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Matthew W. Ray

THE TEXAS LIMITED LIABILITY COMPANY — A POSSIBLE ALTERNATIVE FOR BUSINESS FORMATION

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I. INTRODUCTION

IN 1977, Wyoming became the first state to authorize the creation of the Limited Liability Company ("LLC").[1] The LLC business form combines the limited liability of a corporation with the flow-through tax benefits of a partnership.[2] Wyoming initially hoped that its pioneering legislation would lure additional business to the state.[3] However, the Treasury Department's inconsistent treatment of the LLC's tax status acted as an obstacle to its broad acceptance.[4] Consequently, Wyoming's initial hopes for the LLC met with a less than overwhelming response.[5]

In 1988, the Internal Revenue Service (IRS) solidified the LLC's tax advantages with the issuance of Revenue Ruling 88-76, which classified the Wyoming LLC as a partnership for federal income tax purposes.[6] This ruling, although somewhat limited in its scope,[7] resolved the uncertainty surrounding the LLC and resulted in increased acceptance of the LLC as a viable business entity.[8] To date, sixteen states have approved LLCs and eight additional states have introduced LLC legislation.[9]

On August 26, 1991, the Texas legislature enacted the Texas Limited Liability Company Act (the "TLLCA" or the "Texas Act") authorizing the creation of LLCs in Texas.[10] This article will discuss the basic structural makeup of an LLC under the TLLCA.[11] The limited liability protection and

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1. Wyoming Limited Liability Company Act, WYO. STAT. §§ 17-15-101-136 (1977).
2. *See infra* note 127 for discussion of the tax benefits received by a partnership and text accompanying notes 178-81 for discussion of the limited liability afforded corporations.
3. Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 389-90 (1977).
4. The Treasury Department's failure to establish clear parameters for an LLC to obtain favorable flow-through tax benefits resulted in a hesitancy on the part of businesses to utilize the LLC form. *See generally* Gazur & Goff, *supra* note 3, at 444-52 (discussing the "troubled history" of the classification of LLCs by the Internal Revenue Service for federal tax purposes).
5. Only 26 Wyoming LLCs were formed by February 22, 1988, over 10 years after Wyoming first authorized the creation of LLCs. *Id.* at 390 n.10.
6. Rev. Rul. 88-76, 1988-2 C.B. 360.
7. As two commentators noted, Rev. Rul. 88-76 "dealt with highly stylized facts." Gazur & Goff, *supra* note 3, at 459.
8. In Colorado, for example, more than 550 LLCs had been formed within approximately eighteen months after the enactment of the Colorado Limited Liability Company Act in April of 1990. Charles R. Johnson, *Texas Limited Liability Company*, Presented to the Probate, Trusts and Estates Section of the Dallas Bar Ass'n, at 1 (Nov. 26, 1991) (transcript available from Dallas Bar Association).
9. The states approving limited liability companies include: Arizona, Colorado, Florida, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, Nevada, Oklahoma, Texas, Utah, Virginia, West Virginia, and Wyoming. Charles E. Price, *Tax Aspects of Limited Liability Companies*, J. ACCT. 48, 52 (Sept. 1992). In addition, Georgia and Indiana have enacted statutes allowing foreign LLCs to conduct business in the State. *Id.* States considering LLC legislation include: Hawaii, Indiana, Missouri, Nebraska, Pennsylvania, Rhode Island, South Carolina, and Tennessee. *Id.*
10. Texas Limited Liability Company Act, TEX. REV. CIV. STAT. ANN. art. 1528n (Vernon Supp. 1992).
11. A detailed discussion of each of the TLLCA's provisions is not the purpose of this article. Rather, the general structural framework of an LLC under the TLLCA will be discussed in order to provide a basic understanding of the entity's characteristics.

flow-through tax treatment afforded an LLC's members will also be explored. Since each organizational decision could impact the IRS' treatment of the entity for taxation purposes, possible tax considerations during the organizational stage will be discussed. In addition, the LLC will be compared to other business forms in order to highlight the situations in which the LLC could be the best choice for doing business.

II. ELEMENTS OF THE TLLCA

The TLLCA combines features from both the Texas Business Corporation Act (the "TBCA") and the Texas Revised Limited Partnership Act (the "TRLPA").[12] Except as limited in the LLC's regulations or articles of organization, the LLC enjoys the power of both a corporation under the TBCA and a limited partnership under the TRLPA.[13] A summary of the significant provisions of the TLLCA follows.

A. FORMATION

An LLC may be formed to engage in any lawful business.[14] In order to form an LLC, one or more of the LLC's organizers must file articles of organization with the secretary of state.[15] Any natural person eighteen years of age or older may organize an LLC and sign the articles of organization.[16] The articles of organization must include the name of the LLC,[17] the duration of the LLC which may not exceed thirty years, the purpose for which the LLC is organized, the address of its principal place of business, the name and address of its registered agent within the state, and a statement concerning the management of the organization.[18] The TLLCA is unique in that it allows single member LLCs.[19] Unlike other states which explicitly require

12. Wolens, Bill Analysis, H.B. 278, 72nd Leg., R.S. § 46, at 9 (1991). According to the bill analysis, parts 1-3 and 7-9 of the TLLCA follow the TBCA; parts 4 and 5 follow the TRLPA; and part 6 combines provisions of both the TBCA and the TRLPA. *Id.* at 10.

13. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.02.

14. *Id.* Art. 2.01. The regulations or the articles of organization may limit the purpose of the LLC. Additionally, an LLC engaging in a statutorily regulated business is subject to the limitations of the pertinent statute. *Id.*

15. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 3.03. If the articles of organization conform to law and all required fees have been paid, the secretary of state shall issue a certificate of organization which initiates the existence of the LLC. *Id.* Arts. 3.03-3.04.

16. *Id.* Art. 3.01.

17. The name must have the word "Limited," the abbreviation "Ltd." or "L.C." *Id.* Art. 2.03 § A(1). The TLLCA also provides substantial guidance concerning deceptive names, assumed names, and the right to reserve exclusive names. *Id.* Arts. 2.03 § A(2)-2.04.

18. Specifically, if the LLC is to be managed by a manager or managers, the articles must include "a statement that the company is to be managed by a manager or managers and the names and addresses of such managers who are to serve as managers until the first annual meeting of members or until their successors are duly elected." TEX. REV. CIV. STAT. ANN. art. 1528n Art. 3.02 § A(5). Alternatively, if the members will manage the LLC, the articles of organization should set forth the names and addresses of the members. *Id.* *See infra* text accompanying notes 34-39 for discussion of the LLC management structure.

19. Although the language of the statute appears to allow a single member LLC, it is not yet clear whether this was intended or merely poor drafting. *See* Robert R. Keatinge, et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 410

two members to form an LLC,[20] the Texas Act requires only one member at the time of formation.[21]

Unlike a corporation, an LLC's life is limited to 30 years.[22] This limitation may seem undesirable for those planning a long-term venture. However, nothing in the TLLCA prohibits dissolving and reorganizing the entity at the end of the thirty year period. Of course, new articles of organization would have to be filed with the secretary of state in order to reset the thirty year time limit and meet the statutory filing requirements.[23]

At inception, the owners of an LLC should adopt regulations which are similar to corporate bylaws or limited partnership agreements.[24] Although provisions addressing the regulation of the LLC's internal affairs may be included in the articles of organization, it is more likely that such provisions will be incorporated in the regulations.[25] The regulations articulate the infrastructure of the entity, including provisions addressing management,[26] dissolution,[27] income distribution matters,[28] indemnification,[29] and admission of members.[30] Any affairs not included in the regulations will be addressed by the provisions of the TLLCA.[31] Conversely, most provisions of the TLLCA can be modified by the regulations.[32] Before adopting the regu-

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(1992) ("It is unclear whether an LLC formed under the Texas statute may have only one member.").

20. Both the Wyoming and the Florida Acts require two or more persons to form an LLC. *See* WYO. STAT. § 17-15-106 (1989); FLA. STAT. ANN. § 608.405 (West Supp. 1992). Alternatively, the Colorado Act requires only one person to form an LLC, but requires at least two members at the time of formation. COLO. REV. STAT. ANN. § 7-80-203(2) (West 1991).

21. According to the bill analysis, the TLLCA was based primarily on the Colorado statute. Wolens, *supra* note 12, at 9. The Colorado statute requires two or more members upon formation. COLO. REV. STAT. ANN. § 7-80-203(2). However, this requirement is not included in the TLLCA. In addition, several provisions of the Colorado Act presuppose the existence of at least two members. For example, the Colorado Act provides for dissolution upon the occurrence of certain conditions. The dissolution, however, can be avoided if there are at least two remaining members and all remaining members consent to continue the LLC. COLO. REV. STAT. ANN. § 7-80-801(1)(c). The Texas statute, on the other hand, requires only that one member remain to avoid dissolution. TEX. REV. CIV. STAT. ANN. art 1528n Art. 6.01 § A(4) (Vernon Supp. 1992). Although Texas allows single member LLCs, they will likely face unfavorable tax treatment by the IRS which would temper the limited liability advantage typically afforded an LLC's members. *See infra* text accompanying notes 194-201 for discussion of tax considerations affecting single member LLCs.

22. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 3.02 (Vernon Supp. 1992). A corporation's life is unlimited. TEX. BUS. CORP. ACT ANN. art. 3.02A(2) (Vernon Supp. 1992).

23. TEX. REV. CIV. STAT. ANN. art. 1528n Arts. 3.02-3.03 (Vernon Supp. 1992).

24. Wolens, *supra* note 12, at 12.

25. Johnson, *supra* note 8, at 1.

26. *See infra* notes 34-50 and accompanying text.

27. *See infra* notes 77-94 and accompanying text.

28. *See infra* notes 68-76 and accompanying text.

29. *See infra* notes 51-54 and accompanying text.

30. *See infra* notes 55-67 and accompanying text.

31. *See* TEX. REV. CIV. STAT. ANN. art. 1528n Art. 3.02 § B.

32. *Id.*

> The power to adopt, alter, amend, or repeal the regulations of a limited liability company shall be vested in the members of the company. . . . Regulations adopted by the members or by the managers may be repealed or altered; new regulations may be adopted by the members; and regulations may provide that they may not, in whole or specified part, be altered, amended, or repealed by the managers. The regulations may contain any provisions for the regulation and

lations, especially regulations that modify the statutory provisions, the members should consider potential tax considerations associated with each formation decision.[33]

B. MANAGEMENT

The LLC provides flexibility in the organization of management and the distribution of management power among its members.[34] An LLC can have either a centralized, corporate form of management, or a decentralized, partnership type structure. The provisions of the TLLCA provide for a centralized management scheme, directing that an LLC will be managed by a group of managers elected annually by the members.[35] Under the TLLCA, the managers are not required to be members of the LLC or even Texas residents.[36] However, if none of the managers are residents of the state, the LLC may risk losing favorable tax treatment by the IRS.[37]

The distribution of managerial power can be modified by the regulations.[38] Accordingly, the members may choose to distribute the managerial authority to the members proportionate to each member's capital contribution. Such a scheme would provide decentralized management similar to a partnership. This flexibility is one of the TLLCA's major advantages over other business forms. With this flexibility, the members can fashion the management scheme to best fit their particular needs. Again, members should be aware of the possible tax ramifications associated with management structure decisions. Such considerations should be addressed at the formation stage. If the corporate form of management is selected, the LLC may risk losing flow-through tax treatment.[39]

The managers of an LLC are similar to a corporation's board of directors. Like a board of directors, an LLC's managers can appoint officers to assist with the LLC's daily operations.[40] The managers and appointed officers are

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> management of the affairs of the limited liability company not inconsistent with law or articles of organization.

Id.

33. *See infra* text accompanying notes 124-201 for discussion of tax consequences associated with each formation decision as well as the benefits or possible problems that can be encountered if the proper organizational decisions are not made at the planning stage.

34. *See* TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.12, "Managers"; Art. 2.13, "Number and Election of Managers"; Art. 2.14, "Classification of Managers"; Art. 2.15, "Vacancies"; Art. 2.16, "Quorum of and Action by Managers"; Art. 2.17, "Interested Managers"; Art. 2.18, "Committees of the Managers"; Art. 2.19, "Place and Notice of Managers' Meetings"; Art. 2.20, "Indemnification"; Art. 2.21, "Powers of Managers and Officers." *See generally*, Gazur and Goff, *supra* note 3, at 405-08 (discussing management scheme of the LLC); Susan Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 FLA. L. REV. 721, 731-34 (1989)(discussing the management provisions of the Florida Limited Liability Act).

35. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.13 (Vernon Supp. 1992).

36. *Id.* Art. 2.12. The regulations may require the managers to be residents of the state and/or members of the LLC. *Id.*

37. *See infra* text accompanying note 193.

38. TEX. REV. CIV. STAT. ANN. art. 158n Art. 2.12.

39. *See infra* text accompanying notes 162-76 for full discussion of this issue.

40. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.21. (Vernon Supp. 1992).

considered agents of the LLC, and thus, have the authority to carry on "in the usual way the business of the [LLC]."[41] Any action taken by the officers and managers will bind the LLC, unless "the manager or officer so acting otherwise lacks the authority to act for the [LLC] and the person with whom the manager or officer is dealing has knowledge of the fact that the manager or officer has no such authority."[42] A member may also transact business that will bind the LLC if the management is retained by the members.[43]

In addition to providing flexibility in the distribution of management power, the TLLCA also provides substantial flexibility in the organization of the overall management infrastructure. For example, the members can choose to establish two or three classes of managers which may serve staggered terms.[44] In addition, the members can establish the number of managers necessary to make the entity's business decisions.[45] The TLLCA also provides guidance concerning the number of managers,[46] management vacancies,[47] interested managers,[48] committees of managers,[49] and management meetings.[50]

C. INDEMNIFICATION

The TLLCA provides that an LLC has the power to indemnify managers, officers, employees, agents and others to the same extent as corporations under the TBCA.[51] Moreover, an LLC must indemnify such individuals at least to the extent indemnification is required under the TBCA.[52] The TBCA provides for indemnification of directors, officers, employees, and agents of the corporation under specified circumstances.[53] The TBCA also provides that corporations may purchase indemnity insurance for certain specified individuals.[54]

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41. *Id.*
42. *Id.*
43. *Id.* Art. 2.10 § A(2).
44. *Id.*
45. A majority of the managers will constitute a forum "for the transaction of business unless a greater number is required by law or the regulations." TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.16. At any meeting at which a quorum is present, any act of a majority of those managers present will represent the act of all the managers, unless a greater number is required by law or the regulations. *Id.*
46. *Id.* Art. 2.13.
47. *Id.* Art. 2.15.
48. *Id.* Art. 2.17.
49. *Id.* Art. 2.18.
50. *Id.* Art. 2.19.
51. *Id.* Art. 2.20.
52. *Id.*
53. TEX. BUS. CORP. ACT ANN. art. 2.02-1 (Vernon 1980 & Supp. 1992). For example, indemnification is provided in situations where a director is a named defendant in a lawsuit and the director acted in good faith in his official capacity in performing the duties in question. *Id.* art. 2.02-1B.
54. *Id.* art. 2.02-1R. Although Article 2.20 of the TLLCA does not explicitly provide for indemnification insurance, the provisions of the TBCA should apply. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 8.12 (provisions of TBCA shall apply to matters not addressed by TLLCA to the extent the TBCA provisions are not inconsistent).

D. Ownership

An owner of an interest in an LLC is termed a member, which is essentially the equivalent of a shareholder in a corporation or a partner in a partnership.[55] An LLC's regulations may establish "groups of one or more members having certain expressed relative rights, powers, and duties, including voting rights."[56] The regulations may also provide for the future creation of additional classes or groups of members.[57] The rights, powers, or duties of a class or group may be senior to those of other groups of members.[58]

In order to become a member of an LLC, a person must acquire a membership interest, which may be acquired either before or after the formation stage.[59] A person can become a new member after the LLC's formation by either: (1) acquiring a membership interest directly from the LLC in compliance with the regulations or, if the regulations do not address admission of new members, by the written consent of all members, or (2) an assignment of a membership interest from an existing member.[60] In the latter instance, an assignee may become a member only to the extent the regulations provide or all members consent.[61] Thus, although a member may assign a membership interest in whole or in part,[62] the assignee is not necessarily entitled to become, or exercise the rights or powers of, a member.[63] For an assignee to receive the unrestricted rights and powers of membership, unanimous consent of the members is required.[64] Absent unanimous consent, the assignee is entitled only to receive the assignor's distributions.[65] Until the assignee becomes a member, "the assignor member continues to be a member and to have the power to exercise any rights or powers of a member, except to the extent those rights or powers are assigned."[66] Note that the provisions addressing assignment play a considerable role in the IRS' analysis of the entity for tax classification purposes.[67] Thus, although the Act's unanimous consent requirement can be altered by the regulations, organizers should consider carefully the potential tax ramifications before making any modifications to the Act's requirements.

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55. *See* Wolens, *supra* note 12, at 10. For example, if the LLC chooses to vest its managerial authority in all of the members, the members would then be analogous to general partners in a limited partnership or general partnership. *Id.*

56. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 4.02 § A.

57. *Id.*

58. *Id.*

59. *Id.* Art. 4.01.

60. *Id.* § B.

61. *Id.* Art. 4.07 § A.

62. *Id.* Art. 4.05 § A(1). The regulations may restrict the members' ability to assign their interests.

63. *Id.* Art. 4.05 § A(2). For example, the assignee cannot vote or participate in management.

64. *Id.* Art. 4.07 § A. The regulations can provide for less than unanimous consent. *Id.*

65. *Id.* § A(3).

66. *Id.* Art. 4.05 § A (4).

67. *See infra* text accompanying notes 151-61 for a discussion of the possible impact on federal taxation treatment by limiting or permitting the free transferability of interests.

E. CONTRIBUTION AND DISTRIBUTION

The TLLCA's provisions dealing with contribution, distribution, and withdrawal have characteristics of both the TBCA and the TRLPA.[68] Under the TLLCA, members' contributions may be in the form of cash, property, or services rendered to the LLC.[69] A member may also make a capital contribution by providing to the LLC a promissory note or other obligation to pay cash or transfer property.[70] Members are personally liable to the LLC for failing to make promised contributions.[71]

A member is entitled to receive a distribution before withdrawal and before the winding up of the LLC.[72] The amount of the distribution is limited to the member's equity in the LLC at the time of the distribution.[73] The TLLCA provides that distributions of cash or other assets of an LLC shall be made to members in the manner provided by the regulations.[74] Unless altered by the regulations, distributions will be made based on the agreed value of the contributions made by each member.[75] However, regardless of the nature of the member's contribution, no member can demand or receive distributions in kind.[76]

F. DISSOLUTION

In order to dissolve, an LLC must wind up its affairs, distribute its assets, and file Articles of Dissolution with the Secretary of State.[77] An LLC will

68. *See* TEX. REV. CIV. STAT. ANN. art. 1528n Art. 5.01 (Vernon Supp. 1992), "Form of Contribution"; Art. 5.02, "Liability for Contribution Obligations"; Art. 5.03, "Sharing of Distributions"; Art. 5.04, "Interim Distributions"; Art. 5.05, "Resignation of Member"; Art. 5.06, "Distribution on Withdrawal"; Art. 5.07, "Distribution in Kind"; Art. 5.08, "Right to Distribution"; Art. 5.09, "Limitations on Distribution."

69. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 5.01 (Vernon Supp. 1992).

70. *Id.* An LLC may provide more flexibility for contributions than corporations under the TBCA. The TBCA was recently amended to allow issuance of shares of stock for: (1) Cash; (2) Promissory notes; (3) Services performed; (4) Contracts for services to be performed; or (5) Other securities of the corporation. TEX. BUS. CORP. ACT ANN. art. 2.16 (Vernon Supp. 1992). The TBCA provides a limitation to its provisions by stating that Article 2.16 is "[s]ubject to any provision of the Constitution of the state of Texas to the contrary." *Id.* The Texas Constitution allows issuance of stock only for "money paid, labor done, or property actually received." Tex. Const., art. XII, § 6. Promissory notes are therefore not authorized as contributions for corporations formed under the TBCA. *See* Johnson, *supra* note 8, at 2. Whether this constitutional limitation will be applied to LLCs as well is not clear.

71. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 5.02 § A (Vernon Supp. 1992).

72. *Id.* Art. 5.04 § A. Members of an LLC may withdraw from the entity upon the occurrence of any event set forth in the regulations. *Id.* Art. 5.05A. Withdrawing members are entitled to the fair value of their interest in the LLC. *Id.* Art. 5.06 § A.

73. *Id.* Art. 5.09 § A.

74. *Id.* Art. 5.03 § A.

75. *Id.*

76. *Id.* Art. 5.07 § A. The articles of organization or the regulations can allow for distributions in kind. *Id.*

77. *See* TEX. REV. CIV. STAT. ANN. art. 1528n Art. 6.01, "Dissolution"; Art. 6.02, "Judicial Dissolution"; Art. 6.03, "Winding Up"; Art. 6.04, "Transfer of Assets"; Art. 6.05, "Procedure Before Filing Articles of Dissolution"; Art. 6.06, "Revocation of Voluntary Dissolution Proceedings"; Art. 6.07, "Articles of Dissolution"; Art. 6.08, "Filing Articles of Dissolution."

dissolve upon the occurrence of any of a specified list of events.[78] However, if there is at least one remaining member, the business of the LLC can continue upon unanimous consent of all remaining members.[79] The articles of organization or the regulations may provide that less than unanimous consent is necessary to continue the LLC's operations.[80] In the case of voluntary dissolution, the LLC can revoke the dissolution proceedings at any time before the issuance of a certificate of dissolution by the Secretary of State.[81] Such a revocation requires the written consent of all members.[82]

Upon dissolution, the managers or members must wind up the LLC's affairs as soon as reasonably practicable.[83] Alternatively, a court may direct the winding up process if the LLC requests the court's supervision or if any member shows cause that the court should perform the liquidation.[84] The court may appoint a person to execute the liquidation.[85] On the winding up of the LLC, the LLC's assets will be distributed as follows: (1) first to creditors, including members who are company creditors, in satisfaction of liabilities other than for distributions, (2) then to members and former members in satisfaction of the company's liability for distributions, and (3) finally to members in accordance with the procedures used to make interim distributions.[86]

Before filing the articles of dissolution, the LLC must stop its business activities, except to the extent the activity is necessary to wind up the LLC's

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78. Article 6.01 provides for dissolution of an LLC upon the occurrence of any of the following:

> (1) When the period fixed for the duration of the LLC expires.
> (2) On the occurrence of events specified in the articles of organization or regulations to cause dissolution.
> (3) Written consent of all members to dissolution.
> (4) Except as otherwise provided in the regulations, upon the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event which terminates the continued membership of a member in the LLC.
> (5) Entry of a decree of judicial dissolution under section 6.02 of [the TLLCA].

Id. Art. 6.01.

79. *Id.* Art. 6.01 § A(4). Although the TLLCA allows single member LLCs, an LLC that has only one member will likely lose partnership tax treatment by the IRS. *See* Keatinge et al., *supra* note 19, at 430 ("[A]ny LLC initially formed with at least two members that later has only one member will terminate for tax purposes"); *see infra* text accompanying notes 191-204 for discussion of the tax considerations regarding single member LLCs.

80. TEX. REV. CIV. STAT. ANN. art. 1528n Art 6.01 § A(4) (Vernon Supp. 1992). Before creating the necessary requirements for the continuation of the LLC after a dissolution event, the members should consider the possible effects of such requirements on the classification of the entity for federal taxation purposes. *See infra* text accompanying notes 136-51 for discussion.

81. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 6.06 (Vernon Supp. 1992).

82. *Id.* The regulations apparently cannot alter this unanimous consent requirement. The unanimous consent is probably due to the requirement that all members must consent to a voluntary dissolution. *See id.*

83. *Id.* Art. 6.03.

84. *Id.* Arts. 6.03 & 6.05(4). Cause may also be shown by a member's legal representative or assignee. *Id.* Art. 6.03.

85. *Id.* Art. 6.03.

86. *Id.* Art. 6.04. Except for the priority afforded creditors, the final distribution of assets can be altered by the regulations. *Id.*

affairs.[87] Additionally, the LLC must inform each known creditor of its intent to dissolve.[88] To the extent of its property and assets, the LLC must pay or discharge its debts and obligations.[89] After paying its obligations, the LLC must distribute any remaining assets to its members according to their respective rights and interests.[90] Once the LLC's assets have been distributed, a manager or authorized member must execute the articles of dissolution.[91] If the dissolution was invoked by the written consent of all the members, a copy of the consent must also be included.[92] The articles of dissolution should be delivered to the Secretary of State who will deliver a certificate of dissolution to the LLC representative.[93] The issuance of this certificate terminates the existence of the LLC except to the extent necessary to deal with outstanding suits or other appropriate matters.[94]

G. Limited Liability of Members

One of the key benefits of the LLC is the limited liability afforded its members.[95] Article 4.03 provides: "Except as and to the extent the regulations specifically provide otherwise, a member or manager is not liable for the debts, obligations or liabilities of a limited liability company including under a judgment decree, or order of a court."[96] The Act provides exceptions to this limited liability protection. For example, members are personally liable for failing to make promised contributions.[97] In addition, members are personally liable for any distributions received that are prohibited by the TLLCA.[98] However, a member is liable for receiving a prohibited distribu-

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87. *Id.* Art. 6.05 § A(1).
88. *Id.* Art. 6.05 § A(2).
89. *Id.* Art. 6.05 § A(3).
90. *Id.*
91. *Id.* Art. 6.07. Article 6.07 requires that the articles of dissolution set forth:
    (1) The name of the limited liability company.
    (2) The names and respective addresses of its managers.
    (3) That all debts, obligations, and liabilities of the LLC have been paid or discharged or that adequate provision had been made therefor, or in case the LLC's property and assets were not sufficient to satisfy and discharge all its debts, liabilities, and obligations, that property and assets have been applied so far as they will go to the payment thereof in a just and equitable manner and that no property or assets remain available for distribution among its members.
    (4) That all remaining property and assets of the LLC have been distributed among its members in accordance with their respective rights and interest or that no property remained for distribution to members after applying it as far as it would go to the just and equitable payment of the debts, liabilities, and obligations of the LLC.
    (5) There are no suits pending against the LLC in any court, or that adequate provisions have been made for satisfaction of any judgment, order, or decree which may be entered against it in any pending suit.

Id.

92. *Id.* Art. 6.07 § A(6).
93. *Id.* Art. 6.08.
94. *Id.* Art. 6.08 § B. Such matters are to be determined by the laws of Texas. *Id.*
95. *Id.* Art. 4.03 § A.
96. *Id.*
97. Tex. Rev. Civ. Stat. Ann. art. 1528n Art. 5.02 (Vernon Supp. 1992).
98. *Id.* Art. 5.09. Article 5.09 prohibits distributions:

tion only if the member knew that the distribution violated the statute.[99] The members may agree to compromise or release another member's liability for either failing to make a promised contribution or for failure to return a prohibited distribution.[100]

In addition to the statutory exceptions to limited liability, it is possible, if not likely, that LLCs will be subject to "the case law doctrines calling for a non-recognition of united liability in certain instances - that is, 'piercing the corporate veil.' "[101] In addition, it is unclear whether states not formally recognizing LLCs will recognize the limited liability of an LLC's members.[102]

H. INTERSTATE OPERATIONS AND FOREIGN LLCs

The TLLCA provides extensive provisions governing the operation of foreign LLCs in Texas.[103] The legislative history indicates that these provisions were "intended to eliminate the concern raised by *Means v. Limpia Royalties*."[104] In *Means*, the court held that an Oklahoma business trust operating in Texas did not enjoy limited liability, even though limited liability was provided by Oklahoma statute.[105] This holding, which was approved as late as 1976,[106] suggested that Texas courts might not recognize the limited liability of foreign LLCs. The TLLCA's numerous provisions addressing the operation of foreign LLCs in Texas were intended to resolve any lingering concerns caused by the *Means* holding.

Since Texas clearly recognizes foreign LLCs, the primary concern for those forming LLCs under the Texas Act is whether foreign states will recognize LLCs formed in Texas.[107] States that currently have LLC enabling

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> to the extent that, immediately after giving effect to the distribution, all liabilities of the limited liability company, other than liabilities to members with respect to their interests and liabilities for which the recourse of creditors is limited to specified property of the limited liability company, exceed the fair value of the limited liability company assets, except that the fair value of property that is subject to a liability for which recourse of creditors is limited shall be included in the limited liability company assets only to the extent that the fair value of that property exceeds that liability.

Id. § A.

99. *Id.* Art. 5.09 § B.

100. *Id.* Art. 5.02 § D.

101. Eddy L. Rogers, Jr. & Blakely R. Stinebaugh, *Limited Liability Companies*, 55 TEX. B.J. 666, 668 (July 1992). A complete discussion of the potential effect of this doctrine on the limited liability of LLC members is beyond the scope of this article. For a discussion of the piercing the corporate veil doctrine, see Keatinge et al., *supra* note 19, at 443-46.

102. *See infra* text accompanying notes 103-18 for discussion of the interstate operation of LLCs.

103. TEX. REV. CIV. STAT. ANN. art. 1528n Arts. 7.01-7.13 (Vernon Supp. 1992).

104. 115 S.W.2d 468 (Tex. Civ. App.—Fort Worth 1938, writ dism'd w.o.j.). *See* Wolens, *supra* note 12, at 10.

105. *Means*, 115 S.W.2d at 475.

106. Cherokee Village v. Henderson, 538 S.W.2d 169, 174 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ dism'd w.o.j.).

107. *See generally* Gazur & Goff, *supra* note 3, at 427-37 (discussing interstate commerce and the approach to foreign LLCs and suggesting possible grounds for the recognition of foreign LLCs in states that do not have LLC enabling statutes).

statutes differ in their approaches to foreign LLC recognition.[108] For example, Colorado provides express provisions dealing with the registration of foreign LLCs.[109] The Wyoming statute, on the other hand, contains no specific provisions addressing foreign LLCs.[110] Georgia and Indiana, which do not have LLC enabling statutes, have statutes that allow foreign LLCs to operate in the state, subject to certain registration requirements.[111]

States that do not have LLC enabling statutes or statutes addressing the operation of foreign LLCs present an uncertain scenario. Such a state may treat an LLC as a general partnership, a foreign corporation, or may not recognize the entity at all.[112] The TLLCA provides a hopeful solution to this problem in Article 4.03, which provides:

> It is the intention of the legislature by the enactment of this Act that the legal existence of limited liability companies formed under this Act 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.[113]

It is unclear, however, whether states that do not statutorily recognize foreign LLCs will heed this provision. Since the number of states considering LLC legislation is currently increasing, this issue soon may diminish in importance.[114] Currently, however, LLCs may not be the most predictable entity for a business unless it plans to operate only in the state of Texas or other states that recognize foreign LLCs.

A complete discussion of the foreign jurisdiction issue is beyond the scope of this article.[115] Members should, however, consider protecting themselves through contractual clauses when conducting business with citizens of other states.[116] For example, the contract could include a clause granting limited liability to its members and a "choice of law" provision providing that Texas law controls any disputes.[117] In addition, an LLC that plans to conduct business in a foreign state should consult the laws of that state. Until more states begin to statutorily recognize foreign LLCs, the LLC's status in this area remains unclear.[118]

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108. *See supra* note 9 for list of states that currently have LLC enabling statutes.

109. COLO. REV. STAT. ANN. §§ 7-80-901 to -913 (1991).

110. *See* Wyoming Limited Liability Company Act, WYO. STAT. ANN. §§ 17-15-101 to -136 (1977).

111. *See supra* note 9.

112. *See* Robert R. Keatinge, *Limited Liability Companies*, Amer. Bar Assoc. Section of Taxation, S Corp. Comm. May Meeting (May 15, 1992).

113. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 4.03 § B (Vernon Supp. 1992).

114. *See supra* note 9.

115. For a more thorough discussion of this issue see Gazur and Goff, *supra* note 3, at 427-39; Keatinge et al., *supra* note 19 at 447-54.

116. *See* Gazur and Goff, *supra* note 3, at 434.

117. *Id.*

118. *Id.*

I. MERGERS

The TLLCA does not explicitly address mergers with other entities.[119] Consequently, the numerous TBCA provisions dealing with mergers should apply.[120] Accordingly, a Texas LLC can "participate in, and be the surviving entity of, a merger with a Texas corporation."[121] It is unclear from this language whether a Texas LLC can merge without a corporation's involvement.[122] However, there does not appear to be any reason why an LLC should not be able to merge with other LLCs, domestic or foreign.[123]

III. TAX CONSIDERATIONS

A. CLASSIFICATION OF THE LLC BY THE STATE

Both foreign and domestic LLCs operating in Texas are subject to the Texas corporate franchise tax, which is effectively a corporate income tax.[124] It is arguably inconsistent for a state to treat the LLC as a corporation for purposes of its tax scheme, or subject it to a franchise tax which is effectively a corporate income tax, and at the same time expect the IRS to treat the entity as a partnership for federal tax purposes. The IRS, however, has not yet considered this as a factor when determining whether an LLC will be taxed at the federal level as a corporation or as a partnership.[125] In addition to the franchise tax, an LLC formed in Texas that operates in foreign jurisdictions will also be subject to the tax classification of each foreign state. It is unclear how states not recognizing LLCs will treat an LLC for state tax purposes. It is possible, however, that such states will classify the LLC as a

119. The TLLCA contemplates the merger issue, providing for a $200 filing fee for "filing articles of merger involving a domestic or foreign limited liability company." TEX. REV. CIV. STAT. ANN. art. 1528n Art. 9.01 § A(3) (Vernon Supp. 1992).

120. *Id.* Art. 8.12. This provision provides that the TBCA shall supplement the TLLCA to the extent that it is not inconsistent. Since the TLLCA clearly contemplates mergers, and fails to provide any guidance in the area, the TBCA should apply. *See* TBCA arts. 5.01-.07 for applicable merger provisions.

121. *See* Keatinge et al., *supra* note 19, at 394 n.126.

122. *Id.* For a discussion of potential dissenters' rights considerations in LLC mergers, see *id.* at 394.

123. *See id.* at 394.

124. *See* Johnson, *supra* note 8, at 18; Keatinge, *supra* note 112, at 11 n. 40 (May 15, 1992); TEX. TAX CODE ANN. § 171.001(a)(2)(A) (Vernon 1992). An LLC must pay tax equal to the greater of (1) 0.25% of its "net taxable capital" or (2) 4.5% of its "net taxable earned surplus." Taxable capital is paid in capital and surplus. Net taxable earned surplus is the reportable federal taxable income (subject to certain adjustments) plus the compensation paid officers and directors (but generally only if the corporation has more than 35 shareholders). *See* Rogers & Stinebaugh, *supra* note 101, at n.6. *See also* Brandon James and Steve Moore, *The New Texas Franchise Tax*, TEX. B.J. (Nov. 1991); Shelley Cashion, *Use of Restricted Business Entities in Estate Planning: Limited Partnerships, S Corporations, Limited Liability Partnerships and Limited Liability Companies*, The Southwestern Legal Foundation, 31st Annual Institute on Wills and Probate at 597 (Apr. 30 - May 1, 1992).

125. The Service can consider any factors it desires in determining whether an organization will be treated as a corporation or a partnership for federal taxation purposes. *See* Treas. Reg. § 301.7701-2(a)(1) (as amended in 1983); *see also* Rev. Rul. 79-106, 1979-1 C.B. 448 (listing factors the Service will not consider as "other" factors in arriving at classification of an entity for federal taxation purposes).

corporation for tax purposes.[126]

B. CLASSIFICATION OF THE LLC BY THE IRS

The LLC is expected to convey upon its members the same flow-through tax benefits afforded a partnership.[127] Unfortunately, however, the IRS will treat an LLC as a partnership for tax purposes only under certain circumstances. As a result, it is important at the formation stage for members to understand the organizational characteristics that the IRS will consider in determining the LLC's tax status. The key concern for LLC members is whether the IRS will classify the LLC as a partnership or as an association (resulting in taxation as a C corporation) for tax purposes.[128]

The IRS classifies an entity for tax purposes by considering six criteria which are considered present in a "pure corporation."[129] The six characteristics indicative of corporate status are: (1) associates, (2) an objective to carry on business and divide gains, (3) continuity of life, (4) centralization of management, (5) limited liability, and (6) free transferability of interest.[130] If an LLC possesses more corporate characteristics than noncorporate characteristics the IRS will classify it as a corporation, not considering those characteristics common to both an LLC and a corporation.[131] Since the first two categories, "associates," and "an objective to carry on business and divide the gains therefrom," are common to both entities, they are not considered.[132] As a result, the remaining four factors, which are weighed equally, will determine the tax classification of the entity.[133] For an LLC to be considered a partnership for taxation purposes, it must not have more than two of these remaining four corporate characteristics.[134] Because an LLC possesses limited liability,[135] it will be taxed as a

126. *See* Gazur & Goff, *supra* note 3, at 458.

127. The partners of a partnership are taxed on the profits of the entity, or receive credit for losses, and the partnership itself is not taxed. This is commonly referred to as the flow-through tax benefit as the partners are the target of the taxation. The partnership itself merely acts as a conduit of the income or loss. *See* LARRY E. RIBSTEIN, BUSINESS ASSOCIATIONS 926 (2d ed. 1990). Unlike the partnership, however, the profits of a corporation may receive a double tax; one tax at the corporate level when earned, and one tax on the shareholders for dividends received. *Id.* If a shareholder has a net loss for the tax year, the dividends received would escape the second tax. *Id.*

128. *See* Treas. Reg. § 301.7701-2(a)(1) (as amended in 1983) ("The term 'association' refers to an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than as another type of organization such as a partnership or a trust"). *Id.*

129. The IRS derived these criteria from the U.S. Supreme Court's decision in *Morrisey v. Commissioner*, 296 U.S. 344 (1935).

130. Treas. Reg. § 301.7701-2(a)(1) (as amended in 1983). Whether a particular organization possesses or lacks these characteristics is a facts and circumstances test. In addition, the Service may consider other factors not listed in the Regulations in determining whether an organization will be treated as a corporation or a partnership. *Id.*

131. Treas. Reg. § 301.7701-2(a)(3) (as amended 1983).

132. *Id.*

133. *Id.*

134. *See* Larsen v. Commissioner, 66 T.C. 159 (1976) (entity that had only 2 corporate characteristics not treated as corporation for taxation purposes).

135. *See infra* text accompanying notes 177-80 for discussion of the limited liability characteristic for tax purposes. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 4.03.

partnership only if it lacks two of the three remaining characteristics. Logically then, an LLC's organizers should seek to fashion the entity's structure to possess no more than one of the three remaining characteristics: (1) continuity of life, (2) free transferability of interest, or (3) centralization of management.

1. Continuity of Life

An organization possesses the corporate characteristic of continuity of life if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member does not cause the dissolution of the entity.[136] If any of these events automatically dissolves the LLC, it will not possess continuity of life.[137] Note that an LLC will lack continuity of life even though the members can unanimously agree to continue the business after the occurrence of a dissolution event.[138] However, if the LLC can continue to exist with anything less than unanimous consent, it will risk possessing the corporate characteristic of continuity of life.[139] Although the IRS traditionally has taken a strict approach to the unanimous consent requirement, recent private letter rulings suggest that it may be liberalizing its approach. In private letter ruling 90-10-027,[140] the IRS predictably ruled that an LLC possessed continuity of life because dissolution could be avoided by a majority vote of members, rather than unanimous agreement.[141] However, in another private letter ruling issued the same day, the IRS concluded that an LLC that required only 85% consent of its members, and not unanimous consent, to continue operations lacked continuity of life.[142] By allowing an 85% consent requirement to defeat the continuity of life characteristic, the IRS appears to be retreating from its traditional position that unanimous consent is required. However, because this is only a single ruling departing from the unanimous consent requirement, it should not be considered a litmus test for future LLCs. Accordingly, an LLC's organizers should require unanimous consent in order to best ensure that the entity will lack the corporate charac-

136. Treas. Reg. § 301.7701-2(b)(1) (as amended 1983).

137. *Id.* The TLLCA's 30 year limitation on the duration of the LLC's life has no effect on the continuity of life issue. Although common sense suggests that an entity that can exist only for thirty years does not possess continuity of life, the regulations provide otherwise. *See* Treas. Reg. § 301.7701-2(b)(3) (as amended in 1983); *see also* Gazur & Goff, *supra* note 3, at 450 ("Under the regulations, a fixed period of existence, however abbreviated, does not vitiate continuity.").

138. Treas. Reg. § 301.7701-2(b)(1) (as amended in 1983). *See* Rev. Rul. 88-76, 1988-2 C.B. 360, 361 (providing that an LLC formed under the Wyoming Limited Liability Company Act which requires consent of all the members to continue the business, lacks the corporate characteristic of continuity of life); Priv. Ltr. Rul. 91-19-029 (Feb. 7, 1991) (because the LLC required unanimous consent to continue the business, it does not have continuity of life); Priv. Ltr. Rul. 90-30-013 (April 15, 1990) (LLC lacks continuity of life because all remaining members must agree to continue the business).

139. *See* Robert R. Keatinge et al., *The Limited Liability Company*, 47 BUS. LAW 375, 426 (Feb. 1992) ("[A] Utah LLC that does not include provisions in its operating agreement requiring unanimous agreement to continue the business may be classified as a corporation.").

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

141. *Id.*

142. Priv. Ltr. Rul. 90-10-028 (Dec. 7, 1989).

teristic of continuity of life. Alternatively, if members desire a less onerous consent requirement, they should consider obtaining a private letter ruling on the selected consent requirement.

The TLLCA provides substantial flexibility concerning the dissolution process.[143] Such flexibility, however, could be a trap for the unwary. The TLLCA provides that an LLC shall be dissolved:

> (e)xcept as otherwise provided in the regulations, upon the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member or the occurrence of any other event which terminates the continued membership of a member in the LLC, unless there is at least one remaining member and the business of the limited liability company is continued by the consent of the number of members or class thereof stated in the articles of organization or regulations of the limited liability company or if not so stated, by all remaining members.[144]

As written, the TLLCA, which requires unanimous consent of the remaining members to continue the business, should safely shield an LLC from possessing continuity of life.[145] As discussed above, members should be cautious when altering the statutory provisions. Regulations that mirror the TLLCA's unanimous consent requirement should enable the LLC to lack continuity of life. Hence, to make certain that the LLC will not possess continuity of life, organizers should draft regulations that either require unanimous consent to continue the LLC after dissolution or simply do not address the consent requirement at all.[146] The latter option would invoke the statutory language that requires unanimous consent.

In addition to altering the unanimous consent requirement, the TLLCA provides an additional option that could cause the LLC to possess continuity of life. As one commentator has noted, the Texas Act allows an LLC's members to "circumvent the traditional automatic dissolution events by adding explicit provisions to the LLC's articles of organization or regulations."[147] If the articles of organization provide for a right to continue the business,[148] the LLC will not dissolve when a dissolution event occurs even though the members did not unanimously agree to carry on the business.[149] Consequently, if the members choose to include a right to continue business in the articles of organization, the LLC will likely possess continuity of

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143. *See* Keatinge et al., *supra* note 19, at 426.

144. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 6.01 § A(4). An LLC will also be dissolved: "(1) When the period fixed for the duration of the LLC expires, (2) On the occurrence of events specified in the articles of organization or regulations to cause dissolution, (3) [by] written consent of all members to dissolution, or (4) [by] entry of a decree of judicial dissolution under Section 6.02" of the TLLCA. *Id.*

145. *See* Keatinge et al., *supra* note 19, at 426 ("If the LLC's articles and regulations are silent, however, all remaining members must consent to a continuation of the business").

146. *See* Johnson, *supra* note 8, at 16.

147. Keatinge et al., *supra* note 19, at 426.

148. The Florida and Kansas statutes allow the members to include a "right to continue business" option in the articles of organization. *See id.* at 425; FLA. STAT. ANN. § 608.441(1)(c) (West Supp. 1991); KAN. STAT. ANN. § 17-7622(a)(3) (Supp. 1991).

149. *See* Keatinge et al., *supra* note 19, at 425-26 ("A right to continue the business in the articles of organization arguably causes the LLC to possess continuity of life because it deprives each member of the power to dissolve the LLC as a matter of law.")

life.[150]

2. Free Transferability of Interests

An organization possesses the corporate characteristic of free transferability of interests if "each of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member of the organization."[151] Thus, an LLC formed under the Texas Act will lack free transferability of interests so long as its members, or those members owning a substantial interest in the LLC, may not transfer their interest without the consent of other members.

Revenue Ruling 88-76,[152] which addressed the tax classification of an LLC formed under the Wyoming Act, provides guidance to the free transferability of interests characteristic. The IRS noted that free transferability of interests exists only if a "member [is] able, without the consent of other members, to confer upon the member's substitute all the attributes of the member's interest in the organization."[153] The ability of a member to assign only the right to share profits and not the right to participate in the management of the entity was not sufficient to conclude that the LLC possessed free transferability of interests.[154] The IRS concluded that the LLC lacked free transferability of interests because a member could not transfer *all* the member's interest without the consent of the remaining members.[155]

The Texas statute closely resembles the Wyoming statute with regard to transferability of interests. The TLLCA allows a member to assign only the right to the assignor's distributions,[156] and specifically provides that "an assignment of a membership interest does not entitle the assignee to become, or to exercise rights or powers of a member."[157] The TLLCA further mirrors the Wyoming Act in that it allows an assignee of a membership interest to obtain the full rights and benefits of membership only upon unanimous consent of the members. However, unlike Wyoming, under the TLLCA, the regulations can provide that less than unanimous consent is required to allow an assignee to become a full member.[158] The regulations can allow a complete transfer of a member's interest with majority consent, less than majority consent, or even no consent.[159] Again, like the TLLCA's provi-

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150. *Id.* at 426.

151. Treas. Reg. § 301.7701-2(e)(1) (as amended in 1983).

152. Rev. Rul. 88-76, 1988-2 C.B. 360, 361.

153. *Id.*

154. *Id.*

155. *Id.* (emphasis added). Under the Wyoming statute, a member could "assign or transfer that member's interest to another who is not a member of the organization. However, the assignee or transferee does not become a substitute member and does not acquire all the attributes of the member's interest in [the LLC] unless all remaining members approve the assignment or transfer." *Id.*

156. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 4.05 § A(3).

157. *Id.* Art. 4.05 § A(2).

158. *Id.* Art. 4.07 § A.

159. *See* Keatinge et al., *supra* note 19, at 427.

sions concerning the continuity of life characteristic,[160] the members should be cautious before altering the structure of the LLC provided by the statutory provisions.

If the regulations allow for anything less than unanimous consent for an assignee of a membership interest to become a full member, the LLC could risk possessing free transferability of interest. It is unclear whether the IRS will treat anything less than a unanimous consent requirement as limiting the transferability of a member's interest. In several private letter rulings, the IRS has indicated that a less than unanimous consent requirement on the transfer issue may not impose on the LLC the corporate characteristic of free transferability of interest.[161] However, since a private letter ruling only applies to the taxpayer who obtained the ruling, the rulings provide only possible treatment by the IRS on this issue. LLCs considering a modification of the TLLCA provisions on this issue should consider obtaining a private letter ruling in order to ensure that the LLC will receive favorable tax treatment.

3. *Centralized Management*

An organization possesses the corporate characteristic of centralized management if any person, or any group of persons not including all the members of the entity, has continuing exclusive authority to make the entity's management decisions.[162] The TLLCA provides for centralized management, except to the extent the regulations provide otherwise.[163] If the members choose to follow the statutory provisions, the LLC will most likely possess centralized management.[164]

In Revenue Ruling 88-76,[165] the IRS ruled that a 25 member Wyoming LLC had centralized management because it was managed by three designated managers.[166] This ruling, however, may not be applicable to all LLCs possessing centralized management. It is arguable that an LLC that vests its managerial authority in designated managers may still lack centralized management under certain circumstances.[167] The Treasury Regulations provide that a limited partnership generally lacks centralized management unless "substantially all the interests in the partnership are owned by the limited

160. *See supra* text accompanying notes 136-50 for discussion of continuity of life characteristic.

161. *See* Priv. Ltr. Rul. 92-19-022 (Feb. 6, 1992) (LLC lacked free transferability of interest where only a majority was necessary to approve full transfer of membership rights); Priv. Ltr. Rul. 92-10-019 (Dec. 6, 1991) (LLC lacked free transferability of interest where majority of members was necessary to approve full transfer of membership interest).

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

163. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.12.

164. *See infra* text accompanying notes 167-76 for discussion of situations in which an LLC may lack centralized management for taxation purposes even though designated managers, and not all the members, are responsible for the management decisions.

165. Rev. Rul. 88-76, 1988-2 C.B. 360.

166. *Id.* at 361.

167. *See* Keatinge et al., *supra* note 19, at 429.

partners."[168] In Revenue Proceeding 89-12,[169] the Service provided that a limited partnership will lack centralized management if the general partners own at least 20% of the partnership.[170] Apparently, the rationale supporting both the treasury regulations and Revenue Procedure 89-12 is that, if the general partners do not own a substantial interest, they must be managing the business for the true owners, the limited partners.

If applicable, Revenue Procedure 89-12 would mandate that an LLC with designated managers would still lack centralized management if the managers own at least 20% of the entity.[171] However, this rational has not yet been applied to LLCs by the IRS. In fact, in Revenue Ruling 88-76,[172] the IRS did not discuss the percentage ownership of the three members selected to manage the LLC.[173] Moreover, LLC managers are not true counterparts to general partners and thus Revenue Procedure 89-12 may be inapplicable.[174] Consequently, in order to avoid centralized management, the best course is to vest the management authority in its managers proportionate to their ownership interest.[175] An LLC that desires centralized management, however, can still obtain partnership tax status if it can avoid the corporate characteristics of continuity of life and free transferability of interests.[176]

4. Limited Liability

One of the primary advantages of the LLC is the limited liability afforded its members.[177] An organization possesses the corporate characteristic of limited liability if no member is personally liable for the debts or claims against the organization.[178] The TLLCA is consistent with the Wyoming Act which provides that no member or manager of the LLC is liable for the LLC's debts; creditors can only force members and managers to pay what they have agreed to contribute to the LLC's capital.[179] Predictably, in Revenue Ruling 88-76, the Service found that the Wyoming LLC possessed the corporate characteristic of limited liability.[180] Likewise, the Texas statute

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168. Treas. Reg. § 301.7701-2(c)(4) (as amended in 1983). Note that a limited partnership is always managed by the general partners. The limited partners are statutorily precluded from becoming actively involved in the management decisions.

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

170. *Id.* at 801.

171. Note that Revenue Procedure 89-12 is not applicable to LLCs that distribute the management power to all LLC members proportionate to their capital contributions. *See* Priv. Ltr. Rul. 90-30-013 (Apr. 25, 1990). In this situation, the LLC would clearly lack centralized management.

172. Rev. Rul. 88-76, 1988-2 C.B. 360.

173. *See id.*

174. *See supra* Keatinge et al., note 19, at 429.

175. *See* Priv. Ltr. Rul. 90-10-027 (Dec. 7, 1989) (holding that Florida LLC lacked centralized management where management was reserved to the members based on members' proportionate ownership interest).

176. *See supra* text accompanying notes 136-61 for discussion of these topics.

177. TEX. REV. CIV. STAT. ANN. art 1528n Art. 4.03 (Vernon Supp. 1992).

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

179. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 4.03 (Vernon Supp. 1992); *see* WYO. STAT. ANN. § 17-15-113 (1977).

180. *See* Rev. Rul. 88-76, 1988-2 C.B. 360, 361. As a matter of state law, LLCs will always possess limited liability. Consequently, for tax purposes, even if the members contractually

should provide an LLC with limited liability for tax classification purposes.

C. Compliance with Rev. Proc. 89-12

In addition to possessing the organizational characteristics discussed above,[181] an LLC must also meet the requirements of Revenue Procedure 89-12[182] in order to obtain a favorable ruling of partnership status.[183] Revenue Procedure 89-12 delineates the general information and supporting documentation that an LLC must provide the Service in order to obtain a ruling on the LLC's classification as a partnership for tax purposes.[184]

In addition to the general information requirements, an LLC apparently must also comply with those requirements specifically applicable to limited partnerships.[185] The provisions applicable to limited partnerships, however, are not easily applied to LLCs. Indeed, the Service itself has acknowledged the difficulty of applying the provisions of Revenue Procedure 89-12 to LLCs.[186] The Service stated that it intended to promulgate specific guidelines applicable to LLCs.[187]

The provisions applicable to limited partnerships, set out in Section 4, are inapplicable to LLCs that distribute the managerial power to its members.[188] However, LLCs that designate managers to manage the entity's business must meet certain requirements under Section 4.[189] Revenue Procedure 89-12 provides that the LLC's designated managers should be treated like general partners of a limited partnership for application of the guidelines.[190]

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assume or guarantee every claim incurred by the LLC, the LLC will still possess the corporate characteristic of limited liability.

181. *See supra* text accompanying notes 126-34 for discussion of characteristics considered by the IRS indicative of corporate or partnership status.

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

183. Although it does not explicitly refer to LLCs, Revenue Procedure 89-12 applies to both those organizations "formed as partnerships and other organizations seeking partnership classification." Rev. Proc. 89-12, 1989-1 C.B. 798; *see* Priv. Ltr. Rul. 90-29-019 (Apr. 19, 1990); Priv. Ltr. Rul. 90-30-013 (Apr. 25, 1990).

184. Rev. Proc. 89-12 § 3, 1989-1 C.B. at 799-800.

185. *See* Rev. Proc. 89-12, § 4 at 801-802. Section 4 of Rev. Proc. 89-12 provides that "[a]ny reference to a 'limited partnership' includes an organization formed as a limited partnership under applicable state law and *any other organization formed under a law that limits the liability of any member for the organization's debts and other obligations to a determinable fixed amount.*" *Id.* at § 1.02 (emphasis added). In a private letter ruling, the IRS required an LLC with centralized management to comply with the provisions of Revenue Procedure 89-12 applicable to limited partnerships. Priv. Ltr. Rul. 90-29-019 (Apr. 19, 1990).

186. *Application of Rev. Proc. 89-12 to Limited Liability Companies Questioned*, 32 BNA Tax Management Memorandum 272, 272 (1991).

187. *Id.*

188. Priv. Ltr. Rul. 90-13-013 (Apr. 25, 1990). The Service held that LLC's whose members share management authority equally are exempt from the requirements set forth in Section 4 of Rev. Proc. 89-12. *See* Rev. Proc. 1989-7 I.R.B. 22, § 1.02.

189. Section 4 also addresses the centralized management characteristic generally considered by the Service in classifying an organization. The requirements of Section 4 applicable to this area are discussed. *See supra* notes 169-76 and accompanying text.

190. Rev. Proc. 89-12, sec. 1.02. "Reference to 'general partners' and 'limited partners' apply also to comparable members of an organization not designated a partnership under controlling law and documents; the 'general partners' of such an organization will ordinarily be those with significant management authority relative to the other members." *Id.* Members not designated as managers should be treated like limited partners. *Id.*

Section 4 sets forth several requirements applicable to general partners including required minimum capital account balances.[191] In addition, all general partners "taken together, in each material item of partnership income, gain, loss, deduction or credit must be equal to at least one percent of each such item at all times during the existence of the partnership, and the partnership agreement must expressly so provide."[192] These requirements apparently apply to LLC managers if the LLC designates managers to operate the business. As a result, the TLLCA, as written, may not conform to Revenue Procedure 89-12. Article 2.12 does not require designated managers to be members of the LLC, unless such a requirement is included in the regulations.[193] If the designated managers are not members, the one percent ownership requirement set forth in Section 4 cannot be met. Consequently, an LLC should appoint managers that taken together meet the one percent requirement.

D. Single Member LLCs — Tax Considerations

Texas is currently the only state that allows single member LLCs.[194] A single member LLC, however, will have a difficult, if not impossible, task of obtaining partnership tax classification. Indeed, the requirement of two or more members may have been instilled by other states in order to support the favorable partnership classification of the LLC.[195] If applicable, an application of the four corporate characteristics considered by the IRS would likely result in a corporate classification.[196] However, it is likely that the Service would not even consider the applicability of these characteristics or give any real consideration to treating a single member LLC as a partnership for tax purposes. The Internal Revenue Code, as well as the Treasury Regu-

191. "Unless section 4.04 applies, the general partners, taken together, must maintain a minimum capital account balance equal to either 1 percent of total positive capital account balances for the partnership or $500,000, whichever is less." Rev. Proc. 89-12, sec. 4.03 1989-1 C.B. 800.

192. Rev. Proc. 89-12, sec. 4.01 1989-1 C.B. 800.

193. TEX. REV. CIV. STAT. ANN. art. 1528n Art. 2.12 (Vernon Supp. 1992).

194. *See supra* notes 19-21 and accompanying text for discussion of applicable TLLCA provisions; *see also* Keatinge et al., *supra* note 19, at 430.

195. *See* Gazur & Goff, *supra* note 3, at 398. "Although no I.R.S. pronouncement addresses this consideration, the LLC requirement of two or more participants was probably intended to support classification of the LLC as a partnership for federal tax purposes." *Id.*

196. *See supra* text accompanying notes 127-35. A single member LLC would possibly lack the corporate characteristic of continuity of life. Logically, if one of the dissolution events occurred, the entity would cease to exist. *See supra* notes 77-94 and accompanying text for discussion of dissolution events. However, the corporate characteristics of limited liability, free transferability of interests and centralized management would most likely attach to the entity. Arguably, a single member LLC lacks the central management characteristic attributed to a corporation because no managers are truly designated as contemplated by the applicable Treasury Regulations. *See* Johnson, *supra* note 8 (letter to IRS). Moreover, based on Rev. Proc. 89-12, the single member is debatably the counterpart to a general partner in a partnership and, as such, owns more than 20% of the entity. As a result, it can be logically argued that the LLC lacks centralized management. However, persuading the IRS that a single member LLC lacks centralized management may be a difficult task, and would likely face a substance over form argument from the IRS.

lations, do not contemplate a single member partnership.[197] In fact, "the very essence of a partnership contemplates two or more partners joining together as co-proprietors to engage in business and share in profits."[198] As a result, one commentator has stated that "Texas LLCs that are formed with only one member cannot be treated as partnerships for tax purposes."[199]

An individual attempting to determine the best organizational vehicle might be better served to avoid the unsettled area surrounding the single member LLC. For example, a sole proprietorship could be formed and the proprietor could obtain adequate insurance as an alternative to the limited liability afforded an LLC. This approach would enable the proprietor to avoid the double tax traditionally conferred on corporations.[200] Alternatively, a sole proprietor could incorporate[201] and avoid the double taxation problem by paying himself a salary to access corporate earnings in lieu of distribution of dividends. With the uncertainty surrounding the tax classification of a sole proprietor LLC, other business entities should be considered.

IV. THE LLC V. OTHER FORMS OF BUSINESS ORGANIZATION—IS IT THE RIGHT CHOICE?

With the recent creation of the LLC business form, the already difficult selection of the most desirable business form becomes even more complicated. Initially, the LLC seems like the best possible choice for business formation. However, the LLC, like other business forms, possesses certain characteristics that may not make it the best vehicle for a particular business concern. The following discussion will provide a comparison of the LLC to traditional business forms.

A. LIMITED LIABILITY COMPANY V. S CORPORATION

The LLC is similar to the traditional S Corporation.[202] Both entities extend limited liability to their members and both receive the flow-through tax benefits of a partnership. Nevertheless, the two entities have several important differences that should be considered before selecting one form for business formation.

The LLC, for example, is not subject to the same somewhat burdensome

197. I.R.C. §§ 761(a), 7701(a)(2). Section 7701(a)(2) provides the following definition of partnership:

> The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation and the term 'partner' includes a member in such a syndicate, group, pool, joint venture, or organization.

See Treas. Reg. 301.7701-3(a) (as amended in 1983).

198. *See* Keatinge et al., *supra* note 19, at 430.

199. *Id.*

200. *See supra* note 127.

201. Single member corporations are allowed under the TBCA. TEX. BUS. CORP. ACT art. 3.01 (Vernon Supp. 1992).

202. *See* I.R.C. §§ 1361-1378. *See generally* RIBSTEIN, *supra* note 127 for discussion of S Corporation characteristics and requirements.

restrictions that are imposed on the S Corporation.[203] Specifically, the membership of an S Corporation may not have more than thirty-five shareholders[204] while the LLC's membership is unlimited. Furthermore, the shareholders in an S Corporation may not be other corporations, partnerships, certain trusts, pension plans, charitable organizations, or non-resident aliens.[205] The same is not true of an LLC. In addition, since an S Corporation may not have more than one class of stock,[206] its flexibility in making distributions and allocations to its shareholders is severely restricted. The capital structure of the LLC, on the other hand, is not so rigid.[207] Finally, an S Corporation is prohibited from owning more than eighty percent of the stock of another corporation.[208] Again, LLC's are not subject to such a restriction.

The tax ramifications associated with the two entities are also important considerations. If the LLC is structured to receive the tax benefits of a partnership,[209] the owners of an LLC can include their respective shares of the liabilities incurred by the LLC in the basis of their ownership interests for purposes of determining the deductibility of losses allocated to them.[210] Conversely, shareholders in an S corporation cannot use the corporation's debt as part of their basis for calculating losses allocated to them.[211] Additionally, the sale or exchange of an interest in an LLC enables the transferee to obtain the benefit of an adjustment to the basis of the interest acquired.[212] The same is true in the event of a member's death.[213] No such basis adjustments are available to members of an S Corporation. It should be noted, however, that these apparent advantages are tempered somewhat by the risk that an LLC will be accorded corporate status for tax purposes.[214]

The fact that an LLC has only recently become a recognized entity can be viewed as either an advantage or a disadvantage. For example, the S Corporation is an established entity recognized in virtually all states.[215] Consequently, the boundaries and limits of the organization are much easier to determine at the planning stage. But this certainty can be both a benefit and a hindrance. While the S Corporation's boundaries may be well established, it lacks the flexibility of the LLC. The organizer of an LLC has virtually a clean slate with which to work or with which to get into trouble. Moreover,

203. I.R.C. §§ 1361-1378.
204. *Id.* § 1361(b)(1)(A).
205. *Id.* § 1361(b)(1).
206. *Id.* § 1361(b)(1)(D).
207. *See supra* text accompanying notes 68-76 for discussion of an LLC's capital structure.
208. I.R.C. § 1361(a)(2)(A).
209. *See supra* text accompanying notes 127-35.
210. I.R.C. § 752.
211. I.R.C. § 1366(a).
212. *Id.*; I.R.C. § 743.
213. *Id.*
214. *See supra* text accompanying notes 127-35.
215. The following jurisdictions do not recognize the S Corporation: Connecticut, Louisiana, Michigan, New Hampshire, New Jersey, New York City, Tennessee, and the District of Columbia. *See* State Tax Guide (CCH) paragraphs 10-100 (March 1991).

the LLC itself provides for more flexibility in the organizational structure.[216]

The LLC's novelty also raises issues regarding the treatment of an LLC by foreign jurisdictions.[217] The TLLCA itself contemplates that, pursuant to the full faith and credit clause of the Constitution, other states will recognize the legal existence of an LLC formed under the Act.[218] The legal effect that will be given LLC's in states which have not enacted LLC legislation remains, however, unsettled. Considering the foreign jurisdiction recognition problem, the LLC may be best suited for those entities planning to limit its business activities to Texas or other states that expressly recognize LLCs.[219]

B. Limited Liability Company v. Limited Partnership

Although properly structured LLCs and limited partnerships enjoy the same tax benefits, LLCs offer certain benefits over limited partnerships. For example, an LLC provides for a more flexible management structure while still affording its members limited liability.[220] While a limited partner who materially participates in the business of the limited partnership does so at the risk of losing his limited liability protection,[221] members of an LLC appear to enjoy limited liability regardless of whether they actively participate in the business.[222] Furthermore, while a limited partnership must have at least one general partner who is liable for all the debts of the partnership, an LLC need not conform to such requirements.[223]

Further, differences between the LLC and the limited partnership parallel the differences between the LLC and the S Corporation.[224] Like the S Corporation, the limited partnership is more likely to enjoy extraterritorial recognition.[225] In addition, since the provisions of the Revised Uniform

216. Two commentators have noted that "state corporation statutes that impose the fewest restrictions are generally viewed as the most advantageous under which to incorporate." *See*, Gazur and Goff, *supra* note 3, at 459, n.386. This view is consistent with the perceived advantage of the limited partnership over the corporation due to its "uncluttered flexibility." *Id.*

217. *See supra* text accompanying notes 103-18 for discussion of the recognition issue.

218. Tex. Rev. Civ. Stat. Ann. art. 1528n Art. 4.03 § B. The extraterritorial recognition problem is particularly troubling in Texas which has itself refused to recognize similar type entities. *See* Means v. Limpia Royalties, 115 S.W.2d 468 (Tex. Civ. App.—Fort Worth, 1938 writ dism'd w.o.j.) (holding that an Oklahoma business trust operating in Texas did not provide limited liability under Texas law although limited liability was provided by Oklahoma statute under trust document), *cited with approval in* Cherokee Village v. Henderson, 538 S.W.2d 169 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ dism'd w.o.j.). *See supra* text accompanying notes 104-07 for discussion of the TLLCA's statutory reversal of the *Means* holding.

219. *See supra* note 9 for list of states recognizing LLCs.

220. *See supra* notes 34-50 and accompanying text.

221. Revised Unif. Ltd. Partnership Act § 7 (1976). This provision provides that "A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, *he takes part in the control of the business.*" *Id.* (emphasis added).

222. Tex. Rev. Civ. Stat. Ann. art. 1528n Arts. 2.12 & 4.03 (Vernon Supp. 1992).

223. *See id.* Art. 4.03.

224. *See supra* text accompanying notes 203-20.

225. At least 47 states and the District of Columbia have enacted the 1976 version of Revised Uniform Limited Partnership Act ("RULPA") and many have also adopted the 1985 amendments as well. Revised Unif. Ltd. Partnership Act, Table of Jurisdictions Wherein Act Has Been Adopted, 6 U.L.A. 253-54 (Supp. 1992).

Limited Partnership Act ("RULPA") make it relatively easy to draft a limited partnership that meets the Service's requirements for partnership status, the tax consequences related to a limited partnership are much more predictable.[226] Finally, RULPA's provisions regarding the transferability of interests and continuity of life are generally more flexible than the LLC provisions for state law purposes.[227]

Two commentators have indicated that an LLC may be less likely to give its members limited liability protection in situations where an LLC member is active in the organization.[228] In this situation, a court may be more willing to pierce the corporate veil of the LLC than in limited partnerships where limited partners are allowed to engage in some activity without liability.[229] The RULPA provisions state that a limited partner does not participate in the control of the general partnership merely by "being an officer, director, or shareholder of a general partner that is a corporation."[230] Although a thorough discussion of the "piercing the corporate veil" doctrine is beyond the scope of this article, the broad limited liability afforded an LLC's members arguably could invite a liberal application by the courts of this doctrine to the LLC form.

The LLC has some additional characteristics that make it more attractive than a limited partnership. For example, the TLLCA does not require the disclosure of the members' names in the articles of organization.[231] Under both the Uniform Limited Partnership Act ("ULPA")[232] and the original Revised Uniform Limited Partnership Act ("RULPA"),[233] the certificate must disclose the names of the limited partners.

A limited partnership and an LLC may be combined in such a way as to reap the benefits of both entities and, at the same time, avoid the pitfalls associated with each. Two commentators have suggested the following entity, which would combine both the limited partnership and the LLC:

A limited partnership with an LLC general partner may represent a

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226. Two commentators have noted that:

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

Gazur and Goff, *supra* note 3, at 461, n. 394.

227. *See id.*, at 461.

228. *Id.*

229. "Piercing a thinly capitalized limited partnership has apparently not been a creditor remedy if the limited partner does not participate in the control of the partnership business." *Id.* at 461, n.398. This advantage, however, may be slight, "and assumes a larger limited partnership arrangement where there are limited partner investors apart from the managing general partner group." *Id.* at 461.

230. Revised Unif. Ltd. Partnership Act § 303(b)(1) (1985).

231. *See* TEX. REV. CIV. STAT. ANN. art. 1528n Art. 3.02 § A(5) (Vernon Supp. 1992). This assumes that the members have selected a corporate type management scheme. If the members allocate managerial authority based on the contribution percentage of each member, each member is required to be listed in the articles of organization. *Id.*

232. Unif. Ltd. Partnership Act § 2(1)(a) IV (1916).

233. Revised Unif. Ltd. Partnership Act § 201(a)(4) (1985).

compromise structure that mitigates the perceived disadvantages of the LLC in the area of extraterritorial recognition and the general uncertainty regarding the legal aspects of its operation. This structure provides a degree of comfort to the limited partners concerning fundamental matters, such as their limited liability in a foreign jurisdiction, the legal aspects of the entity's operation and the rights of members, and federal income tax aspects of the LLC that remain unsettled. The remaining uncertainties would be limited to the LLC general partner and its members. The limited partnership can also facilitate the tiered ownership structure . . . as a solution to the state law impediments to transfer of interests and dissolution.[234]

C. Limited Liability Company v. General Partnership

The obvious advantage of the LLC over a general partnership is the limited liability afforded the LLC's members.[235] Other factors to consider are very similar to those considered in comparing the LLC with a limited partnership.[236] For example, the LLC and the general partnership are treated the same for federal taxation purposes notwithstanding the difficulties that potentially may be confronted when attempting to classify an LLC as a partnership.[237]

Nonetheless, problems do arise in the use of the LLC structure. For example, transferability of member interests is more complicated in an LLC.[238] In addition, unlike the general partnership, the LLC is not dissolvable at the will of the partners.[239] Finally, the general partnership, like the limited partnership[240] and the S Corporation, offers the likely advantage of recognition in foreign jurisdictions. As noted previously, no such guarantee exists for the LLC.[241] Note, however, that even in the event the LLC is not formally recognized in a particular foreign jurisdiction, it seems likely that the entity will be treated like a general partnership anyway.[242] This fact tends to alleviate some of the concerns associated with the decision to use the LLC structure. Nevertheless, when comparing the general partnership to an LLC, it should be noted that the mere fact that the LLC offers both the tax advantages of a partnership and the limited liability protection of a corporation does not necessarily make it preferable to the partnership as an organization form. The LLC is still untested in several areas. Alternatively, the partner-

234. *See* Gazur & Goff, *supra* note 3, at 462.

235. Tex. Rev. Civ. Stat. Ann. art. 1528n Art. 4.03; *see supra* text accompanying notes 95-102.

236. *See supra* text accompanying notes 220-34.

237. *See supra* text accompanying notes 127-35.

238. *See supra* text accompanying notes 55-67.

239. Tex. Rev. Civ. Stat. Ann. art. 1528n Art. 6.01 (Vernon Supp. 1992).

240. *See supra* text accompanying notes 220-34.

241. *See supra* text accompanying notes 103-18.

242. Since the foreign jurisdiction would refuse to recognize the limited liability of the members, the only distinctly different aspect of the LLC remaining would be the flow-through tax benefits afforded the members. *See supra* text accompanying note 127 for discussion of flow-through tax benefits. The foreign state's refusal to recognize the LLC would not have an effect on the Service's classification of the entity for federal taxation purposes.

ship has substantial history and is therefore a more predictable form for conducting business.

V. CONCLUSION

As the above discussion indicates, the LLC has the potential to combine the favorable characteristics of a corporation and a partnership in a single entity. In particular, the entity can provide both limited liability and flow-through tax benefits to its members. As a result, its advantages should not be overlooked when selecting a business form. While it is true that an S Corporation also possesses these two essential features, the LLC's structure is generally more flexible since it is not subject to the same restrictions faced by the S Corporation. Moreover, the LLC is an attractive alternative to the traditional partnership since the former can provide its members with the benefits of limited liability. However, both the S Corporation and the traditional partnership forms are more likely to receive extraterritorial recognition than the LLC, except in those jurisdictions that have LLC enabling statutes. As a result, an LLC may not be the best choice if the organization plans to do business in states not recognizing foreign LLCs.

The IRS will treat an LLC as a partnership for tax purposes only under certain circumstances. Before forming an LLC, the organizers must be aware of the tax consequences of each organizational decision. In drafting the regulations, particular attention should be given to provisions affecting continuity of life, transferability of interests, and centralized management. Of course, if the structural limitations imposed by the IRS do not best fit the entity's needs, the LLC may not be the best choice. If the LLC form is selected, organizers should consider obtaining a private letter ruling concerning the particular entity's tax status.

Book Review