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PASSTHROUGH ENTITIES AND THEIR UNPRINCIPLED DIFFERENCES UNDER FEDERAL TAX LAW

William J. Rands*

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BUSINESS persons and their advisors often confront the question of what form of business organization they should select for their businesses. Nontax factors ordinarily are not difficult to evaluate, generally requiring a balancing of the need for limited liability against the cost and complexity of establishing an entity that provides limited liability. With the low cost of incorporating and state corporation codes allowing flexibility in establishing internal governance, the selection of the corporate form rarely would be a poor choice. Moreover, business people like the corporation, because it is "comfortable with a safe and predictable format." No one, of course, can ignore the federal income tax consequences of operating the business—too often they constitute the single greatest cost affecting the choice of form issue. An estimation of that cost, unfortunately, requires an analysis of the tax consequences of operating under a myriad of business organization forms—as a C corporation, an S corporation, a general partnership, a limited partnership, and a limited liability company.

The differences between the C corporation and the other four forms, all of which are conduits for federal income tax purposes, are stark and perhaps should be preserved. But should the law expect its practitioners to master the rules of four different types of conduits, each with its hybrid complexities? This difficult analysis bewilders lay people and is abstruse even for many lawyers. Indeed, a byproduct of this abstruseness is the substantial work that it produces for those advisors who can detect the nuances in the tax treatment of the different forms and employ them to

their clients' advantage. But the choice of form decision should not be that hard. Congress should undertake to reform the tax law regarding passthrough entities. That, I suggest, would consist of the establishment of uniform rules for all conduits, with respect to both tax consequences and eligibility requirements.

II. PRIVATE SECTOR DESIRES

The private sector frequently desires a form of business organization that will entail limited liability for investors and be treated as a conduit for federal income tax purposes. The conduit mechanism is attractive whenever the enterprise is expected to produce losses or other deductions. Subject to the passive activity loss and at-risk rules, the holders of equity interests in the conduits can take an immediate deduction equal to their basis against income earned from other sources. A C corporation is entitled to a section 172 net operating loss deduction, but it may never have another tax year with taxable income and thus never get the deduction. Even if it is able to use the deduction in a future year, it loses the time value of money that an immediate deduction produces for the owners of a conduit.

A conduit also constitutes a good choice for a prosperous enterprise that will distribute most of its profits to the investors. The enterprise income is taxed to the investors when earned, but the distributions generally are tax-free up to the investors' basis in their investment interests. This single level of taxation is, of course, superior to the infamous system of double taxation of C corporations and their shareholders.

Hoping to spur the economy by encouraging small businesses, Congress adopted Subchapter S to fulfill exactly these desires of the private sector: limited liability and partnership-like tax consequences. Con-

3. The Internal Revenue Code also creates several passthrough investment-oriented entities: regulated investment companies (RICs), I.R.C. §§ 851-855, 860 (1988); real estate investment trusts (REITs), I.R.C. §§ 856-860 (1988); and real estate mortgage investment conduits (REMICs), I.R.C. §§ 860A-860G. See also Snoe, supra note 2, at 25.
9. The choice between a conduit and a C corporation is also tax-rate sensitive. The 1993 changes in the tax rates inverted the I.R.C. § 1 and § 11 rates—the § 1 rates for individuals tend to be higher than the § 11 rates for C corporations. See generally I.R.C. §§ 1, 11 (1988 & Supp. V 1993). That inversion could dampen some of the enthusiasm for conduits, although investors need to account for the increase in the effective tax rate resulting from the shareholder-level tax on dividends and other shareholder transactions. The 1993 changes constitute the second time in seven years that rates were inverted. See H.R. Conf. Rep. No. 2264, 103d Cong., 1st Sess. 73 (1993). The 1986 changes made the § 11 rates generally higher than the § 1 rates. See H.R. Conf. Rep. No. 3838, 99th Cong., 2d Sess. 12-13, 173-74 (1986). Obviously, the differential in the rates is not immutable and is subject to the annual whim of Congress and the President.
gress also thought that Subchapter S would simplify the tax law by reducing its impact on the choice of business form.\textsuperscript{11} Congress probably expected the S corporation to be the nearly universal selection, because it provides not only limited liability, but a choice of the two primary systems of tax consequences (conduits and entity-level taxation). Closely-held business owners have often used Subchapter S, but it has its imperfections and has never achieved its objective of reducing the impact of the tax law on the choice of business form.

III. THE PROBLEMS WITH S CORPORATIONS

A. TAX CONSEQUENCES NOT QUITE AS GOOD AS PARTNERSHIP TAX CONSEQUENCES

"Recondite" is a good adjective to describe what many people feel about the law of partnership taxation: "very difficult to understand and beyond the reach of ordinary comprehension and knowledge."\textsuperscript{12} As one tax court judge said:

The distressingly complex and confusing nature of the provisions of Subchapter K present a formidable obstacle to the comprehension of these provisions without the expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years of experience in the tax field. . . . Its complex provisions may confidently be dealt with by at most only a comparatively small number of specialists who have been initiated into its mysteries.\textsuperscript{13}

Yet, Subchapter K and partnership taxation has an exciting allure to the low percentage of lawyers who actually understand it. These "partnership wizards," it has been said, can wave "magic wands" to reduce or even eliminate taxation for profitable enterprises and ventures.\textsuperscript{14}

The source of much of their magic is section 704\textsuperscript{15} and its nefarious regulations.\textsuperscript{16} According to section 704(a), a partner's distributive share of each income or loss item is generally determined pursuant to the partnership agreement.\textsuperscript{17} A partner's distributive share need not be the same for each item. For example, an item producing income can be allocated to a partner with losses from outside the venture, and any item producing

\begin{itemize}
  \item\textsuperscript{12} \textit{WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY} 189 (unabridged 1976).
  \item\textsuperscript{13} Foxman v. Commissioner, 41 T.C. 535, 557 n.9 (1964), \textit{aff'd}, 352 F.2d 466 (3d Cir. 1965) (quoted in \textit{PAUL R. MCDANIEL ET AL., FEDERAL INCOME TAXATION OF BUSINESS ORGANIZATIONS} 4 (1991)).
  \item\textsuperscript{14} Lee A. Sheppard, \textit{Partnerships, Consolidated Returns, and Cognitive Dissonance}, 63 Tax Notes 936 (1994).
  \item\textsuperscript{16} Treas. Reg. § 1.704 (as amended in 1994). In the 1994-95 edition of \textit{CCH's FEDERAL INCOME TAX, CODE AND REGULATIONS, SELECTED SECTIONS} (Martin B. Dickinson ed., 1994), the section 704 regulations are 64 pages long.
  \item\textsuperscript{17} \textit{I.R.C.} § 704(a); \textit{SAMUEL T. THOMPSON, TAXATION OF BUSINESS ENTITIES} 479 (1989).
\end{itemize}
losses can be allocated to a partner with income from external sources.\textsuperscript{18} The power to allocate items of income or loss is not, however, without limits. Section 704(b) requires that the allocations in the partnership agreement have "substantial economic effect."\textsuperscript{19} If an allocation does not have substantial economic effect, a partner's distributed share of such item is reallocated in accordance with the partner's interest in the partnership.\textsuperscript{20}

Yet, despite the constraint regarding substantial economic effect, the partners' power to allocate tax items gives them unmatched flexibility. As a writer recently quipped, some Subchapter K enthusiasts seem to believe that partnership tax law is so flexible that the partners can do almost absolutely anything they want without incurring any tax.\textsuperscript{21} Subchapter S provides nothing comparable to the section 704 allocations. At most, it permits shareholders to hold corporate debt; indeed, an S corporation is not even allowed to issue preferred stock.\textsuperscript{22}

Another key distinction between Subchapter S and Subchapter K primarily deals with highly leveraged enterprises. Partners can add their proportionate shares of the partnership's liabilities to their basis in their partnership interests.\textsuperscript{23} Despite a taxpayer victory in one aberrational case,\textsuperscript{24} S corporation shareholders are not entitled to add liabilities incurred by the corporation to their basis in their stock.\textsuperscript{25} This is an important disadvantage of the S corporation, because the deductions that flow through to both partners\textsuperscript{26} and S corporation shareholders\textsuperscript{27} are deductible on their individual tax returns in the current year only to the extent of their basis in their investment interests. This makes partnership tax consequences more desirable for highly leveraged enterprises, and it is often

\textsuperscript{18} IRC § 704(a).
\textsuperscript{19} I.R.C. § 704(b); McDANIEL, supra note 13, at 98.
\textsuperscript{20} I.R.C. § 704(b)(2).
\textsuperscript{21} Sheppard, supra note 14.
\textsuperscript{23} I.R.C. §§ 722, 752(a) (1988).
\textsuperscript{24} Selfe v. United States, 778 F.2d 769 (11th Cir. 1985).
\textsuperscript{25} See, e.g., Uri v. Commissioner, 949 F.2d 371 (10th Cir. 1991); Goatcher v. United States, 944 F.2d 747 (10th Cir. 1991); Harris v. United States, 902 F.2d 439 (5th Cir. 1990); Estate of Leavitt v. Commissioner, 875 F.2d 420 (4th Cir. 1989); Ley v. Commissioner, 66 T.C.M. (CCH) 113 (1993); Suisman v. Commissioner, 58 T.C.M. (CCH) 751 (1989); Bellis v. Commissioner, 57 T.C.M. (CCH) 667 (1989); Fear v. Commissioner, 57 T.C.M. (CCH) 306 (1989); Erwin v. Commissioner, 56 T.C.M. (CCH) 1343 (1989); Allen v. Commissioner, 55 T.C.M. (CCH) 641 (1988); Gurdia v. Commissioner, 54 T.C.M. (CCH) 104 (1987); Bader v. Commissioner, 52 T.C.M. (CCH) 1398 (1987).
the primary reason investors choose Subchapter K over Subchapter S.\textsuperscript{28} Other differences in tax consequences are noted in the margin.\textsuperscript{29} 

As long as Subchapter K and Subchapter S have significant differences in tax consequences, it will behoove good practitioners to learn the differences and use them to help their clients. Not that these distinctions make sense. Why should partners get larger deductions than S corporation shareholders? That is a flummoxing question. However, because of the distinctions, the law will remain complicated, businesses will spend money on tax advice, businesses without good tax advisors will pay more taxes, and the federal fisc will be at the mercy of innovative tax advisors using self help as described below.

\textbf{B. Subchapter S's Constraining Eligibility Requirements}

The S corporation eligibility requirements, contained in section 1361, are constraining.\textsuperscript{30} They limit the number and types of shareholders an S corporation can have, its capital structure, and the types of assets it can own.\textsuperscript{31} Section 1361(b)(1)(A) limits S corporations to thirty-five shareholders.\textsuperscript{32} Perhaps these limitations are needed to protect the tax revenue generated by the C corporation regime. Yet there are groups of investors whose numbers exceed the S corporation cap and who still desire conduit tax treatment. They likely will find it under the current system, either as a limited partnership or as a limited liability company. An S corporation cannot have another corporation, a partnership, or a non-

\textsuperscript{28} See, e.g., Abraham P. Friedman, Choosing Between Corporate and Partnership Entities for Real Property Depends on Its Use, 11 TAX’N FOR LAW. 366, 367-68 (1983); Kalinka, supra note 11, at 1108; Burton W. Kanter, To Elect or Not to Elect Subchapter S—That Is a Question, 60 TAXES 882, 912-16 (1982); William J. Rands, Organizations Classified as Corporations for Federal Tax Purposes, 59 ST. JOHN’S L. REV. 657, 705-06 (1985).

\textsuperscript{29} A partner's contribution of capital to a partnership in exchange for a partnership interest is generally tax free to both the partner and the partnership. I.R.C. § 721(a) (1988). However, a shareholder who contributes appreciated property to an S corporation must own at least eighty percent of the corporation immediately after the exchange for the contribution to be tax free. I.R.C. §§ 351(a), 368(c), 1371(a)(1) (1988 & Supp. V 1993). Nonliquidating distributions of appreciated property to a partner are generally tax free to both the partnership and to the partners. I.R.C. § 731(a) (1988). But an S corporation recognizes gain upon a nonliquidating distribution of appreciated property to a shareholder, and the shareholder recognizes gain to the extent that the fair market value of the distributed property exceeds the shareholder’s stock basis. I.R.C. §§ 311(b)(1), 1368(b)(2), 1371(a)(1) (1988). A partnership generally does not recognize gain or loss in a liquidation. I.R.C. § 731(b). The liquidation of an S corporation triggers gain to the corporation to the extent that it distributes appreciated property. I.R.C. §§ 336(a), 1371(a)(1). An S corporation can recognize loss on the distribution of property, provided the distribution does not fall under section 336(d). See I.R.C. §§ 336(a), 1371(a)(1) (1988). A partner can make a § 754 election which allows a basis adjustment in his or her share of the partnership property in order to reflect the outside basis in his or her partnership interest. I.R.C. § 754 (1988). A shareholder in an S corporation does not have a similar option. See, e.g., I.R.C. § 1367 (1988).


\textsuperscript{31} Id.

\textsuperscript{32} I.R.C. § 1361(b)(1)(A). Originally set at ten shareholders, the Danforth-Pryor proposal would increase the cap to 50.
resident alien as a shareholder. Undoubtedly, these restrictions bar some syndicates of investors who want a passthrough entity from using Subchapter S. Again, they likely can achieve conduit status by using a limited partnership or limited liability company, entities that do not have these restrictions.

Additionally, Subchapter S imposes a restriction on capital structure: S corporations cannot have preferred stock. The shareholders and other investors can achieve some of the same objectives that preferred stock provides by taking debt from the S corporation. Indeed, changes in the law have reduced the possibility of shareholder-held debt being deemed a second class of stock, a reclassification that would terminate the S corporation election.

But debt carries nontax problems, e.g., inflexibility and balance sheet problems. It does not provide the flexibility granted to partners by section 704, which invites partners to use their partnership agreement to distribute the tax consequences amongst themselves. S corporations cannot be part of an affiliated group, meaning they cannot own eighty percent or more of the stock of another corporation and still be eligible for the S corporation election. This limitation interferes with state law planning, which might include the use of subsidiaries for limited liability purposes, and impedes acquisitions, which might include the purchase of control of another corporation. Limited partnerships and limited liability companies are not subject to this restriction.

It may be that the eligibility requirements for S corporations are too strict and ought to be relaxed. Many, including the author and some of our legislators in Congress, seem to think so. But until Congress decides that conduit status should be available, or even required, for all businesses, no matter how many investors a business has, no matter how complex its capital structure is, no matter what types of owners it has, some line-drawing is required, and some of the lines drawn will be arbitrary. What does not make sense is to continue these eligibility requirements for S corporations and not for limited partnerships and limited

36. Unlike preferred stock, debt generally carries a fixed obligation from the corporation to the debt holder. If the corporation is in financial trouble, it can withhold the payment of dividends; but, unlike a preferred stockholder, a debtholder has the power either to compel payments on the debt or to force the corporation into bankruptcy. William J. Rands, The Closely-Held Corporation: Its Capital Structure And The Federal Tax Laws, 90 W. VA. L. REV. 1009, 1096 (1988).
37. Putative lenders, e.g., banks, are wary of balance sheets heavily laden with debt. In contrast to debt, preferred stock strengthens the balance sheet by decreasing the debt-to-equity ratio, thereby making the corporation a more attractive borrower to outsiders. Id.
40. See supra note 36 and accompanying text.
liability companies. There is no principled reason to allow limited partnerships and limited liability companies to have a corporation as an owner or to have more than thirty-five owners but not to allow the same for S corporations. It is no more difficult to collect tax from a nonresident alien S corporation shareholder than it is from a nonresident alien partner. Maybe it is difficult to allocate income or loss to holders of different classes of stock, but it is also difficult to make the allocations in accordance with a partnership agreement under section 704. Congress should decide what requirements it wishes to impose on taxpayers who want their businesses to be treated as conduits. For example, if Congress wants to limit conduits to closely-held businesses, it could set a cap on the number of owners, and, perhaps, delimit the types of owners the entity could have. Whatever eligibility requirements Congress deems necessary, they should be imposed on all the forms of conduits.

C. SUBCHAPTER S REFORM EFFORTS ARE LAUDABLE BUT DO NOT ELIMINATE THE BASIC PROBLEMS

Senators Danforth and Pryor, members of the Senate Finance Committee, have introduced legislation that would remove many of the stultifying eligibility requirements contained in Subchapter S. It would also make some attractive tax changes in operating an S corporation. The number of permissible shareholders would be increased from thirty-five to fifty. All the members of a single family would count as just one shareholder. Tax-exempt organizations, financial institutions, and nonresident aliens would be permitted to own corporation stock. The proposed changes would also allow a more flexible capital structure. The S corporation would be permitted to issue convertible debt. It would be permitted to issue preferred stock, though such stock could not be participating, could not have redemption and liquidation rights exceeding its issue price, and could not be convertible. With those restrictions, it looks a lot like debt. Still, it would be an improvement on the prohibition against preferred stock and would go part way toward allowing some of the flexibility accorded partnerships under the section 704(b) special allocation rules.

The proposal would allow an S corporation to own eighty percent or more of the stock of another corporation, though it would not permit the related entities to file a consolidated return. It would expand the types of trusts that can own S corporation stock, and ease some of the pitfalls.

41. See I.R.C. § 704; Treas. Reg. § 1.704; see also supra note 16.
44. Id. § 102.
45. Id. § 111-13.
46. Id. § 201.
47. Id.
caused by invalid elections and inadvertent terminations.\textsuperscript{49} It would apply C corporation rules for fringe benefit purposes.\textsuperscript{50} It would eliminate the requirement of maintaining an AAA account for pre-1983 earnings and profits.\textsuperscript{51}

These reform measures are laudable. They reduce the distinctions between S corporations and partnerships (and one would think, as a byproduct, reduce the allure of limited liability companies). But they still are not enough. The bill does not include a proposal that the principal amount of an S corporation's debt that is personally guaranteed by shareholders be included in the guarantor's basis in his stock. Accordingly, debt-financed entities are still likely to desire partnership tax consequences. In addition, though the reformed law would permit S corporations for the first time ever to issue preferred stock, the bill contains too many restrictions. Preferred stock is always a hybrid form of investment that contains elements of both common stock and debt. Its appeal to investors depends at least partly on taking some of the best attributes from each. Unfortunately, the preferred stock allowed by proposed section 1361(c)(7)(B) would be required to have the worst attributes from both common stock and debt. Because it would be stock,\textsuperscript{52} it would fall behind all debt in a bankruptcy and thus be riskier than debt. Because it would have to be nonparticipating and nonconvertible,\textsuperscript{53} it would have none of the speculative charm of common stock. Indeed, it cannot even pay a premium on a redemption or liquidation,\textsuperscript{54} an unusual negative for a senior security interest. Though it might be useful in a family planning setting, it is unlikely to be the type of investment vehicle that will lure new capital.\textsuperscript{55}

The proposed changes are good in that they are an improvement over the current system, but they leave untouched the basic problem. The tax consequences from operating a business under Subchapters S and K would still differ. Only the best practitioners would understand the differences and use them to help their clients. The practitioners would still advise their clients to use the entity that would produce the lowest tax bill, regardless of whether or not it is the best organizational structure for operating the business. The eligibility requirements would continue to be different. Some investors who might prefer the corporate form would still be relegated to a partnership or limited liability company structure to obtain the desired tax consequences.

\textsuperscript{49.} Id. §§ 114, 211.
\textsuperscript{50.} Id. § 222.
\textsuperscript{51.} Id. § 226.
\textsuperscript{52.} Id. § 201.
\textsuperscript{53.} Id.
\textsuperscript{54.} Id.
\textsuperscript{55.} Sheppard, supra note 1, at 1667.
IV. THE EXAGGERATED DEFECTS OF LIMITED PARTNERSHIPS

A. LIMITED LIABILITY

Until the emergence of the limited liability company, the limited partnership was the refuge for businesses that wanted limited liability, preferred partnership tax consequences over those of Subchapter S, or felt that the Subchapter S eligibility requirements were too constraining. But current thinking is that the limited partnership, though sometimes better than an S corporation, generally is inferior to a limited liability company. It probably is, but hardly by a sufficient margin to justify the creation of a whole new area of business organization law.

While the limited partnership accords limited liability to the limited partners, the limited partnership must have at least one general partner who is personally liable for all the partnership debts. Moreover, limited partners can be reclassified as general partners, and thereby lose their limited liability, by participating too intrusively in the management of the partnership business. In contrast, limited liability companies have neither weakness. The codes creating limited liability companies give all of the owners (called "members") limited liability. Limited liability companies need not have a member with unlimited personal liability. Also, their members are not punished for participating in the management of the business. In short, members are just like shareholders. Members are not vicariously liable for the debts of the business merely by virtue of their status as owners, and they do not automatically lose this protection merely by managing the entity's affairs.

Yet the superiority of the limited liability company over the limited partnership is being exaggerated. It is common practice for a limited partnership to use a corporation as its general partner. This practice insulates the personal assets of the limited partners from potential seizure by a creditor of the partnership. The corporate general partner has unlimited liability, of course, but it need not have many assets.

Furthermore, the Revised Uniform Limited Partnership Act, adopted in 48 states and the District of Columbia, has greatly reduced the
probability that a limited partner will be classified as a general partner merely by participating in the partnership’s business. According to the Act, a limited partner, without fear of being reclassified as a general partner, may act as an agent, employee, contractor, or advisor to either the limited partnership or the general partner.60

Some writers still argue that corporate general partners do not adequately protect the personal assets of the limited partners, because a court might pierce the corporate veil of the general partner to make them individually liable, especially if the general partner is inadequately capitalized.61 Certainly, this is not an absolute impossibility, but it sounds somewhat remote. There are only a few reported cases of attempts to pierce the corporate veil of a general partner.62 Courts also express an

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62. A computer search produced only a few cases involving attempts to pierce the corporate veil of a corporate general partner. While the courts seemed willing to do so under appropriate circumstances, plaintiffs often failed to satisfy the requirements for piercing the veil. See, e.g., Mid Kansas Fed. Sav. & Loan Ass’n v. Orpheum Theater Co., 810 F. Supp. 1184, 1195 (D. Kan. 1992) (not enough facts to complete the piercing analysis, and piercing denied); In re City Communications, Ltd. v. Knobloch, 105 B.R. 1018, 1022-23 (Bankr. N.D. Ga. 1989) (bankruptcy trustee permitted to pursue an alter ego claim against the owners of debtor’s general partner); Butler v. Collins, 14 B.R. 546, 548 (Bankr. E.D. La. 1981) (producer hired by the corporate general partner was unable to pierce the corporate veil to recover money owed to him); Western Camps, Inc. v. Riverway Ranch Enters., 138 Cal. Rptr. 918, 927 (Cal. Ct. App. 1977) (court held that the corporate general partner was solely liable for the obligations of the limited partnership, where the creditor was
extreme reluctance to pierce the corporate veil merely because of inadequate capitalization.63 Lastly, it seems likely that a court would pierce the veil of a limited liability company just as readily as it would pierce the veil of a corporation.64

Moreover, the owners of a closely held venture can never be assured of absolute limited liability. Factually, the distinctions with respect to limited liability between the different forms of business organization are not nearly as dramatic in practice as they are in theory.65 The members of a limited liability company and shareholders may theoretically have limited liability, but if they seek to obtain credit for their businesses, the putative lender is likely to require personal guarantees from the members just like the lender would from shareholders in a closely held corporation. The concept of limited liability also does not insulate shareholders, members, or anyone else from personal liabilities for any torts that they themselves commit while working for the business. Conversely, proprietors and general partners sometimes can avoid personal liabilities to contract creditors through a provision in the contract (e.g., using nonrecourse instead of


64. Steven C. Bahls, Application of Corporate Common Law Doctrines to Limited Liability Companies, 55 MONT. L. REV. 43, 60-66 (1994). Professor Bahls discusses the application of the doctrine of piercing the corporate veil to limited liability companies. Noting that some commentators have reserved judgment as to whether courts should apply the corporate standards for piercing the corporate veil to limited liability companies, Professor Bahls states that others have argued that the corporate standard should apply. The author would allow for piercing the veil of the limited liability company, but with some differences in rules to accommodate the differences between corporations and limited liability companies. Professor Bahls uses the Colorado limited liability statute, which directs the courts to apply the case law for piercing the corporate veil to piercing the veil of limited liability companies, as an example. Id. at 61 n.99; COLO. REV. STAT. § 7-80-107 (Supp. 1991). Most state legislatures, though aware of the option of piercing the veil, are leaving the issue to be developed by common law. See, e.g., Comments to the Montana Limited Liability Company Act § 23 at 10 (1993) (cited in Bahls, supra, at n.94).

recourse debt) in addition to limiting their individual tort liability by taking out liability insurance. Finally, the corporate shield (and presumably the limited liability company shield) is not impenetrable. The voluminous case law in piecing the corporate veil clearly demonstrates this fact. Does the limited liability company provide better protection against personal liability than the limited partnership? Yes, but not by much.

B. PASSIVE ACTIVITY LOSS LIMITATIONS

An unsettled issue is the application of the passive activity loss limitations to the members of limited liability companies. S corporation shareholders and both general and limited partners can run afoul of the section 469 strictures, but the regulations are the toughest on limited partners. The taxpayer can avoid application of the passive activity loss limitation by materially participating in the activity. For most taxpayers, the regulations provide that a taxpayer can be deemed to participate materially in an activity by satisfying any one of seven alternative tests. For example, the taxpayer materially participates if his or her participation in the activity for the taxable year constitutes substantially all of the participation in the activity for such taxable year. But for a limited partner to participate materially, that partner must meet one of three "stricter" tests, each of which requires the limited partner to participate in the activity for more than five hundred hours in a year.

Members of a limited liability company, then, would prefer to be classified as general partners rather than as limited partners, but the language of the current regulation seems to require the members to be treated under the tougher rules applicable to limited partners. This is because the definition in the regulation focuses on a taxpayer's limited liability, and limited liability company members have limited liability. Except for limited liability, members probably have more in common with general partners; like general partners, members are vested with managerial powers, and they run the business. This sounds like material participation, and if the regulations are revised, it might well be that members are treated as general partners. This would remove what might be a current disadvantage for the limited liability company.

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66. See Bahls, supra note 64, at 60-67.
68. See An Interview With Susan Pace Hamill, 72 TAXES 327, 328 (1994); Vitek, supra note 61, at 234-35.
69. I.R.C. § 469(c)(1)(B); Temp. Treas. Reg. § 1.469-5T.
71. Id. § 1.469-5T(a)(2).
74. Id.
75. An Interview With Susan Pace Hamill, supra note 68, at 328-29.
76. Id.; see also Culpepper, supra note 72, at 21.
V. TAX LAW BY SELF-HELP: THE EXAMPLE OF THE MASTER LIMITED PARTNERSHIP

Many of the best tax advisors are crafty. If they do not find the desired mix of tax and nontax features on the current menu of available business organization forms, they will construct a new form. Actually, the term "new form" is an exaggeration. What they really do is reshuffle the characteristics of current business forms to construct a hybrid entity that has as its characteristics features of the preexisting types. In essence, this is a type of self-help by the private-sector tax specialists. Dissatisfied with what federal or state law offers, they use their ingenuity to develop a more suitable form.

The emergence of master limited partnerships presents one such example of self-help.77 Partnerships never have suffered the C corporation disadvantage of double taxation of distributed earnings, but this advantage was tempered by the historically higher marginal tax rates for individuals over C corporations. But Congress closed the gap between the C corporation and individual rates in 1982 and actually inverted them in 1986, making the highest rate for C corporations higher than the highest individual rate for the first time in history.78 As a consequence, partnerships not only avoided the C corporation disadvantage of double taxation, but often provided a lower rate of taxation on the entity-level earnings. While partnership tax consequences had always been good for enterprises that produced tax losses, they now were good for prosperous enterprises as well.79 Moreover, although under the Kintner Regulations80 the publicly traded limited partnership was classified as a partnership for tax purposes, in real life the entity had the nontax advantages associated with a corporation. The limited partners were essentially no different than shareholders. They traded their partnership interests on the public exchanges as if they were shares of stock.81 They had limited liability and benefited from centralized management in the form of a general partner. They were not saddled with managerial responsibilities and accompanying fiduciary duties.82 Thus, the master limited partnership possessed all of the nontax benefits usually associated with a corporate form, and in addition offered lower tax rates and no double tax on distributed earnings.

The allure of the master limited partnership seemed almost irresistible, but Congress quickly responded to this self-help corporate integration.83

77. Master limited partnerships are sometimes referred to as publicly traded limited partnerships. For a general discussion of the history of master limited partnerships, see Marvin F. Milich, Master Limited Partnerships, 20 REAL EST. L.J. 54 (1991).
78. See id. at 61.
79. Id.
81. Milich, supra note 77, at 55.
82. Id. at 58.
Congress feared that the irresistibility of publicly traded partnerships would result in a disincorporation of America. Congress was also concerned that, since the nontax attributes were basically the same as those of a corporation but entailed better tax consequences, virtually all publicly traded entities would transpose themselves into master limited partnerships. That transposition, it was feared, would destroy the corporate income tax and result in a devastating loss of Treasury revenue. Accordingly, in 1987 Congress hastily enacted section 7704. This section requires publicly traded limited partnerships to be treated as C corporations for federal income tax purposes, thereby thwarting the private sector effort at self-help.

VI. LIMITED LIABILITY COMPANIES

A. THE LATEST FORM OF SELF-HELP: BAD FORMATION OF TAX LAW

Limited liability companies are the hottest phenomenon in the legal community. Not wanting to be left behind, virtually every state has enacted legislation that authorizes their creation. They are made the submaster limited partnerships, and I.R.C. § 512(c)(2) (Supp. V 1993), which provides that tax-exempt organizations that invest in master limited partnerships must treat their share of income as derived from an unrelated trade or business.

85. Milich, supra note 76, at 63.
86. Id.
88. Id.
89. Referring to the enactment of limited liability company legislation in Oregon, one writer stated: "Oregon's ability to attract and retain foreign business will be adversely affected until such legislation is enacted. Oregon's need to remain in the forefront of new and emerging trends and developments similarly will require that we legislatively provide for the creation and operation of LLCs." Donald W. Douglas & David C. Culpepper, OR. ST. BAR BULL., Dec. 1992, at 11, quoted in David L. Cameron, Strike Up the Band: The Limited Liability Company Comes to Oregon, 30 WILLAMETTE L. REV. 291, 295 n.11 (1994).
ject of encomiums, discussed in law review articles, described at


itted partnerships. The private sector shuffles the Kintner characteristics to concoct an entity that has both limited liability and partnership taxation. This achieves exactly what Subchapter S was supposed to do, but has never quite accomplished. But the histories of these two tax-driven concoctions also diverge. Fearful of a loss of revenue, Congress immediately took action restricting the advantages of master limited partnerships by enacting section 7704. For some reason Congress has not touched limited liability companies. Moreover, the limited liability company has far more momentum as states have jumped on the bandwagon with new legislation. Whether or not its emergence constitutes good tax policy, it may be too late, as a practical matter, for Congress to quash it as it did with master limited partnerships.

No matter what the merits of the limited liability company (and in my opinion, they are modest), its emergence is an example of badly formulated tax law. Congress is expected to play the primary role in the creation of federal income tax law, but it has failed to act in the case of the limited liability company. It has done nothing. Limited liability companies are not the brainchild of a brilliant tax policy expert, on loan to the Treasury Department from Yale or Georgetown. Rather, the germinal point in the history of limited liability companies was the issuance of Revenue Ruling 88-76,\(^9\) which interprets the long outdated Kintner Regulations and applies them to a Wyoming state statute! No disparagement of the Wyoming legislature or people who issue revenue rulings is intended, but they are not the parties who should be forging major shifts in federal tax law.

Here is what should have happened. Prior to the issuance of Revenue Ruling 88-76, the IRS should have alerted congressional staff members that it was about to issue a revenue ruling treating Wyoming limited liability companies as partnerships rather than as corporations under the Kintner Regulations. With the experience of master limited partnerships fresh in everyone's mind, both the congressional staff and the IRS would have known that, once the private sector digested the information about limited liability companies, it would flock to that type of entity to circumvent the problems associated with other forms of business associations, especially S corporations. Congress should then have decided whether or not to permit this circumvention of the Subchapter S rules. It would have

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been most sensible to engage in a full-scale review of conduits and to rewrite the rules so that they made more sense. Congress, of course, has numerous pressing matters before it and may have lacked the time necessary to complete such a major project. Still, Congress could have adopted stop-gap legislation, e.g., by making limited liability companies meet the Subchapter S standards as a prerequisite to being treated as conduits, until it had time to engage in a fuller review. Instead, Congress remained inert, allowing virtually all of the states to pass legislation. It may now be hard to put the bull back in the barn.

B. Classification Issues: The Kintner Regulations

In general, an organization may be classified as a corporation (called an "association" in the regulations), a partnership, a proprietorship, or a trust. Despite the importance of the classification issue, the Internal Revenue Code is unusually terse, leaving delineation of the law to courts and regulations. Because of the virtual absence of statutory guidelines, the Treasury regulations have served as a primary source of rules governing the classification issue. A product more of adversarial zeal than of deliberative rule-making, the regulations represent the government's persistent efforts to stop a particular tax practice that had seemed especially odious to the Commissioner: professionals treating their businesses as corporations for tax purposes so that they may achieve favorable tax treatment for fringe benefits and deferred compensation plans. The current regulations can be traced back to a 1954 Ninth Circuit opinion, United States v. Kintner. In that case a group of doctors convinced the Ninth Circuit that the group's unincorporated association should be classified as a corporation for federal tax purposes. Incensed that physicians and other professionals could obtain the tax benefits of qualified pension plans, the Commissioner initially refused to follow the Kintner decision. After several subsequent courtroom defeats, however, the Commissioner conceded on the issue. Undaunted, the Commissioner quickly launched an attack against doctors by proposing new regulations, which were adopted in 1960, known colloquially as the "Kintner Regulations." These regulations, still in effect today, constituted an un-
abashed attempt to overrule Kintner and are heavily weighted toward partnership classification and against the association classification.103

The Kintner Regulations are thus a product of a bygone era. They have also produced unintended byproducts: first, the proliferation of tax shelter limited partnerships, and now the emergence of limited liability companies.

The regulations take a mechanical approach to the classification issue. They list the six characteristics of the "pure" corporation, the same characteristics promulgated in Morrissey v. Commissioner,104 a 1935 Supreme Court case: (1) the presence of associates; (2) an objective to carry on business and divide the profits; (3) continuity of life; (4) centralized management; (5) limited liability of investors; and (6) free transferability of investor's interests.105 The regulations say that two of these characteristics—the presence of associates and a business objective—are essential to classification as an association. If these two characteristics are present, the next step is to determine whether the organization has any of the other four corporate characteristics. An unincorporated organization should not be classified as an association unless it has more corporate characteristics than noncorporate characteristics. If, however, any characteristic is common to both the corporate and noncorporate form under consideration, that common characteristic must be disregarded in the weighing process. Hence, because both partnerships and corporations are assumed to have associates and a business objective, an unincorporated entity must possess three of the other four characteristics to be classified as a corporation.

The Kintner Regulations, criticized106 and outdated, provide the context for limited liability companies.107 Limited liability companies are unincorporated enterprises whose owners want to be treated as partnerships for federal income purposes. According to the Kintner Regulations, this means that they can have no more than two of the four characteristics that differentiate corporations from partnerships. Invariably, the owners

104. 296 U.S. 344, 359 (1935).
106. See, e.g., Rands, supra note 28; Larson v. Commissioner, 66 T.C. 159, 185-86 (1976) (upholding regulations, though disagreeing with the way they were written).
107. Rev. Proc. 95-10, 1995-3 I.R.B. 20, specifies the criteria that the I.R.S. will use to evaluate a request for a letter ruling that a limited liability company is a partnership for federal income tax purposes. For a full discussion of the Kintner Regulations and their application to limited liability companies, see Alan G. De Nee, Limited Liability Companies, 31 U.S. Tax Rep., July 29, 1993, § 3.
PASSTHROUGH ENTITIES

want limited liability. As a consequence, they can have only one of the other three corporate characteristics (continuity of life, free transferability of interests, and centralized management). To be classified as a partnership, they must forgo at least two of these three often very desirable characteristics, though so far both the regulations and the Commissioner’s rulings have been liberal in finding that the entity lacks the corporate characteristic in question. This liberality is a function of the regulations’ heavy and outdated bias towards partnership classification. But is this not the tax tail wagging the dog?

Opponents and commentators vaunt the limited liability company for its flexibility. Yet, a closer look reveals that the attributes of the entity must conform to fit within the confines of the Kintner Regulations. For example, limited liability company statutes generally give each of the members managerial powers equal to their equity in the enterprise, but allow the articles or operating agreement to alter that general rule, providing for the election or appointment of managers. Centralized management is an attractive, and at times essential, attribute for a business with more than a few owners. Presumably many limited liability companies would choose to have this corporate characteristic. That means that such entities can have neither continuity of life nor free transferability of interest.

If they do not need limited liability, they can choose a general partnership and have the tax consequences they desire without the need of using a limited liability company.

Zuckman v. United States, 524 F.2d 729 (Ct. Cl. 1975); Rev. Proc. 95-10, 1995-3 I.R.B. 20; Priv. Ltr. Rul. 92-10-019 (Mar. 6, 1992). For example, to avoid having the corporate characteristic of continuity of life, the limited liability company must dissolve on the death, insanity, bankruptcy, retirement, resignation, expulsion, or other event of withdrawal of a member. Treas. Reg. § 301.7701-2(b)(1) (1994). Because continuity of life is often a desirable feature for a business entity, the rule against it in the Kintner Regulations is a negative for the limited liability company. It implies that the entity may have to be liquidated upon the loss of just one member. But this perception is misleading, because the members are allowed to agree in advance that members holding a majority interest in the company can vote to prevent the dissolution of the entity and continue its business, despite the dissolution event. Id. Limited liability companies can also limit dissolution to just one type of event, e.g., death of the company’s manager.

Free transferability of interest is a corporate characteristic and is also often desirable. According to the regulations, it means that each of the members owning substantially all the interests in the organization must have the power, without the consent of the other members, to substitute for themselves someone who is not a member of the organization. Treas. Reg., § 301.7701-2(e)(1). Substitution means a complete transfer of all the attributes of ownership. The right to assign a member’s economic interests in the organization is not enough to constitute free transferability of interest. Accordingly, the general rule in the limited liability statutes is that the members have the power to confer all of their economic rights on their transferees, but cannot transfer their rights to manage without consent of the other members. This need to avoid free transferability of interest is a negative feature of limited liability companies. The transfer of economic rights may satisfy some potential buyers, but certainly others will want the managerial powers usually associated with ownership. Rev. Proc. 95-10, 1995-3 I.R.B. 20, allows full transfers by members owning less than 20% of the company.
C. AUTHOR'S LACK OF ENTHUSIASM FOR LIMITED LIABILITY COMPANIES

I am not as enthusiastic about limited liability companies as many others seem to be. They accomplish what Subchapter S was intended to achieve—partnership tax consequences and limited liability. That may be a good result, but this benefit is at least partially offset by the cost of adding yet another type of business organization and thus complicating what is already too complicated an issue—the choice of business entity for a closely held enterprise. I would overlook this adverse side effect, if the limited liability company represented a true improvement over each of the forms that it is replacing. Though it constitutes a marginal improvement over the limited partnership, I do not see the limited liability company as an improvement over the corporation as a form for operating a business. The limited liability company is not a new, improved business form that will result in better management. The "safest" limited liability company statutes, those that are "bullet-proof," contain mandatory rules to prevent companies organized under them from having too many corporate characteristics. The more flexible the statute, the more danger that a company will accidentally cross the C corporation line and lose its status as a conduit. In contrast, state corporation codes are enabling acts that permit the owners of closely-held corporations to set the governance structure for their business that best suits their needs. Moreover, corporate structures and corporate law are the product of more than one hundred years of evolution. There is a well-established jurisprudence about corporations. The American Law Institute recently completed a thirteen-year study and analysis of corporate law. In contrast, there is nothing settled about the law of limited liability companies. Should the jurisprudence of piercing the corporate veil be applied to limited liability companies? What fiduciary duties should apply to members and managers? Should limited liability companies be allowed to have more than one member? Should lawyers or other professionals

112. I see the limited liability company as an improvement over the limited partnership, because the limited liability company requires nothing akin to a general partner. With the advent of thinly capitalized corporate general partners, this limited partnership requirement, though a nuisance, is easily enough met. But why bother with it at all? These corporate general partners are really shams and do not serve the purpose of providing partnership creditors with some financial security.


114. See, e.g., Bahls, supra note 64.

115. See Miller, supra note 92; Curwin, supra note 92.

be allowed to organize as limited liability companies? These are some of the questions being explored. Is this not reinventing the wheel?

D. Notice 95-10: "Check-the-Box"

The Treasury Department and the Internal Revenue Service are considering changes in the regulations that would allow unincorporated businesses to choose to be taxed as either a partnership or a C corporation. The proposed new system, announced in Notice 95-10 and called "check-the-box," would replace the current four-factor Kintner Regulations system. Why are Treasury and the Service proposing what is virtually a capitulation? Unofficial remarks indicate a bowing to the inevitable: with the advent of limited liability companies, the choice between partnership and C corporation taxation has become functionally elective anyway. Moreover, both the government and the private sector, they say, are wasting resources on rulings for limited liability companies. If adopted, the proposal would eliminate the nettlesome problem that currently affects limited liability companies: the need to conform the entity with the obsolete Kintner Regulations. For example, a limited liability company no longer would be required to forgo free transferability of interests, even though it needs continuity of life and centralized management. The new system likely would solidify the limited liability company as a primary choice for a passthrough entity and further reduce the appeal of the Subchapter S corporation.

Would anyone still use the S corporation? Many S corporations already in existence probably would want to preserve their status, because there is a tax cost in transferring assets out of an existing corporation. Moreover, Subchapter S is substantially simpler than Subchapter K. Some parties might be willing to trade away the flexibility of special allocations available under Subchapter K, and its concomitant complexity, in exchange for the simplified system of Subchapter S. Others may want

119. Rod Garcia & Nancy Loube, LLCs, or How the Government Got to the Check-the-Box Classification, 67 Tax Notes 1139 (1995); Sheryl Stratton, IRS Proposes Check-the-Box Entity Classification Procedure, 67 Tax Notes 26 (1995).
120. Garcia & Loube, supra note 119, at 1139; Stratton, supra note 119 at 26; see also Marlis Carson, Treasury Officials Address Check-the-Box Entities, 67 Tax Notes 1009 (1995).
121. At this point, it is hard to see why the proposal would not be adopted. The government is making the proposal, and it concedes the game to the practitioners.
to avoid the uncertainty associated with such a new entity as the limited liability company.\footnote{124 See generally Miller, supra note 92.}

Substantively, the check-the-box system would constitute only a slight improvement over the current system. In constructing a limited liability company, business owners would be able to choose characteristics for their entities based on business considerations instead of tax classification rules. That is good. Their advisors would no longer be required to wend their way through the obsolete Kintner Regulations and could be assured of partnership taxation when desired. But the improvement is only slight. It leaves intact the operative tax rules, which are more complex than the classification rules. The default rule under the check-the-box regime would be Subchapter K and partnership taxation, the most complex of all the possibilities. Choice of entity is such a routine decision for a lawyer that the author suggests that the default rule might be something simpler. Tax advisors already should have mastered the complexities of partnership taxation, but many have not. Moreover, there still would be C corporations and four types of conduits. It is tempting to believe that owners and their advisors always would choose limited liability companies and partnership taxation over the other conduits, but that would not always be the case. For example, someone might choose the S corporation for passive activity loss reasons or just because it is simpler. That means that advisors would still need to know the distinctions between all the conduits. They would certainly still need to be aware of the distinctions between Subchapter C and Subchapter K. It is worth noting that incorporations actually increased in 1994 over 1993. Obviously, many people are not getting the message that limited liability companies are preferable. The blissfully ignorant, of course, are also unlikely to be using S corporations. Finally, the proposal would leave intact the unprincipled distinctions between partnerships and S corporations. Why, for example, limit the number of participants for S corporations but not for limited liability companies?

The methodology of making the changes is poor, even if the substance is good. The changes are about to be rushed through without careful analysis. The Internal Revenue Service and the Treasury Department seem to be reacting to pressure more than making an informed, reasoned policy decision. No one, for example, appears to be considering the revenue impact of the changes, or whether it would make better policy sense to revamp Subchapter S than to rubberstamp the states' hurried decision that limited liability companies should be the conduit of choice. The sensible route would be a full-scale congressional review of the whole area of conduit taxation. The changes would constitute too significant a shift in the tax law for the executive branch to make on its own.
VII. PROPOSAL

A. ELIGIBILITY STANDARDS

Congress should reform the treatment of passthrough entities by adopting standard eligibility requirements for all of them. I am not much concerned what the standards are, just that they be the same. There is no principled reason why the standards should be different. One possibility would be to allow elective conduit tax treatment for all closely held concerns. Such a rule would preserve Congress’s apparent resolve to preserve entity-level tax for publicly traded enterprises.\(^{125}\) Allowing an election for such a large class of entities might well seem too expensive, because owners would select conduit status only when that status would result in a smaller tax burden.\(^{126}\) But such an elective system virtually exists already, because owners of any entity short of a publicly held enterprise can use a limited partnership or a limited liability company to achieve passthrough tax treatment.\(^{127}\) The term “publicly traded” is used in section 7704, and therefore it does not seem too amorphous as the line of demarcation. But perhaps it is, and perhaps it will allow too great a drain on the federal fisc. If Congress concludes that it is not a proper standard for these or other reasons, Congress certainly could resort to a bright-line rule, as it so often does in Subchapter C. Congress could decide, for example, that only businesses with a hundred or fewer owners could elect conduit treatment. As with all bright-line rules, the one-hundred owners mark is arbitrary. It would also require some backup rules to prevent circumvention, such as not permitting a holding company with thousands of shareholders to be regarded as a single shareholder. It would be less arbitrary than the current system, which limits S corporations, but not limited liability companies, to thirty-five owners.

B. OPERATIVE TAX RULES

Congress should also make the taxation of S corporations and partnerships as close as possible. One suggestion is to repeal Subchapter S, retain Subchapters C and K, allow eligible entities to select conduit tax treatment under Subchapter K, and subject all ineligible or nonelecting businesses to section 11 and Subchapter C.\(^{128}\) Alternatively, but in a similar vein, Congress could repeal Subchapter K, retain Subchapters C and S, treat all entities like corporations, and allow conduit tax treatment for eligible entities that select Subchapter S status. My preference is the latter choice because the Subchapter K rules are recondite and the Subchapter S rules are easier to understand.

\(^{125}\) Congress evinced this resolve when it enacted section 7704 to quash conduit treatment for publicly traded partnerships. See supra text accompanying notes 83 to 88.

\(^{126}\) Kalinka, supra note 11, at 1178-79.

\(^{127}\) Id.

\(^{128}\) Id.
Another possibility would be to eliminate the key differences between partnership and Subchapter S taxation seriatim, i.e., on a section-by-section basis. This process would leave in place two parallel systems that accomplish mostly the same tax consequences, a situation that I think should be avoided, because it complicates the choice of entity issue. But partnerships and corporations have different structures, and perhaps Congress will decide that it cannot fit both structures under one set of sections. One important change would involve the section 704 allocations. Congress should either make them available to eligible corporations or take them away from partnerships. I am not much concerned with the direction in which that change goes. Another important change would involve the ability of investors to add entity-level debt to their outside basis. Congress could either take away the partners’ capacity to increase their basis in partnership interests by their share of partnership-level debt, or it could let S corporation shareholders increase their basis in their stock by their respective proportions of corporate-level debt. The point of this paper is that the rule should be the same, no matter which way it goes. Naturally, it would also make sense to eliminate the smaller differences. For example, section 351 could be amended for S corporations so that the shareholders transferring property to the corporations for stock would no longer be required to control the corporation immediately after the transfer.\footnote{129} Section 351 would then be aligned with section 721(a), Subchapter K’s parallel rule to section 351, which does not condition a partner’s nonrecognition upon his control of the partnership.\footnote{130} Congress could also exempt S corporations from the sections that cause corporate-level recognition of gain on distributions of appreciated property to shareholders.\footnote{131} All the differences between S corporation taxation and partnership taxation should be eradicated.

VIII. CONCLUSION

No matter what the detailed distinctions between Subchapter S and K may be, they make no sense. The conduit systems for partnerships and S corporations are similar. It was the original intention of Congress to treat S corporations like partnerships. Never has there been an intention to make the tax consequences of one form better than the other. The distinctions have no principled basis. They are the result of the ad hoc development of the tax law. They encourage the private sector to concoct enterprise forms solely to attain the slightly better tax consequences of partnership tax law. This happened with master limited partnerships and is now happening with limited liability companies. The limited liability company is not the product of serious reform. Its terms have to be

\footnote{129. See I.R.C. §§ 351(a), 368(c) (1988 & Supp. V 1993).}
molded to fit within the confines of the Kintner Regulations. The "safest" limited liability company statutes have mandatory rules to prevent companies organized under them from having too many corporate characteristics before attaining partnership tax status. The more flexible the statute, the greater the danger that a company will accidentally cross the C corporation line and lose its status as a conduit. In contrast, state corporation codes are enabling acts permitting the owners of closely-held corporations to set the governance structure that best suits their needs. Congress should revisit the tax rules for conduits, evaluate their relative merits, and enact a coherent system of reasoned tax regulation.