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The Limited Liability Company: A Study of the Emerging Entity

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***378** INTRODUCTION

The recent development in the United States of the limited liability company (LLC) as an alternative form for the conduct of business has rekindled the longstanding interest in an unincorporated organization that limits the liability of its owners to their investment in the enterprise. [FN1] While entities similar to LLCs have existed in several European and South American countries, [FN2] prior to 1990, only two U.S. states had enacted legislation allowing for the creation of LLCs. [FN3] Recently, however, a confluence of favorable income tax rulings and changes in the tax structure making pass-through entities more viable, combined with the concerns of small business owners to limit their liability and the desire of state legislatures to create an environment attractive to business, has ***379** led to the enactment of LLC legislation in six additional states [FN4] and its consideration in many others. [FN5]

Defining or even describing LLCs at this incipient stage of their legal development is made difficult by the fact that there is currently no uniform statute that sets the norm for this form of business entity. Discussions of the nature of LLCs in statutory drafting sessions and committee meetings have often produced entirely unanticipated questions. Some generalizations are, however, appropriate. LLCs are non-corporate entities [FN6] under which neither the owners (known as members) nor those managing the business are personally liable for the LLC's obligations. [FN7] While the present LLC statutes are far from uniform, they are generally based upon the Wyoming LLC Act, [FN8] with variations drawn from the corporation and partnership laws of the state of enactment as well as the Uniform Partnership Act (UPA), the Uniform Limited Partnership Act (ULPA), the Revised Uniform Limited Partnership Act (RULPA), the Model Business Corporation Act (MBCA), and the Revised Model Business Corporation Act (RMBCA).

As a result of the temporal nature of LLCs, [FN9] the limitations on the transfer of ownership interests, [FN10] and the possibility of direct management by the owners, [FN11] ***380** a properly structured LLC will be treated as a pass-through entity for federal income tax purposes. [FN12] Pass-through entities, such as partnerships and S corporations, are not subject to federal income tax at the entity level. [FN13] Rather, all items of income, loss, credit, and deductions flow through to, and are reported by, the owners. [FN14] Higher corporate tax rates, the potential of double taxation and other corporate disincentives added by the Tax Reform Act of 1986 have made pass-through entities a more desirable form for conducting business than the classic C corporation. [FN15]

The LLC, which combines the tax advantages of a partnership with limited liability for all members, offers significant advantages over other pass-through entities such as the general partnership, limited partnership, or S corporation. [FN16] For example, in a general partnership, all partners are jointly and severally liable for all obligations of the partnership. [FN17] Similarly, limited partnerships organized under ULPA [FN18] or RULPA [FN19] must have at least one general partner who is personally liable for the obligations of the limited partnership. [FN20] Moreover, limited partners are subject to limitations on their ability to participate in the management of the limited partnership's business. [FN21] The LLC also has several advantages over the S corporation, [FN22] which cannot make special allocations of items of income and deduction, [FN23] is restricted as to the number and type ***381** of owners that it may have, [FN24] and can lose its classification as a pass-through entity under certain circumstances. [FN25]

This Article discusses the important tax and business aspects of LLCs. Part I outlines the historical antecedents of the LLC and the development of the government positions on the LLC's classification for federal tax purposes. Part II sets forth the business characteristics of the LLC and compares the LLC with the other principal business forms: the general and limited partnership and the corporation. Part III compares the eight existing LLC statutes, emphasizing how each statute operates as well as the major differences among the statutes. Part IV discusses the treatment of LLCs for federal tax purposes. Part V focuses on a particularly troubling aspect of LLCs, the personal liability of members for the obligations of an LLC in intrastate and interstate transactions. Finally, Part VI considers the current and anticipated development of the LLC.

HISTORY

In the United States, the earliest precursor of the LLC is the partnership association or limited partnership association created in Pennsylvania, Michigan, New Jersey and Ohio between 1874 and 1881. [FN26] Partnership associations and limited partnership associations are unincorporated organizations wherein the owners, known as associates, are not personally liable for the obligations of the organization. Some statutes restrict the transferability of the associates' interests in the organization. At various times, the Internal Revenue Service (Service) has treated partnership associations as either partnerships or corporations for tax purposes. [FN27] Because many states have failed to adopt statutes ***382** recognizing partnership associations, this form of business entity has not attained great popularity. [FN28]

Another entity that somewhat resembles an LLC in providing the flexibility of a partnership without personal liability is the statutory close corporation. [FN29] A close corporation organized under the Model Statutory Close Corporation Supplement may have characteristics similar to the partnership association: (1) no owner will be personally liable for the obligations of the corporation; [FN30] (2) if the appropriate language is included in the articles of incorporation, no owner may transfer his entire interest without the consent of the other owners; [FN31] and (3) if provided in the articles of incorporation, one or more of the owners may dissolve the corporation. [FN32] Statutes of this sort were adopted in numerous states, including California, Delaware, New York and Texas. Although many of these entities would qualify as partnerships for federal tax purposes under the entity classification test adopted by the Service, [FN33] the Service has consistently taken the position that because close corporations are “incorporated,” they can never be treated as partnerships under the Internal Revenue Code. [FN34]

***383** In 1977, after the Service classified some limited partnership associations as partnerships, but before the rulings were issued denying partnership treatment to all close corporations, Wyoming enacted its LLC Act [FN35] as special interest legislation for an oil company. [FN36] An LLC subsequently formed under the Act was granted a private letter ruling indicating that the Service would treat the LLC as a partnership for federal tax purposes. [FN37] On November 17, 1980, however, the Service issued proposed regulations that would have denied partnership classification to any entity in which no member had personal liability for the entity's debts. [FN38]

The proposed regulations generated many unfavorable comments. The commentators argued that the regulations were inconsistent with longstanding principles of entity classification for federal tax purposes, that they would disrupt certain domestic commercial arrangements such as equipment leasing trusts, and that they would interfere with participation by U.S. persons in certain foreign enterprises. [FN39] The Service subsequently withdrew the proposed regulations and opened a study project to determine the proper classification of LLCs. [FN40]

Taking its lead from the Service's withdrawal of the proposed regulations, Florida adopted an LLC act largely based on the Wyoming Act in 1982. [FN41] As a new version of the uniform limited partnership act was being enacted, Florida lawmakers modified and added to certain provisions from the Wyoming statute in an effort to afford the new entity greater flexibility. [FN42] As in Wyoming, [FN43] the Florida statute was enacted to lure capital into the state. [FN44] The Act, however, did not cause a rush to form LLCs in Florida. [FN45] As a result of the lingering ***384** uncertainty as to both the tax treatment [FN46] and the protection of the entity's members from personal liability, [FN47] no other state enacted an LLC statute until 1990.

After six years of consideration, the Service study project concluded that limited liability, in and of itself, should not preclude an entity from being classified as a partnership. [FN48] The Service subsequently issued a public ruling concluding that it would treat a Wyoming LLC as a partnership for tax purposes. [FN49] The Service later stated that the lack of personal liability would not preclude the Service from classifying an entity as a partnership for tax purposes. [FN50]

After Revenue Ruling 88-76, several states began to consider LLC statutes. In 1990, Colorado [FN51] and Kansas [FN52] enacted LLC statutes and Indiana enacted a statute requiring foreign LLCs to register with the

Indiana Secretary of State. [FN53] In 1991, Virginia, [FN54] Utah, [FN55] Texas, [FN56] and Nevada [FN57] passed LLC statutes, and many other states have begun work on such statutes. [FN58]

BUSINESS LAW ISSUES

BASIC CHARACTERISTICS OF LLCS

An LLC is a non-corporate business that provides its members with limited liability and allows them to participate actively in the entity's management. [FN59] In considering the non-tax aspects of LLCs, it is important to remember the diversity among the statutes and the fact that the LLC is still a developing entity. Accordingly, this Section identifies basic elements of LLCs that are not only common to all or most of the LLC statutes, but also for various reasons are likely to remain so.

***385** Non-Corporate Elements

The LLC is not simply an entity that provides its members with limited liability, but one that is non-corporate in nature. This structure has two important aspects. First, LLCs generally are not subject to restrictions as to finance and management that historically have bound corporations. In particular, there is no need to create special “surplus” accounts for dividends and, in most statutes, no special requirement for management by a board of directors or equivalent body. [FN60] Second, LLCs are designed to avoid two-tier corporate tax treatment. Because LLCs always possess the corporate characteristic of limited liability, it follows that LLCs must avoid at least two of the other three characteristics that distinguish corporations and partnerships for tax purposes-free transferability of ownership interests, continuity of life and centralized management. This has important implications for the default terms governing LLCs under state law. [FN61]

Limited Liability

One of the primary functions of the LLC is to provide an alternative to the corporate form of obtaining limited liability. This differentiates LLCs both from general partnerships, where all partners are generally liable for the debts of the partnership, and from limited partnerships, which must have at least one general partner who is personally liable for the obligations of the partnership.

Because LLCs limit the liability of members and managers, it follows that, unlike general partnerships, LLCs only protect creditors through rules regarding disclosure, distributions and dissolution. In order to maximize this protection, the statutes provide that the LLC members may not agree to waive these rules. [FN62] Some LLC statutes do not anticipate that the members will make credit contributions to the LLC. The standard statutory terms (which generally may be waived by the members) provide that the members' rights to participate in profits, distributions and governance will be allocated according to financial contributions and withdrawals, rather than equally as in general partnerships.

Participation in Control

Most of the LLC statutes provide for management directly by the members, although the statutes permit the parties to provide, by agreement, for centralized management. LLCs differ from limited partnerships in the important respect that LLC members do not lose their limited liability by participating in LLC management.

***386** COMPARISONS WITH OTHER BUSINESS FORMS [FN63]

LLCs vs. Corporations

Formation

LLCs, like corporations, are formed through a central filing with a state agency such as the Secretary of State. Other formalities, such as the number of initial organizers and the precise contents of the articles of organization vary among the statutes. [FN64] It is not clear whether the courts will apply some sort of a veil-piercing theory to LLCs that have technically complied with statutory formalities but have engaged in misrepresentation, undercapitalization, or other conduct that would justify veil-piercing in the corporate context. [FN65]

Capital Structure and Capital Contributions

A corporate shareholder's capital contribution is represented by shares of stock, which the corporation must issue in classes and series, with all shares in a given class or series receiving like treatment. [FN66] Although the articles of incorporation must state the total number and terms of authorized shares, [FN67] corporation statutes generally do not require explicit disclosure of capital contributions represented by issued shares. [FN68] While some corporation statutes restrict the consideration for which shares may be issued, [FN69] there is a trend away from such restrictions. [FN70]

LLCs do not have rules concerning issuance of ownership interests or discrimination within classes and series of such interests. Accordingly, LLCs afford more flexibility in capital structure than do corporations. LLCs generally do not issue certificates equivalent to corporate shares, but instead record member contributions in the articles of incorporation or other records. This reflects the fact that LLC interests are not expected to be fully transferable; [FN71] accordingly, there is less need to provide a mechanism for the transfer of ***387** ownership rights. The LLC statutes vary regarding valid consideration for satisfying contribution obligations. [FN72]

LLC members, like corporate shareholders, [FN73] are liable to the LLC for failing to make agreed contributions. [FN74] This is not surprising, since the duty to contribute is a contractual obligation. The principal questions regarding the liability of shareholders and LLC members are whether they are liable directly to creditors for failing to meet these obligations [FN75] and whether this liability extends beyond the terms of the shareholders' or members' agreement with the entity. The corporation statutes generally neither explicitly impose nor preclude such direct liability to creditors, [FN76] although there is some dubious case law holding that shareholders are liable to creditors where the creditor has relied on contribution obligations. [FN77] Corporation statutes also appear to provide only for liability in the amount of the consideration actually fixed by the board, [FN78] which would almost always be the amount agreed to by the shareholder. Once again, however, a weak contrary argument may exist under some statutes. [FN79]

The LLC statutes generally provide that LLC members are directly liable to relying creditors for contribution obligations, even if the obligations have been compromised among the members. [FN80] By contrast, corporate boards can, within broad limits, revise the amount of consideration owed, or at least cancel stock, ***388** without triggering liability to interim creditors. [FN81] The distinction may be based partly on the fact that some LLC statutes require disclosure of contribution obligations in the LLC's articles of organization, on which creditors may rely. [FN82] The distinction between corporations and LLCs as to liability for contributions is more difficult to explain for those LLC statutes that do not require disclosure of contribution obligations in the articles of organization.

Distributions

Distributions have two aspects: allocation of distributions among members, and liability to creditors for excessive distributions. The corporation statutes do not explicitly prescribe any particular allocation for distributions among shareholders. Rather, the corporation statutes provide that the articles of incorporation may specify the rights of each class of shares. [FN83] In contrast, the LLC statutes provide a default provision that LLC members will share in LLC profits in proportion to their contributions. [FN84] The critical difference between the two approaches is that, in the corporation, the shareholders' share of future distributions will correspond to the amount of the shareholders' contribution only if the directors realistically have valued the company's future cash flows in determining the number of shares to be issued for a given contribution. [FN85] The corporation statutes typically give directors wide discretion in making this valuation. [FN86]

Both corporations and LLCs provide for liability in the event the entity makes distributions to shareholders or members where the entity is insolvent or would be rendered insolvent by the distribution. [FN87] An important difference exists, however, between the corporation and the LLC: in the corporation, the liability generally is imposed on the directors who authorized the distribution in violation of the applicable standard of care, with a right of contribution from shareholders who knowingly accepted a wrongful distribution. [FN88] By contrast, the ***389** LLC statutes provide for liability directly on the members receiving the distribution, regardless of whether the members knew the distribution was wrongful. [FN89]

The LLC statutes generally also provide for member liability for returned contributions to the extent necessary to discharge claims of creditors who relied on the contributions. This differs from statutes based on the RMBCA, [FN90] although some corporation statutes continue to restrict dividends out of “capital,” an amount somewhat analogous to the amount of an LLC member's contribution. [FN91] As with direct liability to creditors for contributions, the distinction may be based on the obligation in some LLC statutes to disclose contribution obligations in the LLC's articles of organization, although such liability is hard to justify when the statute does not require such disclosure. [FN92]

Transfer of Interests

Corporate stock is freely transferable under state corporation law unless transfer is restricted by agreement. Indeed, the courts sometimes refuse to enforce, [FN93] or narrowly interpret, transfer restrictions. [FN94] By contrast, all LLC statutes generally provide that only financial rights are freely assignable, and that an assignee can acquire the full management rights of LLC membership only by the members' unanimous consent. [FN95]

Member Withdrawal

Corporate shareholders, in effect, “withdraw” from a corporation by selling all of their shares. Corporate statutes generally do not provide for a right to sell shares back to the corporation. In contrast, a “standard form” LLC restricts transferability. [FN96] Accordingly, the LLC statutes, in the absence of contrary agreement, give members the right to withdraw and receive the fair value of their interests on withdrawal. [FN97]

***390** Management

Corporation statutes provide for management by a board of directors on behalf of passive shareholders. Most corporation statutes explicitly permit closely held corporations to opt out of this standard form, either by dispensing with the board of directors or by restricting the board's power to act autonomously. [FN98]

One LLC statute, consistent with the corporate model, provides for LLC management by separate managers. [FN99] This is consistent with a critical similarity between corporations and LLCs-the limited liability of the members. It is reasonable to assume that LLC owners are willing to trade off higher credit costs for the ability to avoid active involvement in the business. The LLC model adopted by all of the other LLC statutes, however, calls for management directly by the members. [FN100] This is based on two important factors. First, because LLC interests are not freely transferable, members who are dissatisfied with their investment must resort to active involvement. In this critical respect, LLCs necessarily resemble close corporations. Second, decentralized management helps avoid tax classification as a corporation. [FN101]

Just as close corporations can opt out of the standard form and provide for direct management by shareholders, [FN102] LLCs can opt out of the member-managed form and provide for corporate-style management. Some LLC statutes require that such a change be embodied in the LLC's articles of organization. [FN103] This formal requirement may be a trap for the unwary. In particular, the parties' expectations may be frustrated if an agreement delegating authority to one or more members is unenforceable among the parties because the entity did not comply with the statutory requirements. [FN104] On the other hand, disclosure in the articles of organization may be necessary in order for third parties to be bound by a management arrangement that restricts the members' authority to bind the LLC. [FN105]

If the LLC separates management and control-that is, has centralized management-the question becomes whether all corporate-type formalities for election and annual meetings apply. Some LLC statutes require that the members elect management annually. [FN106] The better approach, as provided for in the more recent LLC statutes, does not require annual elections or other ***391** cumbersome formalities. Unlike the publicly traded corporation that is the model for the corporate statutes, LLCs can be expected to be closely held because their interests are nontransferable. Accordingly, LLC members should be able to join together to remove managers when such action is appropriate. Members should not have to depend on the formal mechanism of an annual meeting to coordinate such a vote. Whether the LLC is managed by managers or managed directly by the members, the LLC statutes generally provide for voting rights in proportion to capital contributions. [FN107]

Fiduciary Duties

The duties of LLC managers where management is centralized should be at least generally comparable to those of corporate directors. Such is the approach of the LLC statutes addressing the issue. [FN108]

The principal difference in the standards of fiduciary duty between LLC managers and the corporate board of directors concerns liability for self-dealing. To validate a conflict-of-interest transaction, corporate statutes provide for voting by a majority of shareholders or disinterested directors. [FN109] In contrast, because an LLC is likely to be closely held, none of the managers will be "disinterested." It is reasonable to expect, therefore, that the rule that will emerge in the LLC context will require consent by all members to each conflict transaction in the absence of contrary agreement.

Another difference between the fiduciary duties of LLC managers and those of corporate directors concerns the ability to waive such duties and to provide for indemnification. Corporate statutes only provide for limited waiver of fiduciary duties [FN110] and contain elaborate restrictions on the corporation's ability to indemnify officers and directors. [FN111] While all LLC statutes empower the LLC to indemnify its members and managers, the statutes tend to vary in terms of the specificity on which indemnification is available. [FN112] Although restrictions on indemnification arguably are necessary to protect dispersed and largely ***392** uninvolved shareholders of public corporations, [FN113] a strong argument can be made that members of closely held LLCs should be able to contract freely with respect to indemnification.

Derivative Actions

Corporate shareholders may bring actions in the corporation's interest against managers and third parties. This allows minority shareholders to enforce the fiduciary duties of managers who otherwise would control the decision whether to bring suit. Some of the LLC statutes provide for derivative actions. [FN114] There is little reason to distinguish between LLCs and corporations in this respect. Even if an LLC member has the power to bind the firm, this power does not necessarily imply that a minority member can maintain suit on behalf of the firm over the objection of other managers or members. Yet the member may have no other way to obtain an adjudication of the duties of managers or co-members short of an even more costly action for a partnership-type accounting. [FN115] Indeed, the member may be more helpless in this regard than a corporate shareholder, since the member may be opposed by a solid majority. A determination that a member should be able to sue over the objection of other members and managers is a determination, in effect, to permit derivative suits. The rules regarding such actions should be spelled out in the statute rather than left to case-by-case adjudication.

Rules governing LLC derivative actions might, however, differ from those governing corporate suits. In particular, demand should be mandatory, since there are no costs that might justify refusal to make demand. [FN116] On the other hand, it is questionable whether the managers should be able to obtain dismissal of the action through a determination by a "special litigation committee" that the suit is not in the LLC's best interests. Unlike a publicly held corporation, it is doubtful that such a committee could be staffed by truly disinterested managers or that its investigation truly could be impartial. Moreover, because of the difficulty in assembling such a committee and the fact that an LLC has a greater coincidence of ownership and management, the resulting savings from the use of such a device are apt to be lower in an LLC than in a publicly traded corporation.

By contrast, the corporate-style derivative action may be out of place in a member-managed LLC. Indeed, a member-managed LLC is similar to a general partnership, where derivative suits generally have not been recognized. Where all members share in management, perhaps the rule should be that, in ***393** the absence of contrary agreement, all suits should proceed only by the unanimous agreement of disinterested members, or at least subject to a demand requirement and a right on the part of the entity to investigate the demand prior to litigation. [FN117] Member-managed LLCs without customized agreements are likely to be smaller firms, for which the costs of wasteful litigation are likely to be significant in relation to the firm's wealth, and in which the cost of securing the unanimous agreement of the disinterested members would not be high. [FN118] Moreover, in a member-managed LLC, the non-litigating members should be able to recover the expenses of unauthorized litigation, less any amounts recovered, from the member who brought the unauthorized suit. However, since the non-litigating members have a right to object and to recover expenses, they should be bound by the litigation. [FN119] Third-party defendants should not be able to obtain dismissal on the ground that the action is unauthorized, although such defendants should be protected from further suits by statute or common law doctrines.

Dissolution

Corporation statutes generally provide for dissolution upon a vote by directors and shareholders, [FN120] followed by a formal filing of articles of dissolution or an equivalent document that gives notice to the creditors of the pendency of the winding up. [FN121] By contrast, LLC statutes generally provide for dissolution upon death, withdrawal, consent, or some other event of partner disassociation, subject to continuation of the LLC by consent-usually unanimous-of the non-disassociating members. [FN122] When less than the requisite number of members wish to continue the business, they must form a new entity, and perhaps enter into a new agreement. This approach is necessary in order to ensure that the LLC lacks the corporate characteristic of continuity of life. [FN123]

***394** Most LLC statutes require a corporate-type central filing upon dissolution. [FN124] If the statute requires the filing of articles of dissolution or an intent to dissolve, after the firm already technically has dissolved by reason of member disassociation, it is unclear precisely when the firm dissolves or the effect of a failure to file. Without such a filing, however, the LLC's creditors may not be informed of the pendency of the winding up and the need to present claims. For this reason, several LLC statutes provide for a filing upon dissolution, rather than after the completion of the winding up. Similarly, future LLC statutes should provide for a non-mandatory method of disposing of creditors' claims after dissolution, similar to that contained in some corporation statutes. [FN125] Any delay in filing or a failure to file would affect the period during which creditors can sue the LLC, or, if assets have been distributed, its members.

Merger

Four of the LLC statutes provide for merger between LLCs or between LLCs and other types of entities. [FN126] There is no reason why mergers should not be allowed, or why the effect of such a merger should differ significantly from a traditional corporate merger. The principal distinction should concern dissenters' rights. Dissenters' rights arguably are important in publicly traded corporations because voting rights alone may not be enough to protect small, passive shareholders. This is less likely to be a problem for more active LLC members, particularly in member-managed firms. Moreover, in a closely held LLC, members may protect themselves from a self-dealing majority by requiring unanimous consent to mergers and other significant transactions, or by exercising their right of withdrawal. Accordingly, LLC statutes are unlikely to provide for dissenters' rights in mergers.

Foreign LLCs

Some LLC statutes explicitly allow LLCs formed in other jurisdictions to do business in the enacting state. [FN127] Like corporations, [FN128] foreign LLCs are governed in their internal affairs and the liability of their managers and members ***395** by the law of the state of organization. [FN129] The principal difference between corporations and LLCs concerns possible questions about the definition of an LLC. Typically, a foreign LLC is defined as an LLC organized under another state's laws. Unlike corporations and limited partnerships, however, there is no general agreement as to precisely what constitutes an LLC. For example, does an LLC include a business trust or a limitada? [FN130] Similarly, does it include an LLC that has terms significantly different from those defined in the forum state's statute? The statutes or case law may have to address this problem.

LLCs vs. Close Corporations

Because LLCs restrict the transferability of ownership interests, [FN131] almost all LLCs will be closely held. Accordingly, it is important to compare LLCs with statutory close corporations. The statutes under which these corporations are formed allow shareholders to dispense with the board of directors and other corporate formalities. [FN132] Thus, a statutory close corporation may have flexibility regarding management and other matters comparable to that of an LLC.

There are, however, several significant differences between LLCs and statutory close corporations. First, the close corporation statutes may not permit as much flexibility as the LLC statutes. For example, the Delaware close corporation statute provides for shareholder agreements only on certain matters-specifically, management by shareholders and dissolution. [FN133] The RMBCA, while permitting more types of shareholder agreements than Delaware, also is limited in scope. [FN134]

Second, even if the close corporation statutes provide flexibility comparable to that of an LLC, close corporation statutes have many procedural requirements that create uncertainty about the effectiveness of shareholder agreements. For example, in order for an agreement adopted pursuant to the Delaware close corporation statute to be effective, the corporation must amend its certificate of incorporation. [FN135] Similarly, an agreement adopted pursuant to the RMBCA's provisions may not be enforceable unless it is either set forth in the articles or bylaws and "approved" by all existing shareholders, or set forth in a written ***396** agreement signed by all existing shareholders and "made known to the corporation." [FN136] In contrast, agreements among members of an LLC are effective (at least in the state of organization) as long as the parties have complied with a simple formation procedure. [FN137]

Third, the close corporation statutes impose certain specific requirements, such as share transfer restrictions, buy-out provisions and dissolution rights, that do not exist in the LLC context. [FN138] Indeed, the courts have gone so far as to imply special protection for minority shareholders in all close corporations even without statutory authority. [FN139] An LLC may be preferable to the statutory close corporation in avoiding these requirements.

LLCs vs. Limited Partnerships

Limited partnerships, like LLCs, are limited liability entities formed to receive partnership tax classification. Because LLCs generally possess the corporate characteristic of limited liability, LLCs seek to attain partnership tax classification by lacking two of the other three characteristics of corporations: free transferability of ownership interests, continuity of life, and centralized management. Not surprisingly, for most of the factors discussed above, including formation, [FN140] finance, [FN141] transfer of interests, withdrawal of members, dissolution, merger and foreign entities, LLC statutes have been modeled after ***397** limited partnerships. Accordingly, these characteristics will not be discussed in detail here.

The principal difference between LLCs and limited partnerships is, of course, that limited partnerships are managed by personally liable general partners, while there are no personally liable members of an LLC. This gives rise to important differences concerning the members' participation in management and, possibly, their fiduciary duties. There are also differences between LLCs and limited partnerships regarding consent to continuation and the transferability of interests-two key tax classification elements. The following discussion focuses on these principal areas of difference.

Management

Because a limited partnership is managed by personally liable general partners, limited partners have a significantly smaller role in management than do members of member-managed LLCs. Indeed, limited partners may even have a smaller role in management than members of manager-managed LLCs. Removal of general partners, who by definition are also owners, involves costs in terms of renegotiating investments and guarantees of business debts. [FN142] Managers of LLCs, on the other hand, are not necessarily members of the LLC, and their management rights are no more legally vested than those of corporate directors. Accordingly, managers of LLCs are more likely to be elected annually than are managers of limited partnerships. [FN143]

Most importantly, LLCs, unlike limited partnerships, are not subject to a "control rule," under which limited partners may be held liable as general partners if they participate in the control of the business. [FN144] The application of the "control rule" to limited partnerships serves to assure creditors who may have relied on the general partners' "bonding" their good behavior with individual liability that these partners will, in fact, manage the firm. The policy underlying the rule is dubious enough in the limited partnership context, [FN145] and the rule has even been abandoned in one limited partnership statute. [FN146] The rule has no place in an LLC, since, in the absence of personal guarantees, creditors do not rely on the managers' personal liability. In fact, LLC statutes specifically provide that LLC members and managers are not liable for the LLC's debts. [FN147]

***398** Fiduciary Duties

The LLC statutes are comparatively limited or silent on the fiduciary duties of LLC members and managers. [FN148] It is not clear, therefore, whether the fiduciary duties of members or managers of LLCs differ from those of general partners in limited partnerships. Courts have held that the fiduciary duties of general partners in limited partnerships are similar to those of corporate directors. [FN149] Perhaps managers of LLCs with centralized management should be treated likewise. Arguably, however, general partners in limited partnerships should be distinguished from corporate directors and LLC managers because of their personal liability for business debts and the limited partners' relatively passive role in business governance. Because general partners are personally liable for business debts, there may not be a need to discipline them through liability for negligent management. On the other hand, because limited partners are constrained in their ability to remove or periodically reelect general partners, [FN150] limited partners may need the protection of stricter fiduciary duties against the self dealing of general partners than do LLC members.

Transfer of Interests

Under most of the LLC statutes, a transferee of an interest does not obtain full management rights (as distinguished from financial rights), unless the non-transferring members consent to the transfer. [FN151] Accordingly, most LLC statutes thereby ensure that the LLC will lack the “corporate” tax feature of free transferability of interests. [FN152] Although limited partnership statutes also condition transfer of management rights on the unanimous agreement of the non-transferring partners, [FN153] RULPA permits partners to “pre-agree” to such a transfer in the partnership agreement. [FN154]

***399** Dissolution and Continuation

The provisions relating to dissolution in LLC statutes have been closely modeled after limited partnership statutes. The principal difference is that most LLC statutes provide that the LLC continues following a member's disassociation only if the remaining members unanimously consent to the LLC's continuation at the time of dissolution. [FN155] In contrast, RULPA provides that a limited partnership may be continued pursuant to a written partnership agreement even without the partners' contemporaneous consent, as long as there is at least one remaining general partner. [FN156] As with transferability, [FN157] the LLC statutes requiring unanimous contemporaneous consent protect against corporate tax classification, in this case, the corporate feature of continuity of life. [FN158]

LLCs vs. General Partnerships

LLCs, in many respects, are structured for tax purposes to resemble partnerships. In other respects, however, they differ substantially from general partnerships, particularly regarding the provisions in LLC statutes that protect creditors.

Formation

LLCs are formed by an official filing, which serves to notify creditors of the limited liability nature of the entity. Partnerships, on the other hand, do not have limited liability, and accordingly, can come into being informally. Indeed, parties can create a general partnership without any specific intent to do so. [FN159]

Finance

There are two principal differences between general partnerships and LLCs regarding finance. First, since the partners are personally liable for partnership debts, general partnership statutes do not provide for special partner liability for partnership distributions. Second, while both partners and LLC members may agree otherwise, general partners share equally in profits, losses and distributions. This aspect of the general partnership recognizes that partners contribute credit and services in addition to capital. In contrast, LLC members, like partners in a limited partnership, share in profits, losses and distributions in ***400** proportion to their contributions. [FN160] Note, however, that in an LLC in which members contribute services and guarantees, contributions would be adjusted accordingly, and a per capita profit split might result. [FN161]

Transfer of Interests

LLC statutes include restrictions on transferability comparable to those applicable to general partnerships-that is, LLC members can freely transfer their financial interests in distributions, but the unanimous consent of the other members is required for the assignee to become a member with full management rights. [FN162] Because it is an important factor affecting partnership tax classification, this restriction is likely to remain a feature of LLCs. [FN163]

Partner Withdrawal

LLC statutes, like partnership statutes, permit members, in the absence of contrary agreement, to withdraw at will and receive the value of their interests. [FN164] In the absence of contrary agreement, however, partners who withdraw prior to the expiration of an agreed term or undertaking are not entitled to share in the goodwill of the firm. [FN165] In contrast, withdrawing LLC members are entitled to the fair value of their interests irrespective of when they withdraw. [FN166] Unlike partners, LLC members must give six months' notice prior to withdrawal under most statutes. [FN167]

Management

Both general partnerships [FN168] and LLCs under most statutes [FN169] are managed directly by the members in the absence of contrary agreement. [FN170] There are two ***401** principal differences between LLCs and partnerships with respect to management. First, each partner has an equal vote. [FN171] In contrast, LLC members generally vote in proportion to their contributions. [FN172] As with the payout ratio, [FN173] this difference is based on the assumption that general partners contribute services and credit in addition to capital.

A second difference between LLCs and partnerships is that the LLC statutes do not specify the scope of a member's power to bind the LLC in transactions with third parties. The partnership rule provides that a partner's act in the ordinary course of business binds the partnership. [FN174] This probably will be the rule applied to members in member-managed LLCs. In manager-managed LLCs, the courts are similarly likely to apply the partnership rule and find that the manager's act binds the LLC unless the creditors were aware of a restriction on the manager's authority. [FN175] It is not clear whether the presence of a restriction on a member's or manager's authority in the LLC's officially filed articles of organization is sufficient to put creditors on notice of such a restriction.

Fiduciary Duties

General partners are subject to the duty of full disclosure [FN176] and must refrain from benefiting from partnership property without co-partner consent. [FN177] The LLC statutes do not clarify the fiduciary duties of members or managers. [FN178] This may be because the LLC statutes have been based on the limited partnership statutes, which do not expressly provide such duties, but rather incorporate the duties of general partners from the UPA. [FN179] The rule for LLCs probably will evolve toward general partnership-type duties for members in member-managed LLCs, and toward corporate director-type duties for managers in manager-managed LLCs.

Remedies

The partnership statutes explicitly provide for a right of accounting, [FN180] which is a complete adjudication of all rights and liabilities of the partners. [FN181] Indeed, the courts have developed a rule that an accounting is the exclusive remedy for many types of partnership claims, thereby avoiding the costs of piecemeal ***402** litigation. [FN182] In contrast, only one LLC statute provides for an accounting. [FN183] Such a proceeding is helpful in the partnership context because partners have rights against co-partners and also have a duty to contribute in varying amounts for partnership liabilities. In an LLC, the claims probably will run in only one direction, with passive members suing managers for amounts owed the members as a group. The appropriate remedy in this situation is a suit by the firm, with some mechanism for allowing injured members to bypass managers who refuse to sue themselves. Accordingly, LLC statutes may provide for derivative claims in some or all of the situations in which a general partner would be required to pursue an accounting action. [FN184]

Dissolution

LLCs and general partnerships both dissolve upon member disassociation, including, among other grounds, withdrawal, bankruptcy, or death. Important differences exist, however, between the two business forms regarding dissolution. First, the LLC may continue with unanimous agreement of the non-withdrawing members. [FN185] By contrast, non-withdrawing partners may continue a partnership over the objection of the withdrawing partner only if the dissolution was caused wrongfully, such as prior to the expiration of an agreed term or undertaking. [FN186] Second, following partner disassociation, nondisassociating partners may continue only the business of the partnership; the partnership in which the business is conducted technically dissolves and the business is carried on as a new partnership. As a result, executory agreements may not carry over to the new partnership. [FN187] In an LLC, by contrast, the agreement by the non-disassociating members to continue the business avoids even a technical dissolution. A third difference between partnership and LLC dissolution is that, unlike partners, [FN188] LLC members have no obligation to contribute toward the LLC's debts upon dissolution.

***403** Merger

There are no provisions in the UPA explicitly covering mergers, and only four LLC statutes specifically address mergers. [FN189] There are theoretical distinctions that may lead to the two business forms being treated differently in this respect. A partnership “merger” may involve a combination of two partnerships either following withdrawal of some members, which causes a technical dissolution, or simply by what is, in effect, an admission of new partners to an existing partnership. In either of these situations, the liabilities of the two partnerships automatically are combined, although each partner is personally liable only for the debts of his original firm. [FN190] In LLCs, by comparison, an automatic assumption of the LLC's liabilities as a result of a business combination would be unlikely. In other words, the parties would have to agree to such an assumption, either explicitly, or by characterizing the transaction as a “merger.”

Foreign Partnerships

The UPA makes no provision for foreign general partnerships. The lack of a particular state law to which a general partnership can trace its existence may be an impediment to out-of-state operation, since a firm may be subject to the laws of each state in which it operates. The provisions in corporation, limited partnership and LLC statutes for foreign entities helps ensure that the foreign entity retains the limited liability protection of its state of organization in the foreign state. [FN191] This obviously is unnecessary with respect to general partnerships, because general partners do not enjoy limited liability.

APPLICATION OF SECURITIES LAWS

The federal securities laws apply to transactions involving “securities.” Securities include, in addition to specific types of instruments, any “investment contract.” [FN192] The leading United States Supreme Court case on this subject has defined an “investment contract” as “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” [FN193]

An LLC undoubtedly involves an investment of money in a common enterprise with an expectation of profits. The critical question is whether profits are ***404** expected “from the efforts of the promoter or a third party.” In a very closely held member-managed LLC, in which each member actively participates, the courts probably will hold that an LLC interest does not constitute a security. In a manager-managed LLC, or even a member-managed LLC in which members do not actively participate in management, there is a greater possibility that the federal securities laws will apply.

The difficult case arises when an LLC has somewhat centralized management, but the members retain significant voting or veto powers. Some courts have found a “security” where the investors had significant control powers, but the investors were unsophisticated or otherwise unable realistically to exercise these powers. [FN194] In the partnership context, some cases have purported to hold that the partners' ability to exercise their powers is determinative. [FN195] One leading case relied exclusively on the powers granted the general partner under the partnership statute or agreement, without regard to the partners' exercise of these powers. [FN196] Other courts, while emphasizing these powers, have allowed some room for extrinsic evidence as to whether the partner realistically could exercise such powers. [FN197] The former cases support the argument that a general partnership is at least close to a per se non-“security.” [FN198]

The same sort of per se argument probably could not be extended to LLCs. The critical difference between LLCs and general partnerships is that the general partners' personal liability necessarily gives the partner an incentive to be highly informed about the business. At the same time, personal liability discourages involvement by unsophisticated investors. It follows that LLCs may have greater securities law exposure than general partnerships.

APPLICATION OF BANKRUPTCY LAW

Any "person" may be a debtor under chapter 7, 11, or 12 of the Bankruptcy Code (Code). [FN199] A "person" includes individuals, partnerships, and corporations. [FN200] An LLC undoubtedly is a "person," but it is not clear whether it is a ***405** "partnership" or a "corporation" in the bankruptcy context. The Code defines corporation as including an "(i) association having a power or privilege that a private corporation, but not an individual or a partnership, possesses; (ii) partnership association organized under a law that makes the capital subscribed responsible for the debts of such association; (iii) joint-stock company; (iv) unincorporated company or association; or (v) business trust." [FN201] Limited partnerships are not considered corporations under the Code. [FN202]

LLCs appear to fit within the definition of "corporation," because they resemble partnership associations and because they have limited liability-a "power or privilege that a private corporation ... possesses." Moreover, LLCs probably are not "partnerships," because the UPA, which should apply in the absence of any definition in the Bankruptcy Code, excludes from the definition of partnership firms "formed under any other statute." [FN203]

There are, however, some problems with characterizing LLCs as corporations under the Bankruptcy Code. First, LLCs strongly resemble limited partnerships, [FN204] which specifically are not considered corporations under the Code. Second, and more troublesome, the Bankruptcy Code definition turns on the LLC being an "association." The Code does not define "association," but a court could hold that an LLC is not an "association" under the Bankruptcy Code if it is not one under the Internal Revenue Code. [FN205] On the other hand, the UPA explicitly defines a partnership as an "association." [FN206] From a policy standpoint, LLCs should be considered corporations for bankruptcy purposes because the special bankruptcy provisions that apply to partnerships primarily relate to the general partners' duty to contribute to payment of the firm's debts. [FN207]

Even if an LLC is treated as a "corporation" under the Bankruptcy Code, there are many potential questions concerning application of specific Code provisions. Although detailed treatment of these questions is beyond the scope of this general survey, the question of how the parties would commence an LLC bankruptcy proceeding is critical. It is not clear whether approval by any or all members of an LLC is necessary for commencement of a voluntary case. [FN208] A ***406** bankruptcy court might treat a manager-managed LLC like a limited partnership, in which only general partner approval is required. [FN209] On the other hand, a bankruptcy court might treat a member-managed LLC like a general partnership, in which a petition approved by less than all the partners is treated as an involuntary proceeding. [FN210]

The LLC statutes provide that the bankruptcy of a member dissolves the LLC unless the nonbankrupt members unanimously agree to continue the LLC. [FN211] This makes little practical sense. Assuming the trustee in bankruptcy is treated as an unconsented assignee, the only sound reason why a general partner's bankruptcy dissolves a partnership is that the co-partners and partnership creditors have relied on the personal credit of the bankrupt partner. [FN212] Even in such a case, the costs in terms of discontinuity may exceed the benefits of compelling dissolution in a bankruptcy situation, apart from any tax classification implications. [FN213] For this reason, Georgia's version of the UPA does not include the bankruptcy of a general partner as a cause of partnership dissolution. [FN214] Perhaps this will be the future direction of LLC statutes.

ENTITY CHARACTERIZATION OF LLCS

Some question exists as to whether an LLC should be considered a separate entity or merely an aggregate of individual members. Entity characterization of partnerships is far from certain. [FN215] The UPA does not explicitly characterize the partnership, and contains both aggregate features, such as the technical dissolution upon disassociation of a partner, and entity features, such as the partnership's power to take title to property. [FN216] LLCs similarly are not explicitly characterized under most LLC statutes. [FN217] This may cause the same confusion that has occurred in partnership cases, where the courts choose to characterize the firm as an aggregate or entity based upon other issues. [FN218] In particular, it is ***407** not clear whether property of the LLC is owned in all respects directly by the LLC, or whether, as in a general partnership, the LLC's members are technically the property owners. [FN219]

CHOICE OF LLC FORM FOR PARTICULAR BUSINESS USES

An LLC is a potentially useful form of entity for any business in which the members desire limited liability, flow-through tax treatment and control over management. The following are some important situations in which an LLC may prove superior to other business forms with respect to these features. [FN220]

First, conversion to an LLC may be a useful alternative to a leveraged buyout in avoiding double taxation. In this situation, the management of the former corporation could become the management and owners of a manager-managed LLC. Because an LLC and its members are subject to a single level of taxation, there is less tax-driven concern about debt being reclassified as equity. Thus, those providing financing can be given rights as LLC members. The parties could design the LLC's payout schedule and form of governance to fit the financiers' needs better than even the most complex LBO capital structure. For example, the members could grant those providing financing a significant voice in management or increased voting rights in the event of the firm's failure to make payouts to a class of members. Moreover, if members are the largest creditors of the LLC, as those providing financing in LBOs often are, the risk of bankruptcy is reduced because the creditors already have control over LLC management. This avoids not only costly discontinuity of the firm, but also the threat that claimants' rights would be reshuffled by a bankruptcy court. [FN221] The principal drawback of using LLCs for leveraged buyouts is that limits on membership transferability effectively preclude membership interests from being widely held.

***408** Second, LLCs could be used in venture capital firms or joint ventures where investors want both flow-through tax treatment and a level of control over the business that might present problems in corporations or limited partnerships. The limited partnership “control rule” presents an obvious impediment. In the corporation, there is concern with the enforceability of shareholder agreements that do not comply with the provisions of the close corporation statutes. [FN222] An LLC could be structured to avoid both of these problem areas.

Third, professional firms could use LLCs to combine significant member control with limited liability for the acts of co-members. [FN223]

Fourth, transactions involving international participants could use LLCs. Such participants are frequently familiar with LLCs through their use in many foreign countries. Using LLCs with international participants would be beneficial because such participants are prohibited under United States law from forming Subchapter S corporations.

In sum, LLCs ultimately may replace other forms of closely held limited liability business entities including limited partnerships and close corporations. Indeed, it is even conceivable that LLCs will replace general partnerships for most purposes. General partnerships offer significant flexibility regarding management and finance, but at the cost not only of personal liability but also of greater discontinuity in the event of dissolution. [FN224] Personal liability may be an advantage in some situations because it affords lower credit costs without imposing additional oversight burdens on owners who would, in any event, actively participate in management. [FN225] Personal liability, however, also can be provided through specific guarantees in particular situations. This may be a better approach for several reasons: the guarantees can be designed for specific creditors, they do not extend to tort liability, and it is easier for the guarantor to discontinue the guarantees as to specific creditors than to discontinue their liability for partnership debts. [FN226] Thus, the general partnership may be relegated to a default business form for those businesses that do not expressly adopt the LLC form.

While it is true that the general partnership offers more certainty through its long history in case law, this advantage may not survive the revision of the Uniform Partnership Act. [FN227] Commentators are concerned about many of the provisions in the proposed revision. [FN228] To the extent the revision contains provisions objectionable in some jurisdictions, partnership law will lose uniformity and predictability. In light of the swift rise of the LLC, such lack of ***409** uniformity might reduce the use of the general partnership as the dominant form of organization for closely held firms.

COMPARISON OF EXISTING STATUTES [FN229]

This section describes the similarities and differences among the LLC statutes. [FN230] As has been noted throughout this Article, LLCs contain partnership characteristics, corporate characteristics, and some unique characteristics. [FN231] The LLC statutes vary with regard to the features that each statute has borrowed from other business forms. Additionally, drafters of the more recent LLC statutes have modified features of earlier statutes which, for one reason or another, they believed hampered an LLC's efficient formation or functioning.

LLC FORMATION PROVISIONS

Method of Formation

Most of the LLC statutes require that "two or more persons" are needed to form an LLC and that an LLC must contain two or more members. [FN232] As in the corporate and partnership statutes, the LLC statutes broadly define the term "person" to include individuals, partnerships, limited partnerships, LLCs, trusts, business trusts, estates, or other associations. The Colorado statute requires that the person forming the LLC be a "natural person eighteen years or over." [FN233]

While the Florida, Nevada, Utah, and Wyoming statutes [FN234] contain the requirement that two or more persons are needed to form an LLC, other states ***410** depart from this rule. The Colorado, Kansas, and Virginia statutes, for example, allow an LLC to be organized by one person. [FN235] These statutes, however, still require that an LLC have at least two members. [FN236] It is unclear whether an LLC formed under the Texas statute may have only one member. [FN237] This may present a problem in terms of classification. [FN238]

Articles of Organization

Under each statute, the organizer of the LLC must file articles of organization (articles) with a department of state government. [FN239] The LLC's articles are similar to a corporation's articles of incorporation. [FN240] Both are publicly filed documents available to creditors or other parties desiring information on a particular firm. The statutes declare that an LLC will not be considered formed until the articles are filed [FN241] and that parties acting as an LLC without filing articles will be jointly and severally liable for any debts or liabilities accrued prior to filing. [FN242]

The statutes differ with regard to how much information an LLC must disclose in its articles. All the statutes provide that the LLC members may supplement the articles with additional information. The Virginia and Nevada statutes require an LLC's articles to disclose the LLC's name, [FN243] period of ***411** duration, the purpose for which it is organized (Nevada only), the name and address of its initial resident agent in the state, and the address, if any, of the LLC's initial principal office in the state. [FN244] The Colorado statute has similar requirements, but also requires that the articles disclose the names and business addresses of the LLC's initial manager or managers. [FN245]

The Kansas, Texas, and Utah statutes require slightly more information. In these states, the LLC's articles must also disclose whether the LLC is to be governed by its members or by elected managers. [FN246] Additionally, these statutes require disclosure of the names and addresses of the LLC's managers if it is governed by managers, or the LLC's members, if it is member-managed. [FN247]

The Florida and Wyoming statutes mandate the most extensive disclosure. LLCs in these states must include all the information required of LLCs in the other states, as well as the total amount of cash or other property contributed to the LLC, the total contributions members have agreed to contribute in the future, and other information pertaining to the LLC's finances. [FN248]

Amendments to the Articles of Organization

Provision is made in each statute for amendments to the articles of organization. In all states except Texas and Virginia, amendments to the articles are mandatory if there is a change in the name of the LLC or the character of its business, if there is a false or erroneous statement in the articles, or if the LLC members decide to provide or alter the stated time or event upon which the LLC will dissolve. [FN249] The Utah statute additionally requires an LLC's articles to be amended if there is a change in the name or street address of any of the LLC's managers, or, if the LLC is managed by its members, a change in the name or street address of any of the LLC's members. [FN250] All of the statutes allow the ***412** LLC's members to change any other statement in the articles so that the articles more accurately represent the agreement among the members.

Unlike the other statutes, the Texas and Virginia statutes do not require the LLC members to amend the articles upon the occurrence of certain stated events. [FN251] These statutes do, however, require that the LLC file a statement with a particular state office if there is a change in the LLC's registered office or registered agent. [FN252]

FORM OF CONTRIBUTIONS

The statutes differ on the type of consideration that can be contributed for a membership interest. In Florida and Wyoming, members may contribute "cash or other property, but not services." [FN253] Under the other statutes, a member may contribute nearly anything of value, including cash, property, services, promissory notes, or other binding obligations to contribute cash or property or to perform services. [FN254] The contribution of services may give rise to troubling tax issues. [FN255]

LIABILITIES OF MEMBERS [FN256]

Each of the statutes explicitly states that members cannot be held personally liable for the LLC's debts. [FN257] Furthermore, the statutes state that a member is not a proper party to a proceeding by or against an LLC unless the object of the proceeding is to enforce the member's right against, or liability to, the company. [FN258] In the event that a member is made a party to a proceeding in his capacity as a representative of the firm, members may be indemnified for the costs of defending the suit. [FN259]

***413** All of the statutes provide that LLC members are personally liable to the LLC for failing to make agreed contributions. [FN260] The members are also liable, under certain circumstances, for the amount of the initial contribution returned to that member. [FN261] These liabilities may run to creditors of the LLC who have extended credit to the LLC in reliance on the member's contribution or obligation to contribute. With respect to the waiver or compromise of a member's obligations, the statutes loosely follow RULPA, [FN262] which provides that an obligation may be waived or compromised only with the consent of the other members. [FN263] Some waivers and compromises are ineffective against creditors, although the statutes split on the inclusion of the 1985 changes to RULPA. Five of the statutes follow the 1976 version of RULPA, which makes such alterations ineffective against creditors who have extended credit or whose claim arose prior to the compromise. [FN264] The remaining statutes follow the 1985 version, which protects creditors only if the creditor has acted in reliance on the obligation. [FN265] In addition, members and others will be personally liable for the unauthorized assumption of an LLC's powers. [FN266]

GOVERNANCE PROVISIONS

Operating Agreement

The first enacted LLC statute, the Wyoming LLC Act, provided LLC members with only a skeletal outline for the LLC's operation. [FN267] The Florida, Kansas, Nevada, and Utah statutes follow the example of the Wyoming statute ***414** and furnish few provisions that pertain to the LLC's operation. [FN268] LLC members may fill in the gaps through an operating agreement. This agreement is correlative to a partnership agreement, and unlike the LLC's articles of organization, [FN269] is not available to the public.

All the LLC statutes refer to an operating agreement or, in the case of Florida and Texas, to regulations that bear a greater resemblance to corporate bylaws than a partnership agreement, but generally serve the same function as an operating agreement. [FN270] Generally, the statutes state that the LLC members may enter into an operating agreement to regulate or establish the affairs of the LLC, the conduct of its business, and the relations of its members. The agreement cannot be inconsistent with the statute or with the LLC's articles of organization.

The Colorado and Nevada statutes expressly require the operating agreement to be in writing, while the Virginia statute specifically allows nonwritten operating agreements. [FN271] All of the other statutes are silent as to whether the operating agreement must be in writing. [FN272] In Texas, however, because the statute requires that the LLC maintain a record of its regulations, it appears that Texas requires regulations to be in writing. [FN273]

Management of the Firm by LLC Members

Except for the Colorado and Texas statutes, the LLC statutes provide that the firm will be managed by the LLC members unless the LLC's articles of organization indicate otherwise. [FN274] The statutes generally direct that the members' voting rights will be in proportion to their interests in the LLC's profits. [FN275] ***415** The majority of the statutes do not contain specific requirements regarding membership meetings or other day-to-day operations. Only two statutes provide certain mandatory (Colorado) or optional (Kansas) rules with regard to such matters. [FN276]

The Kansas statute requires that the operating agreement provide for meetings of managers or members to be held “at such times as prescribed in the operating agreement or upon a minimum of 10 days' written notice.” [FN277] The statute also includes provisions for special meetings, which, if the proper procedures are followed, “may be called at any time.” [FN278]

The Colorado LLC Act is the only statute to dictate the form of management that the LLC must have. The Colorado statute provides that managers must manage the LLC. [FN279] Of course, nothing in the statute prevents members from serving as some or all of the managers.

The Texas statute indicates that, unless reserved to the members under the LLC's regulations, managers will exercise the LLC's powers. [FN280] The statute contains extensive provisions regarding the LLC's management. [FN281]

The members' power to bind the LLC varies in those states that permit an LLC to be managed by its members. In Florida, Texas, Utah, and Wyoming, unless the LLC is managed by managers, in which case only managers may bind the firm, the members automatically have such a right. [FN282] In Nevada, the articles of organization or operating agreement must delineate the members' authority to bind the LLC. [FN283] The Virginia statute does not have a specific provision dealing with the member's authority to bind the LLC, apparently relying instead on the common law concepts of agency, or perhaps upon the assumption that those who have management authority also have the authority to bind the LLC to others. [FN284]

If the LLC is managed by elected managers, members are generally not given any power to bind the firm. The statutes, however, appear to allow LLC members to retain some power through the articles of organization or operating agreement, despite the fact that the firm is managed by elected managers. [FN285]

***416** Management of the Firm by Elected Managers

All of the statutes allow or require the LLC to be managed by elected managers. [FN286] Most of the statutes, however, provide only a minimal number of rules pertaining to the operation of the LLC by such managers. The Florida, Nevada and Wyoming statutes, for example, while requiring that managers be elected annually, provide few other rules pertaining to LLC management by elected managers. [FN287] The Colorado, Texas, and Virginia statutes provide a more detailed framework for LLC governance. Specifically, these statutes provide rules pertaining to the number and election of managers, the classification of managers, the filling of managerial vacancies, and the removal of managers. [FN288]

Except Virginia, all of the statutes provide that the elected managers have the power to bind the LLC. [FN289] Additionally, managers, like members, cannot be held liable for the LLC's debts, obligations, or liabilities. [FN290] Furthermore, all of the statutes provide that the LLC may indemnify managers for any legal action taken against them in their capacity as a representative of the firm, to the extent that they were acting on the firm's behalf. [FN291]

Only the Colorado and Virginia statutes explicitly address the fiduciary duties of managers. [FN292] The Virginia statute states that a manager is to act “in accordance with his good faith business judgment of the best interests of the limited liability company.” [FN293] The Colorado statute dictates that a manager “shall perform his duties in good faith, in a manner he reasonably believes to be in the best interests of the limited liability company, and with such care as an ***417** ordinarily prudent person in a like position would use under similar circumstances.” [FN294] These statutes indicate that managers will be required to adhere to the same standards as those imposed on corporate managers. [FN295]

Relationship of the Members to the LLC and to Each Other

Because the LLC statutes provide only a minimal number of mandatory rules, LLC members have a great deal of freedom in organizing the LLC's economic and managerial structure.

Voting

The Colorado, Texas and Virginia statutes explicitly permit LLC members to separate themselves into different classes or groups. [FN296] These separate classes can be accorded different duties, rights and privileges in the same way that different shareholders in a corporation can be accorded different rights and privileges. The other statutes, while not specifically addressing the possibility of separating members into different classes, appear to permit LLC members in their articles of organization or operating agreement to establish whatever economic or managerial relationship they wish. Except for Colorado, Texas and Kansas, the statutes provide, either mandatorily or by default, that the members' voting rights will be in proportion to the members' contribution to the LLC. [FN297]

Distributions

Several of the statutes provide default rules with regard to distributions made by the LLC prior to dissolution. These statutes indicate that, unless the LLC's articles or operating agreement otherwise provides, the LLC is to make distributions to its members in proportion to the contribution that the members made to the LLC. [FN298]

***418** Withdrawal of Members

Each statute accords members the right to withdraw from the LLC. Except Colorado and Texas, the statutes provide that, unless otherwise specified in the articles or operating agreement, a member may withdraw after giving all other members six months notice in writing. [FN299] The Colorado statute allows members to withdraw at any time "by giving written notice to the other members, but, if the resignation violates the operating agreement, the limited liability company may recover from the resigning member damages for breach of the operating agreement and offset the damages against the amount otherwise distributable" to that member. [FN300] The Texas statute provides that "a member may withdraw from a limited liability company at the time or on the occurrence of events specified in the regulations." [FN301] Regardless of procedural differences for member withdrawal, the statutes are uniform in that upon withdrawal, the LLC member has the right to receive only cash in return for the member's contribution to capital, irrespective of the nature of the contribution. [FN302]

Derivative Suits

Only a few of the statutes address the right of a member to institute a derivative suit or a suit for remedies. The Utah and Virginia statutes explicitly permit derivative suits. [FN303] The Colorado statute provides for a right of accounting. [FN304] The other statutes are silent with regard to this topic.

Records and Reports

The statutes differ as to whether LLCs must submit reports to a state department and whether they must maintain certain records. Colorado, Kansas and Utah require the filing of reports with the Secretary of State. [FN305] Utah only requires that the LLC disclose its name and the agent appointed for service of process in its annual report. [FN306] Colorado requires that the report disclose the name and address of each LLC manager. [FN307] The Kansas statute requires the most extensive disclosure, requiring an LLC to file an annual report that ***419** includes a reconciliation of the capital accounts, balance sheets, and other financial information. [FN308]

Except Florida, Kansas and Wyoming, the statutes require the LLC to maintain certain records at its principal place of business. [FN309] Such information includes the names and addresses of the members; the articles of organization and any amendments thereto; and copies of the federal, state, and local income tax returns for certain years. Additionally, unless the information is contained in a written operating agreement, the LLC must keep records of the amount of cash and other contributions made by the members, the rights of any member to receive a distribution, and the event or date upon which the LLC will dissolve.

SCOPE AND TYPE OF BUSINESS

Powers

Each statute provides a list of the LLC's powers. These powers are derived from the RMBCA and include such things as the right to sue or be sued; to acquire, hold, and use, or otherwise deal in or with real and personal property; to lend and invest money; to trade in interests in business entities; to carry on business within or outside the state of organization; to elect managers and define their duties; to make operating agreements or regulations; to indemnify members and managers; to cease existence; to become a member of a partnership or other entity; to make charitable contributions, to conduct business in aid of governmental policy (Florida, Kansas, Virginia, Utah); to pay pensions (Florida, Kansas, Virginia); to insure the life of members and managers (Virginia and Utah); and to perform professional services (Kansas and Utah). [FN310] While a majority of the statutes are identical, there are some differences. For example, only the Florida, Kansas, Utah and Virginia statutes provide that the LLC can make donations to the public welfare or for charitable, scientific, or educational purposes. [FN311] On the other hand, unlike the other statutes, the Florida statute does not expressly authorize an LLC to lend money to its members.

Purposes for the Formation of LLCs

The states have imposed few restrictions upon an LLC's activities. For example, Colorado allows an LLC to conduct any business that a limited partnership may conduct. [FN312] Florida and Texas provide that an LLC may be organized for any lawful business, except in the case of specific statutes for the ***420** regulation of particular kinds of businesses. [FN313] The Kansas statute allows an LLC to conduct any business that a partnership or individual may conduct. [FN314] Until a recent amendment, however, an LLC could not own agricultural land within the state of Kansas. [FN315] Nevada and Wyoming allow an LLC to conduct any business except for banking and insurance. [FN316] Utah allows an LLC to conduct any activity that a partnership, general corporation, or professional corporation may conduct. [FN317] Virginia permits an LLC to engage in any lawful business except professional services. [FN318]

LIMITATIONS ON TRANSFERABILITY

All of the LLC statutes characterize a member's interest in an LLC as personal property. [FN319] All of the statutes permit members to assign their pecuniary interest in the LLC to third parties. [FN320] In a majority of the statutes, however, LLC members may not transfer the “right to participate in the management of the business and affairs of the limited liability company” without the unanimous consent of the other members. [FN321] The Utah statute permits a member to transfer his interests, including all rights and privileges, but only if “the nontransferring members entitled to receive a majority of the nontransferred profits of the limited liability company” consent to the proposed transfer. [FN322] In a Texas LLC, the LLC's regulations can provide that the consent of the other LLC members is not required in order to transfer the rights and privileges of an LLC interest. [FN323]

***421** DISSOLUTION

Termination of Fixed Duration

Except for the Kansas, Utah and Virginia statutes, the LLC statutes limit an LLC's period of duration to no more than thirty years. [FN324] The Kansas, Utah and Virginia statutes do not provide a mandatory period of duration, but do require the articles of organization to set forth a period of duration or, in Kansas, the latest date on which the LLC is to dissolve. [FN325]

Disassociation of a Member

Most of the statutes state that the LLC must automatically dissolve:

> [U]pon the death, retirement, resignation, expulsion, bankruptcy, or 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 continue stated in the articles of organization of the limited liability company. [FN326] Thus, if the LLC's articles of organization do not state that the members have a right to continue the business upon unanimous vote, the LLC must dissolve upon the departure of one of its members. In Virginia, the right to consent does not have to be set forth in the articles of organization. [FN327] Nonetheless, the consent must be unanimous. [FN328] While the right to continue the LLC must be stated in the articles of organization, the Utah statute only requires the consent “of the remaining members entitled to receive a majority of the capital of the limited liability company.” [FN329]

The Texas, Florida and Kansas statutes differ significantly from the other statutes. The Texas statute provides that, unless the LLC's regulations provide otherwise, the LLC will dissolve upon the occurrence of any event that terminates the continued membership of an LLC member, unless “there is at least one remaining member, and the

LLC is continued by the consent of the number of members or class thereof stated in the articles of organization or regulations of the LLC, or if not so stated, by all remaining members." [FN330] The Florida and Kansas statutes provide that the LLC will dissolve following the departure or ***422** discontinued membership of any of the firm's members, "unless the business of the limited liability company is continued by the consent of all the remaining members or under a right to continue stated in the articles of organization." [FN331]

Consent of Members

All of the statutes provide for the dissolution of the LLC upon the written consent of its members. Some of the statutes, however, vary the dissolution events. For example, in Utah, the unanimous written agreement of all members is not necessary to dissolve the LLC. Unless the LLC's operating agreement otherwise specifies, the LLC can be dissolved by the written agreement of the members entitled to receive a majority of the LLC's profits. [FN332] The Utah statute also provides that the LLC dissolves if it is not the successor LLC in a merger or consolidation of two or more LLCs. [FN333] The Texas and Virginia statutes provide for the LLC's dissolution upon the occurrence of an event stated in the articles of organization or operating agreement to cause dissolution. [FN334]

Involuntary Dissolution

The statutes provide for the involuntary dissolution of the LLC under certain circumstances. The Colorado, Florida, Texas, Virginia and Utah statutes allow a court to dissolve an LLC on the application of or for a member, "if it is not reasonably practicable to carry on the business of the LLC in conformity with its articles of organization." [FN335] The Wyoming and Nevada statutes do not provide for involuntary dissolution upon the events stated above. Instead, in Nevada and Wyoming, the LLC can be deemed dissolved if it has failed for thirty days to appoint and maintain an agent for service of process, has failed for thirty days after change of its registered office or agent for service of process to file with the office of the Secretary of State a statement of the change, or has failed to pay requisite fees charged by the state. [FN336]

Winding Up and the Filing of the Articles of Dissolution

While the dissolution process in each state is roughly the same, there are differences with respect to whether the LLC is legally obligated to contact creditors or other parties prior to dissolution, how long prior to the dissolution the LLC must give notice of its intent to dissolve, and how the LLC's assets are ***423** to be distributed upon dissolution. Some variation also exists with regard to the contents of an LLC's articles of dissolution or certificate of cancellation.

The Colorado, Florida, Kansas, Nevada and Wyoming statutes require the LLC to file a statement of its intent to dissolve with a specified state department. [FN337] In addition, in Florida, Kansas, and Texas, the LLC must notify its creditors by mail within twenty days after filing its statement of its intention to wind up its activities. [FN338] Utah and Virginia have no requirement regarding a notice of intent to dissolve.

Prior to filing articles of dissolution, the LLC must discharge all of its liabilities and distribute its remaining assets to its members. All of the statutes provide that the LLC should first discharge all liabilities to creditors (except those to members on account of contributions); it should then discharge liabilities due LLC members with regard to their share of the profits and other compensation; finally, it should discharge liabilities to members in respect to their capital contributions. [FN339] After the LLC discharges its liabilities, the LLC must file articles of dissolution or, in Virginia, a certificate of cancellation. The articles of dissolution must state that the LLC has disposed of all its debts, obligations and liabilities; that the remaining assets have been distributed among its members; that there are no pending lawsuits against the LLC; and, except in Texas and Utah, that the LLC previously has filed a statement of its intent to dissolve. [FN340] The Virginia certificate of cancellation must set forth the LLC's name, the date of the filing of the LLC's articles of organization and all amendments thereto, the reason for filing the certificate of cancellation, and the effective date of the dissolution. [FN341]

FEDERAL INCOME TAXATION

CLASSIFICATION OF THE LLC AS A PARTNERSHIP

LLCs are unincorporated organizations. [FN342] For tax purposes, depending on whether the LLC possesses certain corporate characteristics, [FN343] the LLC may be ***424** taxed as a partnership or as a corporation. [FN344] The Treasury Regulations identify six characteristics indicative of corporate status: (1) associates, (2) an objective to carry on business and divide the gains, (3) continuity of life, (4) free transferability of interests, (5) centralization of management, and (6) limited liability. [FN345]

The regulations will treat an unincorporated organization, such as an LLC, as a corporation for tax purposes if it has more corporate than noncorporate characteristics. [FN346] Because both partnerships and corporations possess the characteristics of associates and a business objective, those characteristics will not be considered when classifying the LLC. [FN347] Moreover, by definition, LLCs will always possess the limited liability characteristic; [FN348] under the applicable state laws no member is personally liable for the LLC's liabilities. [FN349] Consequently, to ensure partnership tax status, LLCs must lack two of the remaining three corporate characteristics-continuity of life, free transferability of interests, and centralized management. [FN350]

The Service has published one ruling classifying an LLC as a partnership for federal income tax purposes. Revenue Ruling 88-76 states that a Wyoming LLC lacks the corporate characteristics of continuity of life and free transferability of interests, and consequently, the Service will classify a Wyoming LLC as a partnership. [FN351] This ruling confirms that the Service is willing to grant partnership status to LLCs that lack at least two of the identifying characteristics. LLCs formed in states other than Wyoming, however, cannot automatically rely on Revenue Ruling 88-76. Such LLCs must demonstrate that they lack two of the relevant corporate characteristics under the tests set out in the classification regulations. [FN352]

***425** Continuity of Life

Continuity of life is a corporate characteristic because a corporation continues to exist even if one of the original owners dies, retires, resigns, suffers insanity, goes into bankruptcy, or is expelled. [FN353] An organization lacks continuity of life-even though the remaining members may agree to continue the business-if under local law any member has the power to dissolve the organization, notwithstanding the members' agreement. [FN354]

LLCs organized in Wyoming should lack continuity of life regardless of the LLC's operating agreement. [FN355] Under the Wyoming statute, an LLC dissolves at the earlier of: (1) expiration of the period fixed for its duration; (2) the unanimous agreement of the members to terminate; or (3) the death, retirement, resignation, bankruptcy, expulsion, dissolution or any other event terminating membership of a member, unless all remaining members consent to continue the business under a right to do so in the articles of organization. [FN356] If the members do not agree to continue the business, the statute requires dissolution when a dissolution event occurs, notwithstanding any contrary provisions in a particular LLC agreement. [FN357]

LLCs organized in other states must independently demonstrate that the LLC lacks continuity of life. The dissolution provisions in the Colorado, [FN358] Virginia, [FN359] and Nevada [FN360] statutes are similar to the Wyoming provisions. The Florida and Kansas dissolution provisions, however, are materially different from that of Wyoming. If the articles of organization provide a right to continue the business, LLCs in Florida and Kansas will not dissolve when a dissolution event occurs, even if all the remaining members do not agree to continue the business. [FN361] A right to continue the business in the articles of organization arguably causes the LLC to possess continuity of life because it deprives each ***426** member of the power to dissolve the LLC as a matter of law. [FN362] The Florida and Kansas dissolution provisions would be similar to the Wyoming provisions if the statute did not include the option to continue the business in the articles of organization. [FN363] Unless the LLC clearly lacks both free transferability of interests and centralized management, [FN364] LLCs in Florida or Kansas that contain a right to continue the business in the articles of organization run a substantial risk of being classified as corporations.

The dissolution provisions of the Utah statute are also materially different from those of Wyoming. In Utah, when a dissolution event occurs, the business continues upon the agreement of a majority of the LLC members entitled to receive a majority of the capital of the LLC (rather than all of the members). [FN365] There is no clear authority in the Treasury Regulations endorsing majority rather than unanimous agreement to continue the business. [FN366] Consequently, a Utah LLC that does not include provisions in its operating agreement requiring unanimous agreement to continue the business [FN367] may be classified as a corporation. [FN368]

The dissolution provisions of the Texas statute are more flexible than those of the other statutes. The Texas statute offers two options, either of which could cause the LLC to possess continuity of life. Like Florida and Kansas, Texas allows the members to circumvent the traditional automatic dissolution events by adding explicit provisions to the LLC's articles of organization or regulations. [FN369] A Texas LLC that adopts a right to continue the business similar to the option in the Florida and Kansas statutes runs a risk of possessing continuity of life. [FN370] A Texas LLC may alter the default rule that requires all members to consent to the continuation of the business [FN371] by either requiring less than unanimous consent to continue the business or by dispensing with consent altogether. [FN372] If the LLC's articles and regulations are silent, however, all remaining members must consent to a continuation of the business. [FN373] Like the Utah statute, [FN374] if the articles or regulations provide that less than all remaining ***427** members can agree to continue the business when a dissolution event occurs, a Texas LLC runs the risk of being classified as a corporation.

Free Transferability of Interests

An entity possesses the corporate characteristic of free transferability of interests if members owning substantially all of the interests of the LLC have the power to transfer all aspects of ownership to a person who is not a member without obtaining consent from the other members. [FN375] Without a corresponding right to participate in LLC management, free transferability of interests does not exist merely because LLC members can freely transfer the right to share in the LLC's profits. [FN376] LLCs organized in Wyoming always lack free transferability of interests. [FN377] The Wyoming statute states that the transferee shall have no rights to participate in the management of the business or otherwise become a member of the LLC unless all members consent to the transfer. [FN378]

The transferability provisions in the Colorado, Florida, Kansas, Nevada, and Virginia statutes are similar to the Wyoming provisions. [FN379] The Utah and Texas transferability provisions materially differ from that of Wyoming. In Utah, a complete transfer need only be approved by those members entitled to receive a majority of the profits. [FN380] In other words, a transferee can acquire all aspects of LLC membership even if some of the original members refuse to consent.

The Texas statute generally requires all members to consent to a complete transfer. [FN381] Members of Texas LLCs, however, can alter the general rule with provisions in the company's regulations. [FN382] Apparently, a Texas LLC can allow complete transfers with majority consent, less than majority consent, or without any consent. [FN383]

The Treasury Regulations do not explicitly require unanimous consent or endorse majority (or even smaller) consent to transfer a complete membership ***428** interest. [FN384] Because the regulations are not clear, the Service may treat Utah LLCs, which require only a majority of the remaining members to agree to a complete transfer, [FN385] and Texas LLCs, which can provide for less than unanimous consent, [FN386] as possessing the corporate characteristic of free transferability of interests.

Centralized Management

Centralized management generally exists in an organization if the power to make essential management decisions is not vested with all of the organization's owners. [FN387] A statutory corporation typically empowers a board of directors to run the business and make management decisions for the shareholders. [FN388] With the exception of Colorado [FN389] and Texas, [FN390] all of the existing LLC statutes provide flexibility concerning LLC management. If the articles of organization are silent, the power to manage the LLC generally vests in the members in proportion to their capital contributions. [FN391] If the members want to concentrate management into a smaller group, the LLC may appoint a manager or group of managers in its articles of organization. [FN392]

General partnerships, organized in a state that has adopted the UPA, will automatically lack centralized management because, by statute, all partners ***429** have equal management rights. [FN393] Applying similar principles, a strong argument can be made that LLCs that do not provide for a manager also lack centralized management. [FN394] Because many LLCs will be able to establish that they lack both continuity of life and the free transferability of interests, [FN395] the absence of centralized management often will not be important. [FN396]

It is unclear whether a manager-managed LLC will be considered to have centralized management. Under the Treasury Regulations, limited partnerships organized in states that have adopted RULPA lack centralized management unless the limited partners own substantially all of the partnership. [FN397] Revenue Procedure 89-12 states that the Service generally will rule that centralized management is lacking if the general partner owns at least twenty percent of the partnership. [FN398] Because Revenue Procedure 89-12 states that managers will be treated as "general partners" and nonmanagers will be treated as "limited partners" when an organization that is not a state law partnership is involved, one could argue that LLCs with managers lack centralized management so long as the managers own at least twenty percent of the LLC. [FN399]

Revenue Procedure 89-12, however, may not control the determination of whether an LLC is centrally managed. In the LLC at issue in Revenue Ruling 88-76, three of the twenty-five members were designated managers. The Service held that the LLC possessed centralized management without stating the percentage of the LLC owned by the managers. [FN400] Furthermore, LLC managers differ substantially from general partners. Unlike LLC managers, general partners are personally liable for the partnership's debts. [FN401] Moreover, general partners traditionally are granted absolute management authority by statute and such authority cannot be passed on to the limited partners. [FN402] In contrast, LLC managers derive their authority from the LLC's articles of organization, and the LLC statutes do not limit a nonmanager's right to participate in management. [FN403]

***430** Two or More Members

At formation, LLCs must have at least two members to secure partnership status and, to avoid terminating for tax purposes, must continue to have at least two members at all times. The Internal Revenue Code defines the term partnership to include a "syndicate, group, pool, joint venture, or other unincorporated organization" that carries on any business. [FN404] A partnership terminates for tax purposes if no part of its business continues to be carried on by its partners. [FN405] The very essence of a partnership contemplates two or more partners joining together as co-proprietors to engage in business and share in profits. [FN406] Thus, the regulations specifically state that a partnership's business is no longer carried on by the partners if there is only one remaining partner; consequently, such a partnership terminates. [FN407]

With the exception of Texas, all existing LLC statutes require that there be at least two members at formation. [FN408] The Texas statute only requires an "organizer" to form the LLC, and contains no requirement that there be at least two members at formation. [FN409] Texas LLCs that are formed with only one member cannot be treated as partnerships for tax purposes. [FN410] Furthermore, any LLC initially formed with at least two members that later has only one member will terminate for tax purposes. [FN411]

***431** APPLICATION OF THE SUBCHAPTER K PROVISIONS [FN412]

Formation

Under the Florida and Wyoming statutes, contributions in exchange for an interest in the LLC's capital can consist of only cash or property; members cannot contribute services to the LLC for a capital interest. [FN413] Under the Texas statute, to obtain a capital interest, members may contribute cash, property, promissory notes to contribute cash or property in the future, or services that have already been rendered. [FN414] Members of a Texas LLC, however, cannot contribute a promise to render future services. [FN415] Under the other statutes, LLC members can obtain an interest in the LLC's capital by contributing or promising to contribute cash, property, or services. [FN416] All of the existing LLC statutes allow members to divide the LLC's profits in any manner stipulated in their agreement. [FN417] Consequently, members of LLCs formed under any of the existing statutes can agree to perform services for an interest in the LLC's future profits.

No gain or loss is recognized if the member contributes cash, property, or a promise to contribute cash or property in the future. [FN418] The basis of the member's interest in the LLC generally will reflect the amount of cash and the basis of the property contributed. [FN419] The member's interest in the LLC's capital (the member's capital account) will reflect the value of the cash and property contributed. [FN420]

Like partners in partnerships, LLC members who contribute services for an interest in the LLC's capital immediately recognize ordinary income equal to the value of the capital interest, unless the receipt of the capital interest is ***432** contingent or otherwise subject to a substantial risk of forfeiture. [FN421] In these cases, the ordinary income recognition is delayed until the capital interest is no longer subject to a substantial risk of forfeiture or is freely transferable. [FN422] The undesirable tax consequence of recognizing compensation income before payment is received normally discourages most LLC members from contributing services for an interest in the LLC's capital.

Partners contributing services to their partnerships historically have avoided recognizing ordinary income on the date of contribution by agreeing to receive a larger share of the partnership's future profits. On the date of contribution, the service-providing partner's capital account is not increased and that partner's right to be compensated is deferred until the partnership actually earns profits. As previously mentioned, members of LLCs can agree to divide the LLC's profits in any manner that they see fit; therefore, like partners, service-contributing members can attempt to avoid immediate recognition of income by being compensated with shares of the LLC's future profits.

The tax consequences to a partner who receives a share of partnership profits for the performance of services, however, are unclear. For many years, despite Diamond v. Commissioner, [FN423] a disturbing case to the contrary, many assumed that a service-contributing partner did not recognize income merely from the receipt of an interest in the partnership's future profits. [FN424] Instead, the service-contributing partner would obtain a distributive share of income when the partnership actually realized profits and allocated the profits to the partner. [FN425]

***433** In Campbell v. Commissioner, [FN426] the Tax Court held that a service-contributing partner recognized ordinary income in the year that he received an interest in the partnership's profits. [FN427] The court valued the profits interest by discounting projected cash flow and tax benefits. [FN428] The Tax Court broadly reasoned that any partnership profits interest that has more than a speculative or de minimis value is taxable upon receipt. [FN429]

On August 27, 1991, the Eighth Circuit Court of Appeals reversed the Campbell decision on the narrow ground that the interests in partnership profits “were without fair market value at the time [Campbell] received them.” [FN430] The Eighth Circuit refused to address the Service's argument that the Court should affirm the Tax Court's decision because Campbell received the profits interest from a third party, rather than from the partnership. [FN431] Although the court extensively discussed the broader issue of how profits interests should generally be treated, and distinguished the circumstances in Campbell from those in Diamond, the holding was nevertheless based on the narrow issue of valuation. [FN432] Until the courts, the Service, or the Code itself establish clear guidelines, the treatment of the receipt of a partnership profits interest in exchange for services will remain unclear.

Allocations of Profits and Losses

If the LLC lacks two of the three corporate characteristics discussed above, the partnership provisions in Subchapter K of the Internal Revenue Code [FN433] will apply. [FN434] Under Subchapter K, LLCs are not subject to income tax; [FN435] LLC members are liable in their separate and individual capacities and must take into account separately their respective distributive shares of the LLC's income, gain, loss, deduction and credit. [FN436] Generally, a member's basis in the LLC interest (outside basis) is increased by the member's distributive share of income and gains and decreased by the member's distributive share of losses and deductions. [FN437] The character of each member's distributive share is determined ***434** with reference to the LLC. [FN438] A member cannot deduct allocations of the LLC's losses to the extent the member's outside basis is insufficient to absorb the loss. [FN439]

As noted, the LLC statutes permit the members to divide the LLC's profits and losses in any way that they see fit. [FN440] For tax purposes, the operating agreement normally will control how the LLC's tax items are allocated among the members. [FN441] If, however, the operating agreement does not provide for allocations or if the allocations agreed upon either do not have substantial economic effect or are not deemed to be according to the members' economic interests in the LLC, the distributive shares will be reallocated among the members according to their economic interests in the LLC. [FN442]

The “substantial economic effect” test applies to all income, gain and loss allocations that are not attributable to nonrecourse liabilities or partner nonrecourse debt. [FN443] The test is designed to ensure that members receiving loss allocations bear any economic burden and members receiving income allocations have rights to any economic benefits associated with those allocations. The basic safe harbor for economic effect requires that: (1) capital accounts be maintained; [FN444] (2) liquidating distributions follow positive capital accounts; [FN445] and (3) members with negative capital accounts have a deficit restoration obligation that ***435** meets certain requirements in the Treasury Regulations. [FN446] The substantiality test examines the members as a group and compares the tax and economic effects of the particular allocation. If the tax saving is likely to be large and the economic impact on the members is likely to be small, the allocation being tested may be reallocated on insubstantiality grounds. [FN447]

An LLC's liabilities will always initially be nonrecourse for tax purposes because no member has personal liability for the LLC's debts. [FN448] Allocations attributable to nonrecourse liabilities cannot have substantial economic effect because only the creditor bears the economic burden associated with nonrecourse deductions. [FN449] Moreover, the income attributable to nonrecourse liabilities merely offsets the nonrecourse deductions previously taken. [FN450] The Treasury Regulations governing allocations attributable to nonrecourse liabilities determine when the LLC has nonrecourse deductions, provide a safe harbor that deems allocations of nonrecourse deductions to be according to members' economic interests in the LLC, and determine when the LLC must allocate income to the members who were previously allocated the nonrecourse deductions pursuant to the minimum gain chargeback requirement. [FN451]

If a member (or a person related to a member) guarantees the LLC's nonrecourse liability or if a member (or a person related to a member) makes a nonrecourse loan to the LLC, the liability is treated as “partner nonrecourse debt” and a separate set of rules, within the rules governing allocations attributable to nonrecourse liabilities, apply to the deductions and the income attributable to the debt. [FN452] These rules ensure that only the member who bears the economic burden if the LLC cannot pay the liability receives the deductions attributable to the liability, and impose minimum gain chargeback requirements to that member similar to the minimum gain chargeback requirements associated with nonrecourse debt.

***436** Generally an LLC will have nonrecourse deductions, triggering the application of the nonrecourse debt allocation rules, to the extent losses and deductions reduce the basis of property securing the nonrecourse debt below the principal amount of the nonrecourse note. [FN453] To qualify for the safe harbor (deeming the allocations of the nonrecourse deductions to be in accordance with the members' economic interests), the LLC must allocate nonrecourse deductions among the members in a ratio that corresponds to an allocation that has substantial economic effect attributable to property securing nonrecourse liabilities. [FN454] The Treasury Regulations contain examples where this requirement, known as the “reasonable consistency requirement,” is met if the members share the nonrecourse deductions according to how they share economic losses, or profits, or any ratio between those two figures. [FN455] The operating agreement must contain a minimum gain chargeback that conforms with the requirements of the regulations. [FN456] Generally, the minimum gain chargeback requires the members that received allocations of nonrecourse deductions to receive income allocations as the nonrecourse liability is repaid or at such time the property securing the nonrecourse liability is disposed. [FN457]

If the partner nonrecourse debt rules apply, a set of rules that parallel the rules applicable to nonrecourse debt apply to the deductions and income that are attributable to each partner nonrecourse debt. [FN458] Generally, the losses and deductions that reduce the basis of property securing each partner nonrecourse debt must be allocated to the member that bears the economic burden (generally, the guaranteeing or lending member) if the LLC cannot pay the liability. [FN459] Members who have been allocated “partner nonrecourse deductions” have minimum gain chargeback requirements that parallel the rules applicable to nonrecourse debt. [FN460]

Terminations, Mergers and Conversions

The partnership tax rules concerning terminations should apply to LLCs and their members. [FN461] An LLC terminates for tax purposes if no part of the business ***437** continues or if there is a sale or exchange of more than fifty percent of the total interests in capital and profits within a twelve month period. [FN462] Upon termination, the taxable year closes with respect to all members. [FN463] If a sale or exchange triggers the termination, the LLC is deemed to distribute all assets to its members (including any new members), and immediately thereafter the members are deemed to contribute the assets to a new LLC. [FN464] Numerous collateral consequences result from a termination, many of which may have a negative effect on the members. [FN465]

If two or more partnerships merge or consolidate, a straight calculation of the percentage of interests sold or exchanged would automatically treat all the partnerships as terminated. Technically, all of the partners exchange their old interests for interests in the surviving or new partnership. If two or more partnerships merge or consolidate into a single partnership, however, special rules determine which partnership continues for tax purposes and which partnerships terminate. [FN466] If none of the partners of the merging partnerships own more than fifty percent of the resulting partnership, all of the merging partnerships terminate and a new partnership results. [FN467] If the partners of a particular merging partnership own more than fifty percent of the resulting partnership, the resulting partnership is treated as a continuation of that merging partnership and all other merging partnerships terminate. [FN468] A partnership that terminates from a merger is treated as first contributing its assets to the resulting partnership and then distributing the interests in the resulting partnership to its partners in complete liquidation. [FN469] Where an LLC is treated ***438** as a partnership for tax purposes, these special rules should apply to LLCs that merge with partnerships or other LLCs. [FN470]

The Service has long recognized that general and limited partnerships can convert from one form to the other without causing a termination [FN471]-if, after the conversion, the old partnership's business is continued and each partner's total percentage interest in profits, losses and capital remains the same. [FN472] The partners are deemed to exchange their old interests for the new interests, and their outside basis will not change if their shares in the new partnership's liabilities remain the same. [FN473] Consistent with treating LLCs as partnerships for tax purposes, the Service has ruled privately [FN474] that partnerships converting to LLCs do not terminate if the above requirements are met. [FN475]

Other Subchapter K Provisions

There are two major rules in Subchapter K that help coordinate the LLC members' tax consequences with their economic positions. If an interest in an LLC is sold, exchanged, or passed by inheritance, an Internal Revenue Code Section 754 election [FN476] gives the transferee a positive basis adjustment in the LLC's assets that have a fair market value greater than the adjusted basis at the time the transferee becomes a member. [FN477] This essentially prevents an incoming member from recognizing taxable gain due to appreciation that occurred before the member's interest was acquired. This feature preserves the value of the LLC if the LLC's assets are expected to appreciate or decline at a rate less than that for tax depreciation. A similar mechanism adjusts the inside basis of the LLC's assets if a member recognizes gain from a distribution. [FN478]

***439** Another rule requires that built-in gain or loss from contributed property be allocated back to the contributing member. [FN479] The built-in gain or loss is the difference between the property's basis (which carries over to the LLC after the contribution) and the book value of the property that is credited to the contributing member's capital account. [FN480] If a new member is admitted to the LLC (by contributing cash, for example), and the LLC revalues its assets and adjusts the members' capital accounts, the regulations similarly require the built-in gain or loss in the LLC's revalued property to be allocated back to the existing members. [FN481] These rules help prevent economic distortions [FN482] that otherwise would occur if noncontributing members (in situations where property is contributed) or newly admitted members (in situations where existing property is revalued) were allocated tax gain or loss attributable to appreciation or depreciation occurring before the property was contributed or revalued. [FN483]

OTHER TAXATION ISSUES

Passive Activity Loss Limitations

For certain members, a distributive share of the LLC's losses will be suspended if the passive activity loss limitations apply. [FN484] If the taxpayer is an individual, estate, trust, or closely held C corporation, the passive activity loss limitations suspend all losses from passive activities to the extent the losses exceed the taxpayer's income from passive activities. [FN485] Losses are deemed passive unless the taxpayer can show that he materially participated in the trade or business generating the losses. [FN486] Like partnerships and Subchapter S corporations, an LLC is a pass-through entity. Consequently, the passive loss limitations will apply to members that are otherwise within the scope of the rules. [FN487]

Members of LLCs that are individuals, trusts, estates, or closely held C corporations must establish material participation in the LLC's trade or business to avoid the passive activity loss limitations. [FN488] In defining “material participation,” the Treasury Regulations appear to apply a more stringent test ***440** to LLC members than is applied to limited partners and Subchapter S shareholders. [FN489] Generally, to materially participate, a limited partner must participate in a partnership's trade or business for more than 500 hours. [FN490] The regulations broadly define the term limited partner to include all holders that are not personally liable for the entity's debts even if the entity is not a limited partnership as defined by state law. [FN491]

Arguably, there are strong policy reasons to apply a more stringent material participation test to limited partners than to the owners of other pass-through entities. Traditionally, limited partners were not allowed to materially participate in the partnership's day-to-day activities. [FN492] Moreover, limited partnerships traditionally have been used as tax shelters, the precise activity at which the passive activity loss limitations were aimed. [FN493] However, none of these concerns apply to LLCs. Unlike the traditional limited partner, LLC members can participate in the LLC's business affairs in a manner similar to a general partner or a Subchapter S shareholder. [FN494] Until the regulations are amended or otherwise clarified, however, LLC members should plan to meet the stricter material participation test applicable to limited partners to ensure that the passive activity loss limitations do not apply.

The At-Risk Limitations

Individuals and certain closely held C corporations that are members of LLCs can only deduct the losses flowing out of the LLC if the members are considered “at-risk.” [FN495] A member is considered “at-risk” for the amount of money and the adjusted basis of property that the member contributed to the LLC, as well as for any shares of the LLC's debt for which the member is personally liable. [FN496] Although the proposed Treasury Regulations appear somewhat contradictory, LLC members should be able to increase their at-risk amount by guaranteeing the LLC's debt-if under state law a guarantee renders the member personally liable and there are no contribution or subrogation rights to inherit from others. [FN497]

***441** If the LLC's debt is qualified nonrecourse financing, the members are treated as being at-risk for a share of that debt even though no member is personally liable. [FN498] Generally, qualified nonrecourse financing exists if the amounts were borrowed from a qualified person who is in the business of lending money and used to hold real property. Except as provided in the regulations, no person can be personally liable for the loan. [FN499] If the loan is a traditional state law nonrecourse loan secured by a particular piece of property, an LLC should have no trouble meeting the qualified nonrecourse financing rules. If the loan is secured by all of the LLC's assets, however, the LLC as a person may be personally liable. It is not clear if the “person” personally liable is the entity or its owner. [FN500] It appears that the qualified nonrecourse financing rules require that no person be personally liable to prevent the property from being undervalued. [FN501] Until regulations are issued clarifying the persons who can be personally liable, LLCs seeking to meet the qualified nonrecourse financing rules should structure their debt as traditional nonrecourse debt secured by a particular piece of property.

Partnership Audit Issues

LLCs with more than ten members will generally be subject to comprehensive unified audit proceedings. [FN502] These proceedings are designed to facilitate audits by determining adjustments at the partnership level, rather than at the individual partner level. [FN503] Every partnership or LLC subject to these provisions must have a tax matters partner. [FN504] The Internal Revenue Code defines tax matters partner as the general partner so designated or the general partner with the largest profits interest if there is no designated general partner. [FN505] Because LLCs have no general partner, LLCs will find it difficult to meet the statute's literal terms. Arguably, any member of an LLC should qualify as a general partner, because all members have the right to participate in the LLC's management. Until the Service or the courts clarify which members may be designated as a tax matters partner, the Service theoretically could require the member with the largest profits interest to serve as the tax matters partner.

***442** Published and Private Rulings

There is only one published ruling dealing with the classification of an LLC as a partnership for tax purposes. [FN506] As discussed above, this ruling dealt with a Wyoming LLC. [FN507] Persons forming LLCs in states other than Wyoming should carefully examine that state's statute as well as the LLC's operating agreement to ensure that the LLC will be classified as a partnership. [FN508] Although no additional published rulings have been released, the Service appears willing to entertain private letter rulings. [FN509] Consequently, persons considering the LLC form who are not comfortable with the tax consequences should consider seeking a private letter ruling.

MEMBER LIMITED LIABILITY ANALYSIS IN INTRASTATE AND INTERSTATE LLC TRANSACTIONS

A critical factor in the choice of business entity is the personal liability of the owners and managers for the entity's obligations. Because of the relatively recent development of LLCs in the United States, there are no reported cases involving the liability of LLC members. [FN510] This section analyzes the liability of members of an LLC in intrastate or interstate transactions.

INTRASTATE LLC TRANSACTIONS

Member's Liability Under LLC Statutes

Currently, all LLC statutes expressly provide that members (and managers) are entitled to limited liability for the LLC's obligations. [FN511] For example, the Wyoming statute provides: "neither the members of an LLC nor the managers of an LLC 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 LLC." [FN512] With slight variation, this language is used in the other ***443** LLC statutes. [FN513] Like RULPA, the statutes generally provide that members will be liable for failing to make agreed contributions. [FN514] In addition, a member or manager will generally be personally liable for any tort committed by that member or manager. [FN515]

Piercing The Veil Exceptions

Notwithstanding these provisions, concern remains over the extent to which a concept similar to piercing the corporate veil will be applied to LLCs. [FN516]

Piercing the Veil in the Corporate Context

Shareholders of a corporation, unlike general partners, are not personally liable for the corporation's debts. [FN517] The RMBCA codifies this principle by stating that, "unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct." [FN518]

In the early case of United States v. Milwaukee Refrigerator Transit Co., [FN519] Judge Sanborn set forth the general rule on piercing the corporate veil. Judge Sanborn stated that "a corporation will be looked upon as a legal entity ... until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of the persons," thereby subjecting the shareholders to personal liability. [FN520] The concept of piercing the corporate veil is based on common law, rather than state or federal statutory law. [FN521] It is one of the most frequently litigated theories in corporate law. [FN522] In analyzing piercing issues, courts look to the totality of the circumstances, as ***444** opposed to applying hard and fast rules or definitive legal standards. [FN523] Moreover, courts are reluctant to pierce the corporate veil and will do so only in extraordinary circumstances. [FN524]

Nevertheless, courts have developed certain common factors that influence their decision. [FN525] These factors include: lack of separateness, inadequate capitalization, illegal purpose, equity and justice, and failure to comply with corporate formalities. [FN526] When a court decides to pierce the corporate veil, however, only the shareholder responsible for the violative factors will be held personally liable. [FN527] Accordingly, a shareholder who is only a passive investor runs little risk of being personally liable in the event that a court pierces the corporate veil. [FN528]

Limited Partner Liability in the Limited Partnership Context

As with a shareholder, a limited partner is generally entitled to limited liability. [FN529] Unlike a shareholder, however, a limited partner's liability is not based on the concept of piercing the limited partnership's veil, but rather usually depends on whether the limited partner acted like a general partner or participated in the control of the partnership's business. [FN530] RULPA codifies this principle by providing that "a limited partner is not liable for the obligations of a limited partnership unless he [or she] is also a general partner or, in addition to the exercise of his [or her] rights and powers as a limited partner, he [or she] participates in the control of the business." [FN531] Based on RULPA, a court will only impose personal liability on a limited partner if that person conducts certain prohibited activities. [FN532] It follows, therefore, that a limited partner who ***445** is a passive investor runs only a small risk that he will be subject to personal liability. [FN533]

Not all states, however, have adopted this provision of RULPA. The Georgia Revised Limited Partnership Act, for example, has abandoned the control rule and instead provides that "a limited partner is not liable for the obligations of a limited partnership by reason of being a limited partner and does not become so by participating in the management or control of the business." [FN534] Under this formulation, limited partners, regardless of their exercise of management control, would not be personally liable for the limited partnership's debts and obligations. [FN535]

Piercing the Veil in the LLC Context

Only Colorado has statutorily applied the piercing the veil doctrine to LLCs. [FN536] To determine whether an LLC member is personally liable for the alleged improper actions of the LLC, the Colorado statute requires the court to apply the Colorado cases applicable to piercing the corporate veil. [FN537] Because the piercing of the veil doctrine is a common law theory, little inference can be drawn from the absence of such a provision in the other statutes. [FN538]

LLC members, like corporate shareholders and contrary to limited partners under RULPA, are entitled to participate in firm management without losing their limited liability protection. [FN539] For this reason, corporate precedents may be appropriately analogous for LLC veil piercing purposes. Furthermore, because the Georgia Revised Limited Partnership Act has eliminated the control rule, cases under that statute also might provide appropriate precedents. [FN540]

***446** An LLC's failure to comply with corporate-like formalities is less likely to create a veil piercing problem if the LLC statute provides few corporate-like formalities. For example, the RMBCA requires that a corporation file articles of incorporation, [FN541] hold an organizational meeting, [FN542] adopt bylaws, [FN543] maintain a registered office and agent, [FN544] issue shares, [FN545] hold shareholder meetings, [FN546] hold board of director meetings, [FN547] appoint officers, [FN548] and file reports. [FN549] By comparison, the Wyoming LLC statute only requires that an LLC file articles of organization, [FN550] maintain a registered office and agent, [FN551] and, if the LLC is to be managed by managers, appoint such managers. [FN552] Since there are so few statutory formalities, it is not likely that there will be many LLC veil piercing cases based on a failure to follow corporate-like formalities.

Indeed, in the LLC context, it is questionable whether the failure to follow corporate-like formalities should even be a factor in an LLC piercing analysis. Courts have held that the failure to follow corporate formalities is not sufficient, in and of itself, to justify piercing a corporation's veil. [FN553] In addition, the Model Statutory Close Corporation Supplement expressly provides that the failure of a close corporation to observe the usual corporate formalities pertaining to corporate powers or management of its business is not grounds for imposing personal liability on the shareholders. [FN554]

The many similarities between LLCs and close corporations in terms of corporate powers and business management [FN555] suggest that courts should apply the Model Statutory Close Corporation Supplement's prohibition on imposing shareholder liability to LLCs based on a failure to follow corporate-like formalities. Nevertheless, if a court should pierce an LLC's veil, it should impose personal liability only upon those members who cause the violation. [FN556] Consequently, a passive LLC investor runs only a small risk of incurring personal liability if a court pierces the LLC's veil. [FN557]

***447** INTERSTATE LLC TRANSACTIONS

LLC Statutes

The LLC statutes allow LLCs to conduct interstate, intrastate and international business. For example, the Wyoming statute provides that "each limited liability company organized and existing under this act may ... 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." [FN558] A similar provision is provided in the other LLC statutes. [FN559]

Interstate Commerce Clause Protection

The Interstate Commerce Clause of the U.S. Constitution provides authority for an LLC to transact interstate business. The Commerce Clause has been interpreted to preclude states from imposing undue burdens upon corporations engaged in interstate commerce. [FN560] Any state statute that attempts to bar or unduly hinder interstate commerce will violate the Commerce Clause and be declared void. [FN561] Thus, a corporation organized in one state may enter into another state for purposes of interstate commerce, without obtaining permission from that other state. [FN562] States, however, are not precluded from exercising reasonable control over foreign corporations transacting business within their state through the use of the police power. [FN563] Consequently, an LLC organized in one state is constitutionally entitled to enter into all other states for purposes of interstate commerce, and those other states may not enact laws which bar or unduly burden an LLC's ability to engage in interstate commerce. [FN564]

***448** Qualification Statutes

Unlike interstate commerce, the states may regulate intrastate commerce. [FN565] One example of such regulation is the state law requirement that foreign corporations and foreign LLCs apply for authority to transact business within the state. [FN566] Currently, six of the eight LLC statutes provide qualification procedures for foreign LLCs. [FN567] In addition, Indiana, which has not enacted a domestic LLC statute, has enacted a statute that provides qualification procedures for foreign LLCs. [FN568] A foreign LLC that has qualified under one of these statutes or under other existing law [FN569] should enjoy the same rights and privileges and be subject to the same duties and restrictions as a domestic LLC. [FN570]

To the extent an LLC organized in one state qualifies to do business in a foreign state that also has an LLC statute, the foreign state should respect the member's limited personal liability since members of that state's LLCs enjoy limited personal liability. Because Indiana has not yet enacted a complete LLC act, it is unclear whether Indiana will respect the limitation on personal liability. It can be argued that principles of equity and public policy demand that a state that statutorily requires qualification procedures for foreign LLCs should respect the single most important corporate element of LLCs-limited member liability. This same equity argument also should apply where a foreign LLC qualifies to conduct business in a state that has not yet enacted an LLC statute or a foreign LLC statute.

An LLC that transacts business in a state without first qualifying in that state may be prohibited from maintaining an action, suit, or proceeding in that state; may be deemed to have appointed the Secretary of State as its agent for service of process; may be required to pay certain fees, taxes and penalties; and may be ***449** enjoined from transacting business within that state. [FN571] The failure to qualify, however, should not impair the validity of any contract, including a contract among the state of organization, the LLC, and the members, granting the members limited personal liability. [FN572] Consistent with this interpretation, several of the LLC statutes provide that the failure of a foreign LLC to qualify shall not subject the foreign LLC's members to personal liability. [FN573] Similarly, the failure of an LLC to qualify to do business in a foreign state should not cause the LLC's members to become personally liable for the LLC's obligations.

Conflict of Law Rules in Interstate LLC Transactions

In order to determine whether the provisions for limited member liability in the LLC statutes will be recognized when an LLC transacts business in another state, one must analyze the conflict of laws choice of law rules of the foreign state. [FN574] Such an analysis should consider at least three different fact patterns: first, where an LLC organized in one state transacts business in a state that has enacted an LLC statute; second, where an LLC organized in one state transacts business in a state that has enacted a foreign LLC statute; and third, where an LLC organized in one state transacts business in a state that has not enacted an LLC statute or a foreign LLC statute. The first two fact patterns require consideration of the Restatement (Second) Conflict of Laws (the Restatement), while the last fact pattern requires consideration of the Restatement, the common law principle of comity, [FN575] and the Full Faith and Credit Clause [FN576] and the Interstate Commerce Clause [FN577] of the U.S. Constitution.

LLC Interstate Transactions in States with LLC Statutes

The choice of law issue raised in an action against an LLC organized in one state and transacting business in a foreign state with an LLC statute is whether the forum state's courts will adopt the limited liability provisions of the LLC's state of organization. If the forum state is Colorado, Kansas, Texas, or Virginia, the choice of law result is clear. These states' LLC statutes provide that the law ***450** of the state of organization governs the liability of the LLC's members. [FN578] When a forum state provides for a statutory directive on choice of law, such directive is likely to be followed. [FN579]

If the forum state is Nevada, the result is not as clear. Section 551 of Nevada's LLC statute [FN580] provides that a foreign LLC may register with the Secretary of State by complying with sections 570 through 605 of Nevada's Limited Partnership Act, [FN581] which provides for the registration of foreign limited partnerships. [FN582] Section 570 of Nevada's Limited Partnership Act provides that the law of the state under which a foreign limited partnership is organized governs the liability of its members. [FN583] If section 551 of the Nevada LLC statute means that all provisions of sections 570 through 605 of Nevada's Limited Partnership Act are to be applied to LLCs, Nevada's LLC choice of law analysis would be identical to that of Colorado, Kansas, Texas and Virginia, which requires that the law of the LLC's state of organization govern member liability. [FN584]

If, however, section 551 of the Nevada LLC statute is interpreted as applying only those specific registration provisions of Nevada's Limited Partnership Act to LLCs, Nevada's LLC choice of law analysis would be identical to that of Wyoming, Florida and Utah, as those states' LLC statutes do not provide for a statutory directive on choice of law. Under such circumstances, section 6(2) of the Restatement suggests numerous factors for determining whether the forum state should adopt the limited liability provisions of the LLC's state of organization. Section 6(2) of the Restatement provides:

> [W]hen there is no such directive [on choice of law], the factors relevant to the choice of the applicable rule of law include (a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interest of those states in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability and uniformity of result, and (g) ease in the determination and application of the law to be applied. [FN585] ***451** Because the critical “relevant policies of the forum” factor favors limited member liability, it would appear likely that the forum court would apply the limited liability provisions of the LLC's state of organization. [FN586]

LLC Interstate Transactions in States with Foreign LLC Statutes

The second choice of law fact pattern is when a suit is brought by or against a duly organized foreign LLC in a state that requires or allows the registration of foreign LLCs. [FN587] Indiana's foreign LLC statute contains sections on registration requirements, exempt activities, service of process and cancellation of registration. [FN588] The Indiana statute does not, however, expressly contain a choice of law directive indicating that the law of the jurisdiction under which the foreign LLC was organized governs the liability of its members. In such a case, section 6(2) of the Restatement may govern the determination of whether Indiana would recognize the liability limitations of the LLC's state of organization. [FN589] The “relevant policies of the forum” factor again will be critical. The Indiana foreign LLC statute was codified as part of Indiana's limited partnership laws. This may reflect the Indiana legislature's intent to apply the limited partnership liability provisions to LLC members. [FN590]

LLC Interstate Transactions in States without either an LLC Statute or a Foreign LLC Statute

When a suit is brought against an LLC in the courts of a state that has not enacted an LLC statute or a foreign LLC statute, a more expanded analysis may be necessary. Under such circumstances, section 6(2) of the Restatement, the common law principle of comity, and the Full Faith and Credit Clause and the Interstate Commerce Clause of the U.S. Constitution all could be factors in determining whether the forum state would adopt the limited liability provisions of the LLC's state of organization.

Restatement (Second) Conflict of Laws

Because the forum state has not enacted a statutory directive on choice of law, section 6(2) of the Restatement provides the general basis for determining whether the forum state would adopt the limited liability provisions of an LLC's state of organization. [FN591] In addition to these general provisions, however, ***452** the Restatement contains specific provisions for determining the liability of a shareholder to a corporation and the liability of limited and general partners to a limited partnership. [FN592] Because the LLC is a relatively recent creation, the Restatement has not yet provided specific provisions to determine the liability of a member to an LLC. [FN593] Nevertheless, the introductory note to both the Business Corporations and Agency and Partnerships sections of the Restatement provide that to the extent an entity enjoys the same attributes as a business corporation or a partnership, the same choice of law rules should apply. [FN594]

If an LLC member is analogized to a corporate shareholder, section 307 of the Restatement provides that the forum state would adopt the limited liability provisions of the LLC's state of organization. [FN595] If an LLC member is analogized to a limited partner or general partner, however, the Restatement does not provide a dispositive rule as to whether the forum state would adopt the limited liability provisions of the LLC's state of organization. Instead, section 295 of the Restatement indicates that the local law of the state selected by applying the rules under section 6(2) of the Restatement would govern. [FN596] Section 6(2) gives the forum court wide latitude in examining the critical "relevant policies of the forum" factor. Interestingly, in the only reported decision discussing this issue, the court in Abu-Nassar v. Elders Futures, Inc. [FN597] treated an LLC organized under Lebanese law as though it were a foreign corporation for purposes of analyzing choice of law and veil piercing liability. [FN598]

In Abu-Nassar, a creditor of a Lebanese limited liability company brought an action to hold the limited liability company's shareholders personally liable for the limited liability company's debts. In denying the shareholders' motion for ***453** summary judgment, the court took a bifurcated approach to the choice of law issue. [FN599] The court began its analysis by looking to Lebanese law to determine whether the limited liability company complied with Lebanese statutory requirements. [FN600] The court then looked to New York law to determine whether the shareholders' activities justified a piercing of the limited liability company's veil. [FN601] Under each prong of its analysis, the court determined that material issues of fact existed that prevented it from granting the shareholders' summary judgement motion. [FN602] Abu-Nassar is significant because the court indicated that if the shareholders could have demonstrated that the limited liability company had complied with the statutory requirements under Lebanese law, the court would have applied the shareholder limitation of liability provisions of Lebanese law. By analogy, as long as an LLC is validly organized, a forum court should adopt the limited liability provisions of the LLC's state of organization.

Comity

In addition to the choice of law rules under the Restatement, common law principles of comity also may influence whether a forum state without a statute recognizing LLCs will adopt the limited liability provisions of an LLC's state of organization. [FN603] Courts frequently rely on the principles of comity in applying another state's law. [FN604] Comity is defined as "courtesy, complaisance, respect, a willingness to grant a privilege, not as a matter of right, but out of deference and goodwill." [FN605] The U.S. Supreme Court has indicated that comity is neither a matter of absolute obligation, nor of mere courtesy and goodwill. [FN606] Because of the imprecise meaning of the term, courts frequently rely on comity as added support when adopting or rejecting the application of another state's law. [FN607]

For example, in Means v. Limpia Royalties, [FN608] a Texas Court of Civil Appeals refused to apply Oklahoma law to limit the liability of shareholders of a business trust. In Means, the plaintiff brought an action for rescission and cancellation of a mineral deed against an unincorporated association operating under a declaration of trust under Oklahoma law. Both the declaration of trust and Oklahoma law provided that the trustee and shareholders of the trust were entitled to limited liability for any debt, obligation, or demand against the trust, ***454** or arising out of any business transaction of the trust. Texas law, however, did not similarly limit the liability of shareholders of a trust.

In refusing to adopt the limited liability provisions of Oklahoma law, the Texas court reasoned that the established public policy of the forum state was supreme and would not be relaxed upon the grounds of comity to enforce contracts which contravene such policy, even though the contracts were valid where made. [FN609] The court's decision was based on Texas case law holding that shareholders of an unincorporated or joint-stock association are liable to its creditors for the debts of the association. [FN610] The cases relied on by the Means court did not limit shareholder liability because, among other reasons, no one person was personally liable for the obligations of the trust. [FN611] In applying the common law principle of comity to the LLC context, it seems doubtful that comity will provide a consistently predictable basis for a forum court's adoption of the limited liability provisions of the LLC's state of organization.

Full Faith and Credit Clause

The Full Faith and Credit Clause of the U.S. Constitution may also influence whether a forum state without a statute recognizing LLCs will adopt the limited liability provisions of an LLC's state of organization. [FN612] The Full Faith and Credit Clause provides that "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." [FN613]

As a general matter, the Full Faith and Credit Clause does not ensure unlimited extraterritorial recognition of all statutes or of any particular statute under all circumstances. [FN614] In deciding constitutional choice of law issues under the Full Faith and Credit Clause, courts traditionally examine the contacts of the parties and the transactions giving rise to the dispute with the state whose law the court will apply. Such an examination will be used to determine that the choice of law is not arbitrary or fundamentally unfair. [FN615] Under the Full Faith and Credit Clause a court will invalidate the selection of one state's choice of law only if that state has no significant contacts or aggregation of contacts to create a valid state interest. [FN616]

***455** The Full Faith and Credit Clause does not mandate that the forum state adopt the limited liability provisions of the LLC's state of organization. The clause appears to provide only a low-threshold backstop to prevent a forum state from applying its own laws where it has no significant contacts or aggregation of contacts to the LLC. In light of this minimum constitutional protection, it seems curious that the Colorado and Nevada statutes added a section providing that an LLC organized in their state be granted the protection of the Full Faith and Credit Clause when transacting business outside of the state. [FN617] Arguably, the legislature could have made a more forceful recitation of the state's legislative intent without referencing the Full Faith and Credit Clause.

Interstate Commerce Clause

The Interstate Commerce Clause of the U.S. Constitution [FN618] may also influence whether a forum state without a statute recognizing LLCs will adopt the limited liability provisions of an LLC's state of organization. Specifically, the Commerce Clause may bar a forum state from applying its own law, as opposed to the law of an LLC's state of organization, to regulate an LLC's internal affairs. In CTS Corp. v. Dynamics Corp., [FN619] the U.S. Supreme Court held that the Commerce Clause did not bar Indiana from applying its own corporate laws to regulate interstate tender offers. [FN620] The Court reasoned that Indiana's corporate statute did not create an impermissible risk of inconsistent regulation of tender offers by different states, [FN621] that states can regulate the internal corporate governance of locally incorporated entities, [FN622] and that a state of incorporation has an interest in promoting stable relationships between the corporations that it charters and the shareholders thereof. [FN623] Several post-CTS cases, however, have invalidated anti-takeover statutes that applied to foreign corporations on Commerce Clause grounds. [FN624]

***456** Unlike the state tender offer involved in CTS, the application of the law of every state with which an LLC transacts business could result in an impermissible risk of inconsistent regulation. Such a result would run counter to the principles that the state of organization governs an entity's internal corporate governance and the relationship between the entity and its shareholders. Furthermore, an LLC's ability to take advantage of interstate product and capital markets requires recognition of a state of organization rule to determine member liability and other aspects of LLC governance.

CONCLUSION OF MEMBER LIABILITY ANALYSIS IN INTRASTATE AND INTERSTATE LLC TRANSACTIONS

Corporate precedents appear to be the appropriate analogy for determining whether LLC members are entitled to limited liability in intrastate and interstate LLC transactions. Corporate precedents are appropriate because LLC members, like corporate shareholders, are entitled to participate in the management of their entity without losing their limited liability protection. In interstate transactions, the Colorado, Kansas, Texas and Virginia LLC statutes expressly provide that the law of the jurisdiction under which a foreign LLC is organized governs the liability of its members. As for the other forty-six states, the choice of law rules under the Restatement, the common law principle of comity, and the Full Faith and Credit Clause and the Interstate Commerce Clause of the U.S. Constitution all indicate that in actions against an LLC in a foreign jurisdiction, the foreign court should treat the LLC as though it were a foreign corporation and should apply the limited liability provisions of the LLC's state of organization.

EVOLVING USES AND UNIFORMITY
DRAFTING PROJECTS

In January, 1991, the Scope and Program Committee of the National Conference of Commissioners on Uniform State Laws (NCCUSL), in response to letters from the Limited Liability Companies Subcommittee of the Partnerships and Unincorporated Business Organizations Committee of the Business Law Section of the American Bar Association (the Subcommittee on Limited Liability Companies), recommended the commencement of a study project on a Uniform LLC Act. The Executive Committee of NCCUSL approved the recommendation on February 9, 1991, [FN625] and a study committee has been ***457** formed that includes representatives of most of the states that have enacted LLC legislation. [FN626] NCCUSL anticipates that the Study Committee will make its report in 1992. If the report is favorable and the Executive Committee adopts the report, a committee to draft a uniform LLC act may be appointed.

It is anticipated that if NCCUSL undertakes a drafting project, its activities will be guided by the existing statutes and the uniform and model acts upon which the statutes are based. [FN627] As a result of the limited history of LLCs and the differences in the state statutes described above, NCCUSL will have to approach the project without an established and familiar body of statutory law. If NCCUSL undertakes a drafting project, it may choose, as most states have, to draw as many concepts as possible from existing legislation in order to obtain the benefit of both legislative and legal experience, and to maximize certainty and predictability.

In addition to the possible NCCUSL drafting project, a working group of the Subcommittee on Limited Liability Companies is drafting a prototype LLC act. It is anticipated that the group will complete this project by the end of 1992. [FN628]

USE OF LLCS FOR PROFESSIONAL PRACTICE

An important development and one that was not directly addressed by the earliest LLC statutes is the practice of a profession through the LLC form. In particular, attorneys and accountants have expressed a strong interest in practicing as LLCs in order to limit liability for the negligence of others in the same firm [FN629] and to avoid the tax disadvantages of operating in a corporate form. [FN630] Utah and Kansas have provisions in their LLC statutes specifically allowing professionals to practice as LLCs. [FN631] Virginia expressly prohibits such practice. [FN632] Colorado, while not expressly prohibiting such practice, allows an LLC to engage in any business in which a limited partnership may engage. [FN633] This ***458** limitation would presumably exclude professional practices. Similarly, in Arizona, deletion of a proposed provision authorizing the practice of law by LLCs made the Arizona proposed statute more desirable to the general public. [FN634]

The mere enactment of a statute allowing professionals to practice as LLCs would not be sufficient without approval of the agency regulating that profession, customarily, for attorneys, either the state bar association or the highest state court. This process may become more complex as Congress and federal regulatory agencies attempt to ensure the accountability of professionals. [FN635] Thus, as part of the evolution of LLCs, the professions' regulators will have to approve this form of entity.

Because professionals often have complex financial arrangements not susceptible to the simplicity of an S corporation, [FN636] they may be constrained to use a C corporation to limit personal liability. Use of the C corporation, however, will subject the entity to a double level of taxation and a higher tax rate. While the double taxation problem may be minimized by paying large salaries and bonuses, the C corporation may still be an unacceptable tax vehicle for a professional practice. An LLC allows professionals to limit personal liability for the negligence and malfeasance of others in the firm, while avoiding the tax problems of C corporations. To the extent a state has conditioned the limitation on liability on maintenance of professional liability insurance or the number and qualifications of those managing the entity, such requirements could equally be imposed upon LLCs. Thus, concerns over professionals responsibility should not prevent professionals practice in LLC form.

LLCs as Law Firms

While many states have statutes and rules allowing the practice of law by professional corporations, there does not appear to be a specific authorization for the practice of law by partnerships. This may be because courts started regulating the practice in response to the development of professional corporations long after the establishment of law firms organized as partnerships. Under both the ABA Code of Professional Responsibility [FN637] and the ABA Model Rules ***459** of Professional Conduct, [FN638] a lawyer is allowed to practice in a professional corporation which may, depending upon state law, limit the liability of individual lawyers for the errors and omissions of other attorneys (often only if there is appropriate insurance). Currently, only one state entity governing the practice of law has expressly permitted the practice of law by LLCs. [FN639]

LLCs as Accountancy Practices

Unlike the American Bar Association, the American Institute of Certified Public Accountants (AICPA) specifies which entities may engage in the practice of certified accounting. [FN640] On October 20, 1990, the AICPA Council sent a ballot asking members whether to allow the practice of accountancy by LLCs. [FN641] The proposal was overwhelmingly approved. [FN642] The vote changed the provisions of Rule 505 of the AICPA Code of Professional Conduct, which formerly allowed the practice of accountancy only by proprietorships, partnerships, or professional corporations meeting AICPA conditions. By deleting the term professional and making other changes to rule 505, accountants are now allowed to practice accountancy in any form permitted by state law. [FN643] This amendment clearly authorizes the practice of accountancy by LLCs where permitted by ***460** state law. [FN644] The changed rule does not include any minimum capital or insurance requirements. [FN645]

CONCLUSION

There is no question that LLCs can fill an important gap as an alternative business form. To the extent LLCs provide the flexibility and integrated taxation of partnerships, combined with the benefits of limited personal liability, they will be useful as a method of conducting a closely held business. There are two necessary elements for the development of LLCs. First, more states must recognize the LLC to provide certainty with respect to the liability of members. Second, a uniform or model statutory framework must be developed to provide more certainty in transactions with LLCs. The growing number of states considering LLC legislation is providing the former element, while the nationwide study is providing the latter. Given these developments, it appears likely that many more businesses will be looking to the LLC as the preferred business form.

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[FN1]. This interest has extended beyond the legal literature and into the popular press. See, e.g., Jeffrey A. Tannenbaum, Partnership, Corporation Aren't Only Ways to Start Out, Wall St. J., May 14, 1991, at B2; It's Time:

LLCs Make Sense; Let's Do It, Phoenix Gazette, May 21, 1991, editorial.

[FN2]. See, e.g., Priv.Ltr.Rul. 78-17-129 (Jan. 30, 1978) and Priv.Ltr.Rul. 80-03-072 (Oct. 25, 1979) (referring to limitadas organized under the limited liability company laws of Brazil); Priv.Ltr.Rul. 82-21-136 (Feb. 26, 1982) (Gesellschaft mit beschraenkter Haftung (GmbH) organized under the laws of the Federal Republic of Germany); Priv.Ltr.Rul. 78-26-023 (Mar. 28, 1978) (Portuguese "sociedate por quotas de responsibilidade limitada"); Priv.Ltr.Rul. 80-06-086 (Nov. 19, 1979) (limited liability partnerships under Part VII of the Regulations for Companies of the Kingdom of Saudi Arabia, Royal Decree No. M/6, July 20, 1965).

[FN3]. Fla.Stat.Ann. § § 608.401-.471 (West Supp.1991); Wyo.Stat. § § 17-15-101 to -136 (Supp.1989).

[FN4]. Colo.Rev.Stat. § § 7-80-101 to -913 (Supp.1990); Kan.Stat.Ann. § § 17-7601 to -7650 (Supp.1991); Nev.Rev.Stat.Ann. § § 86.011-.571 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 1.01-9.02 (West Supp.1992); Utah Code Ann. § § 48-2b-101 to -156 (Supp.1991); Va.Code Ann. § § 13.1-1000 to -1069 (Michie Supp.1991).

[FN5]. For example, bills have been introduced in Arizona, S.B. 1084, 40th Leg., 2d Reg.Sess., 1992 Ariz.; Hawaii, S.B. 3368, 16th Leg., 1992 Haw.; Illinois, S.B. 1429, 87th Leg., Reg.Sess., 1991 Ill.; Indiana, H.B. 1217, 107th Gen.Ass., 2d Reg.Sess., Ind.1992; Maryland, H.B. 491, 1991 Reg.Sess., 1991 Md.; Michigan, H.B. 5464, 85th Leg., Reg.Sess., 1990 Mich., and H.B. 4902, 86th Leg., Reg.Sess., 1991 Mich.; Oklahoma, S.B. 456, 43rd Leg., 1st Reg.Sess., 1991 Okla.; and Pennsylvania, S.B. 1083, 175th Leg., Reg.Sess., 1991 Pa. The California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions is considering introduction of a proposed California Limited Liability Act. See Letter from Keith T. Schultz, Deputy Legislative Counsel of California, to Stuart Levine, Esq., Cohan & Francomano, Balt., Md. (July 18, 1991) (on file with The Business Lawyer). In addition, groups are studying legislation in Delaware, Georgia, Iowa, Missouri, Minnesota, Montana, New Jersey, New York, Ohio, Rhode Island, South Dakota, and Washington.

[FN6]. Although LLCs will be referred to in this Article as entities, an LLC may as easily be thought of as an aggregate of its members. See infra text accompanying notes 215-19.

[FN7]. See infra text accompanying notes 511-13.

[FN8]. Wyo.Stat. § § 17-15-101 to -136 (Supp.1989).

[FN9]. LLCs, like partnerships, are institutionally transitory and are subject to dissolution upon the occurrence of various events. For a discussion of the limitations on the continuity of life of an LLC as a matter of business law, see infra text accompanying notes 122-23. For a comparison of the current LLC statutes on this point, see infra text accompanying notes 324-31. For a discussion of the tax characterization of this factor, see infra text accompanying notes 353-74.

[FN10]. For a discussion of the limitations on the free transferability of LLC memberships as a matter of business law, see infra text accompanying notes 93-95. For a comparison of the current LLC statutes on this point, see infra text accompanying notes 319-23. For a discussion of the tax characterization of this factor, see infra text accompanying notes 375-86.

[FN11]. For a discussion of the right to participate in the management of an LLC as a matter of business law, see infra text accompanying notes 98-107. For a comparison of the current LLC statutes on this point, see infra text accompanying notes 274-85. For a discussion of the tax characterization of this factor, see infra text accompanying notes 387-403.

[FN12]. See infra text accompanying notes 342-52.

[FN13]. See, e.g., I.R.C. § § 701, 1363(a) (1988).

[FN14]. Id. § § 702, 1366. Under some circumstances, an S corporation may be subject to tax on its income. See id. § § 1374-1375 (imposing entity level taxes on an S corporation for certain built-in gains and passive investment income).

[FN15]. Among the important changes in the taxation of corporations introduced by the Tax Reform Act of 1986, Pub.L. No. 99-154, 100 Stat. 2085, were: the inversion of the corporate and individual rates of tax, see I.R.C. § § 1, 11 (1988); the repeal of the General Utilities doctrine, which prior to 1987 had allowed corporations to distribute appreciated property to shareholders without recognition of corporate-level gain, id. § § 311(b), 336; the abolition of the tax preference for capital gains at the individual level, which had encouraged the accumulation of profits at the then-lower corporate rates, and their distribution at lower capital gains rates on liquidation or redemption, id. § 1202; and the increase in the rate and effectiveness of the corporate alternative minimum tax, id. § § 55-59.

[FN16]. It also should be noted that the Internal Revenue Service (Service) has clarified its position on business trusts, which may be treated as partnerships. See Rev.Rul. 88-79, 1988-2 C.B. 361.

[FN17]. See Unif. Partnership Act § 15 (1914).

[FN18]. Unif. Ltd. Partnership Act § 1 (1916).

[FN19]. Rev. Unif. Ltd. Partnership Act § 101(7) (1985).

[FN20]. Unif. Ltd. Partnership Act § 9(1); Rev. Unif. Ltd. Partnerrship Act § 403(1)

[FN21]. Unif. Ltd. Partnership Act § 7; Rev. Unif. Ltd. Partnership Act § 303.

[FN22]. The S corporation enjoys the advantage of perpetual life. As a corporation, it is not subject to a statute requiring dissolution upon the termination of a member's interest in the entity. As discussed infra text accompanying notes 353-74, an LLC will, for the most part, be structured without continuity of life.

[FN23]. I.R.C. § 1361(b)(1)(D) (1988).

[FN24]. Id. § 1361(b)(1).

[FN25]. Id. § 1361(b)(1). As discussed infra text accompanying notes 342-52, the classification of an entity as a partnership or an association taxable as a corporation is generally based upon the rights of the parties under the parties' initial agreement. Alterations in the form of distributions or the nature or number of owners will not normally result in a reclassification of a partnership. An S corporation, on the other hand, is subject to losing its status as a pass-through entity if it makes inappropriate distributions, if a shareholder transfers to or becomes an ineligible shareholder, or even if the S corporation has too much of the wrong kind of income. See id. § 1361(b)(1)(D) (disqualifying corporation that has more than one class of stock); id. § 1361(b)(1) (those eligible to be shareholders); id. § 1362(d)(3)(A) (terminating corporation's S corporation status due to Subchapter C earnings and profits and an excessive amount of passive investment income); see also James S. Eustice, Subchapter S Corporations and Partnerships: A Search for the Pass-Through Paradigm (Some Preliminary Proposals), 39 Tax L.Rev. 345 (1984); American Bar Association Section of Taxation Committee on S Corporations, Subcommittee on the Comparison of S Corporations and Partnerships, Report on the Comparison of S Corporations and Partnerships (pts. 1 & 2), 44 Tax Law. 483, 813 (1991).

[FN26]. See Wayne M. Gazur & Neil M. Goff, Assessing the Limited Liability Company, 41 Case W.Res.L.Rev. 387, 393-94 (1991).

[FN27]. In Priv.Ltr.Rul. 71-02-100370A (Feb. 10, 1971), the Service ruled that it would classify a limited partnership association engaged in furnishing professional engineering services as an association taxable as a corporation for federal tax purposes. Accord Rev.Rul. 71-434, 1971-2 C.B. 430 (holding that a professional service organization, also an engineering firm, formed as an Ohio limited partnership association, was an association taxable as a corporation). In both cases, the limited partnership association had the corporate characteristics of limited liability, centralized management, and continuity of life. But cf. Priv.Ltr.Rul. 75-05-0290310A (May 29, 1975) (holding that a Michigan partnership association engaged in the oil and gas exploration and production business was a partnership for federal tax purposes).

[FN28]. See Edward R. Schwartz, The Limited Partnership Association-An Alternative to the Corporation for the Small Business with "Control" Problems?, 20 Rutgers L.Rev. 29, 88 (1965); Susan P. Hamill, The Limited Liability Company: A Possible Choice for Doing Business?, 41 Fla.L.Rev. 721 (1989). For a discussion of partnership associations as predecessors of LLCs, see Gazur & Goff, supra note 26, at 393.

[FN29]. For a comparison of LLCs and statutory close corporations, see infra text accompanying notes 131-39.

[FN30]. Model Statutory Close Corp. Supp. § 25 (1984) (providing that failure to observe "usual corporate formalities" is not grounds for imposing personal liability on the shareholders for obligations of corporation); id. § 2 (incorporating all provisions of the MBCA and the RMBCA not inconsistent with the Model Statutory Close Corp. Supp.).

[FN31]. Id. § 11(b)(3).

[FN32]. Id. § 33.

[FN33]. See infra text accompanying notes 342-52.

[FN34]. In Gen. Couns. Mem. 37,127 (May 18, 1977) and Gen. Couns. Mem. 37,953 (May 14, 1979), the Chief Counsel of the Service determined that an incorporated entity could not be treated as a partnership for federal tax purposes. Citing Dartmouth College v. Woodward, 17 U.S. 518, 636 (1819), these memorandums held that a corporation must (1) be a legal entity, (2) derive its existence from a charter granted by a sovereign, and (3) be able to maintain its existence and identity throughout a continually occurring succession of persons having interests in it. Any entity meeting these standards would be considered a corporation and therefore not an "unincorporated entity," a prerequisite for partnership classification. After a false start, the Service followed this approach. In Priv.Ltr.Rul. 79-18-056 (Jan. 30, 1979), the Service ruled that a close corporation organized under Arizona law would be treated as a corporation for federal tax purposes. This determination was made using the conventional four-characteristic test. See infra text accompanying notes 342-50. In Priv.Ltr.Rul. 79-21-084 (Feb. 27, 1979), the Service reconsidered the same case and adjusted its rationale to hold that an "incorporated" entity could never be classified as a partnership for tax purposes. The ruling stated:

> [W]e still conclude that X2 will be classified as a corporation for federal income tax purposes, but now believe the following rationale should be used to reach that conclusion.
>
> ....
>
> An entity that is "incorporated" as that term was used at common law cannot be a partnership within the meaning of sections 761(a) and 7701(a)(2) of the Code. An incorporated entity must be a corporation within the meaning of section 7701(a)(3) of the Code irrespective of whether it meets the standards set forth in section 301.7701-2 of the regulations for classification as an association taxable as a corporation.

Id.

[FN35]. Act of March 4, 1977, ch. 155, 1977 Wyo.Sess.Laws 512.

[FN36]. See Thomas N. Long, The Wyoming Limited Liability Company 9-10 (1989) (unpublished paper available from Wyoming Secretary of State).

[FN37]. Priv.Ltr.Rul. 81-06-082 (Nov. 18, 1980).

[FN38]. Prop.Treas.Reg. § 301.7701-2, 45 Fed.Reg. 75,709 (1980).

[FN39]. I.R.S. News Release, IR-82-145 (Dec. 16, 1982).

[FN40]. Id.

[FN41]. Fla.Stat.Ann. 608.401-.471 (West Supp.1991).

[FN42]. See, e.g., Fla.Stat.Ann. § 608.441(1)(c) (West Supp.1991) (allowing LLC to continue by consent of its members or by an explicit right in charter despite, among other things, the death, retirement, or resignation of member). This language may result in tax consequences different from those resulting from the Wyoming statute. See infra text accompanying notes 361-64.

[FN43]. See Long, supra note 36, at 9-10.

[FN44]. See Richard Johnson, Comment, The Florida Limited Liability Company Act, 11 Fla.St.U.L.Rev. 387 (1983).

[FN45]. In the first year after its enactment, only two LLCs were formed under the Florida statute. See id. at 388.

[FN46]. See infra notes 342-509 and accompanying text.

[FN47]. See infra notes 510-624 and accompanying text.

[FN48]. Announcement 88-118, 1988-38 I.R.B. (Sept. 19, 1988).

[FN49]. Rev.Rul. 88-76, 1988-2 C.B. 360.

[FN50]. Gen. Couns. Mem. 39,798 (October 18, 1989).

[FN51]. Colo.Rev.Stat. § § 7-80-101 to -913 (Supp.1990); see John R. Maxfield et al., Colorado Enacts Limited Liability Legislation, 19 Colo.Law. 1029 (1990).

[FN52]. Kan.Stat.Ann. § § 17-7601 to -7650 (Supp.1991); see Alson R. Martin, The Kansas Limited Liability Act-Business and Tax Considerations, J. Kan. Bar Ass'n, Oct. 1990, at 17.

[FN53]. Ind.Code Ann. § 23-16-10.1-1 (Burns Supp.1991).

[FN54]. Va.Code Ann. § § 13.1-1000 to -1069 (Michie Supp.1991); see Allan G. Donn, Limited Liability Company: The New Form of Business Organization, Va.Bus.Law., Spring 1991, at 8.

[FN55]. Utah Code Ann. § § 48-2b-101 to -156 (Supp.1991).

[FN56]. Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 1.01-9.02 (West Supp.1992).

[FN57]. Nev.Rev.Stat.Ann. § § 86.011-.571 (Michie Supp.1991).

[FN58]. See supra note 5 and accompanying text.

[FN59]. Of course, each member is personally liable under personal guarantees or for torts committed by that member.

[FN60]. The exception is Colorado. See Colo.Rev.Stat. § 7-80-401 (Supp.1990); see also Curtis J. Braukmann, Comment, Limited Liability Companies, 39 Kan.L.Rev. 967, 978-80 (1991).

[FN61]. See infra text accompanying notes 342-52 for a discussion of tax classification issues.

[FN62]. See infra text accompanying notes 243-48 for a discussion of the information and disclosure requirements of LLCs. See infra text accompanying notes 304-09 for a discussion of the record-keeping requirements of LLCs.

[FN63]. In comparing the characteristics of LLCs with those of the other major business forms, it is necessary to consider that the LLC statutes have not settled on any clear overall approach.

[FN64]. See infra text accompanying notes 239-48.

[FN65]. For a discussion of the application of veil-piercing to LLCs, see infra text accompanying notes 536-57.

[FN66]. See Rev. Model Business Corp. Act § 6.02(c). This requirement can cause some uncertainty and confusion where shares within a class or series are not treated alike, such as by discriminating among holders. See Amalgamated Sugar Co. v. NL Indus., Inc., 644 F.Supp. 1229, 1235-36 (S.D.N.Y.1986); Bank of N.Y. Co. v. Irving Bank Corp., 536 N.Y.S.2d 923, 924-25 (N.Y.Sup.Ct.1988).

[FN67]. See Rev. Model Business Corp. Act § 6.01.

[FN68]. See id. § 6.21.

[FN69]. See Del.Code Ann. tit. 8, § 152 (1991) (consideration for shares may be paid only in form of "cash, services rendered, personal property, leases of real property or a combination thereof").

[FN70]. See Rev. Model Business Corp. Act § 6.21(b) (providing that consideration may consist of "any tangible or intangible property or benefit to the corporation").

[FN71]. This fact is largely tax-related. See infra text accompanying notes 375-86.

[FN72]. See infra text accompanying notes 253-55.

[FN73]. See Rev. Model Business Corp. Act § 6.22(a).

[FN74]. See infra text accompanying note 260.

[FN75]. The shareholders' or members' liability to the entity could be enforced by a bankruptcy trustee, but this would technically involve enforcement of the entity's cause of action rather than one directly on behalf of creditors. For a discussion of LLC members' liability for the obligations of the entity, see infra text accompanying notes 510-624.

[FN76]. See Rev. Model Business Corp. Act § 6.22(a) (providing that share purchaser is not liable "to the corporation or its creditors" except to pay consideration for which shares were issued).

[FN77]. See Hospes v. Northwestern Mfg. & Car Co., 50 N.W. 1117, 1120-21 (1892). For a criticism of Hospes, see Larry E. Ribstein, Business Organizations 663 (2d ed. 1990).

[FN78]. See Rev. Model Business Corp. Act § 6.22 (shareholder liable for "consideration for which shares were authorized to be issued," referring to id. § 6.21(d), which provides that "when the corporation receives the consideration for which the board of directors authorized the issuance of shares, the shares issued therefor are fully paid and nonassessable").

[FN79]. Unlike the RMBCA, the Delaware statute, Del.Code Ann. tit. 8, § 162 (1983), provides for liability for the "consideration payable," which may refer to an amount, such as that disclosed in the financial statements or par value, beyond what the shareholder agreed to pay. See Ernest L. Folk, III et al., Folk on the Delaware General Corporation Law § 162.1, at 312 (2d ed. 1988); Carlos L. Israels, Problems of Par and No Par Shares: A Reappraisal, 47 Colum.L.Rev. 1279 (1947).

[FN80]. Some LLC statutes follow the ULPA in not requiring reliance. Compare Unif. Ltd. Partnership Act § 17(3) (1916) with Rev. Unif. Ltd. Partnership Act § 502(c) (1985). See Fla.Stat.Ann. § 608.435(3) (West Supp.1991); Kan.Stat.Ann. 17-7619(c) (Supp.1991); Nev.Rev.Stat.Ann. § 86.391(3) (Michie Supp.1991) (creditors may set aside a compromise regardless of reliance); Utah Code Ann. § 48-2b-133(3) (Supp.1991); Wyo.Stat. § 17-15-121(d) (Supp.1989). But see Colo.Rev.Stat. 7-80-502(2) (Supp.1990); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.02(D) (West Supp.1992) (only creditors having relied upon contribution obligation may set aside compromise or waiver); Va.Code Ann. § 13.1-1027C (Michie Supp.1991). See infra text accompanying notes 262-66.

[FN81]. The compromise of contribution obligations might, however, reduce the amount of agreed consideration to the point that the amount would be fraudulently low, or might constitute a fraudulent conveyance to the shareholder if the firm is insolvent or in poor financial condition at the time of the compromise. See Unif. Fraudulent Conveyance Act § 1 (1918) ("conveyance" defined to include a "release").

[FN82]. See infra text accompanying note 248.

[FN83]. See Rev. Model Business Corp. Act § 6.01(a).

[FN84]. By agreement, LLC members may waive or vary such an allocation. See infra text accompanying note 298.

[FN85]. In both the LLC and the corporation there also may be uncertainty concerning the monetary value of non-cash contributions.

[FN86]. See Rev. Model Business Corp. Act § 6.21(c) (board's determination of adequacy of consideration is "conclusive").

[FN87]. See infra text accompanying notes 260-62.

[FN88]. See Rev. Model Business Corp. Act § 8.33.

[FN89]. See infra text accompanying note 261.

[FN90]. Although there is not shareholder liability for distributions, the RMBCA prohibits distributions from being made if the corporation would not subsequently be able to pay its debts arising in the usual course of business. See Rev. Model Business Corp. Act § 6.40.

[FN91]. See, e.g., Delaware Code Ann. tit. 8, § § 170(a), 173, 174 (1983 & Supp.1990).

[FN92]. The justification for liability is not strong for either type of statute, since creditors rarely rely on member contributions, as distinguished from the firm's general financial condition. For a criticism of comparable provisions in limited partnership statutes, see Larry E. Ribstein, An Applied Theory of Limited Partnership, 37 Emory L.J. 835, 886-89 (1988).

[FN93]. See, e.g., Frandsen v. Jensen-Sundquist Agency, Inc., 802 F.2d. 941, 946 (7th Cir.1986) (holding right of first refusal inapplicable).

[FN94]. See, e.g., Rafe v. Hindin, 288 N.Y.S.2d 662, 665 (N.Y.App.Div.) (holding consent restriction against public policy), aff'd mem., 244 N.E.2d 469 (N.Y.1968).

[FN95]. See infra text accompanying notes 319-23 for a general discussion on the limitations of LLC transferability. See infra text accompanying notes 375-86 for a discussion on the effect of transferability restrictions on the classification of an LLC as a partnership for tax purposes.

[FN96]. See supra text accompanying notes 93-95.

[FN97]. See infra text accompanying notes 299-302.

[FN98]. See Rev. Model Business Corp. Act § 7.32.

[FN99]. See Colo.Rev.Stat. § 7-80-401 (Supp.1990); see also infra text accompanying note 279.

[FN100]. See infra notes 274-85 and accompanying text.

[FN101]. See infra text accompanying notes 387-403.

[FN102]. See infra notes 131-39 and accompanying text.

[FN103]. See infra text accompanying note 274.

[FN104]. For an example of the confusion that can result from such formal requirements in the close corporation context, see Zion v. Kurtz, 405 N.E.2d 681, 682, 688-91 (N.Y.1980) (close corporation management agreement enforced over strong dissent, despite failure to comply with Delaware close corporation statute).

[FN105]. It is not yet clear whether and to what extent such restrictions on member authority will bind creditors of the LLC. See infra text accompanying notes 282-84.

[FN106]. See infra text accompanying note 287.

[FN107]. See infra text accompanying note 297. For a comparison between LLCs and partnerships in this respect, see infra text accompanying notes 171-73.

[FN108]. See infra text accompanying notes 292-95.

[FN109]. See Rev. Model Business Corp. Act § 8.61-.63.

[FN110]. See id. § 2.02(b)(4).

[FN111]. See id. § 8.50-.58.

[FN112]. See Colo.Rev.Stat. § 7-80-410 (Supp.1990) (where member acted in good faith and reasonably believed actions were not opposed to LLC's best interests); Fla.Stat.Ann. § 608.404(11) (West Supp.1991) (no restrictions); Kan.Stat.Ann. § 17-7604(j) (Supp.1991) (no restrictions); Nev.Rev.Stat.Ann. § 86.411 (Michie Supp.1991) (where member acted in good faith and reasonably believed actions were not opposed to LLC's best interests); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.20 (West Supp.1992) (same extent as corporation); Utah Code Ann. § 48-2b-155 (Supp.1991) (limited to managers who are successful in action); Va.Code Ann. § 13.1-1009(16) (Michie Supp.1991) (same extent as corporation); Wyo.Stat. § 17-15-104(xi) (Supp.1989) (except to the extent the individual is guilty of negligence or misconduct).

[FN113]. Even this is debatable. See Henry N. Butler & Larry R. Ribstein, Opting Out of Fiduciary Duties: A Response to the Anti-Contrarians, 65 Wash.L.Rev. 1 (1990).

[FN114]. See Utah Code Ann. § 48-2b-150 to -154 (Supp.1991) (apparently only when managed by managers); Va.Code Ann. § 13.1-1042 to -1045 (Michie Supp.1991).

[FN115]. See infra text accompanying notes 180-83.

[FN116]. For a good discussion of arguments for mandatory demand, see Kamen v. Kemper Fin. Serv., Inc., 908 F.2d 1338, 1341-47 (7th Cir.1990), rev'd, 111 S.Ct. 1711 (1991).

[FN117]. See, e.g., Rev. Model Business Corp. Act § 7.40(b). “Whether or not a demand for action was made, if the corporation commences an investigation of the charges made in the demand or complaint, the court may stay the proceeding until the investigation is completed.” Id.

[FN118]. See 2 Alan R. Bromberg & Larry E. Ribstein, Bromberg & Ribstein on Partnership § 6.08(c)9 (1988 & Supp.) (discussing actions by partners that are treated as on behalf of partnership, and therefore analogous to derivative actions).

[FN119]. It is an open question whether all members should be necessary parties to such an action. One might analogize an LLC to a corporation, where the only necessary party (other than the alleged malefactor) is the corporation, based upon the fact that a shareholder's interest is a passive one. To the extent that an LLC resembles a partnership as a result of the combination of economic and management interests, particularly in a member-managed LLC, it may be more appropriate to require that all members be named as parties to a derivative action, as all partners are required to participate in an accounting. See id. § 6.08(d).

[FN120]. See Rev. Model Business Corp. Act § 14.02.

[FN121]. See id. § 14.03.

[FN122]. See infra text accompanying notes 326-31.

[FN123]. See infra notes 353-74 and accompanying text.

[FN124]. For a discussion of LLC formalities on dissolution, see infra notes 337-41 and accompanying text.

[FN125]. See Rev. Model Business Corp. Act § 14.06-.07.

[FN126]. See Kan.Stat.Ann. § 17-7650 (Supp.1991); Utah Code Ann. § 48-2b-149 (Supp.1991). Because the Texas LLC Act defines an LLC as an "other entity" for purposes of the Texas Business Corporation Act, it thereby allows a Texas LLC to participate in, and be the surviving entity of, a merger with a Texas Corporation. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 8.12 (West Supp.1992). It is unclear whether a Texas LLC could merge without the involvement of a corporation. The Virginia statute provides rules dealing with the merger of foreign LLCs, but does not provide rules for the merger of domestic LLCs. Va.Code Ann. § 13.1-1060 (Michie Supp.1991).

[FN127]. See infra notes 565-73 and accompanying text.

[FN128]. See Rev. Model Business Corp. Act § 15.01(2).

[FN129]. See infra notes 578-86 and accompanying text.

[FN130]. See supra note 2.

[FN131]. See infra notes 319-23 and accompanying text (comparing LLC statutes) and notes 375-86 and accompanying text (discussing importance of transfer restrictions for partnership tax classification).

[FN132]. See Del.Code Ann. tit. 8, § § 350-351, 354-355 (1983); Rev. Model Business Corp. Act § 7.32; Model Statutory Close Corp.Supp. § § 20-21 (1984).

[FN133]. See supra note 104 and accompanying text.

[FN134]. See Rev. Model Business Corp. Act § 7.32(a)(8) (agreement cannot contravene "public policy"); id. § 7.32 cmt. 1 (provision is limited to types of agreements provided for and, specifically, does not expand ability to opt out of fiduciary duties).

[FN135]. See Del.Code Ann. tit. 8, § 344 (1983).

[FN136]. See Rev. Model Business Corp. Act § 7.32(b). The shareholders' agreement will not be effective against any subsequent purchaser who does not have knowledge of the agreement and will cease to be effective as against all shareholders when the shares become listed on a national exchange. See id. § 7.32(c)-(d).

[FN137]. See infra text accompanying notes 232-48.

[FN138]. See Md. Corps. & Ass'ns Code Ann. § § 4-503, 4-602 to -606 (1985); Model Statutory Close Corp.Supp. § § 11-12 (1984) (providing for share transfer restriction but permitting company to specify permitted transfers in articles of incorporation); N.Y.Bus.Corp.Law § § 1104-a, 1118 (McKinney 1986 & Supp.1991) (providing for dissolution on grounds of fraud and oppression and for right of buy-out at "fair value" of plaintiff's shares, applicable to firms that do not have publicly traded shares); Rev. Model Business Corp. Act § 14.34 (providing for "fair value" buy-out where oppression action brought in firm that has no publicly traded shares). For a case in which the statutory buy-out price was held to control over the parties' share transfer agreement, see In re Pace

Photographers, Ltd., 525 N.E.2d 713, 718 (N.Y.1988).

[FN139]. For the leading case, see Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 511-21 (Mass.1975). It is not clear whether parties can waive the Donahue rule by a provision in the bylaws or other specific agreement. See Rainer L.C. Frost, Note, Contractual Disclaimer of the Donahue Fiduciary Duty: The Efficacy of the Anti-Donahue Clause, 26 B.C.L.Rev. 1215, 1217 (1985).

[FN140]. The older limited partnership statutes required more elaborate certificate disclosures than the most recent uniform act. The earliest LLC statutes follow the old limited partnership form, while the more recent statutes follow the 1985 RULPA format. Compare Rev. Unif. Ltd. Partnership Act § 201(a) (1985) with Unif. Ltd. Partnership Act § 2(1) (1916).

[FN141]. Commentators have criticized limited partnership statutes for imposing liability for the return and compromise of contributions that are unnecessary to protect creditors. See Ribstein, supra note 92. Consistent with this criticism, the Georgia statute does not provide for such liability. If limited partnership statutes change in this way, LLC statutes modeled on these statutes probably will follow suit.

[FN142]. See Ribstein, supra note 92, at 849-50.

[FN143]. See id. at 881-82 (contrasting limited partnerships and corporations in this respect).

[FN144]. See Unif. Ltd. Partnership Act § 7; Rev. Unif. Ltd. Partnership Act § 303.

[FN145]. See Joseph J. Basile, Jr., Limited Liability for Limited Partners: An Argument for the Abolition of the Control Rule, 38 Vand.L.Rev. 1199 (1985); Ribstein, supra note 92, at 882-86.

[FN146]. See Ga.Code Ann. § 14-9-303 (Michie 1989). “A limited partner is not liable for the obligations of a limited partnership by reason of being a limited partner and does not become so by participating in the management or control of the business.” Id. Although this aspect of the statute apparently concerned the Service, the Service has recently determined that the Georgia limited partnership statute corresponds to ULPA for purposes of the classification regulations. Rev.Rul. 91-51, 1991-38 I.R.B. 4.

[FN147]. See infra note 511 and accompanying text.

[FN148]. The Virginia statute provides for a business judgment rule for members and managers, as well as a limitation of liability for breach of the duty, but does not clarify liability for self-dealing. See Va.Code Ann. § 13.1-1024 to -1025 (Michie Supp.1991).

[FN149]. See Wyler v. Feuer, 149 Cal.Rptr. 626, 632-33 (1979).

[FN150]. See supra text accompanying note 142.

[FN151]. See infra text accompanying notes 321-23.

[FN152]. See infra notes 375-86 and accompanying text.

[FN153]. See Rev. Unif. Ltd. Partnership Act § 401 (1985) (admission of general partner); id. § 704 (right of assignee of limited partnership interest to become limited partner).

[FN154]. See id. § 401 (additional general partners may be admitted “as provided in writing in the partnership agreement”); id. § 704(a) (assignor may give assignee of limited partnership interest the right to become limited partner “in accordance with authority described in the partnership agreement”). Although § 401 of RULPA only refers to “additional” general partners, any question that the same rule applies to a transfer of interests is eliminated by § 18(g) of the UPA which provides: “subject to any agreement between [the partners] ... (g) No person can become a member of a partnership without the consent of all the partners.” Unif. Partnership Act § 18(g) (1914). “Agreement” in the lead-in to the section obviously is distinguishable from contemporaneous “consent” in subsection (g). The UPA applies to limited partnerships to the extent that there is no inconsistent limited partnership act provision. See id. § 6(2); Rev. Unif. Ltd. Partnership Act § 1105 (1985).

For an argument that a contemporaneous consent requirement existed under prior versions of ULPA, see Joseph J. Basile, Jr., Admission of Additional and Substitute General Partners to a Limited Partnership: A Proposal for Freedom of Contract, 1984 Ariz.St.L.J. 235; see also Gazur & Goff, supra note 26, at 414-15 (comparing LLCs and limited partnerships in this respect).

[FN155]. See infra text accompanying notes 326-31.

[FN156]. See Rev. Unif. Ltd. Partnership Act § 801(4). For a discussion comparing limited partnerships and LLCs in this respect, see Gazur & Goff, supra note 26, at 420-24.

[FN157]. See infra text accompanying notes 375-86.

[FN158]. See infra notes 353-74 and accompanying text.

[FN159]. See Unif. Partnership Act § § 6-7.

[FN160]. See infra text accompanying note 298.

[FN161]. See infra text accompanying notes 421-32 for a discussion of the tax consequences of a member's receipt of an ownership interest in an LLC in exchange for services.

[FN162]. LLCs differ from partnerships in that LLC members cannot "pre-agree" to allow the transfer of interests. See supra notes 151-54 and accompanying text.

[FN163]. See infra text accompanying notes 375-86.

[FN164]. See infra text accompanying notes 299-302.

[FN165]. See Unif. Partnership Act § 38(2)(c) (wrongfully withdrawing partner not entitled to be compensated for goodwill of continuing firm).

[FN166]. See infra text accompanying note 302.

[FN167]. See infra text accompanying note 299. The effect of this difference is unclear. While it means that withdrawing LLC members have to wait more than six months after their decision to withdraw to receive the value of their interests, partners may have to wait even longer for the firm to be wound up. The other main consequence of withdrawal in the partnership context is that the withdrawing partner is not liable for partnership debts to creditors who are aware of the withdrawal. See Unif. Partnership Act § 35. This, of course, is not a factor with respect to LLC members.

[FN168]. See Unif. Partnership Act § 18(e).

[FN169]. See supra notes 100-01 and accompanying text.

[FN170]. For a discussion of the reasons for member-management in LLCs, see supra text accompanying notes 103-04.

[FN171]. See Unif. Partnership Act § 18(e).

[FN172]. See infra text accompanying note 297.

[FN173]. See supra text accompanying note 160.

[FN174]. See Unif. Partnership Act § § 9-14.

[FN175]. See id. § 9(4).

[FN176]. See id. § 20.

[FN177]. See id. § 21.

[FN178]. The exception is the Virginia statute, which provides for a business judgment rule for members and managers, as well as a limitation of liability for breach of the duty, but does not clarify liability for self-dealing. See Va.Code Ann. § 13.1-1024 to -1025 (Michie Supp.1991).

[FN179]. See Unif. Partnership Act § 6(2); Rev. Unif. Ltd. Partnership Act § 1106.

[FN180]. See Unif. Partnership Act § 22.

[FN181]. See 2 Bromberg & Ribstein, supra note 118, § 6.08(d).

[FN182]. See id. § 6.08(c).

[FN183]. See Colo.Rev.Stat. § 7-80-712(c) (Supp.1990).

[FN184]. Note, however, that the procedural rules governing the prosecution of a derivative action and the joinder of members of an unincorporated association and claims may result in the equivalent of an accounting action. See Fed.R.Civ.P. 23.1. The Utah and Virginia LLC statutes permit derivative claims. See supra note 114.

[FN185]. See infra text accompanying notes 326-31.

[FN186]. See Unif. Partnership Act § 38(2). Unlike a general partnership, however, in most states the members of an LLC cannot "pre-agree" to a continuation of the LLC. See supra notes 151-54 and accompanying text, 162-63 and accompanying text.

[FN187]. See Fairway Dev. Co. v. Title Ins. Co., 621 F.Supp. 120, 122-25 (N.D.Ohio 1985) (successor partnership not entitled to sue under policy guaranteeing title of original partnership); Frederick C. Smith Clinic v. Lastrapes, 170 N.E.2d 497, 500-02 (Ohio Ct.App.1959) (non-competition covenant of employee unenforceable after change in firm's membership where contract provided for automatic termination on dissolution of firm); Larry E. Ribstein, A Statutory Approach to Partner Dissociation, 65 Wash.U.L.Q. 357, 370-71 (1987); 2 Bromberg & Ribstein, supra note 118, § 7.14(b).

[FN188]. See Unif. Partnership Act § 40.

[FN189]. See supra note 126 and accompanying text.

[FN190]. See Unif. Partnership Act § 41(4) (1914). On the other hand, if a corporation or other entity acquires a general partnership's assets, the result is either a sale of assets or a merger, depending on whether the new firm agrees to acquire the partnership's liabilities. See id. § 41(1)-(3).

[FN191]. See infra notes 558-624 and accompanying text.

[FN192]. See 15 U.S.C. § § 77b, 78c. The United States Supreme Court has ruled that stock constitutes a security regardless of the fact that 100% of the stock of the corporation is being sold. Landreth Timber Co. v. Landreth, 471 U.S. 681, 694-97 (1985). Because an LLC is not an incorporated entity, its memberships should not be subject to this per se rule.

[FN193]. SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

[FN194]. For a leading case involving licensees who effectively relied on the promoter to be a sales agent, see SEC

v. Aqua-Sonic Products Corp., 687 F.2d 577, 582-84 (2d Cir.), cert. denied sub nom. Hecht v. SEC, 459 U.S. 1086 (1982).

[FN195]. For a leading case applying this rule, see Williamson v. Tucker, 645 F.2d 404, 422-26 (5th Cir.), cert. denied, 454 U.S. 897 (1981). For cases applying Williamson, see Youmans v. Simon, 791 F.2d 341, 346-47 (5th Cir.1986) (no security where investors were sophisticated and had power to terminate venture and replace manager); Casablanca Productions, Inc. v. Pace Int'l Research, Inc., 697 F.Supp. 1563, 1567 (D.Or.1988) (no security because plaintiff had sufficient business expertise to enforce partnership rights).

[FN196]. See Goodwin v. Elkins & Co., 730 F.2d 99, 103-05 (3d Cir.), cert. denied, 469 U.S. 831 (1984).

[FN197]. See Williamson, 645 F.2d at 422-26; Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 240-42 (4th Cir.1988); Koch v. Hankins, 928 F.2d 1471, 1479-81 (9th Cir.1991).

[FN198]. See Larry E. Ribstein, Private Ordering and the Securities Laws: The Case of General Partnerships, 42 Case W.Res.L.Rev. 1 (1992).

[FN199]. 11 U.S.C. § 109(b), (d), (f) (1988).

[FN200]. 11 U.S.C.A. § 101(41) (West Supp.1991).

[FN201]. Id. § 101(9).

[FN202]. Id.

[FN203]. Unif. Partnership Act § 6(2) (1914).

[FN204]. See supra text accompanying notes 140-58.

[FN205]. I.R.C. § 7701(a)(3) (1988) defines "corporation" as including an "association." The key classification regulation, Treas. Reg. § 301.7701-2 (as amended in 1983), governs the determination of what constitutes an "association." See infra notes 342-52.

[FN206]. See Unif. Partnership Act § 6(1). Similarly, one LLC statute defines an LLC as "an entity that is an unincorporated association." See Va.Code Ann. § 13.1-1002 (Michie Supp.1991).

[FN207]. See 11 U.S.C. § 548(b) (1988) (transfer by partnership may be avoided only if made by "insolvent" debtor or if transfer rendered partnership insolvent; "insolvent" defined in 11 U.S.C.A. § 101(32)(B) (West Supp.1991) to take into account general partners' non-partnership property); 11 U.S.C. § 723 (1988) (partners' duty to contribute toward debts of insolvent partnership).

[FN208]. Voluntary proceedings are provided for in 11 U.S.C. § 301 (1988), which is silent concerning requirements for approval by corporations.

[FN209]. See In re Bel Air Assocs., Ltd., 4 B.R. 168, 171 (Bankr.W.D.Okla.1980).

[FN210]. See 11 U.S.C. § 303(b)(3) (1988). This similarity between member-managed LLCs and general partnerships should not, however, necessarily result in LLCs being characterized as partnerships for other purposes under the Bankruptcy Code, as the same problem applies to other forms of closely held businesses identified in the Code as "corporations," including partnership associations, joint-stock companies and, indeed, closely held corporations in which there is no, or only a weak, board of directors.

[FN211]. See infra text accompanying note 326.

[FN212]. See 2 Bromberg & Ribstein, supra note 118, § § 7.52-.53.

[FN213]. See infra text accompanying notes 511-15.

[FN214]. See Ga.Code Ann. § 14-8-31 (Michie 1989).

[FN215]. See 1 Bromberg & Ribstein, supra note 118, § 1.03.

[FN216]. Id. § § 1.22-.23.

[FN217]. The exception is Virginia, which defines "limited liability company" as "an entity that is an unincorporated association." Va.Code Ann. § 13.1-1002 (Michie Supp.1991). In the 1991 amendments to the Kansas statute, § 17-7603(b) was added providing that "[a] limited liability company formed under this act shall be a separate legal entity and shall not be construed as a corporation."

[FN218]. For a review of partnership issues affected by the aggregate-entity characterization, see 1 Bromberg & Ribstein, supra note 118, § 1.03(c).

[FN219]. See Unif. Partnership Act § 25(1) (stating that partner is co-owner with other partners of specific partnership property holding as tenant in partnership). Although § 25(2) of the UPA provides that partners lack most incidents of ownership, characterizing the partners as owners has some important consequences, such as precluding application of embezzlement statutes to the partners' taking of firm property. See id. § 25(2); 1 Bromberg & Ribstein, supra note 118, § § 3.40-.41.

[FN220]. The following uses of LLCs were noted in Robert B. Webb, Organizing and Operating the Limited Liability Company, in Limited Liability Companies: the Newest Game in Town 29-31 (Fairfax, Va. Bar Assoc., June 19, 1991).

[FN221]. The use of LLCs to avoid bankruptcy supports one writer's argument that, but for current tax considerations and restrictions on a corporation's ability to opt out of bankruptcy, many firms would avoid traditional debt and issue obligations that let the holders control an insolvent firm. See Barry E. Adler, The Uneasy Case for Corporate Bankruptcy (Working Paper, Emory University School of Law, 1991). Unless LLCs are characterized as partnerships, the problem is that LLC managers may be able to put the firm in bankruptcy over the objection of a senior class of membership interests. See supra text accompanying notes 200-10 for a discussion of the classification of LLCs as partnerships in bankruptcy.

[FN222]. See supra text accompanying note 132.

[FN223]. See infra text accompanying notes 629-45.

[FN224]. See supra notes 159-91 and accompanying text.

[FN225]. See Ribstein, supra note 92, at 847.

[FN226]. Partnership liability continues even after dissolution to creditors who do not have knowledge or notice of the dissolution. See Unif. Partnership Act § 35 (1914).

[FN227]. See Unif. Partnership Act (Draft for Partial Approval 1991).

[FN228]. See Larry E. Ribstein, A Mid-Term Assessment of the Project to Revise the Uniform Partnership Act, 46 Bus.Law. 111 (1990) (commenting on an earlier draft).

[FN229]. The LLC statutes considered in this section are those of Colorado, Florida, Kansas, Nevada, Texas, Utah, Virginia, and Wyoming. Colo.Rev.Stat. § § 7-80-101 to -913 (Supp.1990); Fla.Stat.Ann. § § 608.401-.471 (West Supp.1991); Kan.Stat.Ann. § § 17-7601 to -7650 (Supp.1991); Nev.Rev.Stat.Ann. § § 86.011-.571 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 1.01-9.02 (West Supp.1992); Utah Code Ann. § § 48-2b-101 to -156 (Supp.1991); Va.Code Ann. § § 13.1-1000 to -1069 (Michie Supp.1991); Wyo.Stat. § § 17-15-101 to -136 (Supp.1989).

[FN230]. For a discussion of the business aspects of LLCs, see supra text accompanying notes 59-228. For a discussion of tax ramifications of LLCs, see infra text accompanying notes 342-509.

[FN231]. For a comparison of LLCs to other business entities, see supra text accompanying notes 63-191.

[FN232]. For a discussion of the tax ramifications of the membership requirements in the various statutes, see infra text accompanying notes 404-11.

[FN233]. Colo.Rev.Stat. § 7-80-203(1).

[FN234]. Fla.Stat.Ann. § 608.405; Nev.Rev.Stat.Ann. § 86.151 (1991); Utah Code Ann. § 48-2b-103; Wyo.Stat. § 17-15-106. The Utah LLC Act requires the LLC to be formed by two persons. The statute, however, does not indicate whether it is necessary for the LLC to have more than one member or whether the persons forming the LLC must be members. See Utah Code Ann. § 48-2b-103.

[FN235]. Colo.Rev.Stat. § 7-80-203; Kan.Stat.Ann. § 17-7605 (1991 amendment substituted "Any person may form a limited liability company, which shall have two or more members," for "[t]wo or more persons may form a limited liability company"); Va.Code Ann. § 13.1-1010.

[FN236]. Colo.Rev.Stat. § 7-80-203; Kan.Stat.Ann. § 17-7605; Va.Code Ann. § 13.1-1002 (defining "limited liability company" as an unincorporated association having two or more members). For the effect of the number of members at formation, see infra text accompanying notes 404-11.

[FN237]. See Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.04 (appears to permit continuation of LLC after dissolution if there is one remaining member). The statute is unclear whether there needs to be more than one member at the time of formation. See id. art. 1528n, art. 3.01. "Any natural person of the age of eighteen years or more, or any other person (without regard to place of residence, domicile, or organization) may act as an organizer of a limited liability company ..." Id.

[FN238]. See infra text accompanying notes 404-11.

[FN239]. Colo.Rev.Stat. § 7-80-203 (Office of the Secretary of State); Fla.Stat.Ann. § 608.408 (Department of State); Kan.Stat.Ann. § 17-7605 (Office of Secretary of State); Nev.Rev.Stat.Ann. § 86.191 (Office of Secretary of State); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 3.03 (Secretary of State); Utah Code Ann. § 48-2b-117 (Division of Corporations and Commercial Code of the Department of Commerce); Va.Code Ann. § 13.1-1010 (State Corporation Commission of Virginia); Wyo.Stat. § 17-15-106 (Office of the Secretary of State).

[FN240]. See supra text accompanying note 64.

[FN241]. Colo.Rev.Stat. § 7-80-207(1)(a); Fla.Stat.Ann. § 608.409(1); Kan.Stat.Ann. § 17-7609; Nev.Rev.Stat.Ann. § 86.201; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 3.04 (certificate of organization must be issued); Utah Code Ann. § 48-2b-118(1) (placement of stamp or seal must be placed on articles before company is considered organized); Wyo.Stat. § 17-15-109 (certificate of organization must be issued).

[FN242]. Colo.Rev.Stat. § 7-80-105 (unless parties believed in good faith that they were acting with authority); Fla.Stat.Ann. § 608.437; Kan.Stat.Ann. § 17-7621; Nev.Rev.Stat.Ann. § 86.361; Utah Code Ann. § 48-2b-118(3); Wyo.Stat. § 17-15-133.

[FN243]. All the LLC statutes require that the words "Limited Liability Company," "LLC," or something to that effect be the last words of the LLCs name. This requirement ensures that third parties are alerted to the fact that the company's owners, managers, and employees have limited liability. See Colo.Rev.Stat. § 7-80-201; Fla.Stat.Ann. § 608.406; Kan.Stat.Ann. § 17-7606; Nev.Rev.Stat.Ann. § 86.161(1)(a); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.03; Utah Code Ann. § 48-2b-106; Va.Code Ann. § 13.1-1012; Wyo.Stat. § 17-15-05.

[FN244]. Nev.Rev.Stat.Ann. § 86.161(1)(d); Va.Code Ann. § 13.1-1011. The Virginia statute requires that the address of the LLC's initial registered office also be disclosed, if such an office exists. Id.

[FN245]. Colo.Rev.Stat. § 7-80-304.

[FN246]. Kan.Stat.Ann. § 17-7607(a)(7); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 3.02; Utah Code Ann. § 48-2b-116(f).

[FN247]. Kan.Stat.Ann. § 17-7607(a)(7); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 3.02; Utah Code Ann. § 48-2b-116. The Utah statute also requires that the LLC's articles of organization contain a statement expressly allowing the Director of the Utah Division of Corporations and Commercial Code of the Department of Commerce to be appointed agent for service of process if the LLC's agent cannot be located. Id. § 48-2d-116(1)(e).

[FN248]. Fla.Stat.Ann. § 608.407; Wyo.Stat. § 17-15-107.

[FN249]. Colo.Rev.Stat. § 7-80-209; Fla.Stat.Ann. § 608.411; Kan.Stat.Ann. § 17-7610 (articles also must be amended when there is a disassociated member if member-managed, or if new managers are chosen); Nev.Rev.Stat.Ann. § 86.221; Utah Code Ann. § 48-2b-121; Wyo.Stat. § 17-15-129(b).

[FN250]. Utah Code Ann. § 48-2b-121(5).

[FN251]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 305; Va.Code Ann. § 13.1-1014.

[FN252]. Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 2.06-.07; Va.Code Ann. § 13.1-1016.

[FN253]. Fla.Stat.Ann. § 608.4211; Wyo.Stat. § 17-15-115.

[FN254]. Colo.Rev.Stat. § 7-80-102(4); Nev.Rev.Stat.Ann. § 86.041; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.01 (Texas statute does not allow interest in LLC to be given for promise to perform services); Utah Code Ann. § 48-2b-124; Va.Code Ann. § 13.1-1002.

[FN255]. See infra text accompanying notes 421-32.

[FN256]. This part compares the liability of members under the existing statutes. For a broader discussion of the liability of members in interstate and intrastate transactions, see infra notes 510-624 and accompanying text.

[FN257]. Colo.Rev.Stat. § 7-80-705; Fla.Stat.Ann. § 608.436; Kan.Stat.Ann. § 17-7620 (1991 amendments eliminated word officers from the provision); Nev.Rev.Stat.Ann. § 86.371; Texas Rev.Civ.Stat.Ann. art. 1528n, art. 4.03(A) (unless regulations specify otherwise); Utah Code Ann. § 48-2b-109; Va.Code Ann. § 13.1-1019; Wyo.Stat. § 17-15-113.

[FN258]. Fla.Stat.Ann. § 608.462; Kan.Stat.Ann. § 17-7631 (1991 amendments added managers to those who are not proper parties); Nev.Rev.Stat.Ann. § 86.381; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.03(C); Utah Code Ann. § 48-2b-112; Va.Code Ann. § 13.1-1020; Wyo.Stat. § 17-15-130.

[FN259]. Colo.Rev.Stat. § 7-80-104(1)(k); Fla.Stat.Ann. § 608.404(11); Kan.Stat.Ann. § 17-7604(j); Nev.Rev.Stat.Ann. § § 86.411-.421; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.20; Utah Code Ann. § 48-2b-105(1)(l); Va.Code Ann. § 13.1-1009(16); Wyo.Stat. § 17-15-104(a)(xi). All of the statutes provide that LLCs may indemnify their members to the same extent that a corporation may indemnify corporate directors or other agents, except for the Utah statute, which allows LLCs to indemnify their managers to the same extent that a partnership may indemnify its partners.

[FN260]. Colo.Rev.Stat. § 7-80-502 (unless the operating agreement states otherwise); Fla.Stat.Ann. § 608.435; Kan.Stat.Ann. § 17-7619(a); Nev.Rev.Stat.Ann. § 86.391(1); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.02 (unless articles of organization or regulations state otherwise); Utah Code Ann. § 48-2b-133(1); Va.Code Ann. § 13.1-1027(B) (unless articles of organization or operating agreement states otherwise); Wyo.Stat. § 17-15-121(a).

[FN261]. Colo.Rev.Stat. § 7-80-607 (unless operating agreement states otherwise); Fla.Stat.Ann. § 608.435(4); Kan.Stat.Ann. § 17-7619(d); Nev.Rev.Stat.Ann. § 86.391(4); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.09(B) (only in case of distribution at time when liabilities of LLC exceed recourse obligations due creditors, and then only if recipient knew that distribution was wrongful); Utah Code Ann. § 48-2b-133(4); Va.Code Ann. § 13.1-1036(B) (member only required to restore wrongful distribution); Wyo.Stat. § 17-15-121(d).

[FN262]. Colo.Rev.Stat. § 7-80-502(2); Fla.Stat.Ann. § 608.435(3); Kan.Stat.Ann. § 17-7619(c); Nev.Rev.Stat.Ann. § 86.391(3); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.02(D); Utah Code Ann. § 48-2b-133(3); Va.Code Ann. § 13.1-1027(C); Wyo.Stat. § 17-15-121(c).

[FN263]. Rev. Unif. Ltd. Partnership Act § 502(c).

[FN264]. Fla.Stat.Ann. § 608.435(3); Kan.Stat.Ann. § 17-7619(c); Nev.Rev.Stat.Ann. § 86.391(3); Utah Code Ann. § 48-2b-133(3); Wyo.Stat. § 17-15-121(c).

[FN265]. Colo.Rev.Stat. § 7-80-502(2); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.02(D); Va.Code Ann. § 13.1-1027(C).

[FN266]. Colo.Rev.Stat. § 7-80-105; Fla.Stat.Ann. § 608.437; Kan.Stat.Ann. § 17-7621; Nev.Rev.Stat.Ann. § 86.361; Va.Code Ann. § 13.1-1007 (making it class 1 misdemeanor to transact business as LLC without authority); Utah Code Ann. § 48-2b-110; Wyo.Stat. § 17-15-133.

[FN267]. Wyo.Stat. § § 17-15-101 to -136.

[FN268]. See Colo.Rev.Stat. § § 7-80-101 to -913; Fla.Stat.Ann. § § 608.401-.471; Kan.Stat.Ann. § § 17-7601 to -7650; Nev.Rev.Stat.Ann. § § 86.011-.571; Utah Code Ann. § § 48-2b-101 to -156.

[FN269]. See supra text accompanying note 64.

[FN270]. The Florida statute at times refers to the operating agreement as the LLC's regulations. The Texas statute uses the term regulations instead of operating agreement. The Kansas statute used the terms bylaws and operating agreement at different places in the statute, but appears, after the 1991 amendments, to have settled on operating agreement.

[FN271]. Colo.Rev.Stat. § 7-80-102(11); Nev.Rev.Stat.Ann. § 86.101; Va.Code Ann. § 13.1-1023(B)(1).

[FN272]. The Florida, Kansas, Texas, and Utah statutes define the term regulations or operating agreement, but do not indicate whether these agreements have to be written in order to be valid. Prior to 1991 amendments to the Kansas statute, Kansas explicitly required written "bylaws." Kan.Stat.Ann. § 17-7613 (Supp.1990), as amended by Kan.Stat.Ann. § 17-7613 (Supp.1991). The Wyoming statute never defines the term operating agreement, nor does it make any reference as to whether it can be written or oral.

[FN273]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.22(3).

[FN274]. Fla.Stat.Ann. § 608.422; Kan.Stat.Ann. § 17-7612; Nev.Rev.Stat.Ann. § 86.291; Utah Code Ann. § 48-2b-125; Va.Code Ann. § 13.1-1022 (can also be stated in operating agreement); Wyo.Stat. § 17-15-116.

[FN275]. Fla.Stat.Ann. § 608.422; Nev.Rev.Stat.Ann. § 86.291; Utah Code Ann. § 48-2b-125; Va.Code Ann. § 13.1-1022 (can also be stated in operating agreement); Wyo.Stat. § 17-15-116. The Kansas statute vests management authority in the members equally. Kan.Stat.Ann. § 17-7612.

[FN276]. Colo.Rev.Stat. § § 7-80-706 to -711; Kan.Stat.Ann. § 17-7613.

[FN277]. Kan.Stat.Ann. § 17-7613.

[FN278]. Id.

[FN279]. Colo.Rev.Stat. § 7-80-401. For a discussion of this provision, see Braukmann, supra note 60, at 978-80.

[FN280]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.12.

[FN281]. Id. art. 1528n, arts. 2.12-.21.

[FN282]. Fla.Stat.Ann. § 608.424(2); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.10(2); Utah Code Ann. § 48-2b-125(1); Wyo.Stat. § 17-15-117.

[FN283]. Nev.Rev.Stat.Ann. § 86.301.

[FN284]. See Va.Code Ann. § 13.1-1022, -1024. The statute also provides that any person acting without authority will be guilty of a misdemeanor. Id. § 13.1-1007. It remains to be seen whether management power will be synonymous with authority to bind as it is with partnerships, or whether management and agency powers will be separated as in corporations.

[FN285]. Fla.Stat.Ann. § 608.424(1); Kan.Stat.Ann. § 17-7612; Nev.Rev.Stat.Ann. § 86.301; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.12 (members can retain power in whole or in part through the LLC's regulations); Utah Code Ann. § 48-2b-125(2); Va.Code Ann. § 13.1-1024; Wyo.Stat. § 17-15-117.

[FN286]. Colo.Rev.Stat. § 7-80-401; Fla.Stat.Ann. § 608.422; Kan.Stat.Ann. § 17-7612; Nev.Rev.Stat.Ann. § 86.291; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.12; Utah Code Ann. § 48-2b-125(2); Va.Code Ann. § 13.1-1024; Wyo.Stat. § 17-15-116.

[FN287]. Fla.Stat.Ann. § 608.422; Nev.Rev.Stat.Ann. § 86.291; Wyo.Stat. § 17-15-116.

[FN288]. Colo.Rev.Stat. § § 7-80-401 to -411; Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 2.12-.21; Va.Code Ann. § 13.1-1024.

[FN289]. Colo.Rev.Stat. § 7-80-407; Fla.Stat.Ann. § 608.424; Kan.Stat.Ann. § § 17-7612, -7614 (if the managers are designated to do so); Nev.Rev.Stat.Ann. § 86.301; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.21; Utah Code Ann. § 48-2b-125(2); Wyo.Stat. § 17-15-117. For a discussion of the Virginia statute, see supra note 284 and accompanying text.

[FN290]. Colo.Rev.Stat. § 7-80-705; Fla.Stat.Ann. § 608.436; Kan.Stat.Ann. § 17-7620; Nev.Rev.Stat.Ann. § 86.371; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.03(A) (unless regulations specify otherwise); Utah Code Ann. § 48-2b-109; Va.Code Ann. § 13.1-1019; Wyo.Stat. § 17-15-113.

[FN291]. Colo.Rev.Stat. § 7-80-104(1)(k); Fla.Stat.Ann. § 608.404(11); Kan.Stat.Ann. § 17-7604(j); Nev.Rev.Stat.Ann. § 86.411-.421; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.20; Utah Code Ann. § 48-2b-105(1)(l); Va.Code Ann. § 13.1-1009(16); Wyo.Stat. § 17-15-104(a)(xi). All of the statutes provide that LLCs may indemnify their managers to the same extent that a corporation may indemnify corporate managers, except for the Utah statute, which allows LLCs to indemnify their managers to the same extent that a partnership may indemnify its managers.

[FN292]. Colo.Rev.Stat. § 7-80-406; Va.Code Ann. § 13.1-1024(G)(1).

[FN293]. Va.Code Ann. § 13.1-1024(G)(1).

[FN294]. Colo.Rev.Stat. § 7-80-406.

[FN295]. For a discussion of the fiduciary duties of managers in corporations, see supra text accompanying notes 109-13.

[FN296]. Colo.Rev.Stat. § 7-80-503; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.02; Va.Code Ann. § 13.1-1029 to -1030.

[FN297]. Fla.Stat.Ann. § 608.422 (mandatory); Nev.Rev.Stat.Ann. § 86.301 (mandatory); Utah Code Ann. § 48-2b-125 (default); Va.Code Ann. § 13.1-1022(B) (default voting rights determined based upon contributions and withdrawals); Wyo.Stat. § 17-15-116 (mandatory). Colorado and Texas do not provide a mandatory or default rule with regard to voting privileges. Members are to establish their own rules. Colo.Rev.Stat. § 7-80-706; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.02. The Kansas statute provides that each member has one vote. Kan.Stat.Ann. § 17-7612.

[FN298]. Colo.Rev.Stat. § 7-80-503; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.03 (operating agreement governs); Utah Code Ann. § § 48-2b-128 to - 129 (Utah statute varies slightly, indicating that distributions will be made upon basis of value of members unreturned contribution to LLC); Va.Code Ann. § 13.1-1029. So long as the operating agreement or articles of organization allow, all statutes allow for distributions prior to dissolution.

[FN299]. Fla.Stat.Ann. § 608.427(2)(c); Kan.Stat.Ann. § 17-7616(b)(3); Nev.Rev.Stat.Ann. § 86.331(2); Utah Code Ann. § 48-2b-132(2)(c); Va.Code Ann. § 13.1-1032; Wyo.Stat. § 17-15-120(b)(ii).

[FN300]. Colo.Rev.Stat. § 7-80-602.

[FN301]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.05.

[FN302]. Colo.Rev.Stat. § 7-80-604; Fla.Stat.Ann. § 608.427(3); Kan.Stat.Ann. § 17-7616(c); Nev.Rev.Stat.Ann. § 86.331(3); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.07; Utah Code Ann. § 48-2b-132(3); Va.Code Ann. § 13.1-1034; Wyo.Stat. § 17-15-120(c).

[FN303]. Utah Code Ann. § 48-2b-150; Va.Code Ann. § 13.1-1042.

[FN304]. Colo.Rev.Stat. § 7-80-712.

[FN305]. Colo.Rev.Stat. § 7-80-303 (report must be filed upon request of Secretary of State); Kan.Stat.Ann. § 17-7647 (report must be filed annually); Utah Code Ann. § 48-2b-120 (report must be filed annually).

[FN306]. Utah Code Ann. § 48-2b-120(1).

[FN307]. Colo.Rev.Stat. § 7-80-303(1).

[FN308]. Kan.Stat.Ann. § 17-7647(b).

[FN309]. Colo.Rev.Stat. § 7-80-411; Nev.Rev.Stat.Ann. § 86.241; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.22; Utah Code Ann. § 48-2b-119; Va.Code Ann. § 13.1-1028.

[FN310]. Colo.Rev.Stat. § 7-80-104; Fla.Stat.Ann. § 608.404; Kan.Stat.Ann. § 17-7604; Nev.Rev.Stat.Ann. § 86.281; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.02; Utah Code Ann. § 48-2b-105; Va.Code Ann. § 13.1-1009; Wyo.Stat. § 17-15-104.

[FN311]. Fla.Stat.Ann. § 608.404(10); Kan.Stat.Ann. § 17-7604(i); Utah Code Ann. § 48-2b-105(k); Va.Code Ann. § 13.1-1009(10).

[FN312]. Colo.Rev.Stat. 7-80-103.

[FN313]. Fla.Stat.Ann. § 608.403; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.01.

[FN314]. Kan.Stat.Ann. § 17-7603. As originally enacted, the Kansas statute limited the purposes of an LLC to those "which a general corporation or partnership may conduct or promote." Kan.Stat.Ann. § 17-7603 (Supp.1990), amended by Kan.Stat.Ann. § 17-7603 (Supp.1991).

[FN315]. Kan.Stat.Ann. § 17-7651 (repealed 1991).

[FN316]. Nev.Rev.Stat.Ann. § 86.141; Wyo.Stat. § 17-15-103.

[FN317]. Utah Code Ann. § 48-2b-104.

[FN318]. Va.Code Ann. § 13.1-1008.

[FN319]. Colo.Rev.Stat. § 7-80-702(1); Fla.Stat.Ann. § 608.431; Kan.Stat.Ann. § 17-7617; Nev.Rev.Stat.Ann. § 86.351; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.04; Utah Code Ann. § 48-2b-103; Va.Code Ann. § 13.1-1038; Wyo.Stat. § 17-15-122.

[FN320]. For a discussion of how the LLC's limitations on the transferability of interests compare to the transferability of interests in corporations, see supra text accompanying notes 93-95. For a discussion of the tax implications of the limitation on transferability of interests, see infra text accompanying notes 375-86.

[FN321]. Colo.Rev.Stat. § 7-80-702(1); see Fla.Stat.Ann. § 608.432; Kan.Stat.Ann. § 17-7618; Nev.Rev.Stat.Ann. § 86.351; Va.Code Ann. § 13.1-1039 (assignment of pecuniary interest allowed without consent of other LLC members unless LLC's articles of organization provides otherwise); Wyo.Stat. § 17-15-122.

[FN322]. Utah Code Ann. § 48-2b-131(1) (otherwise, only a pecuniary interest is transferred).

[FN323]. Tex.Rev.Civ.Stat.Ann. arts. 1528n, art. 4.05-.07. For a discussion of free transferability in tax classification, see infra text accompanying notes 375-86.

[FN324]. Colo.Rev.Stat. § 7-80-204(1)(b); Fla.Stat.Ann. § 608.407(1)(b); Nev.Rev.Stat.Ann. § 86.161(1)(b); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 3.02(2); Wyo.Stat. § 17-15-107(a)(ii).

[FN325]. Kan.Stat.Ann. § 17-7607(2); Utah Code Ann. § 48-2b-116(1)(b); Va.Code Ann. § 13.1-1011.A.4.

[FN326]. Wyo.Stat. § 17-15-123(a)(iii); see also Colo.Rev.Stat. § 7-80-801(1)(c) (Colorado also requires that there be at least two members remaining in LLC and members must vote within 90 days following occurrence of event of dissolution to continue LLC); Nev.Rev.Stat.Ann. § 86.491(1)(c); Va.Code Ann. § 13.1-1046(3).

[FN327]. See Va.Code Ann. § 13.1-1046(3).

[FN328]. Id.

[FN329]. Utah Code Ann. § 48-2b-137(3).

[FN330]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.01.

[FN331]. Fla.Stat.Ann. § 608.441(1)(c) (emphasis added); see Kan.Stat.Ann. § 17-7622(a)(3).

[FN332]. Utah Code Ann. § 48-2b-137(2).

[FN333]. Id. § 48-2b-137(4).

[FN334]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.01(2); Va.Code Ann. § 13.1-1046(1).

[FN335]. Colo.Rev.Stat. § 7-80-808; see Fla.Stat.Ann. § 608.448; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.02; Utah Code Ann. § 48-2b-142; Va.Code Ann. § 13.1-1047. The Kansas statute allows a court to dissolve an LLC "in an action filed by the attorney general," when, among other grounds, it has "exceeded the authority conferred upon it by law." Kan.Stat.Ann. § 17-7629(b).

[FN336]. Nev.Rev.Stat.Ann. § 86.271; Wyo.Stat. § 17-15-112.

[FN337]. Colo.Rev.Stat. § 7-80-803; Fla.Stat.Ann. § 608.442; Kan.Stat.Ann. § 17-7623; Nev.Rev.Stat.Ann. § 86.501; Wyo.Stat. § 17-15-124.

[FN338]. Fla.Stat.Ann. § 608.443(2); Kan.Stat.Ann. § 17-7624(b); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.05(2).

[FN339]. Colo.Rev.Stat. § 7-80-805; Fla.Stat.Ann. § 608.444; Kan.Stat.Ann. § 17-7625; Nev.Rev.Stat.Ann. § 86.521; Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.04; Utah Code Ann. § 48-2b-138; Va.Code Ann. § 13.1-1049; Wyo.Stat. § 17-15-126.

[FN340]. Colo.Rev.Stat. § 7-80-806 to -807; Fla.Stat.Ann. § 608.445-.446; Kan.Stat.Ann. § 17-7626; Nev.Rev.Stat.Ann. § 86.531-.541; Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 6.07-.08; Utah Code Ann. § 48-2b-139 to -140; Wyo.Stat. § 17-15-127 to -128.

[FN341]. Va.Code Ann. § 13.1-1050.

[FN342]. See supra text accompanying notes 60-61.

[FN343]. Treas.Reg. § 301.7701-1(c) (as amended in 1977); see Hamill, supra note 28, at 724-40 (discussing partnership classification regulations and how they apply to LLCs); see also Edward J. Roche, Jr. et al., Limited Liability Companies Offer Pass-Through Benefits without S Corp. Restrictions, 74 J. Tax'n 248, 248-50 (1991).

[FN344]. LLCs that are treated as corporations unexpectedly face disastrous tax consequences. The Internal Revenue Code generally taxes corporate income at both the entity and shareholder level. Partnerships are not subject to an entity level tax; the partners take into account their respective shares of the partnership's income, gain, loss and deduction items. See I.R.C. § § 11, 301 (West Supp.1991); I.R.C. § § 701, 702(a), 704(b) (West 1988 & Supp.1991).

[FN345]. Treas.Reg. § 301.7701-2(a)(1) (as amended in 1983).

[FN346]. Id.

[FN347]. Id. § 301.7701-2(a)(3).

[FN348]. Id. § 301.7701-2(d); Rev.Rul. 88-76, 1988-2 C.B. 360; Gen. Couns. Mem. 39,798 n. 3 (Oct. 18, 1989).

[FN349]. Colo.Rev.Stat. § 7-80-705 (Supp.1990); Fla.Stat.Ann. § 608.436 (West Supp.1991); Kan.Stat.Ann. § 17-7620 (Supp.1991); Nev.Rev.Stat.Ann. § 86.371 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.03 (West Supp.1992) (members of Texas LLC can agree in LLC's regulations to accept limited liability, although other LLC statutes provide that no member or manager is personally liable for LLC's debts); Utah Code Ann. § 48-2b-109 (Supp.1991); Va.Code Ann. § 13.1-1019 (Michie Supp.1991); Wyo.Stat. § 17-15-113 (Supp.1989).

[FN350]. Treas.Reg. § 301.7701-2(a)(3) (as amended in 1983).

[FN351]. Rev.Rul. 88-76, 1988-2 C.B. 360, 361. For a discussion of the classification of LLCs, see Arthur B. Willis et al., Partnership Taxation § 34.10 (4th ed. 1989).

[FN352]. See Treas.Reg. § 301.7701-2(a)(3) (as amended in 1983).

[FN353]. See Rev. Model Business Corp. Act § § 2.03(a), 14.02, 14.20, 14.30. If any of these factors causes a dissolution, the organization lacks continuity of life. See Treas.Reg. § 301.7701-2(b)(1) (as amended in 1983).

[FN354]. Treas.Reg. § 301-7701-2(b)(3) (as amended in 1983).

[FN355]. See Rev.Rul. 88-76, 1988-2 C.B. 360, 361 (ruling that LLC organized under Wyoming LLC statute lacks continuity of life).

[FN356]. Wyo.Stat. § 17-15-123 (Supp.1989).

[FN357]. Id.

[FN358]. Remaining members of a Colorado LLC have 90 days from the event triggering dissolution to agree to continue the business. Colo.Rev.Stat. § 7-80-801 (Supp.1990).

[FN359]. In Virginia, the remaining members have the right to continue the business of the LLC by unanimous consent, and this right does not have to be specified in the articles of organization. See Va.Code Ann. § 13.1-1046(3) (Michie Supp.1991). The consent must be unanimous and thus cannot be altered in the articles of organization or the operating agreement. See id. The Virginia statute additionally states that an assignment of a membership interest in an LLC is only a transfer of distribution rights; the transferee has no rights to participate in the management of the LLC and the assignment does not dissolve the LLC. Va.Code Ann. § 13.1-1039 (Michie Supp.1991).

[FN360]. Nev.Rev.Stat.Ann. § 86.491-.541 (Michie Supp.1991).

[FN361]. Fla.Stat.Ann. § 608.441(1)(c) (West Supp.1991); Kan.Stat.Ann. § 17-7622(a)(3) (Supp.1991).

[FN362]. Treas.Reg. § 301.7701-2(b)(3) (as amended in 1983); see also Priv.Ltr.Rul. 89-37-010 (June 16, 1989) (Service explicitly stated that Florida LLC lacked continuity of life because articles contained no right to continue business); Hamill, supra note 28, at 729-30.

[FN363]. See Fla.Stat.Ann. § 608.441(1)(c) (West Supp.1991); Kan.Stat.Ann. § 17-7622(a)(3) (Supp.1991).

[FN364]. See infra text accompanying notes 375-403.

[FN365]. Utah Code Ann. § 48-2b-137(3) (Supp.1991).

[FN366]. See Treas.Reg. § 301-7701-2(b) (as amended in 1983).

[FN367]. Cf. Treas.Reg. § 301.7701-2(b)(3) (as amended in 1983) (continuity of life is lacking if any member has power under local law to dissolve organization).

[FN368]. Unless it clearly lacks free transferability of interests and centralized management. See infra text accompanying notes 375-403.

[FN369]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. § 6.01(4) (West Supp.1992).

[FN370]. See supra text accompanying notes 361-64.

[FN371]. See supra notes 356-57 and accompanying text.

[FN372]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 6.01(4) (West Supp.1992).

[FN373]. Id.

[FN374]. See supra text accompanying note 365-68.

[FN375]. Treas.Reg. § 301.7701-2(e) (as amended in 1983).

[FN376]. Id.; see also Rev.Rul. 77-137, 1977-1 C.B. 178 (substitute transferee limited partner is substitute limited partner for federal income tax purposes even if general partner did not consent to transfer of complete interest).

[FN377]. RevRul. 88-76, 1988-2 C.B. 360, 361 (ruling that Wyoming LLC lacked free transferability of interests because statute did not allow transferee to acquire all attributes of membership unless all remaining members approved of transfer).

[FN378]. Wyo.Stat. § 17-15-122 (Supp.1989). If the required consent is not obtained, the transferee is entitled to receive only the share of profits or other compensation to which the transferor would otherwise be entitled. Id.

[FN379]. Colo.Rev.Stat. § 7-80-702 (Supp.1990); Fla.Stat.Ann. § 608.432 (West Supp.1991); Kan.Stat.Ann. § 17-7618 (Supp.1991); Nev.Rev.Stat.Ann. § 86.351(1) (Michie Supp.1991); Va.Code Ann. § 13.1-1039 to -1040 (Michie Supp.1991).

[FN380]. Utah Code Ann. § 48-2b-131 (Supp.1991).

[FN381]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.07 (West Supp.1992).

[FN382]. Id.

[FN383]. A Texas LLC requiring no membership consent for complete transfers of interests clearly possesses free transferability of interests. See Treas.Reg. § 301.7701-2(e) (as amended in 1983).

[FN384]. See Treas.Reg. § 301.7701-2(e)(1) (as amended in 1983) (requiring the consent of other members, not the other members or all the other members). Under the Treasury Regulations, it appears that an undetermined percentage of the interests may be transferable without any member's consent without causing the organization to have the corporate characteristic of free transferability. Id. (free transferability of interests exists if substantially all of the interests can be transferred without the consent of other members). This implies that an organization would lack the characteristic of free transferability even though members, owning less than substantially all of the interests, had the right to transfer their interests without consent.

[FN385]. Presumably, a Utah LLC could provide in the operating agreement that all members must consent to a complete transfer. Utah Code Ann. § 48-2b-131(1) (Supp.1991) (operating agreement may generally provide for restrictions on transferability).

[FN386]. See supra text accompanying note 382-83.

[FN387]. Treas.Reg. § 301.7701-2(c)(1) (as amended in 1983).

[FN388]. See id. But see Rev. Model Business Corp. Act § 801(c) (corporation having 50 or fewer shareholders may dispense with board of directors).

[FN389]. Colorado LLCs must appoint a manager who is a natural person at least 18 years of age. Colo.Rev.Stat. § 7-80-401 (Supp.1990).

[FN390]. The Texas statute requires a manager unless management powers are explicitly reserved to the members under the LLC's regulations. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.12 (West Supp.1992). The statute contains no language indicating in what proportion members share management rights if management authority is reserved to them.

[FN391]. Fla.Stat.Ann. § 608.422 (West Supp.1991); Va.Code Ann. § 13.1-1022, -1024 (Michie Supp.1991); Wyo.Stat. § 17-15-116 (Supp.1989). The Utah statute vests management authority according to how the members share profits. Utah Code Ann. § 48-2b-125(1) (Supp.1991). The Kansas statute vests management authority in the members equally. Kan.Stat.Ann. § 17-7612 (Supp.1991).

[FN392]. See, e.g., id.

[FN393]. Treas.Reg. § 301.7701-2(c)(4) (as amended in 1983); see Unif. Partnership Act § 18(e) (1914).

[FN394]. See Priv.Ltr.Rul. 90-10-027 (Dec. 7, 1989) (ruling that LLC that did not provide for a manager lacked centralized management).

[FN395]. See supra text accompanying notes 351-52, 355-60, 375-86.

[FN396]. But see supra text accompanying notes 361-74, 380-86.

[FN397]. Treas.Reg. § 301.7701-2(c)(4) (as amended in 1983).

[FN398]. See Rev.Proc. 89-12, 1989-2 C.B. 798, § 4.06.

[FN399]. See id § 4; see also Hamill, supra note 28, at 734.

[FN400]. Rev.Rul. 88-76, 1988-2 C.B. 360, 361.

[FN401]. See Rev. Unif. Ltd. Partnership Act § 403 (1985).

[FN402]. See id. But see Ga.Code Ann. § 14-9-303 (Michie 1981) (providing that limited partner will not become liable for partnership obligations by participating in management or control of business); Rev.Rul. 91-51, 1991-38 I.R.B. 4 (Service determined that the Georgia Limited Partnership Act corresponds to RULPA for purposes of applying partnership classification regulations).

[FN403]. See Hamill, supra note 28, at 753.

[FN404]. I.R.C. § § 761(a), 7701(a)(2) (1988).

[FN405]. Id. § 708(b)(1)(A). See infra text accompanying notes 461-75 for a discussion of terminations resulting from sales or exchanges of interests or mergers.

[FN406]. Treas.Reg. § § 1.761-1(a) (as amended in 1972), 301.7701-3(a) (as amended in 1986); Commissioner v. Culbertson, 337 U.S. 733, 740 (1949); Luna v. Commissioner, 42 T.C. 1067, 1077 (1964); Allison v. Commissioner, 35 T.C.M. (CCH) 1069, 1076 (1976).

[FN407]. Treas.Reg. § 1.708-1(b)(1)(i) (1983). If one partner of a two member partnership dies, the partnership will not terminate if the estate or other successor continues to share in the partnership's profits and losses. Id.

[FN408]. Several statutes require that two or more persons organize the LLC and that two or more persons be members of the LLC at formation. Fla.Stat.Ann. § 608.405 (West Supp.1991); Nev.Rev.Stat.Ann. § 86.151 (Michie Supp.1991); Utah Code Ann. § 48-2b-103 (Supp.1991); Wyo.Stat. § 17-15-106 (Supp.1989). Other statutes allow one person to organize the LLC but explicitly require there to be at least two members at formation. Colo.Rev.Stat. § 7-80-203 (Supp.1990); Kan.Stat.Ann. § 17-7605 (Supp.1991); Va.Code Ann. § § 13.1-1002, 13.1-1010 (Michie Supp.1991).

[FN409]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 3.01 (West Supp.1992). Moreover, if a dissolution event occurs, the Texas statute only requires one remaining member to continue the business. Id. art. 1528n, art. 6.01(4).

[FN410]. See supra text accompanying notes 404-06.

[FN411]. See supra text accompanying note 407.

[FN412]. An LLC that is classified as a partnership for tax purposes will be subject to the provisions of Subchapter K of the Internal Revenue Code.

[FN413]. Fla.Stat.Ann. § 608.4211 (West Supp.1991); Wyo.Stat. § 17-15-115 (Supp.1989).

[FN414]. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.01 (West Supp.1992).

[FN415]. Id.

[FN416]. Colo.Rev.Stat. § 7-80-102, -501 (Supp.1990); Nev.Rev.Stat.Ann. § 86.041 (Michie Supp.1991); Va.Code Ann. § 13.1-1002, - 1027 (Supp.1991); Utah Code Ann. § 48-2b-124 (Supp.1991).

[FN417]. Colo.Rev.Stat. § 7-80-503 (Supp.1990); Fla.Stat.Ann. § 608.407(j), .423, .426 (West Supp.1991); Kan.Stat.Ann. § 17-7615 (Supp.1991); Nev.Rev.Stat.Ann.§ 86.341 (Michie Supp.1991); Utah Code Ann. § 48-2b-128, -130 (Supp.1991); Va.Code Ann. § 13.1-1029 (Michie Supp.1991); Wyo.Stat. § 17-15-119 (Supp.1989).

[FN418]. I.R.C. § 721 (1988).

[FN419]. Id. § 722. If the member contributes a promise to contribute cash or property in the future, his basis will not increase until the contribution is actually made. See Oden v. Commissioner, 41 T.C.M. (CCH) 1285, 1289 (1983). If the contributed property is encumbered, the member's basis will decrease by the amount of the liability, and will increase by his share of the liability at the LLC level. Prop.Treas.Reg. § 1.752-1(f), 56 Fed.Reg. 36,707 (1991).

[FN420]. Treas.Reg. § 1.704-1(b)(2)(iv)(b) (as amended in 1988). The contribution of a promissory note generally is not reflected in the member's capital account until there is either a taxable disposition of the note or payment is made on the note. Treas.Reg. § 1.704-1(b)(2)(iv)(d)(2) (as amended in 1989).

[FN421]. I.R.C. § 61 (West 1988 & Supp.1991); Treas.Reg. § 1.721-1(b)(1) (as amended in 1965); I.R.C. § 83 (West 1988 & Supp.1991); Treas.Reg. § 1.83-1(a) (1978).

[FN422]. Id.

[FN423]. 492 F.2d 286, 291 (7th Cir.1974) (holding that partner recognized ordinary income from receipt of partnership profits interest rather than capital gain when he sold profits interest). Because the taxpayer sold the profits interest shortly after he received it, the case arguably involved a receipt of a capital interest for services or a situation in which the service provider was not substantively a partner. Id. at 287-88.

[FN424]. See Treas.Reg. § 1.721-1(b)(1) (as amended in 1965). “To the extent that any of the partners gives up any part of his right to be repaid his contributions (as distinguished from a share of partnership profits) in favor of another partner as compensation for services (or in satisfaction of an obligation), section 721 does not apply.” Id. (emphasis added). This language arguably suggests that the rule requiring income recognition if services are contributed for a capital interest does not apply if a share in partnership profits is received. See also Gen. Couns. Mem. 36,346 (July 23, 1975) (suggesting that if facts show interest received is pure profits interest rather than hidden interest in partnership capital, profits interest will not be taxable on receipt); National Oil Co. v. Commissioner, 52 T.C.M. (CCH) 1223, 1229 (1986); Kenroy, Inc. v. Commissioner, 47 T.C.M. (CCH) 1749, 1756 (1984); Wheeler v. Commissioner, 37 T.C.M. (CCH) 883 (1978) (suggesting that services contributed for profits interest will not be taxable on receipt).

[FN425]. I.R.C. § 704(b) (West 1988 & Supp.1991); see infra text accompanying notes 433-60 (discussing substantial economic effect requirements); see also I.R.C § 707(a)(2)(A) (1988); General Explanation of the Revenue Provision of the Deficit Reduction Act of 1984, H.R.Doc. No. 4170, 98th Cong., 2d Sess. 223-33 (1984) (if allocation and distribution to partner is more properly characterized as occurring between third parties rather than partner and partnership, the partner will have ordinary income rather than distributive share).

[FN426]. 59 T.C.M. (CCH) 236 (1990), aff'd in part, rev'd in part, 943 F.2d 815 (8th Cir.1991).

[FN427]. Id. at 249-50.

[FN428]. Id. at 256.

[FN429]. Id. at 255.

[FN430]. Campbell v. Commissioner, 943 F.2d 815, 823 (8th Cir.1991).

[FN431]. Id. at 818.

[FN432]. Id. at 823.

[FN433]. For a comprehensive discussion of partnership taxation, see generally, Willis et al., supra note 351; William S. McKee et al., Federal Taxation of Partnerships and Partners (2d ed. 1990).

[FN434]. See Treas.Reg. § 301.7701-2(a)(1), (3) (as amended in 1983) (unincorporated organization will be classified as partnership if it lacks at least two of the four corporate characteristics). Because Subchapter K does not require an affirmative election to trigger its application, the Subchapter K provisions presumably will apply automatically as soon as the LLC's articles are filed with the Secretary of State.

[FN435]. I.R.C. § 701 (1988).

[FN436]. Id. § § 701, 702(a).

[FN437]. Id. § 705. The outside basis is decreased by the amount of any distributions to a member. See id. A member's outside basis is increased by the amount and adjusted basis of property that the member contributes to the LLC. See id. § 722. A member's outside basis also increases for its share of the LLC's liabilities and decreases when such member's share of the LLC's liabilities declines. See id. § 752(a)-(b). Persons that purchase an LLC interest from an existing member will have an outside basis equal to the amount of money and fair market value of any property tendered plus any share in the LLC's liabilities. See id. § § 742, 752(d); Treas.Reg. § 1.742-1 (as amended in 1971).

[FN438]. I.R.C. § 702(b) (1988).

[FN439]. I.R.C. § 704(d) (West 1988 & Supp.1991). If the member's outside basis is not enough to cover the loss, such loss will be suspended until the member's outside basis can cover it. For a discussion of other possible limitations on the deductibility of a loss item, see infra text accompanying notes 484-501.

[FN440]. Colo.Rev.Stat. § § 7-80-104(m), -204(1)(e), -503 (Supp.1990); Fla.Stat.Ann. § § 608.407(j), .423, .426 (West Supp.1991); Kan.Stat.Ann. § 17-7615 (Supp.1991); Nev.Rev.Stat.Ann. § 86.341 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 5.03 (West Supp.1992); Utah Code Ann. § 48-2b-130 (Supp.1991); Va.Code Ann. § 13.1-1029 (Michie Supp.1991); Wyo.Stat. § 17-15-119 (Supp.1989). The Texas statute provides an elaborate mechanism for establishing classes of interests similar to different classes of stock. Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.02 (West Supp.1992).

[FN441]. I.R.C. § 704(a) (West 1988 & Supp.1991).

[FN442]. Id. § 704(b). The determination of the members' economic interests in the LLC involves a facts-and-circumstances test to determine the member's overall economic arrangement independent of tax consequences. See Treas.Reg. § 1.704-1(b)(3) (as amended in 1987).

[FN443]. For a more complete description of the substantial economic effect test, see Willis et al., supra note 351, § 104; 1 McKee et al., supra note 433, ¶ 10.02; Hamill, supra note 28, at 757-71; Gregory J. Marich, The Value Equals Basis Conundrum, 42 Tax L.Rev. 509 (1986).

[FN444]. Treas.Reg. § 1.704-1(b)(2)(ii)(b)(1) (as amended in 1987). A member's capital account represents the member's share of the LLC's net worth. For the rules stating how adjustments to capital accounts must be made, see id. § 1.704-1(b)(2)(iv).

[FN445]. Id. § 1.704-1(b)(2)(ii)(b)(2).

[FN446]. Id. § 1.704-1(b)(2)(ii)(b)(3), (c), (d). Because the LLC's liabilities increase the members' outside basis but do not increase capital accounts, allocations of losses causing a member's capital account to be negative are usually attributable to the LLC's liabilities. If a member bears the risk of loss for the LLC's failure to pay the liability, and the liability is not partner nonrecourse debt under Treas.Reg. § 1.704-2(b)(4), -2(i), the losses must meet the substantial economic effect test. The member who bears the risk of loss is treated as having both a deemed deficit restoration obligation and an outside basis increase. Treas. Reg. § 1.704-1(b)(2)(ii)(c) (as amended in 1987); Treas.Reg. § 1.752-2 (1991).

[FN447]. Treas.Reg. § 1.704-1(b)(2)(iii) (as amended in 1987).

[FN448]. See id. § § 1.704-2(b)(3), 1.752-1(a)(2) (1991).

[FN449]. See id. § 1.704-2(b)(1).

[FN450]. See id. § 1.704-2(b)(2).

[FN451]. See generally id. § 1.704-2. For a more complete discussion of the nonrecourse debt allocation rules, see Willis et al., supra note 351, § 61.0; McKee et al., supra note 433, ¶ 10.02[4][e].

[FN452]. See Treas.Reg. § 1.704-2(b)(4), -2(i) (1991). The § 752 regulations generally allocate the liability for purposes of computing outside basis to the guaranteeing or lending member (or to the member related to the person that entered into the guarantee or made the loan). See id. § 1.752-2(b)-(c); see also id. § 1.752-4(b) (definition of related person).

[FN453]. See id. § 1.704-2(c).

[FN454]. See id. § 1.704-2(e). The safe harbor also requires that members must maintain capital accounts under the rules in the substantial economic effect portion of the § 704(b) regulations and the members must liquidate in accordance with positive capital accounts. The members also must comply with the alternate test for economic effect (members with deficit capital accounts must have either an unconditional deficit restoration obligation or agree to a qualified income offset). Id. Members that are allocated nonrecourse deductions that comply with the safe harbor under § 1.704-2 receive a corresponding outside basis increase for a share of the LLC's nonrecourse liabilities. See id. § 1.752-3.

[FN455]. See id. § 1.704-2(m), Ex. 1(ii), (iii).

[FN456]. See id. § 1.704-2(f).

[FN457]. See id. § 1.704-2(c), (g), (j)(2)(i).

[FN458]. See id. § 1.704-2(i).

[FN459]. See id. § 1.704-2(i)(2).

[FN460]. See id. § 1.704-2(i)(4).

[FN461]. See supra notes 433-34 and accompanying text.

[FN462]. I.R.C. § 708(b)(1) (1988).

[FN463]. Treas.Reg. § 1.708-1(b)(1)(iii) (1983).

[FN464]. Id. § 1.708-1(b)(1)(iv). The rules in § § 731 and 732 of the Code apply to the deemed distributions and the rules in § § 721, 722 and 723 apply to the deemed contributions. Normally the hypothetical distributions and contributions do not cause the recognition of gain or loss. 3 Willis et al., supra note 351, § 162.03; 1 McKee et al., supra note 433, ¶ 12.05[2][d].

[FN465]. See 3 Willis et al., supra note 351, § 162; 1 McKee et al., supra note 433, ¶ 12.05. For example, a termination may trigger a deficit restoration obligation under the § 704(b) regulations, Treas.Reg. § 1.704-1(b)(2)(ii)(g) (as amended in 1987); cause recapture of an investment tax credit, see Siller Bros. v. Commissioner, 89 T.C. 256, 265 (1987); or cause the disappearance of § 704(d) suspended losses, Sennett v. Commissioner, 80 T.C. 825, 835 (1983), aff'd, 752 F.2d 428 (9th Cir.1985).

[FN466]. I.R.C § 708(b)(2)(A) (1988); Treas.Reg. § 1.708-1(b)(2) (1983).

[FN467]. 3 Willis et al., supra note 351, § 163.01; 1 McKee et al., supra note 433, ¶ 12.06[1].

[FN468]. Id.

[FN469]. Rev.Rul. 68-289, 1968-1 C.B. 314; Rev.Rul. 77-458, 1977-2 C.B. 220; Rev.Rul. 90-17, 1990-1 C.B. 119. The contributing or the resulting partnerships will not recognize any gain or loss, I.R.C. § 721 (1988); the basis of the contributed property will carryover from the contributing partnerships, id. § 723; the terminating partnerships will not recognize any gain or loss on the distribution of (or to the partners from the receipt of) the interests in the resulting partnerships, id. § 731(a)-(b); and the partners' outside basis in the resulting partnership equals their outside basis in the terminating partnerships, id. § 732(b). The treatment of merger terminations differs from an I.R.C. § 708(b)(1)(B) sale or exchange termination. See 3 Willis et al., supra note 351, § 163.01; 1 McKee et al., supra note 433, ¶ 12.06[1].

[FN470]. See supra text accompanying note 434.

[FN471]. A transaction governed by I.R.C. § 721 is not treated as a sale or exchange for purposes of the termination rules. See Treas.Reg. § 1.708-1(b)(1)(ii) (1983). The conversion between general and limited partnership status is generally treated under I.R.C. § 721 to the extent there has been no shift in the partners' shares of partnership liabilities. See Rev.Rul. 84-52, 1984-1 C.B. 157, 158.

[FN472]. Rev.Rul. 84-52, 1984-1 C.B. 157.

[FN473]. Id. If there is a change in the partners' shares of the partnership's liabilities then any net increase should be treated as a deemed contribution of money and any net decrease should be treated as a deemed distribution of money. See id.; Treas.Reg. § 1.752-1 (1991).

[FN474]. Private rulings are only directed to the taxpayer who requested it and cannot be cited as precedent. See I.R.C. § 6110(j)(3) (1988).

[FN475]. See Priv.Ltr.Rul. 91-19-029 (Feb. 7, 1991); Priv.Ltr.Rul. 90-29-019 (Apr. 19, 1990); Priv.Ltr.Rul. 90-10-027 (Dec. 7, 1989).

[FN476]. The LLC must file the election by the due date for its tax return in the taxable year that the transfer or distribution occurs. Treas.Reg. § 1.754-1(b)(1) (as amended in 1972). LLCs that fail to make the election on time must apply for an extension. Treas.Reg. § 1.9100-1 (1970).

[FN477]. I.R.C. § 743(b) (1988). The increase in the basis of the assets inside the LLC is for the transferee's benefit only. If the LLC's assets have declined in value, the transferee's share of the inside basis in the LLC's assets is decreased by the transferor's share of the inside basis minus the amount paid for the interest. See id.

[FN478]. Id. § 734(b). Decreases to inside basis will occur if a member recognizes a loss from a distribution. Similar increases or decreases to inside basis are made if a member receives a distribution of property with a lower or higher basis than the LLC had. See id.

[FN479]. I.R.C. § 704(c) (West 1988 & Supp.1991).

[FN480]. Treas.Reg. § 1.704-1(c)(2) (as amended in 1987).

[FN481]. Id. § 1.704-1(b)(4)(i).

[FN482]. There will not always be enough tax gain or loss to cure the disparity between the property's book value and adjusted tax basis. In these cases the LLC will not be able to prevent economic distortions with tax allocations. See id. § 1.704-1(c)(2).

[FN483]. For a more detailed discussion of I.R.C. § 704(c) (1988) and Treas.Reg. § 1.704-1(b)(4)(i) (as amended in 1987), see 2 Willis et al., supra note 351, § 105.02; 1 McKee et al., supra note 433, ¶ ¶ 10.02[4][a], 10.04.

[FN484]. I.R.C. § 469 (West Supp.1991).

[FN485]. Id. § 469(b).

[FN486]. Id. § 469(c). Losses from rental activities are automatically treated as passive losses. See id.

[FN487]. Treas.Reg. § 1.469-2T(e) (as amended in 1990).

[FN488]. Id.

[FN489]. Id. § 1.469-5T(e) (as amended in 1989).

[FN490]. Id. § 1.469-5T.

[FN491]. Id. For a detailed description of the passive loss limitations and a policy critique, see Robert J. Peroni, A Policy Critique of the Section 469 Passive Loss Rules, 62 S.Cal.L.Rev. 1 (1988); see also Willis et al., supra note 351, § § 81-88; 1 McKee et al., supra note 433, ¶ 10.08.

[FN492]. See supra text accompanying note 144.

[FN493]. See Staff of the Joint Comm. on Taxation, 99th Cong., 2d Sess., General Explanation of the Tax Reform Act of 1986, 210-14 (Joint Comm. Print 1987).

[FN494]. See supra text accompanying notes 98, 168-70.

[FN495]. I.R.C. § 465(a) (1988). For a detailed description of the at-risk limitations as applied to partnership losses, see Willis et al., supra note 351, § § 71-79; 1 McKee et al., supra note 433, ¶ 10.06.

[FN496]. I.R.C. § 465(b) (West Supp.1991).

[FN497]. Prop.Treas.Reg. § 1.465-24(a)(2), 44 Fed.Reg. 32,242 (1979), treats partners as being at-risk for their shares of the partnership's debt that they are personally liable for if the partnership cannot pay the liability. Prop.Treas.Reg. § 1.465-6(d), 44 Fed.Reg. 32,238 (1979) states that guarantees do not produce an at-risk amount if the guarantor acquires subrogation rights. While partners clearly have this right, see Unif. Partnership Act § 34 (1914), it appears that members of LLCs do not. See Roche et al., supra note 343. But see Martha W. Jordan & Peter K. Kloepfer, The Limited Liability Company: Beyond Classification, 69 Taxes 203, 205-06 (1991).

[FN498]. I.R.C. § 465(b)(6)(C) (West Supp.1991). A member's share of the at-risk amount will correspond to the member's share of the LLC's debt under I.R.C. § 752. See id.

[FN499]. Id. § 465(b)(6).

[FN500]. See id.; see also Jordan & Kloepfer, supra note 497, at 208.

[FN501]. See Staff of the Joint Comm. on Taxation, supra note 493, at 255.

[FN502]. I.R.C. § 6231(a) (1988).

[FN503]. See Willis et al., supra note 351, § § 201-209; 1 McKee et al., supra note 433, ¶ 9.06.

[FN504]. I.R.C. § 6231(a)(7) (1988).

[FN505]. Id.; see also Roche et al., supra note 343.

[FN506]. Rev.Rul. 88-76, 1988-2 C.B. 360.

[FN507]. See supra notes 350-52 and accompanying text.

[FN508]. See supra text accompanying note 352.

[FN509]. See Priv.Ltr.Rul. 91-47-017 (Aug. 12, 1991); Priv.Ltr.Rul. 91-19-029 (Feb. 7, 1991); Priv.Ltr.Rul. 90-52-039 (Oct. 2, 1990); Priv.Ltr.Rul. 90-30-013 (Apr. 25, 1990); Priv.Ltr.Rul. 90-29-019 (Apr. 19, 1990); Priv.Ltr.Rul. 90-10-027 (Dec. 7, 1989); Priv.Ltr.Rul. 89-37-010 (June 16, 1989).

[FN510]. Lexis search conducted on August 7, 1991. But see Abu-Nassar v. Elders Futures, Inc., No. 88 Civ. 7906, 1991 U.S.Dist. LEXIS 3794, at *13 (S.D.N.Y. Mar. 28, 1991) (denial of summary judgment motion concerning liability of members of a Lebanese LLC). See infra notes 597-602 and accompanying text.

[FN511]. Colo.Rev.Stat. § 7-80-705 (Supp.1990); Fla.Stat.Ann. § 608.436 (West Supp.1991); Kan.Stat.Ann. § 17-7620 (Supp.1991); Nev.Rev.Stat.Ann. § 86.371 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 4.03(A) (West Supp.1992); Utah Code Ann. § 48-2b-109 (Supp.1991); Va.Code Ann. § 13.1-1019 (Michie Supp.1991); Wyo.Stat. § 17-15-113 (Supp.1989).

[FN512]. Wyo.Stat. § 17-15-113 (Supp.1989).

[FN513]. Colo.Rev.Stat. § 7-80-705 (Supp.1990); Fla.Stat.Ann. § 608.436 (West Supp.1991); Kan.Stat.Ann. § 17-7620 (Supp.1991); Nev.Rev.Stat.Ann. § 86.371 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1529n, art. 4.03(A) (West Supp.1992); Utah Code Ann. § 48-2b-109 (Supp.1991); Va.Code Ann. § 86.3.1-1019 (Michie Supp.1991).

[FN514]. See supra text accompanying note 260. Cf. Rev. Unif. Ltd. Partnership Act § 502 (1985).

[FN515]. The rule is similar to that applicable to corporations. See infra text accompanying note 518.

[FN516]. See Hamill, supra note 28, at 744; Gazur & Goff, supra note 26, at 401; Kathleen K. Parker, The Limited Liability Company; Don't Leave Home With It 95, 100 (May 23-24, 1991) (presentation to the Georgetown Institute of State and Local Taxation, Washington, D.C.).

[FN517]. 6 Zolman Cavitch, Business Organizations § 120.04[1], at 120-44 (1991); Edward Brodsky & M. Patricia Adamski, Law of Corporate Officers and Directors § 20:01, at 1 (1984 & Supp.1990).

[FN518]. Rev. Model Business Corp. Act § 6.22. The Act, however, provides for shareholder liability for pre-incorporation transactions, id. § 2.04, for derivative proceedings, id. § 7.40-.47, and for receiving unlawful distributions, id. § 8.33.

[FN519]. 142 F. 247 (E.D.Wis.1905).

[FN520]. Id. at 255.

[FN521]. 7 Cavitch, supra note 517, § 154.03[1], at 154-13 n. 3.

[FN522]. 1 F. Hodge O'Neal & Robert B. Thompson, O'Neal's Close Corporations § 1.10, at 39-40 (3d ed. 1987 & Supp.1991). A Westlaw search for piercing the corporate veil cases produced more than 2,000 cases. Id. § 1.10, at 45 n. 1.

[FN523]. Brodsky & Adamski, supra note 517, § 20.02, at 3-4; see, e.g., United States v. Healthwin-Midtown Convalescent Hosp. and Rehabilitation Ctr., Inc., 511 F.Supp. 416, 418 (C.D.Cal.1981), aff'd without opinion, 685 F.2d 448 (9th Cir.1982).

[FN524]. O'Neal & Thompson, supra note 522, § 1.10, at 40; see, e.g., Establissement Tomis v. Shearson Hayden Stone, Inc., 459 F.Supp. 1355, 1365 (S.D.N.Y.1978) (using remedy reluctantly), cert. denied sub nom. Prudential-Bache Sec., Inc. v. Angelastro, 474 U.S. 935 (1985); Hickman v. Rawls, 638 S.W.2d 100, 102 (Tex.Ct.App.1982) (extraordinary circumstances).

[FN525]. 6 Cavitch, supra note 517, § 120.05[1], at 120-59.

[FN526]. Id. § 120.05[2]-[6], at 120-59 to -89; see Robert B. Thompson, Piercing the Corporate Veil: An Empirical Study, 76 Cornell L.Rev. 1036, 1063-70 (1991); William P. Hackney & Tracey G. Benson, Shareholder Liability for Inadequate Capital, 43 U.Pitt.L.Rev. 837, 848-99 (1982) (surveying corporate veil piercing cases).

[FN527]. Brodsky & Adamski, supra note 517, § 20.12, at 25; see, e.g., Sutton v. Reagan & Gee, 405 S.W.2d 828, 837 (Tex.Civ.App.1966).

[FN528]. Brodsky & Adamski, supra note 517, § 20.12, at 25.

[FN529]. Rev. Unif. Ltd. Partnership Act § 303(a) (1985).

[FN530]. Id.

[FN531]. Id. (brackets in original). Under § 303, however, a limited partner is personally liable if he knowingly permits his name to be used in the name of the limited partnership and creditors who extend credit to the limited partnership are without knowledge that the limited partner is not a general partner. Id. § 303(d).

[FN532]. Id. § 303(a).

[FN533]. See Van Arsdale v. Claxton, 391 F.Supp. 538, 540 (S.D.Cal.1975).

[FN534]. Ga.Code Ann. § 14-9-303 (Michie 1989).

[FN535]. See supra text accompanying notes 144-47; Ribstein, supra note 92, at 886-90; Basile, supra note 145, at 1199-1233 (analysis of control rule).

[FN536]. The Colorado LLC Act provides:

> In any case in which a party seeks to hold the members of a limited liability company personally responsible for the alleged improper actions of the limited liability company, the court shall apply the case law which interprets the conditions and circumstances under which the corporate veil of a corporation may be pierced under Colorado law.

Colo.Rev.Stat. § 7-80-107 (Supp.1990). For an analysis of veil piercing in the LLC context, see Hamill, supra note 28, at 751-52; Gazur & Goff, supra note 26, at 401-03; Joseph P. Fonfara and Corey A. McCool, Comment, The Wyoming Limited Liability Company: a Viable Alternative to the S Corporation and the Limited Partnership?, 23 Land & Water L.Rev. 523, 531-34 (1988).

[FN537]. Colo.Rev.Stat. § 7-80-107 (Supp.1990).

[FN538]. See supra text accompanying note 521-22.

[FN539]. Compare Rev. Model Business Corp. Act § § 7.32, 8.01(c), 8.02 and Rev. Unif. Ltd. Partnership Act § 303(a) (1985) with Colo.Rev.Stat. § 7-80-401 (Supp.1990), Fla.Stat.Ann. § 608.422 (West Supp.1991), Kan.Stat.Ann. § 17-7612 (Supp.1991), Nev.Rev.Stat.Ann. § 86.291 (Michie Supp.1991), Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.10 (West Supp.1992), Utah Code Ann. § 48-2b-125 (Supp.1991); Va.Code Ann. § 13.1-1022 (Michie Supp.1991); Wyo.Stat. § 17-15-116 (Supp.1989).

[FN540]. Ga.Code Ann. § 14-9-303 (Michie 1989).

[FN541]. Rev. Model Business Corp. Act § 2.01.

[FN542]. Id. § 2.05.

[FN543]. Id. § 2.06.

[FN544]. Id. § 5.01.

[FN545]. Id. § 6.21.

[FN546]. Id. § 7.01.

[FN547]. Id. § 8.20.

[FN548]. Id. § 8.40.

[FN549]. Id. § 16.22.

[FN550]. Wyo.Stat. § 17-15-108 (Supp.1989).

[FN551]. Id. § 17-15-110.

[FN552]. Id. § 17-15-116.

[FN553]. See, e.g., DeWitt Truck Brokers, Inc. v. W. Ray Fleming Fruit Co., 540 F.2d 681, 686 n. 14 (4th Cir.1976).

[FN554]. Model Statutory Close Corp. Supp. § 25 (1984).

[FN555]. For a comparison of a close corporation to an LLC, see supra text accompanying notes 131-39.

[FN556]. See supra text accompanying notes 527, 532.

[FN557]. See supra text accompanying notes 528, 533.

[FN558]. Wyo.Stat. § 17-15-104(a)(viii) (Supp.1989).

[FN559]. Colo.Rev.Stat. § 7-80-104(h) (Supp.1990); Fla.Stat.Ann. § 608.404(7) (West Supp.1991); Kan.Stat.Ann. § 17-7604(g) (Supp.1991); Nev.Rev.Stat.Ann. § 86.281(8) (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 2.02(A) (West Supp.1992); Va.Code Ann. § 13.1-1009(7) (Michie Supp.1991); Utah Code Ann. § 48-2b-105(1)(h) (Supp.1991).

[FN560]. See Robert A. Leflar et al., American Conflicts Law § 256, at 709 (4th ed. 1986); George W. Stumberg, Principles of Conflict of Laws 429 (3d ed. 1963). The Commerce Clause gives Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes." U.S. Const. art. I, § 8, cl. 3.

[FN561]. See, e.g., Dahnke-Walker Milling Co. v. Bondurant, 257 U.S. 282, 291 (1921).

[FN562]. Chester J. Antieau, 2 Modern Constitutional Law § 10:35, at 71-72 (1969 & Supp.1991).

[FN563]. Leflar et al., supra note 560, § 256, at 709. For example, a state exercises reasonable control over commerce by requiring foreign corporations to apply for authority to transact business within the state. See 3A

Cavitch, supra note 517, § 63A.01[1], at 63A-4.

[FN564]. The Wyoming, Nevada and Texas LLC statutes explicitly provide that the Commerce Clause applies to their statutes. Wyo.Stat. § 17-15-135 (Supp.1989); Nev.Rev.Stat.Ann. § 86.131 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 8.09 (West Supp.1992).

[FN565]. 3A Cavitch, supra note 517, § 63A.01[1], at 63A-4. Because the determination of whether commerce is interstate or intrastate is of a factual nature, courts have had difficulty formulating a specific rule that will control in all cases. Id.

[FN566]. Id. § 63A.01[1], at 63A-4 n. 2.

[FN567]. Colo.Rev.Stat. § § 7-80-901 to -913 (Supp.1990); Kan.Stat.Ann. § § 17-7636 to -7644 (Supp.1991); Nev.Rev.Stat.Ann. § 86.551 (Michie Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, arts. 7.01-.13 (West Supp.1992); Va.Code Ann. § § 13.1-1051 to -1060 (Michie Supp.1991); Utah Code Ann. § § 48-2b-143 to -148 (Supp.1991).

[FN568]. Ind.Code Ann. § § 23-16-10.1-1 to -4 (Burns Supp.1991).

[FN569]. At least one state, Maryland, allows LLCs to register as foreign corporations, while two states, Georgia and North Carolina, do not allow such registration. In all cases, these determinations are made by the state Attorney General based upon the state's foreign corporation or limited partnership statute. Letter from Kaye Brooks Bushel, Asst. Attorney General, Maryland Attorney General's Office, to Dean W. Kitchen; Letter from Roger M. Siegel, Asst. Attorney General, to The Honorable Max Cleland, Georgia Secretary of State (May 21, 1991) (on file with author); Letter from Richard H. Carlton, Chief Deputy Secretary of State, to Frank L. Liggett, III, Esq., LeBoeuf, Lamb, Leiby & MacRae, Raleigh, N.C. (Oct. 16, 1991) (on file with author).

[FN570]. See 3A Cavitch, supra note 517, § 63A.02[2][c], at 63A-20.

[FN571]. Colo.Rev.Stat. § 7-80-910 to -911 (Supp.1990); Kan.Stat.Ann. § § 17-7642 to -7644 (Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 7.13 (West 1992); Va.Code Ann. § § 13.1-1057 to -1058 (Michie Supp.1991); Utah Code Ann. § § 48-2b-146 to -147 (Supp.1991).

[FN572]. Colo.Rev.Stat. § 7-80-910(2) (Supp.1990); Kan.Stat.Ann. § § 17-7642 to -7643 (Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 7.13(B) (West Supp.1992); Va.Code Ann. § § 13.1-1057(B) (Michie Supp.1991); Utah Code Ann. § § 48-2b-146(2) (Supp.1991).

[FN573]. Colo.Rev.Stat. § 7-80-910(7) (Supp.1990); Kan.Stat.Ann. § 17-7642(c) (Supp.1991); Utah Code Ann. § 48-2b-146(3) (Supp.1991).

[FN574]. Restatement (Second) Conflict of Laws § 2 cmt. a (1971) [[[[hereinafter Restatement].

[FN575]. The comity discussion also may be applicable to the first two fact patterns, except in a situation where a foreign LLC statute is on point.

[FN576]. The Full Faith and Credit discussion also may be applicable to the first two fact patterns, except in a situation where a foreign LLC statute is on point.

[FN577]. The Interstate Commerce Clause discussion also may be applicable to the first two fact patterns, except in a situation where a foreign LLC statute is on point.

[FN578]. Colo.Rev.Stat. § 7-80-901 (Supp.1990); Kan.Stat.Ann. § 17-7636(a) (Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 7.02 (West Supp.1992); Va.Code Ann. § 13.1-1051 (Michie Supp.1991).

[FN579]. See Restatement § 6(1).

[FN580]. Nev.Rev.Stat.Ann. § 86.551 (Michie Supp.1991).

[FN581]. Id. § § 88.010-.645.

[FN582]. Id. § 88.570-.605.

[FN583]. Id. § 88.570.

[FN584]. Colo.Rev.Stat. § 7-80-901 (Supp.1990); Kan.Stat.Ann. § 17-7636(a) (Supp.1991); Tex.Rev.Civ.Stat.Ann. art. 1528n, art. 7.02 (West Supp.1992); Va.Code Ann. § 13.1-1051 (Michie Supp.1991).

[FN585]. Restatement § 6(2).

[FN586]. Fla.Stat.Ann. § 608.436 (West Supp.1991); Utah Code Ann. § 48-2b-109 (Supp.1991); Wyo.Stat. § 17-15-113 (Supp.1989).

[FN587]. Thus far, Indiana is the only state to enact such a statute.

[FN588]. Ind.Code Ann. § § 23-16-10.1-1 to -4 (Burns Supp.1991).

[FN589]. See supra text accompanying note 585.

[FN590]. Brian L. Schorr & Aileen R. Leventon, Limited Liability Company: An Alternative Business Form, N.Y.L.J., May 30, 1991, at 7. This analysis seems reasonable if one assumes that the control rules under the Indiana limited partnership act would not be applied to an LLC member. Ind.Code Ann. § 23-16-4-3 (Burns 1989).

[FN591]. See supra text accompanying note 585.

[FN592]. Restatement § 307 (shareholder); id. § 295 (general and limited partners).

[FN593]. The introductory comments to the Restatement state that it has ignored other forms of organization because such forms only rarely have engaged the courts in choice of law issues. Restatement Chapter 13, Business Corporations Introduction Note; id. Chapter 12, Agency and Partnerships Introductory Note.

[FN594]. Id. Until the case law develops, the only means to address questions regarding the liability of members for the LLC's obligations will be by analogy to other forms of business. See Roche et al., supra note 343, at 253.

[FN595]. Restatement § 307. Section 307 provides that "the local 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." Id. Interestingly, the comments to § 307 provide that the local laws of the state of incorporation should be applied because "(1) this is the law which the shareholders ... would usually expect to have applied to determine their liability, (2) exclusive application of this law will assure uniform treatment of shareholders and, (3) [the state of incorporation] will usually have the dominant interest in the determination of the issue." Id. cmt. a.

[FN596]. Id. § 295. The comments to § 295 note that the relationship of a limited partner to the limited partnership is comparable to the relationship of a shareholder to a corporation. Id. cmt. d. Thus, if an LLC member is compared to a limited partner, an analysis under § 6 of the Restatement should lead to the same conclusion as that under § 307; the forum state will adopt the limited liability provisions of the LLC's state of organization.

[FN597]. No. 88-Civ. 7906, 1991 U.S.Dist. LEXIS 3794 (S.D.N.Y. Mar. 28, 1991).

[FN598]. Id. at *11. "The first issue we face is the choice of law governing a suit in an American court attacking the corporate status of a foreign corporation." Id.

[FN599]. Id. at *6. "This court looks to foreign law regarding requirement of corporate status ... but with respect to piercing the corporate veil ... different choice of law principles may be applicable.” Id.

[FN600]. Id. at *6-*13.

[FN601]. Id. at *13-*19.

[FN602]. Id. at *6.

[FN603]. The comity discussion contained under this third fact pattern also may be applicable to the first two fact patterns, except in a situation where a foreign LLC statute is on point.

[FN604]. Edward S. Stimson, Conflict of Laws 70-71 (1963).

[FN605]. Black's Law Dictionary 267 (6th ed. 1990).

[FN606]. Hilton v. Guyot, 159 U.S. 113, 135 (1895).

[FN607]. Herbert F. Goodrich, Handbook on the Conflict of Laws 8 (1st ed. 1927).

[FN608]. 115 S.W.2d 468 (Tex.Civ.App.1938).

[FN609]. Id. at 475.

[FN610]. See Thompson v. Schmitt, 274 S.W. 554, 560-61 (Tex.1925).

[FN611]. Id. at 559-560.

[FN612]. The Full Faith and Credit discussion contained under this third fact pattern also may be applicable to the first two fact patterns, except in a situation where a foreign LLC statute is on point.

[FN613]. U.S. Const. art. IV, § 1. The term Acts has been held to include state statutes. Carroll v. Lanza, 349 U.S. 408, 411 (1955).

[FN614]. See Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 498 (1941).

[FN615]. Allstate Ins. Co. v. Hague, 449 U.S. 302, 308 (1981).

[FN616]. Id. The Full Faith and Credit Clause should not invalidate a state's “choice of forum law unless that choice threatens the federal interest in national unity by unjustifiably infringing upon the legitimate interests of another State.” Id. 323 (Stevens, J., concurring).

[FN617]. Colo.Rev.Stat. § 7-80-106 (Supp.1990); Nev.Rev.Stat.Ann. § 86.131 (Michie Supp.1991). For example, the Colorado statute provides:

> It is the intention of the general assembly by the enactment of this article that the legal existence of limited liability companies formed under this article be recognized beyond the limits of this state and that, subject to any reasonable registration requirements, any such limited liability company transacting business outside this state be granted the protection of full faith and credit under section 1 of article IV of the constitution of the United States.

Colo.Rev.Stat. § 7-80-106 (Supp.1990).

[FN618]. U.S. Const. art. I, § 8, cl. 3.

[FN619]. 481 U.S. 69 (1987).

[FN620]. Id. at 94.

[FN621]. Id. at 89.

[FN622]. Id.

[FN623]. Id. at 91.

[FN624]. See Tyson Foods, Inc. v. McReynolds, 865 F.2d 99, 101-03 (6th Cir.1989) (striking down on Commerce Clause grounds Tennessee statutes that applied to targets incorporated in other states and that, among other things, regulated disclosure in tender offers); Hyde Park Partners, L.P. v. Connolly, 839 F.2d 837, 847-53 (1st Cir.1988) (striking down on Commerce and Supremacy Clause grounds a Massachusetts statute that, among other things, forbade transfers for a year to bidders who fail to disclose material facts); Campeau Corp. v. Federated Dep't Stores, 679 F.Supp. 735, 738-39 (S.D.Ohio 1988) (invalidating under Commerce Clause Ohio statute that regulated acquisition of “resident” corporation by “foreign” business, thus adversely affecting interstate commerce).

[FN625]. Letter from Richard C. Hite, Chairman, Scope and Program Committee, National Conference of Commissioners on Uniform State Laws, to Robert R. Keatinge, (Feb. 19, 1991) (on file with author).

[FN626]. The study committee is chaired by Edward I. Cutler of Tampa, Florida.

[FN627]. See supra text accompanying notes 8-9.

[FN628]. See ‘Limited Liability Company’ Bandwagon is on a Roll as Legislatures Respond to Interest in Hybrid Entity, Corp. Couns. Wkly. (BNA), Aug. 28, 1991, at 8.

[FN629]. For an example, see the recent enactment of the Texas Registered Limited Liability Partnership Act, codified at Tex.Rev.Civ.Stat.Ann. art. 6132b, § § 2, 15, 45-A, 45-B, 45-C (West 1970 & Supp.1991), which contains a provision limiting the personal liability of a partner for partnership obligations arising from the negligence or malfeasance of other partners.

[FN630]. See, e.g., I.R.C. § 11(b)(2) (West 1988 & Supp.1991) (denying graduated tax rates to personal service corporations).

[FN631]. Kan.Stat.Ann. § 17-7603 (Supp.1991); Utah Code Ann. § 48-2b-105(1)(r) (Supp.1991). The Utah statute, however, does not afford a limitation on liability for professional misconduct. See id. § 48-2b-111(2) (persons rendering professional services in LLC are personally liable for their own acts or omissions but not for those of any other member, manager, or employee).

[FN632]. Va.Code Ann. 13-1-1008 (Michie Supp.1991) (“Every limited liability company formed under this chapter has the purpose of engaging in any lawful business, except the provision of professional services ...”)

[FN633]. Colo.Rev.Stat. § 7-80-103 (Supp.1990).

[FN634]. It's Time, LLCs Make Sense, Let's Do It, Phoenix Gazette, May 21, 1991, editorial (“To avoid charges that the proposed legislation is simply a tool fashioned by special interest professions-people such as lawyers, doctors or accountants-these professions have been omitted from Arizona's LLC bill.”)

[FN635]. See, e.g., AICPA Members to Vote on Proposal to Let CPA Firms Form Corporations, Daily Tax Reports (BNA) No. 205, at G-1 (Oct. 23, 1990) (AICPA Vice President Bernard Lee assured House Energy and Commerce Committee Chairman John Dingell that individuals responsible for audits will not escape personal responsibility through the use of LLCs).

[FN636]. See I.R.C. § 1361(b)(1)(D) (West 1988 & Supp.1991) (S corporation may only have one class of stock).

[FN637]. Model Code of Professional Responsibility DR 6-102, EC 6-6 (1981). EC 6-6 states that “[a] lawyer who is a stockholder in or is associated with a professional legal corporation may, however, limit his liability for malpractice of his associates in the corporation, but only to the extent permitted by law.” See also ABA Comm. on

Professional Ethics & Grievances, Formal Op. 303 (1961).

[FN638]. Rule 1.8(h) of the Model Rules of Professional Conduct (1990) provides:

> A lawyer shall not make an agreement prospectively limiting the lawyers's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement, or settle a claim for such liability with an unrepresented client or former client without first advising that person in writing that independent representation is appropriate in connection therewith.

[FN639]. On October 31, 1991, the Colorado Supreme Court modified rule 265 of the Colorado Rules of Civil Procedure to allow attorneys to practice as LLCs. Colo.Rev.Stat.Ann.R.Civ.P. 265 (effective Nov. 1, 1991). Because the Colorado LLC statute provides that an LLC may be organized for any purpose for which a limited partnership may be organized, Colo.Rev.Stat. § 7-80-103 (Supp.1990), there may be a question of the efficacy of the rule change without a corresponding change allowing attorneys to practice as limited partnerships or a change to the purposes provision of the Colorado statute.

[FN640]. Prior to the recent amendment, rule 505 of the AICPA Code of Professional Conduct provided in part: "A member may practice public accounting only in the form of a proprietorship, a partnership, or a professional corporation whose characteristics correspond to resolutions of the Council." AICPA Code of Professional Conduct Rule 505.

[FN641]. See AICPA Members to Vote on Proposal to Let CPA Firms Form Corporations, supra note 635, at G-2; see also Thomas W. Rimerman, The Need for Expanding Organizational Options for CPAs, J.Acct., Oct. 1991, at 45. ("This rule change may not seem monumental, yet in reality, it could be a significant step in helping to ensure the profession's future viability.")

[FN642]. The resolution was approved by approximately 92% of the members voting. AICPA Press Release, Jan. 16, 1992.

[FN643]. See Rimerman, supra note 641.

[FN644]. See Members to Vote on Rule Regarding Form of Practice, CPA Letter, July 1991, at 1; see also Rimerman, supra note 641.

[FN645]. See Summary of Changes Proposed to Rule 505, Form of Practice & Name, (Helene Kennedy, Director, Communications and Public Relations, AICPA, New York, N.Y.), June 13, 1991, at Question 11. Question 5 provided:

> Several states are developing legislation that would essentially create a new business entity-the Limited Liability Company. This form combines the limited exposure to liability associated with corporations with the tax benefits of partnerships. The new rule will ensure that members are not hindered from choosing this organizational form, or any other form that may better serve their needs.
>
> In addition, the modified rule may allow members to select organizational forms that will facilitate their ability to establish multi-state practices and enable them to better serve clients who operate in more than one state.

Id. at Question 5.