Limited Liability Company: Oklahoma's Limited Liability Company Act: Concerns, Considerations, and Conclusions

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Limited Liability Company: Oklahoma's Limited Liability Company Act: Concerns, Considerations, and Conclusions

I. Introduction

Oklahoma has recently joined a number of other states by enacting legislation which authorizes the formation of a limited liability company (LLC) under state law.1 This relatively new statutory business form is increasingly catching the attention of many state legislatures.2 The most striking feature of this new breed of business organization is that it has characteristics of both a partnership and a corporation.3 When properly organized, the LLC offers the pass-through taxation benefits of a partnership for federal income tax purposes combined with corporation-like limited liability for its members.4

II. Overview

The purpose of this comment is to give the reader a better understanding of the LLC. The focus will lie primarily on the Oklahoma LLC Act and considerations with which the business organizer must be familiar to achieve the desired LLC structural form.

Part III of this comment sets forth a brief history of where the LLC originated and reasons for its popularity among many state legislatures in recent years. Parts IV and V outline some of the more notable aspects of the LLC generally and the Oklahoma LLC Act in particular. Part VI addresses the possible effect an LLC’s operation outside its state of formation may have on a member’s limited liability and how the courts may address that issue.

Part VII discusses the particular tax attributes the Internal Revenue Service (IRS) considers when determining an entity's tax status. The focus of this section will be

on how the IRS will likely rule on those attributes with regard to an LLC formed under the Oklahoma Act. Part VIII will consider how Oklahoma will likely treat the LLC for purposes of state taxes.

Part IX discusses some of the potential problems Oklahoma's Act may present to potential investors as well as possible solutions to those problems. In addition, part X will compare the LLC to some of the more traditional forms of business organization. Finally, part XI will propose possible changes which may be appropriate to further the advancement of the LLC as an alternate form of business organization in the State of Oklahoma.

III. Brief History

The first LLC statute was enacted in Wyoming in 1977;⁵ that state was followed by Florida in 1982.⁶ However, uncertainty concerning whether the IRS would classify the LLC as a partnership for tax purposes slowed both LLC use and its continued legislation.⁷ In 1988 much of the uncertainty was alleviated when the IRS determined that a business formed under the Wyoming LLC statute would be treated as a partnership for federal income tax purposes.⁸ Thus, an LLC, if properly organized, is treated as a partnership for federal income tax purposes. Such treatment results in the avoidance of "double taxation" encountered when using the corporate form of business organization.⁹ "Double taxation" occurs when the income of a corporation is taxed at the corporate level and taxed again as individual income when the same funds are paid out to shareholders in the form of dividends.¹⁰

Since the IRS' favorable ruling there has been an explosion of LLC legislation. At the time this article was written, eighteen states had enacted legislation authorizing the formation of an LLC as a business organization.¹¹ Additionally, there was proposed legislation in another eleven states,¹² and at least two states had enacted statutes allowing LLCs formed in foreign jurisdictions to register and do business in their state.¹³ Because of the LLC's recent arrival and its unfamiliarity

6. FLA. STAT. ANN. § 608.401-.471 (West 1993).
11. See supra note 2.
12. As of September 1, 1992, the following states are known to have proposed LLC legislation: Hawaii, Michigan, Mississippi, Missouri, Nebraska, New Hampshire, New Jersey, New York, Ohio, Oregon, and Pennsylvania.
13. See GA. CODE ANN. § 14-11-1 to -19 (Harrison Supp. 1992); IND. CODE ANN. § 23-16-10.1-1 to -10.1-4 (Burns Supp. 1992). These statutes are similar to the foreign registration requirements found in the Oklahoma Act. In general, the statutes require that a foreign LLC register with the Secretary of State. The registration includes, among other things: (1) the name of the LLC, (2) the state of origin, (3) the nature of business, (4) the name and address of an agent for service of process, (5) the date when
to many, this article will outline some of the more basic aspects of the Oklahoma LLC Act.

IV. Organizational Requirements of the Oklahoma LLC

Under Oklahoma law, two or more persons may form an LLC. For purposes of the statute, a person is defined broadly to include not only individuals, partnerships and trusts, but any other legal entity as well. Formation is accomplished by filing two signed copies of the articles of organization with the Oklahoma Secretary of State.

The articles of organization must include the name, date of dissolution and the addresses of both the principal place of business and the agent of the LLC. The name of the LLC must contain the words "limited liability company," "limited company," or the abbreviations "L.L.C." or "L.C." While the statute does not specifically limit the duration of an LLC, in practice the LLC's existence is limited because the statute requires a date be set for dissolving the organization.

Under the Oklahoma LLC Act, an LLC may be formed to conduct any lawful business in any state, other than the business of banking or insurance. Additionally, under Oklahoma law, an LLC may now engage in the business of farming or ranching, or may own or lease land to be used in the business of farming or ranching.

pertaining to members and their contributions are kept. In addition, the statutes provide lists of activities which do not require the LLC to register and requirements for canceling registration. It should be noted, however, that while these states allow the registration of a foreign LLC, they do not have any provisions allowing the formation of an LLC.

14. 18 OKLA. STAT. § 2004(A) (Supp. 1993). Upon the filing of the articles the organization becomes a limited liability company under the name and subject to the purposes, conditions, and provisions stated in the articles. Id. § 2004(4).

15. Act of June 11, 1993, ch. 366, § 2, 1993 Okla. Sess. Law Serv. 2200, 2203 (West) (codified at 18 OKLA. STAT. § 2001(18) (Supp. 1993)). "Person" means an individual, general and limited partnerships, other limited liability companies, a trust, an estate, an association, a corporation, or any other legal or commercial entity. Id.


17. Act of June 11, 1993, ch. 366, § 3, 1993 Okla. Sess. Law Serv. at 2203 (codified at 18 OKLA. STAT. § 2005(A) (Supp. 1993)). The provisions required in the LLC's articles of organization are similar to the provisions required in the certificate of limited partnership that must be filed with the Secretary of State for a limited partnership. See 54 OKLA. STAT. § 309 (1991).


19. 18 OKLA. STAT. § 2005(A)(2) (Supp. 1993) ("The articles of organization shall set forth . . . [the latest date on which the limited liability company is to dissolve.").

20. Id. § 2002.

21. Act of June 11, 1993, ch. 366, § 1, 1993 Okla. Sess. Law Serv. at 2201-02 (codified at 18 OKLA. STAT. § 955 (Supp. 1993)). Prior to this change only natural persons or their estates, trustees of certain trusts, specially organized corporations, and general and limited partnerships (provided they met specified requirements) could engage in the business of farming or ranching, or own or lease land to be used in the business of farming or ranching. While an LLC may now engage in farming or ranching, in order to do so it must meet the same requirements as general and limited partnerships. Id.
V. Other Provisions Relating to the LLC

A. Powers

The LLC generally has broad powers similar to those of an Oklahoma corporation. These powers include, among others, the right to sue or be sued, make contracts, incur liabilities, lend money, own or lease real or personal property, and in general to do any legal act necessary to further the purpose of the LLC. Among statutes enacted thus far, Texas' statute is the only one that does not spell out the powers of the LLC with particularity. Texas' statute confers general powers, granting the same powers to LLCs as those available to Texas corporations and limited partnerships.

B. Managers

The Oklahoma LLC can be managed either by its members or designated managers. The position of manager carries with it defined duties. The manager should be familiar with these duties in order to shield himself from liability to other members of the LLC or third parties.

The Oklahoma LLC Act requires that the manager of the LLC discharge his duties in good faith. In discharging his duties the manager may rely on information provided by his employers, legal counsel, public accountants, or any other persons the manager reasonably believes have expertise regarding the information provided. Additionally, a manager may rely on information provided by a committee of managers, of which he is not a part, if he believes the committee merits confidence.

It should be noted, however, that the manager is not acting in good faith if he relies on otherwise permitted information when he knows that relying on the information is unwarranted. So long as a manager performs his duties in good faith, he will not be held liable for any action or inaction taken in his position as a manager.

There are, however, instances when the manager may subject himself to liability. For example, in carrying out his obligation of good faith, the manager has a duty to account to the LLC, and hold as trustee for the LLC any profit or benefit he

22. See 18 OKLA. STAT. § 1016 (1991). The powers of an Oklahoma corporation are more inclusive than those of an Oklahoma LLC but in general they are analogous.
25. These powers are similar to those provided in the LLC Acts in general. However, one additional power not granted in many of the LLC Acts is the power to have perpetual life. See id.
27. Id. § 2016(1).
28. Id. § 2016(2).
29. Id.
30. Id. § 2016(3).
31. Id. § 2016(4).
derives as a result of his being a manager. This duty extends to any transaction connected with the conduct or winding up of the LLC or from any personal use of LLC property which was obtained without the consent of the members. Failure to honor the duty of good faith could subject the manager to personal liability.

Moreover, the manager will subject himself to liability for any act or omission not in good faith, involving intentional misconduct, a knowing violation of law, or a transaction from which the manager derived an improper personal benefit. Subject to these impositions of liability, the articles of organization or the operating agreement may eliminate or limit the personal liability of a manager for damages resulting from a breach of the duty of good faith. Further, the articles or operating agreement may provide for indemnification of a manager or members for judgments, settlements, penalties, fines, or expenses incurred because of his position.

If the LLC is managed by more than one manager, all management decisions are to be made by a majority vote of the managers, unless the articles or operating agreement provide otherwise. However, the act of any manager will be binding on the LLC unless: (1) the manager acting lacks the authority to act on behalf of the LLC in the particular matter; and (2) the party with whom the manager is dealing knows that the manager lacks the authority to take action in the particular matter. The binding effect of a manager’s actions results from the fact that every manager is deemed to be an agent of the LLC. As a result, any person acting in good faith and without knowledge that a manager is engaging in an unauthorized act can still bind the LLC.

C. Voting

Generally, members of an Oklahoma LLC will vote in proportion to their capital interests in the LLC, unless the articles or operating agreement provide otherwise.

32. Id. § 2016(5).
33. Id.
34. Id. § 2017(B)(2), (3).
36. Id. (codified at 18 Okla. Stat. § 2017(A)(2) (Supp. 1993)).
38. Id. § 2019(A).
41. Act of June 11, 1993, ch. 366, § 10, 1993 Okla. Sess. Law Serv. at 2206 (codified at 18 Okla. Stat. § 2019(A) (Supp. 1993)). Put more specifically, "the unauthorized acts of the manager shall bind the limited liability company as to persons acting in good faith who have no knowledge of the fact that the manager had no such authority." Id.
42. Id. § 12, 1993 Okla. Sess. Law Serv. at 2207 (codified at 18 Okla. Stat. § 2020(A) (Supp. 1993)). Additionally, any references to a vote or consent of the members in the Act means a vote or the consent of members holding a majority of the capital interests in the LLC. Id.
Likewise, unless there are provisions to the contrary, a majority vote is required to approve the dissolution or winding up of the LLC, or the disposition or encumbrance of all or most of the LLC's assets. Additionally, a majority vote is generally required in the case of a merger or an amendment to the articles or operating agreement.

D. Contributions and Distributions

The Oklahoma Act allows members to obtain their interests in the LLC by contributing cash, services, or a binding promise to contribute cash or services in the future. Additionally, under the Oklahoma Act, a member who makes a written promise to contribute cash, property, or services to the LLC is obligated to do so. This obligation is enforceable even if the failure to perform is due to death, disability, or some other reason. In the event of a failure to perform, the operating agreement may provide for specific remedies or the consequences of a failure to make a required contribution.

In the event a member fails to make a promised contribution, a creditor of the LLC may enforce the obligation. In order for a creditor to enforce a member's obligation to the LLC, the creditor must show that he relied on the promised contribution when he extended credit to the LLC. In addition, the LLC's operating agreement must not have allowed the LLC to compromise the member's obligation. If there was a compromise, it must be shown that a duty to the creditor was breached. Thus, at least to some extent, a member is not completely shielded from personal liability.

Generally, members are entitled to share in the profits and losses of the LLC in proportion to their capital interests. The operating agreement may alter this arrangement, however, and make other provisions for the division of profits.

43. 18 OKLA. STAT. § 2020(B)(1), (2) (Supp. 1993).
44. Id. § 2020(B)(3), (4).
45. Id. § 2023. This section of the Oklahoma Act differs from the original Wyoming Act which only allows contributions to be made in the form of cash or other property, but not services. See WYO. STAT. § 17-15-115 (1992). Thus, the Oklahoma Act is more generous to potential members by allowing an interest to be obtained with the contribution of services rather than only by cash or property.
47. Id.
48. Id. § 2024(C). The remedy or consequences of a failure to perform on a promise to make a contribution to the LLC can take many forms. These remedies and consequences include, for example, the interest of the defaulting member in the LLC being reduced; forcing a sale of the member's interest in the LLC or, forfeiture of the LLC member's interest. Id.
49. Id. § 2024(B)(2).
50. Id.
51. Id. The Oklahoma Act allows the LLC's operating agreement to compromise a member's obligation or, in the absence of such a provision in the operating agreement, the compromise can be accomplished with the unanimous consent of the members. See id. § 2024(B)(1). However, in no event shall a compromise impair the rights of a creditor to enforce the obligation. See id. § 2024(B)(2).
52. Id.
53. Id. § 2025(1).
54. Id.
Additionally, distributions should be made in the same proportion as the members' rights to share in the profits of the LLC.\textsuperscript{55}

To the extent that the members unanimously agree or the operating agreement provides, members are entitled to receive distributions prior to their withdrawal as members and prior to the dissolution and winding up of the LLC.\textsuperscript{56} If a member withdraws or is otherwise dissociated from the LLC, the member is entitled to receive any distribution allowed by the operating agreement, or if no provisions are made in the operating agreement, the fair value of his interest.\textsuperscript{57} The fair value is determined at the time of the dissociation and is payable within a reasonable time unless other provisions are made.\textsuperscript{58} Additionally, a member normally cannot demand a distribution in any form other than cash.\textsuperscript{59}

Distributions may not be made if the effect would be to prevent the LLC from paying its debts as they become due.\textsuperscript{60} Additionally, a distribution may not be made if, after the distribution, the assets of the LLC would be less than the sum of: (1) its liabilities, plus (2) the amount that would be needed to satisfy preferential dissolution rights of members whose rights are superior to those receiving the distribution, if the LLC were dissolved at the time of the distribution.\textsuperscript{61}

The determination of whether a distribution may be made can be based on financial statements or a fair valuation method.\textsuperscript{62} If a member receives a distribution in violation of the operating agreement or Act, he is liable to the LLC for the amount of the wrongful distribution.\textsuperscript{63}

\textbf{E. Dissolution and Winding Up}

Upon dissolution of the LLC, its affairs are to be concluded and its assets distributed.\textsuperscript{64} Under the Oklahoma Act, payment or provisions for payment are to be made first to the LLC's creditors in satisfaction of the LLC's liabilities.\textsuperscript{65} After all creditors have been satisfied, any remaining assets are to be distributed to members or former members to satisfy liabilities for member-voted distributions and distributions which are due because of a member's prior dissociation from the LLC, unless otherwise provided in the operating agreement or articles of organization.\textsuperscript{66}

\textsuperscript{55} Id. \textsuperscript{56} Id. \textsuperscript{57} Act of June 11, 1993, ch. 366, § 15, 1993 Okla. Sess. Law Serv. at 2209 (codified at 18 Okla. Stat. § 2027 (Supp. 1993)). \textsuperscript{58} Id. \textsuperscript{59} 18 Okla. Stat. § 2028(1) (Supp. 1993). The dissociated member can not be compelled to accept a distribution in kind of an asset to the extent that the percentage of the asset distributed exceeds the members percentage interest in the LLC. See id. § 2028(2). \textsuperscript{60} Id. § 2030(A)(1). \textsuperscript{61} Id. § 2030(A)(2). \textsuperscript{62} Id. § 2030(B). \textsuperscript{63} Id. § 2031. \textsuperscript{64} Id. § 2040. \textsuperscript{65} Act of June 11, 1993, ch. 366, § 23, 1993 Okla. Sess. Law Serv. at 2214 (codified at 18 Okla. Stat. § 2040(1) (Supp. 1993)). Creditors include members who are creditors and the distribution may be made only to the extent permitted by law. Id. \textsuperscript{66} Id. § 23, 1993 Okla. Sess. Law Serv. at 2219 (codified at 18 Okla. Stat. § 2040(2) (Supp.
Finally, unless otherwise provided in the articles or operating agreement, any remaining assets will first be distributed to members or former members in return for their contributions and then in proportion to their right to share in distributions. 67

F. Members' Rights to Bring Suit on Behalf of the LLC

Under the Oklahoma Act a member may bring a suit to recover a judgment in favor of the LLC if certain conditions are met. 68 First, to bring suit the LLC's management must be vested in a manager or managers who have the sole authority to cause the LLC to bring suit in its own right. 69 Alternatively, if the management of the LLC lies in the hands of the members, the plaintiff must lack the authority to have the LLC sue in its own right. 70

Second, in order to bring suit, the plaintiff must have demanded that those with the authority to cause the LLC to sue in its own right do so, and the plaintiff's demand must have failed. 71 Third, the suit may be brought if the members or managers with the authority to sue have wrongfully refused to bring the suit, or have failed to respond to the plaintiff's demands after being given a reasonable time to consider them. 72 Finally, a suit is appropriate if the plaintiff was a member of the LLC both at the time the action was filed and when the cause of action arose. 73 Moreover, the plaintiff must fairly and adequately represent the interests of the other members in enforcing the rights of the LLC. 74

In a derivative action, the complaint must set forth with particularity the plaintiff's efforts to have the managers take action for the LLC in its own right. 75 If the derivative action is successful, the court may award the plaintiff reasonable expenses, including attorney fees. 76 However, if the court finds that the action was brought without reasonable cause, the plaintiff risks being forced to pay the defendant's reasonable expenses, including attorney fees. 77

G. Merger or Consolidation

The Oklahoma LLC Act, unlike some LLC statutes, specifically provides that an Oklahoma LLC may merge or consolidate with any LLC or other business entity. 78

67. 18 OKLA. STAT. § 2051(4). If the plaintiff's status as a member occurred after the cause of action arose and was determined according to the terms in the operating agreement from a person who was a member at the time the cause of action arose, this will be sufficient to qualify him as a proper plaintiff. Id.

68. Id. § 2051(5).
69. Id. § 2052.
70. Id. § 2053(A).
71. Id. § 2053(B).
72. Id. § 2054(A). "Other business entity" for purposes of this section means a corporation, business
The merger or consolidation, however, must be approved by a majority vote of the members, or if there is more than one class of members, by a majority vote of each class.79

Unlike shareholders in a corporation formed under Oklahoma law, dissenting members have no appraisal rights.80 However, members always have the right to withdraw or dissociate themselves from the LLC and receive the fair value of their interest at the date of withdrawal or dissociation.81

The surviving entity of a merger or consolidation must file articles of merger or consolidation with the Secretary of State.82 Upon the filing of the articles of merger or consolidation, the merger or consolidation becomes effective.83 Any Oklahoma LLC that does not survive the merger or consolidation is dissolved.84

Once the merger or consolidation is effective, the resulting entity succeeds to all of the rights and obligations of the merged entities.85 Unless otherwise agreed upon by the parties to the merger, a merged LLC is not required to conclude its affairs, pay its debts, or distribute its assets under the winding up provisions of the Act.86

H. Foreign Limited Liability Companies

The Oklahoma Act specifically contemplates an out-of-state LLC doing business in Oklahoma. The Act provides that the laws of the state under which the foreign LLC was organized will govern its organization and internal affairs, as well as the extent of the liability of its members and managers.87 However, a foreign LLC has

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79. Id. § 2054(B).
80. See 18 Okla. Stat. § 1091 (1991 & Supp. 1993). Appraisal rights refer to the fact that a shareholder of a corporation who meets the requirements of the statute is entitled to have his shares appraised by the district court and to receive the value of such appraisal from the surviving entity in the event of a merger or consolidation. Id.
81. See supra notes 56-59 and accompanying text.
82. 18 Okla. Stat. § 2054(C) (Supp. 1993). The articles of merger or consolidation must state: (1) the name and state of formation of each of the entities; (2) that an agreement of merger or consolidation has been executed and approved by each of the entities; (3) the name of the surviving entity; (4) the effective date of the merger or consolidation if different from the date of filing; (5) that the merger or consolidation agreement is on file at the surviving entity's place of business; (6) that a copy of the merger or consolidation agreement will be provided free of charge to members of each of the involved entities upon request; (7) that, in the case of merger, any amendments or changes to the articles of organization that are to be effected by the merger; (8) that, in the case of consolidation, the articles of organization of the resulting LLC are set forth in an attachment to the articles of consolidation; (9) that, if the surviving entity is not a domestic business entity, it will agree to service of process for any claims against any merged domestic entity, that it appoints the Secretary of State as its agent for service of process, and that it furnishes the Secretary of State with its address so that a copy of any process can be mailed to it. Id.
83. Id. § 2054(E). The filing date is the effective date of the merger or consolidation unless a future date or time is provided in the articles of merger or consolidation. Id.
84. Id. § 2054(F). The articles of merger or consolidation act as articles of dissolution for any nonsurviving Oklahoma LLC. Id.
85. Id. § 2054(G).
86. Id.
87. Id. § 2042(A)(1).
no greater rights than a domestic LLC and may not exercise any of its powers or purposes which are forbidden by Oklahoma law.\textsuperscript{88}

Before a foreign LLC conducts business in Oklahoma, the LLC must first register with the Secretary of State.\textsuperscript{89} In order to register, the foreign LLC must pay a fee, provide an original certificate from the foreign LLC's organizing jurisdiction, and submit an application for registration.\textsuperscript{90} The application for registration must be signed and set forth the following: (1) the name of the foreign LLC and, if different, the name under which it intends to do business in the state; (2) the state and date of its organization; (3) the name and address of a registered agent in Oklahoma; (4) if no agent is appointed, a statement that the Office of the Secretary of State is the appointed agent; (5) the address of the office required to be maintained in the state of its organization; and (6) any other information necessary to enable the Office of the Secretary of State to make a determination whether the LLC is entitled to conduct business in this state.\textsuperscript{91}

The failure of a foreign LLC to register will not invalidate any contract or other act of the foreign LLC.\textsuperscript{92} In addition, failure to register will not prevent the foreign LLC from defending any suit brought against it in an Oklahoma court.\textsuperscript{93} The failure to register will, however, bar the foreign LLC from bringing an action in an Oklahoma court until such time as it has registered.\textsuperscript{94} Finally, a member of a foreign LLC will not be subjected to personal liability solely for the failure to register.\textsuperscript{95}

The requirement of registration presupposes that the foreign LLC is transacting business in the state. The statute does not specifically define what constitutes transacting business, but the statute does provide a laundry list of what will not constitute transacting business in the state.\textsuperscript{96} Thus, merely having contacts in Okla-

\begin{itemize}
\item[88.] Id. § 2042(B).
\item[89.] Id. § 2043.
\item[90.] Id.
\item[91.] Id.
\item[92.] Id. § 2048(B).
\item[93.] Id.
\item[94.] Id. § 2048(A).
\item[95.] Id. § 2048(D).
\item[96.] The Act provides that the following activities, among others, do not constitute transacting business within the meaning of the Act:
\begin{enumerate}
\item Maintaining, defending, or settling any proceeding;
\item Holding meetings of its members or carrying on any other activities concerning its internal affairs;
\item Maintaining bank accounts;
\item Maintaining offices or agencies for the transfer, exchange and registration of the foreign limited liability company's own securities or maintaining trustees or depositaries with respect to these securities;
\item Selling through independent contractors;
\item Soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside this state before they become contracts;
\item Creating or acquiring indebtedness, mortgages and security interests in real or personal property;
\end{enumerate}
\end{itemize}
homa will not necessarily require the registration of the foreign LLC.

VI. Special Issues Concerning Operations

While the Oklahoma Act specifically contemplates a foreign LLC doing business in this state, there still remains the troubling question of whether the limited liability feature of the LLC will be honored in a state where the business may be operating but which has no legislation providing for an LLC. In many states that have their own LLC statutes this will pose no problem because, like Oklahoma, their statutes specifically provide for the registration of a foreign LLC. However, this offers no reassurance to the foreign LLC wishing to operate in a state containing no legislation specifically addressing this issue. Therefore, until this issue is resolved, the LLC will likely remain an unattractive form of business organization for companies that conduct business in many states.

In an attempt to determine the personal liability of members if an LLC conducts business in a non-LLC jurisdiction, it is helpful to explore the doctrine of comity. The general principal of comity is that courts of one state or jurisdiction will give force and effect to the laws of another state out of deference and mutual respect. Presumably, the forum state will give deference to the laws of another state unless doing so would be against the public policy of the forum state. Thus, unless a public policy against the recognition of a foreign LLC doing business in the state can be found, the laws of the state under which the LLC was organized should control.

At present, there is no case law regarding the doctrine of comity as applied to an LLC. Presumably, if the court in a foreign jurisdiction recognizes the LLC form of business organization, the court will also recognize the member's limited liability feature. If the court will not recognize the LLC, it will most likely treat the organization as a partnership. If the court treats the organization as a partnership, the liability of individual members for the debts of the LLC is uncertain. The discussion following is an attempt to show the possible consequences of a state's decision on this issue.

In the absence of any case law dealing specifically with the doctrine of comity as applied to an LLC, it may be helpful to look at the application of public policy

8. Securing or collecting debts or enforcing mortgages and security interest in property securing the debts;
9. Holding, protecting, renting, maintaining and operating real or personal property in this state so acquired;
10. Selling or transferring title to property in this state to any person; or
11. Conducting an isolated transaction that is completed within (30) days and that is not one in the course of repeated transactions of a like nature.

Id. § 2049(A).

concerns to a similar form of business organization found in the case law. In Means v. Limpia Royalties, the Texas Supreme Court refused to apply the doctrine of comity to a business trust, which is similar to an LLC. The court determined that "[t]he established public policy of the forum is supreme, and will not be relaxed upon the ground of comity to enforce contracts which contravene such policy, even though such contracts are valid where made." Therefore, the court treated the business trust as a partnership, exposing participants in the trust to personal liability because it was against public policy to shield the participants. Other courts have similarly treated a business trust as a partnership when they were unable to define the organization under their own laws.

If a court were to apply this type of analysis to a foreign LLC, then it is likely that the court would find that an LLC should be treated as a partnership. In that case, the individual members of the LLC would be liable for the debts of the organization. The danger of this particular analysis is a primary reason the popularity of the LLC is not what it would be were the LLC form of business organization uniformly accepted.

Another helpful analysis is to compare the liability of a foreign incorporated entity with the liability of an owner of a partnership interest. If the entity is treated as an incorporated entity, the law of the entity's organization should control the liability of the owners for obligations of the entity. If the entity is a partnership, the liability of the partners will depend upon the law of the jurisdiction which has the most significant relationship to the parties and the transaction. Under this rule, whether a partner will be treated as a limited partner will be determined by the law of the state with the most significant relationship with the partners and the transaction. Because the state where the partnership was formed will likely have the most significant relationship with the partners, that state's laws should normally control. In this case, unless the limited partner has taken a significant role in the control of limited partnership business or has led a third party to believe that he is a general partner, the liability of the limited partner to third parties will be governed by the law of the state of the limited partnership's organization. Should the limited partner exercise control or lead a third party to believe that he is a general partner, then the liability of the limited partner will depend upon the law of the state in which the partnership acts on behalf of the limited partner.

100. 115 S.W.2d 466 (Tex. Civ. App. 1938).
104. Id. § 295(3).
105. Id. § 294.
106. Id. § 295(3).
107. Id. § 292(2).
Following this reasoning, adapted from the Restatement (Second) of Conflict of Laws, a limited partner who is not liable for the partnership's debts under the state's laws where the partnership was organized should not be liable for partnership debts in another state. This analysis assumes that the partner has no control of the partnership and has not led others to believe he is a general partner.

When these rules are applied to an LLC, the liability of a member for the debts of the LLC should be determined by the state's laws where the LLC was formed so long as the member does nothing to suggest that the entity is a general partnership. Further, because there may be no limitation on the rights of a member to exercise control or management of the LLC, there should be no risk of having liability imposed upon him by reason of active management because exercising the right to manage would not be in violation of the LLC's organic act. However, one must bear in mind that the statute may provide that management of the LLC will lie in the hands of a manager or managers. Thus, if the member is in violation of the statute, the state's laws where the debt was incurred will likely control.

There is still the possibility that a court will not adopt this type of analysis and instead apply the public policy analysis discussed earlier. Thus, in summary, it would appear that the operation of the LLC outside its state of origin should not necessarily subject the member to personal liability if the LLC is operating within the confines of its organic statute. However, the uncertainty in this area dictates that extreme caution should be taken if the LLC has potential liability beyond the boundaries of its state of organization. Indeed, one author has suggested that the LLC should include a choice of laws provision in all agreements. This provision should specifically spell out that the liability of the parties will be governed by the law of the LLC's state of organization and include specific references to the limited liability feature in that state's statute.

In addition to considering the possible exposure of LLC members to personal liability, the organizer should also consider whether an LLC interest can be classified as a security. The following discussion is meant only to give the reader a general insight to the analysis which most likely will be applied in

108. Id. § 295 illus. 1.
110. Id.
111. Id.
112. See id. at *20.
113. Id.
114. If LLC interests are securities, LLC investors will be protected by Federal and State security laws. In such case, LLC organizers must comply with the securities laws in order to avoid potential liability for violations of the securities laws when selling the LLC interests to investors. The securities laws require both registration and disclosure unless an exemption from registration can be found. Additionally, if the LLC interest is a security, anti-fraud provisions contained in both the State and Federal Securities acts will aid in protecting the investor in the purchase of an LLC interest. These anti-fraud provisions generally make it unlawful to make any material misstatements or omissions in connection with the purchase or sale of a security. See generally Harold S. Bloomenthal, Securities Law Handbook (1989-90 ed.); 12 Joseph C. Long, Blue Sky Law (15th ed. 1993).
determining whether a particular LLC interest is a security.115 A full discussion of the issue is beyond the scope of this comment.

Because LLC interests can be analogized to "stock," they could be classified as such under the various securities laws and would, therefore, be a security. A more likely analysis, however, is to characterize an LLC interest as an investment contract.116

The term "investment contract" is not defined in the securities acts. The Supreme Court first developed the basic definition of an investment contract in the seminal case of SEC v. W. J. Howey Company.117 Howey set forth a test containing four elements which must be present in order for an instrument to be classified as an investment contract. The elements are: (1) the investment of money (2) in a common enterprise, (3) with the expectation of profit (4) to come about solely through the efforts of others.118

Applying the Howey test to limited partnership interests will result in the interests always being considered investment contracts because, by their legal structure, they will possess all of the Howey elements.119 The first three elements of Howey are almost always present in any joint business venture. The fourth element is present in a limited partnership because limited partners are precluded by law from actively participating in management. In contrast, general partnerships normally will not be investment contracts because management is typically shared by all the partners.

The foregoing analysis indicates that the Howey test, when applied to the LLC, should be reduced to determining whether the fourth element is present, i.e., whether the expectation of a profit comes "solely through the efforts of others." If management is shared among the members of the LLC, then it is likely that this fourth element cannot be met and the LLC interest will not be considered a security. However, if management is centralized in a select group of managing members or if management is vested in the members and those members are unable to make any "real" management decisions, then it is quite possible that the LLC interest will be a security.

Although the above discussion is a much simplified discussion of a complex area of the law, it should alert the organizer to the importance of carefully determining whether compliance with applicable state and federal security laws will be necessary.

115. The discussion which follows is only a cursory overview and is meant only to make the reader aware that security laws may be implicated. For a more indepth discussion of whether an LLC interest is a security, see Mark A. Sargent, Are Limited Liability Company Interests Securities?, 19 Pepp. L. Rev. 1069 (1992); Marc I. Steinberg & Karen L. Conway, The Limited Liability Company as a Security, 19 Pepp. L. Rev. 1105 (1992).
117. 328 U.S. 293 (1946).
118. Id. at 298-99. Each of the Howey elements has been given varying interpretations by the courts. For a more expansive discussion of each of these elements and their various formulations, see Sargent, supra note 115, at 1082-95. Long, supra note 114, § 2.04(2).
119. See Long, supra note 114, § 2.04(2)[d][iii][A]; see also e.g., Bosco v. Serhant, 836 F.2d 271 (7th Cir. 1987), cert. denied, Baranski v. Chicago Mercantile Exch., 486 U.S. 1056 (1988).
when organizing an LLC. The conclusion should be based on an analysis of the statute under which the LLC was organized, the LLC's articles of organization and operating agreement, as well as the practical realities of the way in which the LLC is actually managed.

VII. LLC Classification for Tax Purposes

When selecting between the various forms of business organization, one of the business organizer's basic considerations will be an analysis of how a particular organizational form will be treated for federal income tax purposes. In this respect, the IRS classifies unincorporated organizations for tax purposes as associations taxable as corporations, partnerships or trusts. 120 This classification is based upon a determination of whether the organization possesses or lacks certain characteristics set forth in federal regulations. 121

IRS regulations identify six characteristics to consider in determining corporate classification: (1) associates, (2) an objective to carry on business and divide the gains, (3) continuity of life, (4) centralization of management, (5) limited liability for corporate debts, and (6) free transferability of interests. 122 Further, the regulations provide that if an unincorporated organization possesses more corporate characteristics than noncorporate characteristics, it will be treated as a corporation for federal tax purposes. 123

In determining whether a particular organization possesses more corporate than noncorporate characteristics, the IRS does not consider characteristics which both corporate and noncorporate organizations have in common. 124 Since the characteristic of associates and the characteristic of carrying on a business and dividing the gains are common to both corporations and partnerships, these characteristics are not considered by the IRS when determining an entity's respective classification. 125 Thus, in deciding whether to classify an organization as a partnership or a corporation, the IRS will consider only whether the organization either possesses or lacks the characteristics of centralized management, continuity of life, free transferability of interests, and limited liability. 126 If the organization lacks two of the four corporate characteristics, the IRS will treat it as a partnership for federal income tax purposes. 127

120. See Treas. Reg. § 301.7701-1(b) (as amended in 1977).
121. Id. § 301.7701-1(c). The fact that an organization is treated as a partnership or trust under state law generally does not protect the organization from the IRS classifying it as an association taxable as a corporation. Id. However, the regulation makes clear that local law will determine whether an organization possesses or lacks a particular characteristic. Id.
123. Id. § 301.7701-2(a)(3).
124. Id. § 301.7701-2(a)(2).
125. Id.
126. Id. § 301.7701-2(a)(2). However, the IRS may consider other factors not listed in the regulations in determining whether an organization is a corporation, partnership, or trust. Id. § 301.7701-2(a)(1). For a list of other factors the IRS will consider in classifying an organization as a limited partnership or an association taxable as a corporation, see Rev. Rul. 79-106, 1979-1 C.B. 448.
127. See Hamill, supra note 4, at 726. Under IRS regulations, an organization, collective group, or
A. Limited Liability

Limited liability is one of the key characteristics which makes the LLC an attractive form of business organization. An organization possesses the corporate characteristic of limited liability if, under local law, no member is personally liable for the debts or claims against the organization. In order for an organization to lack limited liability, at least one member of the organization must have unlimited liability for all of the organization's debts.

In jurisdictions where partnerships are organized under either the Uniform Partnership Act (UPA) or the Revised Uniform Limited Partnership Act (RULPA), general partners are personally liable for the debts of the partnership. Consequently, those organizations will always lack the corporate characteristic of limited liability.

When considering an LLC, on the other hand, neither the members nor the managers are liable for the debts of the business. The Oklahoma Act provides that a person who is a member or manager of an LLC is not liable for the obligations of the company solely by reason of his status as a member or manager. This statutory language is similar to the Wyoming, Florida and Kansas acts which provide that neither the members nor the managers of an LLC are liable under any judgment, decree, order of a court, or in any other manner, for a debt, obligation, or liability of the LLC. The Texas and Virginia statutes differ somewhat in that the limited liability of the members may be set forth by the LLC documents.

The IRS has concluded that an LLC organized under the Wyoming Act possessed the corporate characteristic of limited liability. Therefore, because the Oklahoma Act, like the Wyoming Act, limits the liability of LLC members, an Oklahoma LLC should always possess the corporate characteristic of limited liability.

An organization, however, must lack only two of the four corporate characteristics to fall under partnership tax classification. Therefore, because an Oklahoma

other relationship which is not a partnership for state tax law purposes can be classified as a partnership for tax purposes. See Treas. Reg. § 301.7701-3 (1967). For a discussion, examples, and citations concerning how partnerships are distinguished from other relationships, see I WILLIAM S. MCKEE ET AL., FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS § 3.03 (2d ed. 1990).

128. "Personal liability means that a creditor of an organization may seek personal satisfaction from a member of the organization to the extent that the assets of such organization are insufficient to satisfy the creditor's claim." Treas. Reg. § 301.7701-2(d)(1) (as amended in 1983).

129. Id. § 301-7701-2(d) (as amended in 1983).

130. See UNIF. PARTNERSHIP ACT §§ 13-15 (1914); REVISED UNIF. LTD. PARTNERSHIP ACT § 403(b)(1985); see also Treas. Reg. § 301.7701-2(d)(1) (as amended in 1983).


LLC will always possess limited liability, the focus will lie on determining whether the entity will lack at least two of the remaining three corporate characteristics. The remaining characteristics to be considered are free transferability of interests, centralization of management, and continuity of life.

B. Free Transferability of Interest

In order for an entity to possess the corporate characteristic of free transferability of interests, "each of its members or those members owning substantially all of the interests in the organization must 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."136 Substitution refers to a complete transfer of all the attributes of ownership.137 Thus, the right merely to assign a member's interest in profits of the organization, without more, does not constitute free transferability of interests.138

General partnerships formed in UPA jurisdictions are not freely transferable because no person can become a member of the partnership without the consent of all the partners.139 In the case of limited partnerships organized under the RULPA, the issue is less clear. Under the RULPA, partnership interests are assignable in whole or in part.140 However, partners may place restrictions on the transferability of interests in the partnership agreement.141 Thus, unlike the UPA, the RULPA does not impose restrictions on the transferability of interests as a matter of law.142 Whether free transferability will exist in a limited partnership will thus depend on the partnership agreement.143

The provision in the Oklahoma LLC Act addressing this issue provides that a membership interest is assignable in whole or in part.144 Such an assignment, however, will not entitle the assignee to become a member or to exercise any powers of a member, including the right to participate in the management of the LLC.145 The effect of the assignment will only entitle the assignee to receive

137. See id.
138. Id.
139. UNIF. PARTNERSHIP ACT § 18(g) (1914). A transferor can transfer the right to share in partnership profits and losses. See id. § 27(1).
140. REVISED UNIF. LTD. PARTNERSHIP ACT § 702 (1985).
141. See id. § 704(g)(i).
142. See id. §§ 702, 704(a)(i).
143. See Hamill, supra note 4, at 738. Limited partnerships attempting to negate the free transferability of interests, while allowing limited partners maximum freedom to dispose of their interests often make all transfers of a full interest in the partnership subject to the general partner's approval. Under IRS regulations, the power of a general partner to "veto" the transfer of a complete partnership interest causes the partnership to lack free transferability of interests. See Treas. Reg. § 301.7701-3(b)(2) Ex. 1 (as amended in 1967). However, if the general partner is prohibited from unreasonably withholding consent, a court will treat the partnership as possessing the corporate characteristic of free transferability of interests if no reason exists for the general partner to deny the transfer. See Larson v. Commissioner, 66 T.C. 159, 183 (1976), acq. 1979-1 C.B. 1.
distributions which his assignee was otherwise entitled to receive.\textsuperscript{146} Until the assignee becomes an LLC member, the assignor continues to be a member and possesses all the powers to exercise membership rights.\textsuperscript{147} However, a member may grant a security interest, lien, or other encumbrance in his membership interest without losing any of the rights and powers of a member.\textsuperscript{148} In addition, until the assignee becomes a member, the assignee will incur no liability as a member solely as a result of the assignment.\textsuperscript{149} Finally, it should also be noted that an assignment of a member's interest in an LLC will not be considered a dissolution event.\textsuperscript{150}

In regard to the assignee's membership status, under the Oklahoma Act, the assignee may become a member only if (1) the articles of organization or operating agreement so provide, or (2) the members consent in writing.\textsuperscript{151} Therefore, in order for a member's interest to be freely transferable there must be a specific provision providing for that right. Fortunately, as mentioned, the Oklahoma Act allows flexibility with respect to the transferability of interests in that the articles of organization may provide otherwise, or the operating agreement may alter the effect of a transfer.\textsuperscript{152}

The Florida LLC statute also provides some flexibility regarding transferability, although it takes a somewhat different approach than Oklahoma. Under the Florida

\begin{itemize}
\item \textsuperscript{146} Id. to be codified at 18 OKLA. STAT. § 2033(A)(2) (Supp. 1993).
\item \textsuperscript{147} Id. to be codified at 18 OKLA. STAT. § 2033(A)(3) (Supp. 1993).
\item \textsuperscript{148} Id. to be codified at 18 OKLA. STAT. § 2033(A)(4) (Supp. 1993) (emphasis added). This provision is subject to the members' rights to remove the assignor. Id. Removal of a member after assignment of all the member's interest in the LLC can be accomplished by "a majority vote in number of the members who have not assigned their interests." Id. § 20 (to be codified at 18 OKLA. STAT. § 2036(A)(3)(b) (Supp. 1993)) (emphasis added). In any event, the mere removal of an assignor will not alone cause the assignee to become a member. Id. § 17 (to be codified at 18 OKLA. STAT. § 2033(A)(4) (Supp. 1993)).
\item \textsuperscript{149} The accuracy of the statement that an assignor retains his membership rights upon assignment of his membership interest is somewhat called into doubt by the statement in subsection C of Section 2033 where the statute sets forth that "a member ceases to be a member and to have the power to exercise any rights or powers of a member upon assignment of all his membership interest. Id. § 17 (to be codified at 18 OKLA. STAT. § 2033(C) (Supp. 1993)). This ambiguity in the statute is subject to at least three interpretations. The first possible meaning of this ambiguity is that an assignor retains his membership rights to the extent that he does not assign all of his membership interest and only loses his membership rights through an assignment of all his LLC interest. The second interpretation of this ambiguity is that an assignor retains his membership and the powers it conveys only until such time as the assignee becomes a member. The latter interpretation is specifically set forth in a later portion of the Act. Id. § 19 (to be codified at 18 OKLA. STAT. § 2035(D) (Supp. 1993)). Based on the above, the third and more plausible explanation for the ambiguity is that the language stating that the assignor ceases to be a member upon an assignment of his LLC interest was a mere oversight and was intended to be omitted in the latest amendments to the Act.
\item \textsuperscript{150} Id. § 17 (to be codified at 18 OKLA. STAT. § 2033(C) (Supp. 1993)).
\item \textsuperscript{151} Id. (to be codified at 18 OKLA. STAT. § 2033(A)(5) (Supp. 1993)).
\item \textsuperscript{152} Act of June 11, 1993, ch. 366, § 19, 1993 Okla. Sess. Law Serv. at 2210-11 (to be codified at 18 OKLA. STAT. § 2035(A) (Supp. 1993)).
\end{itemize}
The majority of the members consent to the assignment.\(^{153}\) However, the LLC's articles or regulations may alter this provision.\(^{154}\) The net effect of this approach is the same result as reached when applying the Oklahoma transferability provision, although Florida's approach is more straight forward.

Wyoming's LLC Act\(^{155}\) also provides flexible transferability. This is accomplished by allowing the operating agreement to alter the general provision that the membership interest may be transferred or assigned.\(^{156}\) But unlike the Oklahoma Act, the Wyoming Act provides that in no case will the assignee have the right to participate in the management of the business affairs of the LLC, or otherwise be a full member, unless \textit{all} members consent to the transfer.\(^{157}\) Therefore, in contrast to the Oklahoma Act, there should never be a danger of the IRS finding that an LLC organized under the Wyoming Act has freely transferable interests.

Indeed, the IRS has determined that an LLC organized under the Wyoming Act lacked the corporate characteristic of freely transferable interests.\(^{158}\) Because the Oklahoma Act permits the operating agreement or articles of organization to alter the general effect of a transfer of a member's interest,\(^{159}\) an LLC organized under the Oklahoma Act will not automatically lack free transferability of interests. Thus, when drafting the organizational documents, one must take care to ensure that the organization will not inadvertently be subjected to classification as a corporation for federal tax purposes.

Some guidance is provided in respect to how the IRS may treat the issue of free transferability of interests by two private letter rulings involving LLCs.\(^{160}\) In both cases, the IRS determined that the LLCs lacked the corporate characteristic of free transferability of interests even though the assignment of a member's interest required only a majority vote of approval in order for the assignee to become a member.\(^{161}\) Thus, it would appear that an LLC organized under the Oklahoma Act should lack the corporate characteristic of free transferability of interests, assuming there are no provisions in the articles or operating agreement which would alter the general rule set forth in the statute.

More specifically, in one of the private letter rulings the LLC's operating agreement at issue provided that no transfer of an interest in the LLC could be effected without the consent of (1) the manager, or (2) a majority interest if the manager is not a member or the manager is the member making such a disposi-

154. Id.
156. Id.
157. See Hamill, supra note 4, at 739.
159. See supra notes 144-52 and accompanying text.
Additionally, the operating agreement provided that the interest of a member could be transferred without the consent of the manager or any of the members if (1) the transfer occurred by reason of or incident to death, dissolution, divorce, liquidation, merger, or termination of the transferor member, and (2) the transferee is a permitted transferee as defined in the operating agreement. Based on this ruling, it would appear that the IRS is willing to provide additional latitude with respect to free transferability of interests. However, until the IRS issues a public ruling on Oklahoma's LLC statute, the safest approach would be to follow the Wyoming Act and provide in the articles or operating agreement that unanimous consent is required in order for an assignee of a member's interest in the LLC to become a member.

In any event, the fact that the organization may possess freely transferable interests alone will not subject the organization to classification as a corporation. The drafter must insure only that the organization lacks two of the four corporate characteristics in order to obtain partnership classification.

Free transferability will often be a desirable feature for LLCs which expect to have a large number of members. This occurs because members in large ventures will often expect to sell their interests at a profit after the business has become established. In the case of a small, closely held LLC, such as one owned by family members, the members may not desire this feature. The members of these small closely held LLC's will more likely expect that the business will remain in the "family." Thus, if free transferability is an important feature to the organizer, he could provide for that right. The organizer of the LLC must only ensure that partnership tax classification is maintained by being certain that the LLC will lack two of the four corporate characteristics used in determining an organization's tax status.

C. Centralized Management

Centralization of management is another characteristic identified as corporate in nature. Centralized management exists if any person or group of persons has the exclusive authority to make management decisions necessary to conduct business, without consulting the owners. A corporation possesses centralized management because management decisions of the corporation are made by its board of directors on behalf of shareholders.

Whether an LLC has the corporate characteristic of centralized management, however, is a more difficult matter. The Oklahoma LLC Act offers some flexibility in this area by providing that the power to manage the LLC generally lies with one or more managers, who are not necessarily members and who are elected by a majori-

163. See id.
165. Id. § 301.7701-2(c)(4).
166. 18 OKLA. STAT. § 2013 (Supp. 1993). The number of managers and qualifications may be set forth in the articles of organization or operating agreement. Id.
ty vote of the members.\textsuperscript{167} Alternatively, at the option of the organizers, the articles of organization may provide that the LLC be managed by its members so long as the members have and are subject to all duties and liabilities of managers.\textsuperscript{168}

The Wyoming Act takes an opposite approach. Under the Wyoming Act the management of an LLC is vested in its members in proportion to their capital contributions to the LLC.\textsuperscript{169} The articles may provide, however, for management of an LLC to vest in a manager or managers elected by the members in a manner prescribed in the operating agreement.\textsuperscript{170} Other states have enacted similar provisions to the Wyoming Act.\textsuperscript{171}

In a situation where designated managers controlled the management of a Wyoming LLC, the IRS has concluded that the entity possessed the corporate characteristic of centralized management.\textsuperscript{172} It follows that under the Oklahoma Act, unless there are provisions made to the contrary, an LLC will have the corporate characteristic of centralized management when the management of the entity is vested in a manager or managers.\textsuperscript{173} One author has stated that even if an LLC is managed by designated managers, the IRS may not treat the LLC as having centralized management if those managers own enough interest in the LLC.\textsuperscript{174}

As mentioned, organizers may avoid being classified as possessing centralized management simply by vesting management responsibility in the members.\textsuperscript{175} This determination must be made, while maintaining no more than two of the four corporate characteristics, in order to obtain partnership classification for federal income tax purposes.

D. Continuity of Life

Continuity of life exists when an organization continues even if one or more of its owners dies, retires, resigns, or suffers insanity, bankruptcy, or expulsion.\textsuperscript{176} Precisely because an incorporated entity continues to survive until formal liquidation,

\textsuperscript{167} Act of June 11, 1993, ch. 366, § 7, 1993 Okla. Sess. Law Serv. at 2205 (codified at 18 OKLA. STAT. § 2014 (Supp. 1993)). The managers may be removed, with or without cause, by the written consent of the members. Id.

\textsuperscript{168} 18 OKLA. STAT. § 2015 (Supp. 1993).


\textsuperscript{170} Id.


\textsuperscript{173} See supra notes 166-68 and accompanying text.

\textsuperscript{174} See Hamill, supra note 4, at 734. Revenue Procedure 89-12 considers the managers as "general partners" and nonmanagers as "limited partners" by analogy when applying a percentage of ownership test. Rev. Proc. 89-12, 1989-1 C.B. 798. If the managers own at least 20 percent of the LLC, the IRS should rule that the LLC lacks centralized management. Hamill, supra note 4, at 734. Moreover, if managers own a meaningful proprietary interest in the LLC, the LLC should lack centralized management as a matter of substantive law. Id.

\textsuperscript{175} See 18 OKLA. STAT. § 2015 (Supp. 1993).

\textsuperscript{176} Treas. Reg. § 301.7701-2(b)(1) (as amended in 1983).
continuity of life is distinctly a corporate characteristic. Conversely, if an organization dissolves due to one of these events, it lacks continuity of life.

Partnerships formed under the UPA and the RULPA will automatically lack continuity of life. However, if a partnership is not formed under the UPA or RULPA, it may still lack continuity of life as long as the partnership agreement requires that the partnership dissolves upon the occurrence of a dissolution event, unless all remaining partners agree to continue the partnership. In the case of a limited partnership, the agreement must provide that the partnership dissolves if one of the dissolution events occurs with respect to a general partner, unless all remaining general partners agree to continue the business.

The IRS has concluded that an LLC organized under the Wyoming LLC Act lacked continuity of life. Under the Wyoming statute an LLC dissolves if one or more of its owners dies, retires, resigns, suffers insanity, bankruptcy, or expulsion. This continuity of life provision differs slightly from the Oklahoma LLC Act. Under the Oklahoma statute an LLC dissolves upon the earlier of: (1) the time or occurrence of events specified in the articles or operating agreement; (2) the written consent of all the members; (3) the dissociation of a member, unless the remaining members unanimously consent to continue the LLC within ninety days of the dissociation event or as otherwise provided; or (4) entry of a judicial decree of dissolution.

With regard to the dissociation of a member, the Oklahoma Act provides that the death or bankruptcy of a member constitutes a dissociation event unless there are contrary written provisions in the operating agreement or the members consent in

177. See Hamill, supra note 4, at 726-27; see also REVISED MODEL BUSINESS CORP. ACT §§ 203(6), 1402, 1420, 1430 (1985).
179. UNIF. PARTNERSHIP ACT (1914).
181. Treas. Reg. § 301.7701-2(b)(3) (as amended in 1983). The UPA provides that a partnership will dissolve upon the death retirement, resignation, insanity, bankruptcy, or expulsion of any of the partners unless all remaining partners agree to continue the partnership. See UNIF. PARTNERSHIP ACT §§ 29-32, 38(2)(b) (1914). Additionally, the RULPA provides that a limited partnership will dissolve if one of these same events occurs with respect to a general partner unless the agreement permits the remaining general partners to agree to continue the business or if there is only one general partner and the remaining limited partners consent to a new general partner being substituted to avoid dissolution. See REVISED UNIF. LTD. PARTNERSHIP ACT § 801 (1985).
183. Id.
186. An additional difference between the Oklahoma Act and the Wyoming Act is that the Wyoming Act fixes a duration period of up to 30 years. See WYO. STAT. § 17-15-107(a)(i) (1992). The Oklahoma Act does not set a limit for the life of the LLC, rather it requires only that there be a time specified for the dissolution of the LLC in the articles of organization. 18 OKLA. STAT. § 2005(A)(2) (Supp. 1993).
writing. As a result, an Oklahoma LLC should necessarily lack continuity of life for purposes of IRS classification unless the members make provisions to the contrary.

This assessment is bolstered by recent private letter rulings which indicate the IRS is willing to allow some flexibility in this area. For example, in a ruling concerning an LLC organized under Texas law, the IRS determined that an LLC lacked the corporate characteristic of continuity of life even though the operating agreement omitted many of the dissolution provisions present in the statute. Specifically, the operating agreement provided that the LLC would be dissolved upon the bankruptcy of the manager or any subsequent transferee of all or a portion of the manager's interest. This provision further provided that if such an event occurred and there was at least one other member remaining, the LLC would not dissolve if all of the members so agreed.

Similarly, the IRS concluded in another private letter ruling that an LLC lacked continuity of life even though its operating agreement provided for the continuance of the LLC by an affirmative vote of all the managers and only a majority of the members. These rulings appear to conflict with a previous ruling where the IRS stated that an LLC would have the corporate characteristic of continuity of life where the operating agreement allowed for continuing the LLC by a simple majority vote of

188. Act of June 11, 1993, ch. 366, § 20, 1993 Okla. Sess. Law Serv. at 2211-12 (codified at 18 Okla. Stat. § 2036 (Supp. 1993)). In addition to death and bankruptcy constituting a dissociation event the statute sets forth a number of other events which constitute dissociation unless other arrangements are made. These events include, among others: (1) the withdrawal or removal of a member, (2) an assignment of the LLC interest for the benefit of creditors, and (3) failure to contest the material allegations of a petition filed against a member in any proceeding related to reorganization or dissolution. Id.

189. Priv. Ltr. Rul. 9210019 (Dec. 6, 1991). The Texas statute addressed by the IRS provided, in part, that except as otherwise provided in the company's regulations, an LLC would dissolve 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 limited liability company, 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 the company's regulations or if not so stated, by all remaining members. See Texas Limited Liability Company Act, art. 6.01, Tex. Rev. Civ. Stat. Ann. art. 1528n (West Supp. 1993).


191. Id.

192. Priv. Ltr. Rul. 9226035 (Mar. 26, 1992). The statute under which the LLC was organized provided that an LLC was dissolved upon the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member or upon the occurrence of any other event that terminated the continued eligibility of a member for membership in the LLC, unless the business of the LLC is continued by the consent of the remaining members under a right to do so stated in the articles of organization or operating agreement within 90 days after the event of termination.

The LLC operating agreement provided, in part, that the LLC would continue until X, unless sooner dissolved by the death, retirement, resignation, expulsion, bankruptcy or dissolution of a member or the occurrence of any other event that terminated the continued membership of a member in the LLC. Notwithstanding the above, if there were at least two remaining members, the remaining members had the right to continue the business of the LLC. Such right could be exercised only by the unanimous consent of all of the remaining managers and by the affirmative consent of a majority of the members. If such consents were not timely given, the right of the members to continue the business of the LLC would have expired. Id.
the members. Based on these decisions it appears there has been a change in policy since the time the IRS issued its earlier ruling. Furthermore, because a limited partnership formed under the RULPA will always lack the corporate characteristic of continuity of life — as the death or withdrawal of a limited partner, and if at least one general partner remains, the death of a general partner, will not result in dissolution of the limited partnership — there seems no substantive policy reason why the LLC should not be afforded similar treatment.

Nonetheless, it appears that an Oklahoma LLC should lack continuity of life for federal income tax purposes if it adheres to the general rule set forth in the statute. In addition, it appears an organizer might alter the general LLC provisions and allow even more flexibility in the continuity provisions and still maintain partnership tax classification. However, until the IRS issues a definitive statement on how much freedom it will allow in this area, the safest approach would be to adhere to the general provisions in the statute.

In summary, under the Oklahoma Act, an LLC should always possess the corporate characteristic of limited liability and lack continuity of life, provided that no alterations are made in the LLC's articles or operating agreement. This conclusion is based on the IRS' ruling regarding the classification of an LLC formed under the Wyoming Act and the fact that provisions in Oklahoma's Act are similar to those contained in the Wyoming Act concerning limited liability and continuity of life. Because the Oklahoma Act offers flexibility with respect to the remaining two corporate characteristics — free transferability and centralized management — the organizer has the option of doing away with one or the other, whichever is least desirable. The determination of whether the LLC lacks one of these two characteristics will depend on how the operating agreement and articles of organization are drafted.

VIII. State Tax Law Considerations

In addition to determining the status of an LLC for federal income tax purposes, an organizer must also consider the tax laws of the state where the business intends to operate. If a state's tax laws follow federal tax laws, presumably the LLC will be taxed as a partnership and not a corporation because the state would likely employ the same analysis that the IRS has applied. This is the approach taken in Arizona and

193. Priv. Ltr. Rul. 9010027 (Dec. 7, 1989). The IRS concluded that because dissolution under the Act could be avoided by a majority vote of members, rather than unanimous agreement, the LLC possessed continuity of life. Id.

194. See Platner, supra note 9, at 229. The IRS could allow the continuation of an LLC upon the occurrence of a dissolution event involving one or more LLC members without requiring the unanimous consent of the remaining members if at least one member remains. Id. Alternatively, the IRS could allow a simple majority of the remaining members to authorize the continuation of the LLC without creating the corporate characteristic of continuity of life. Id.


196. See Joseph A. Rodriguez, Comment, Wyoming Limited Liability Companies: Limited Liability and Taxation Concerns in Other Jurisdictions, 27 LAND & WATER L. REV., 539, 559 (1992). Under such circumstances, the state is not likely to find a preponderance of corporate characteristics in the LLC if the IRS failed to do so.
Louisiana, where the statutes provide that the LLC will be taxed in the same manner as it is treated for federal income tax purposes.  

If the state does not follow the federal approach in determining an entity's tax status, the LLC may be taxed as a corporation on the income it derives from operations in its state. In states that impose no state income tax on either partnerships or corporations, this issue obviously will pose no concern. In those states that do impose an income tax, the issue must be addressed.

Some of the states adopting the LLC as a form of business organization have specifically provided for their tax treatment. Florida, for example, provides that a Florida LLC will be taxed as a corporation subject to the state's corporate tax. Colorado on the other hand, provides that both resident and foreign LLCs will be taxed as partnerships for its income tax purposes. The Kansas LLC Act provides for a franchise tax to be imposed on the LLC based on a percentage of the business member's net capital account balances.

While Oklahoma's LLC Act does not specify how the LLC will be taxed, apparently an LLC operating in Oklahoma should not be liable for Oklahoma state corporate income or franchise taxes. In Oklahoma the LLC should be taxed the same as a partnership for purposes of its income and franchise taxes. Because of the varied approaches taken by the states, however, the LLC must be careful to check the particular tax laws of each state in which the organization may operate to determine its total tax obligations.

IX. Discussion of Possible Alternatives

Given the four tax attributes discussed above, it is apparent that the organizer of an Oklahoma LLC has three alternatives. First, the LLC may be organized under the Oklahoma Act to possess limited liability and free transferability of interests while lacking continuity of life and centralization of management. Second, the LLC may be organized to have limited liability and centralization of management while lacking continuity of life and free transferability of interests. Finally, the organizer may structure the LLC such that it possesses limited liability and continuity of life but lacks free transferability of interests and centralized management.

Problems will often arise when an organizer is faced with circumstances which dictate that the LLC must lack continuity of life in order to maintain partnership tax classification for federal income tax purposes. This is especially true for organizers who expect the LLC to have a large number of members. As a result, the limited

198. See Rodriguez, supra note 196, at 559.
201. Kan. Stat. Ann. § 17-7647 (Supp. 1992). Under the Kansas Act the LLC is required to file an annual report with the Secretary of State showing the financial condition of the LLC at the same time the franchise tax is to be paid. Id.
partnership may be a preferable alternative. This is because the limited partnership, while lacking continuity of life for federal income tax purposes, can be organized such that it will effectively possess that characteristic. However, there are a few alternatives which the LLC organizer may consider to alleviate this problem.

First, the operating agreement could provide that each member agrees to consent to the continuation of the LLC or allow remaining members who consent to the continuance to liquidate the interest of those members who fail to consent. Alternatively, interests of members failing to consent could be purchased by other members pursuant to cross-purchase agreements. Under these approaches, the statutory power to cause the dissolution of the LLC is not deprived and continuity of life should therefore not exist. These provisions would appear desirable for many organizers wishing to use the LLC form of business organization.

X. The LLC and Other Business Forms

A. The LLC v. The S-Corporation

Since the IRS' favorable ruling regarding the tax status of a Wyoming LLC, the LLC must now be considered along with the other more commonly known forms of business, such as corporations and partnerships. Indeed, one author has suggested that the LLC may eventually replace the S-Corporation.

The S-Corporation, by virtue of its corporate status, insulates shareholders from liability for debts incurred by the organization. At the same time, it can act as a conduit for income tax purposes by passing through profits and losses to its shareholders. However, the benefit an S-Corporation provides in avoiding "double taxation" is undermined by the complex tax rules which accompany this form of business organization.

Among the principal disadvantages that come with choosing the S-Corporation are the restrictions placed on the number and type of shareholders. The number of shareholders in an S-Corporation is limited to thirty-five. Additionally, only U.S. citizens, resident aliens, and certain trusts can be shareholders. Therefore, excluded from being shareholders are corporations, nonresident aliens, general and limited partnerships, most trusts, pension plans, and charitable organizations.

203. See infra note 191 and accompanying text.
204. Platner, supra note 9, at 229. The agreement could further be structured to provide that the liquidation payments would be made over a period of time. Id. This would avoid putting too great a financial burden on the company at one time causing a disruption in operations. Id.
205. Id.
206. Id.
208. See Platner, supra note 9, at 225.
209. See ZOLMAN CAVITCH, BUSINESS ORGANIZATIONS §§ 77.01-.03, 78.01-.02 (1991); Curtis J. Braukmann, Comment: Limited Liability Companies, 39 U. KAN. L. REV. 967, 981 (1991).
211. Id. § 1361(b)(1)(A).
212. See id. § 1361(b)(1).
213. See Alson R. Martin, The Kansas Limited Liability Company Act — Business and Tax
In the case of an LLC, practically all types of persons and entities are eligible for membership, including corporations, partnerships, and other LLCs.214 Furthermore, the number of members in an LLC is not limited by statute. Considering these factors, the LLC would appear to be the more favorable form of business organization.

Another disadvantage of the S-Corporation is that it can have only one class of stock.215 This limitation prohibits shareholders from making special allocations of the corporation's profits and losses, a privilege highly regarded by partnerships.216 In contrast, the LLC statutes allow special classes of membership to be created, thereby allowing special allocations to be made because the interests of each member do not have to be equal.217

Finally, in order to obtain S-Corporation status, the corporation must make an affirmative election with the IRS.218 The LLC, on the other hand, will automatically be taxed as a partnership if the LLC lacks at least two of the four corporate characteristics.219 Additionally, because an S-Corporation is subject to so many special rules, it may inadvertently lose its tax status and thus must be carefully monitored. In contrast, an LLC is not subject to these rigid formalities and its tax status is more stable.220

Possibly the most important advantage of obtaining partnership classification rather than making a Subchapter S election is the treatment of the entities' liabilities for basis purposes.221 The partnership rules of Subchapter K allow an LLC member's basis to increase in its LLC interest for its share of LLC liabilities.222 The rules for Subchapter S allow no comparable basis increase for the debts of the corporation.223 Allowing the basis increase to LLC members has the effect of providing members an opportunity to deduct losses attributable to borrowed funds.224

Another tax advantage which the LLC provides over the S-Corporation is that gains from distributions on appreciated property from a corporation cannot be deferred.225 In contrast, an LLC may distribute property without triggering gain recognition if the members have enough basis to absorb the distribution.226 Therefore, the LLC provides distinct advantages over an S-Corporation, and, provided the entity is not

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214. See supra notes 14-15 and accompanying text.
216. See Hamill, supra note 4, at 755.
219. See Hamill, supra note 4, at 755.
220. See Platner, supra note 9, at 226.
221. See Hamill, supra note 4, at 755.
222. See I.R.C. § 752(a) (West 1980).
223. See id. § 1367(b)(2).
224. See Hamill, supra note 4, at 760-64.
226. See Martin, supra note 213, at 19 (citing I.R.C. § 731 and regulations thereunder).
exposed to liability in foreign jurisdictions, an LLC should be a more preferable choice.

B. The LLC v. The General Partnership

The most obvious advantage an LLC offers over a general partnership is that the liability of LLC members participating in the organization is limited.227 Partners in a general partnership, on the other hand, are jointly and severally liable for the torts of other partners which occur while conducting partnership business228 and jointly liable for partnership contracts.229 In addition, an LLC and a general partnership are treated equally for federal income tax purposes.230 As a result, with the growing recognition of the LLC, it is likely that businesses which traditionally organized as general partnerships will instead begin choosing the LLC in the future.231

The LLC and the general partnership are similar in that both generally require two or more persons in order to exist.232 They differ, however, in that the LLC is a statutory form of business organization and requires a formal filing with the Secretary of State in order to be recognized.233 The general partnership, on the other hand, is a residual organization which may arise informally regardless of whether the parties believe they have formed a partnership.234 Additionally, there is no requirement for a writing evidencing the partnership nor is there a requirement that there be a formal filing with a state agency in order to form the general partnership.235

One of the advantages of organizing as a partnership is the flexibility in management which can be achieved through a partnership agreement.236 In the absence of such an agreement the UPA provides a management structure.237 That structure can

228. 54 OKLA. STAT. § 215(a) (1991).
229. Id. § 215(b).
230. Gazur & Goff, supra note 227, at 460.
231. Larry E. Ribstein, The Deregulation of Limited Liability and the Death of Partnership, 70 WASH. U. L.Q. 417, 427 (1992). For most such firms the cost savings under limited liability will likely outweigh any additional cost of credit when compared to unlimited liability: Id.
232. Under the UPA a general partnership is defined as "an association of two or more persons to carry on as co-owners a business for profit." UNIF. PARTNERSHIP ACT § 6(1) (1914). Typically, LLC statutes provide that two or more persons may form an LLC; see, e.g., FLA. STAT. ANN. § 608.405 (West 1993); 18 OKLA. STAT. § 2004(A) (Supp. 1993); UTAH CODE ANN. § 48-2b-103 (Supp. 1993); WYO. STAT. § 17-15-106 (1992). However, a few LLC statutes require only one person in order to organize an LLC; see, e.g., Texas Limited Liability Company Act, art. 3.01, TEX. REV. CIV. STAT. ANN. art. 1528n (West Supp. 1993); KAN. STAT. ANN. § 17-7605 (Supp. 1992). Colorado and Virginia combine these approaches by allowing one or more persons to form the LLC. see, e.g., COLO. REV. STAT. § 7-80-203 (Supp. 1992); VA. CODE ANN. § 13.1-1010 (Michie Supp. 1992).
234. Geu, supra note 7, at 55.
235. Id.
236. Id. at 59.
237. The UPA provides, in part: "The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules." UNIF. PARTNERSHIP ACT § 18 (1914).
be summarized as giving each partner equal rights in the management and conduct of the partnership business. Nonetheless, "Ordinary matters" connected with partnership business may be decided by a majority vote of the partners. Finally, each partner is accountable to the partnership for any benefit received by the partner on behalf of the partnership without the consent of the other partners. Because each partner is deemed an agent of the partnership under the UPA, third parties may rely on any partner conducting partnership business and the partnership will be bound by that partner's act even if it is wrongful. Additionally, the partnership is charged with the knowledge of, or notice to, any partner with matters relating to partnership affairs.

In contrast, an LLC's management activities are governed by the articles of organization and operating agreement, which more closely resembles a corporation or limited partnership. Under the Oklahoma Act, management power is vested in a manager or managers whose qualifications are set out in the operating agreement or articles of organization, unless the organizers choose to vest management responsibility in LLC members. Thus, aside from the fact that the management responsibilities must be specifically set forth, the LLC can be organized to have the same or even more flexibility in its management structure than the general partnership.

Because many general partnerships have a limited number of participants and adopt a consensus management style, they will be well suited for the LLC format. Furthermore, even if a foreign jurisdiction does not recognize the LLC as a legitimate business form, participants will be no worse off than if they had originally chosen the general partnership form. Nonetheless, there may be situations in which an LLC is not preferable to the partnership as a form of business organization despite the fact that the LLC offers both limited liability and partnership tax treatment.

238. Id. § 18(e).
239. Id. § 18(h).
240. Id. § 21.
241. The UPA states:

Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact he has no such authority.

Id. § 9(1).
242. Id. § 13.
243. Id. § 12.
244. Geu, supra note 7, at 63.
246. See id. § 2015.
247. Gazur & Goff, supra note 227, at 460.
248. Id.
249. Id.
C. The LLC v. The Limited Partnership

When comparing the LLC to the limited partnership, one of the more fundamental distinctions that become apparent is that the LLC is considered a separate legal entity from its members,250 while the limited partnership is not.251 Additionally, under the LLC form of business organization, all members have limited liability.252 The limited partnership, on the other hand, does not afford limited liability to all its partners.253 Under the limited partnership form of business organization there must always be at least one general partner who will be exposed to unlimited liability.254 Only limited partners, who are not also general partners and who do not participate in the control of the business, are afforded limited liability.255

The limited partnership can be effectively structured, however, such that no individual will be exposed to unlimited liability. This can be accomplished through the use of a corporate general partner. Under this arrangement, although the corporate general partner is exposed to unlimited liability, the shareholders of the corporation will be insulated from liability.256 Moreover, if the corporate general partner is an S-Corporation, shareholders presumably will have the advantage of pass-through taxation as well.257 As a result, a limited partnership can be structured in such a way that it will have the same benefits as an LLC in regard to limited liability for its participants and pass-through taxation benefits for federal income tax purposes.

The limited liability aspect of the LLC may, however, increase the entity's cost of obtaining credit. This occurs because banks often demand higher rates of interest from organizations whose investors have no personal liability for the entity's obligations. Thus, where the entity must obtain outside financing from a financial institution, the limited partnership may be a more desirable choice because there will always be a general partner who will be liable for the entity's obligation. To solve

251. See Braukmann, supra note 209, at 983.
253. See REVISED UNIF. LTD. PARTNERSHIP ACT § 403(b) (1985); UNIF. PARTNERSHIP ACT § 15 (1914).
254. See REVISED UNIF. LTD. PARTNERSHIP ACT §§ 303(a), 403(b) (1985); UNIF. PARTNERSHIP ACT § 15 (1914).
255. See REVISED UNIF. LTD. PARTNERSHIP ACT § 403(a) (1914). If a limited partner participates in the control of the business, his liability extends only to those persons transacting business with the limited partnership who reasonably believe, based on the limited partner's conduct, that he is a general partner. Id.
256. See Braukmann, supra note 209, at 983. However, a corporate general partner must meet certain net worth requirements in order for the IRS to rule that the limited partnership lacks limited liability for the purpose of determining whether or not the partnership will be taxed as an unincorporated association. Specifically, in Revenue Procedure 89-12, the IRS concluded that it will automatically rule that a partnership lacks limited liability if the net worth of the corporate general partner equals at least ten percent of the total contributions to the limited partnership and is expected to continue at that level throughout the life of the limited partnership. Rev. Proc. 89-12, 1989-1 C.B. 798.
257. See Braukmann, supra note 209, at 983 n.111.
this problem, some or all of the members of the LLC may guarantee certain debts of the LLC.

One advantage of an LLC over the limited partnership is flexibility in the management of the organization. Limited partners are unable to participate in control of the organization without exposing themselves to unlimited liability. The members of the LLC, on the other hand, can participate in the management and control of the organization without subjecting themselves to unlimited liability. Thus, for investors who want to actively participate in the management of an enterprise, the LLC may be the more attractive organizational form. In organizations involving many participants, however, this feature becomes less practical, due to the number of members, and may be overridden by other concerns.

One of these concerns is possible restrictions placed on the transferability of LLC interests. In this respect, the limited partnership has a distinct advantage. A limited partnership can be structured such that the limited partners can transfer their interests freely without jeopardizing the entity's tax status. An LLC, on the other hand, can not have freely transferable interests without risking the loss of partnership classification for tax purposes. This is true because if an LLC is organized such that it possesses freely transferable interests, it must do so at the expense of losing centralized management and continuity of life. The LLC may thus prove to be an ineffective form of business organization in some situations.

Another consideration is the fact that the limited partnership is more widely recognized and the liability of its members is well defined in all jurisdictions. In contrast, the LLC is a relatively new form of business organization and the liability of its members is uncertain when the organization operates outside of its state of origin.

258. See supra note 255 and accompanying text.
260. See Platner, supra note 9, at 226. Some states have liberal safe harbor provisions which allow a limited partner to play a major role in the control of a limited partnership without incurring personal liability for debts of the enterprise. See, e.g., DEL. CODE ANN. tit. 6 § 17-303 (Supp. 1992). Nevertheless, limited partners can never possess such complete control as general partners without risking personal liability. In contrast, LLC members are not personally at risk for the normal enterprise obligations. Platner, supra note 9, at 226.
261. See Braukmann, supra note 209, at 984; see also REVISED UNIF. LTD. PARTNERSHIP ACT §§ 301(a)(2), 704(a) (1985). However, partnership tax status is not available if interests in a limited partnership are traded on an established securities market or are readily tradable on a secondary market. I.R.C. § 7704 (West 1989).
262. See supra notes 123-27 and accompanying text. This is because the LLC must lack two of the four corporate characteristics the IRS considers when determining an entity's tax status.
263. See supra note 127 and accompanying text.
264. See supra notes 97-113 and accompanying text. Moreover, many attorney's are reluctant to use new statutes which have not been "tested" in the courts. This does not appear to be the case in Oklahoma, however, because there have been in excess of 200 LLCs formed in the state since the statute became effective in September 1992. This figure is based on telephone conversations with the Office of the Oklahoma Secretary of State on May 14, 1993.
Even though both the LLC and the limited partnership generally will be treated as partnerships for federal income tax purposes, the use of the LLC may prove nevertheless to be a tax advantage. Specifically, there is a distinct advantage to the use of the LLC over the limited partnership as a result of the passive loss rules in the tax code.265 If members of an LLC materially participate in management, the tax code should treat them as general partners, allowing the conversion of what might otherwise be passive losses into active ones.266 In contrast, a limited partner's interest in a limited partnership is passive by definition under the Code.267 Thus, investors in a limited partnership must forfeit their limited liability if they wish to take advantage of any potential tax advantages resulting from partnership losses.

In summary, when comparing the LLC to the limited partnership, the result is less obvious than when comparing the LLC to either an S-corporation or general partnership. In many instances the LLC will prove to be a more desirable choice, especially when there are a relatively small number of members involved. Under such circumstances the problems associated with the trade off between centralized management and free transferability of interests are less pronounced.

However, as the number of anticipated investors increases, the need for both free transferability of interests and centralized management results in the LLC becoming a less practical alternative. In that case the limited partnership may be a more attractive organizational form. In addition, the problems associated with the lack of continuity of existence become more pronounced as the number of investors increases. Therefore, the organizer must carefully consider the circumstances under which the business will be operating in order to make a proper determination of whether the LLC or the limited partnership will be the better alternative.

XIII. Conclusion

The LLC should prove to be an attractive form of business organization for both investors and business organizers. Indeed, it offers many advantages over some of the more traditional forms of business organization, particularly when compared to the general partnership and S-Corporation. The Oklahoma Act provides sufficient flexibility, making it a desirable choice for many business organizers. The LLC should be an especially attractive organizational form for relatively small businesses. However, until the LLC is universally accepted, its progress will be hampered. With the increasing number of states enacting LLC legislation, the potential liability problems members face will diminish and the LLC will likely become the organizational form of choice for many business organizers.

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266. See Braukmann, supra note 209, at 986. There are questions under what circumstances the IRS will consider whether members of the LLC have materially participated. See Martin, supra note 213, at 20.