § 305)
		No provision	No provision	A member has a right to a formal accounting of an LLC's affairs whenever circumstances render it just and reasonable COLO. REV STAT § 7-80-712(1)(c) (Origin: ULPA § 10(b))

CATEGORY	WYOMING	FLORIDA	COLORADO
H *Dissolution*			
1 Dissolution	An LLC is dissolved: (a) when the period fixed for its duration expires; (b) by the unanimous written agreement of all members; (c) upon the death, retirement, resignation, expulsion, bankruptcy, dissolution of a member, or occurrence of any other event which terminates the continued membership of a member in the LLC WYO STAT § 17-15-123 (Origin: ULPA § 20)	Almost identical to the Wyo statute FLA STAT § 608 441	Almost identical to the Wyo statute COLO REV STAT § 7-80-801(1)
	An LLC is not dissolved if the business is continued by the consent of all the remaining members under a right to do so stated in the articles of organization WYO STAT § 17-15-123(A) (Origin: ULPA § 9(1)(g))	An LLC is not dissolved if the business of the LLC is continued by the consent of all the remaining members or under a right to continue stated in the articles of organization FLA STAT § 608 441(1)	An LLC is not dissolved if there are at least two remaining members and the business of the LLC is continued by the consent of all the remaining members under a right to do so stated in the articles of organization within ninety days after the termination COLO REV STAT § 7-80-801(1) (Origin: RULPA § 801(4))
2 Execution by Judicial Act	No provision	No provision	Any person who is adversely affected by the failure or refusal to execute and file any amendment, statement of intent to dissolve, or other document to be filed under the Act may petition a court for the execution and filing of such document COLO REV STAT § 7-80-802 (Origin: RULPA § 205)

CATEGORY	WYOMING	FLORIDA	COLORADO
3 Filing of Statement of Intent to Dissolve	Duplicate originals of a statement of intent to dissolve shall be delivered to the Secretary of State WYO STAT § 17-15-124 (Origin: MBCA § 85)	Similar in purpose to the Wyo statute FLA STAT § 608 442	Resembles the Wyo statute, but also expressly states that the filing of the statement of intent to dissolve shall not affect the limited liability of the members COLO REV STAT § 7-80-803
4 Effect of Filing of Statement of Intent to Dissolve	Upon filing the statement of intent to dissolve, the LLC shall cease to carry on its business, except as may be necessary for winding up its business, but its separate existence shall continue until a certificate of dissolution has been issued or a decree has been entered by a court WYO STAT § 17-15-125 (Origin: MBCA § 86)	Almost identical to the Wyo statute FLA STAT § 608 443(1)	Almost identical to the Wyo statute COLO REV STAT § 7-80-804
	No provision	Within 20 days after filing of statement of intent to dissolve, the LLC shall mail notice thereof to each creditor of, and claimant against, the LLC FLA STAT § 608 443(2) (Origin: MBCA § 87)	No provision
	No provision	General language requires the LLC to collect its assets, pay its debts or make adequate provision for their payment, and do all other acts required to liquidate its business and affairs FLA STAT § 608 443(3) (Origin: MBCA § 87)	No provision

CATEGORY	WYOMING	FLORIDA	COLORADO
5 Distribution of Assets upon Dissolution	Liabilities shall be entitled to payment in the following order: (i) those to creditors, in the order of priority as provided by law, except those to members of the LLC on account of contributions; (ii) those to members in respect of their shares of profits and other compensation by way of income on their contributions; and (iii) those to members in respect of contributions to capital WYO STAT § 17-15-126(a) (Origin: ULPA § 23(1))	Almost identical to the Wyo statute FLA STAT § 608 444(1)	Assets shall be distributed: (i) to creditors, including members who are creditors, in satisfaction of liabilities of the LLC other than liabilities for distributions to members; (ii) except as provided in the operating agreement, to members and former members of the LLC in satisfaction of liabilities for distributions; (iii) except as provided in the operating agreement, to members for the return of their contributions and respecting their membership interests in the proportions in which the members share in distributions COLO. REV STAT § 7-80 805 (Origin: RULPA § 804)
	Subject to any statement in the operating agreement, members share in assets in respect to their claims for capital and in respect to their claims for profits by way of income, respectively, in proportion to the respective amounts of the claims WYO STAT § 17-15-126(b) (Origin: ULPA § 23(2))	Almost identical to the Wyo statute FLA STAT § 608 444(2)	COLO REV STAT § 7-80 805
6 Articles of Dissolution	Articles of dissolution shall be filed when all debts, liabilities, and obligations have been paid or discharged or adequate provision has been made therefor and all of the remaining property has been distributed WYO STAT § 17-15-127 (Origin: MBCA § 92)	Almost identical to the Wyo statute FLA STAT § 608 445	Almost identical to the Wyo statute COLO REV STAT § 7-80 806

	CATEGORY	WYOMING	FLORIDA	COLORADO
7	Filing of Articles of Dissolution	Prescribes filing procedures and states that upon filing the articles of dissolution, the existence of the LLC shall cease except for the purpose of suits, other proceedings, and appropriate action WYO STAT. § 17-15-128 (Origin: MBCA § 93)	Almost identical to the Wyo statute FLA STAT § 608 446	Almost identical to the Wyo statute COLO REV STAT § 7-80-807
8	Involuntary Dissolution	See C 5 above for forfeiture of LLC status for the failure to pay required fees or to maintain a registered agent	Provides for involuntary dissolution of the LLC by decree of court or order of the Department of State FLA STAT. § 608 448 (Origin: MBCA § 94) (See also C 5 above)	Resembles the Fla statute. COLO REV. STAT § 7-80 808 (See also C 5 above)
9	Notification to Attorney General	No provision	No provision	Provision for notification of the attorney general by the Secretary of State as to LLCs that have given cause for involuntary dissolution COLO. REV. STAT. § 7-80-809 (Origin: MBCA § 95)
10	Venue and Process	No provision	No provision	Venue prescribed for actions in involuntary dissolution COLO. REV. STAT. § 7-80-810 (Origin: MBCA § 96)
11	Cancellation of Articles of Organization	No provision	On filing of the articles of dissolution, the articles of organization shall be cancelled by the Department of State FLA STAT § 608 447	Almost identical to the Fla statute COLO REV STAT § 7-80-811
12	Parties to Actions	A member of an LLC is not a proper party to proceedings by or against an LLC except where the object of the proceedings is to enforce a member's right against or liability to the LLC WYO STAT § 17-15-130 (Origin: ULPA § 26)	Almost identical to the Wyo statute FLA STAT § 608 462	No provision

I *Foreign Limited Liability Companies*

The Wyoming statute contains no provisions for the registration of foreign LLCs in Wyoming The Florida statute is also silent but, in its name, refers to "a foreign limited liability company, authorized to transact business in this state" FLA STAT § 608 406(1)

The Colorado statute incorporates detailed provisions for the registration of foreign LLCs Many of the provisions are drawn from the Revised Uniform Limited Partnership Act Others resemble the Model Business Corporation Act

COLORADO REV STAT SECTION	*Description*	*Origin*
7-80-901	Law Governing Foreign Limited Liability Companies	RULPA § 901
7-80-902	Name	RULPA § 904
7-80-903	Registered Name - Limitation - Procedure	None
7-80-904	Certificate of Authority - Application	RULPA § 902
7-80-905	Filing - Issuance of Certificate of Authority	RULPA § 903
7-80-906	Changes and Amendments	RULPA § 905
7-80 907	Requirement for Registered Agent and Certain Reports	MBCA § 113
7-80-908	Revocation of Certificate of Authority	MBCA § 121
7-80-909	Certificate of Withdrawal	MBCA § 119
7-80-910	Transaction of Business Without Certificate of Authority	RULPA § 907
7-80 911	Action to Restrain from Transaction of Business	None
7-80-912	Process - Service on a Foreign Limited Liability Company	MBCA § 115
7-80-913	Execution of Application or Certificate	RULPA § 204(c)