BYU Law Review

Volume 1992 | Issue 4 Article 3

11-1-1992

Utah Limited Liability Companies: The "Ugly Ducklings"

Keen L. Ellsworth

Utah Limited Liability Companies: The "Ugly Ducklings"

I. INTRODUCTION

When forming a new business entity, people generally choose between a partnership and a corporation.[1] For small companies, however, these alternatives may not be attractive. If a small company chooses to incorporate, double taxation and adherence to corporate formalities may be cumbersome. On the other hand, potential liability of a partnership may be cost-prohibitive. Fortunately, there is a third alternative—a limited liability company (LLC).[2] An LLC "can be described as a business form much like a partnership, complete with partnership tax advantages, yet providing liability protection for its members similar to that provided by a corporation."[3]

Wyoming, in 1977, was the first state to enact legislation creating LLCs.[4] However, other states have been reluctant to create LLCs due primarily to the uncertainty of whether LLCs would actually be given the tax advantages of a partnership and the liability protection of a corporation. But in September of 1988, the Internal Revenue Service (IRS) published Revenue Ruling 88-76,[5] which "classified an unincorporated organization operating under the Wyoming Limited Liability Company Act as a partnership for federal income tax purposes."[6] With

1. *Cf.* William D. Lewis, Comment, *The Uniform Limited Partnership Act*, 65 U. PA. L. REV. 715, 718 (1917) ("It is a matter of regret that unlike the business men on the continent of Europe, or even England, the American business man is, in the great majority of cases, practically forced today to choose between only two forms: the common law partnership and the corporation.").

2. Aberrations within partnerships and corporations (such as a limited partnership and an S corporation) exist in an attempt to meet the varying needs of small businesses. However, none seem to be as versatile as the relatively young LLC—thus the title "Ugly Ducklings."

3. Joseph P. Fonfara & Corey R. McCool, Comment, *The Wyoming Limited Liability Company: A Viable Alternative to the S Corporation and the Limited Partnership?*, 23 LAND & WATER L. REV. 523, 523 (1988).

4. Wyoming Limited Liability Company Act, 1977 Wyo. Sess. Laws ch. 158, § 1 (codified at WYO. STAT. §§ 17-15-101 to -136 (1987)).

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

6. Susan P. Hamill, *The Limited Liability Company: A Possible Choice for Doing Business?*, 41 FLA. L. REV. 721, 721-22 (1989) (footnote omitted) (explaining

this Ruling in mind, several states cautiously passed legislation allowing for the establishment of LLCs, including Arizona,[7] Colorado,[8] Florida,[9] Kansas,[10] Maryland,[11] Nevada,[12] Texas,[13] Utah,[14] and Virginia.[15] Bills to create LLCs have been introduced in Illinois,[16] Michigan,[17] Oklahoma,[18] and Pennsylvania.[19] However, it is still unclear whether other states will recognize the limited liability of LLCs; without such protection, the advantage of LLCs is substantially diminished.

This comment examines Utah LLCs in more detail, focusing primarily on their partnership tax advantages and limited liability protection. Part II discusses the characteristics LLCs must possess in order to qualify for partnership tax advantages. Part III analyzes more thoroughly the limited liability aspect of LLCs, focusing on the anticipated recognition of limited liability in other states. Finally, part IV concludes that LLCs should enjoy limited liability protection in other states unless prohibited by public policies or statutes.

II. CHARACTERISTICS OF LLCS FOR TAX PURPOSES

According to Revenue Ruling 88-76, whether a particular organization qualifies as a partnership for federal taxation purposes depends on whether it possesses more corporate or noncorporate characteristics.[20] The four relevant corporate characteristics, as set forth in 26 C.F.R. § 301.7701-2(a)(1), are continuity of life, centralization of management, free transferability of interests, and limited liability.[21] According to Revenue Ruling 88-76, if a business organization contains fewer than three of these four corporate characteristics, it will be

---

Rev. Rul. 88-76).

7. ARIZ. REV. STAT. ANN. §§ 29-601 to -857 (Supp. 1992).
8. COLO. REV. STAT. §§ 7-80-101 to -913 (Supp. 1992).
9. FLA. STAT. ANN. §§ 608.401-.471 (West 1982).
10. KAN. STAT. ANN. §§ 17-7601 to -7651 (Supp. 1990).
11. MD. CORPS. & ASS'NS CODE ANN. §§ 4A-101 to -1103 (1992).
12. NEV. REV. STAT. §§ 86.010-.571 (1991).
13. TEX. REV. CIV. STAT. ANN. art. 1528n (West 1992).
14. UTAH CODE ANN. §§ 48-2b-101 to -157 (1991 & Supp. 1992).
15. VA. CODE ANN. §§ 13.1-1000 to -1073 (Michie Supp. 1992).
16. S. 2163, Ill. 87th Gen. Assembly, Reg. Sess. (1992).
17. H.R. 4902, Mich. 86th Leg., Reg. Sess. (1991) (introduced June 4, 1991).
18. H.R. 1075, Okla. 44th Leg., 1st Reg. Sess. (1993).
19. S. 1943, Pa. 175th Gen. Assembly, Reg. Sess. (1992).
20. *See* Rev. Rul. 88-76, *supra* note 5, at 360-61.
21. *Id.* at 360-61.

classified as a partnership for tax purposes. The following sections analyze each of the four corporate characteristics under Utah's limited liability company statute.

A. Continuity of Life

According to 26 C.F.R. § 301.7701-2(b)(1), continuity of life does *not* exist if an organization will dissolve upon the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member. Utah's Limited Liability Company Act provides that an LLC shall be terminated (1) upon the expiration of a fixed period of time if so provided in the articles of organization or the operating agreement;[22] (2) by written agreement of the members of the LLC entitled to receive a majority of the profits, unless otherwise provided by the operating agreement;[23] (3) by the "death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member or upon the occurrence of any other event that terminates the continued eligibility for membership of a member in the limited liability company";[24] or (4) when the LLC is not a successor of two or more merged LLCs.[25]

The Utah LLC appears to lack continuity of life because the LLC will dissolve upon the death, insanity, bankruptcy, retirement, resignation, or expulsion of one of its members (owners) *unless* the LLC is continued by its members under a right outlined in the articles of organization or operating agreement. Thus, a Utah LLC is presumed to *not* have continuity of life *unless* the articles of organization or operating agreement provide otherwise. This position is supported by

22. UTAH CODE ANN. § 48-2b-137 (1991). An LLC's articles of organization must be filed with the state upon its formation. The articles should outline in detail the characteristics of the particular LLC, identifying (among other things) the owners, the principal place of business, limitations (if any) on continuity of life, form of management, and limitations (if any) on transferability of interests. *Id.* § 48-2b-116. An LLC may adopt an operating agreement by unanimous consent of all its members. The agreement can provide the method of management and the procedures for removal of managers, provided they are consistent with all laws and the articles of organization. *Id.* § 48-2b-126. Unlike some states, Utah's statute does not provide a time limitation on the duration of an LLC. *See* NEV. REV. STAT. § 86.161 (1991) (providing that Nevada LLCs shall not exist for more than 30 years).

23. UTAH CODE ANN. § 48-2b-137.

24. *Id.*

25. *Id.*

Private Letter Ruling 89-37-010,[26] which was issued in response to a Florida LLC dispute.

The Florida LLC at issue had nothing in its articles of organization or operating agreement concerning continuity of life. The IRS determined that the LLC lacked continuity of life because Florida's limited liability company act provided that all LLCs dissolve upon the death, retirement, resignation, expulsion, bankruptcy, or any other event which terminates one's membership *unless* all remaining members consented otherwise or the right to continue was stated in the articles of organization.[27]

B. *Centralization of Management*

Centralized management is another corporate characteristic listed in 26 C.F.R. § 301.7701-2(a)(1). "An organization has centralized management if any person . . . has continuing exclusive authority to make the management decisions necessary to the conduct of the business."[28] By their very nature, corporations have centralized management, through boards of directors and officers, that operate the business for the owners (shareholders). However, identifying centralized management for unincorporated entities is more difficult. Nevertheless, for tax purposes the IRS will probably treat an unincorporated organization as having centralized management "if any person or group that does not include all of the owners has the exclusive authority to make the business and management decisions."[29]

Utah's statute provides that "[t]he management of the limited liability company, *unless* otherwise provided in the articles of organization, shall be vested in its members in proportion to their interests in the profits" of the LLC.[30] Under

---

26. Priv. Ltr. Rul. 89-38-010 (Sept. 15, 1989). It should be noted that Private Letter Rulings have no precedential value and are not binding on the IRS. *See* I.R.C. § 6110(j)(3) (1986). Nonetheless, they offer valuable insight to how the IRS may rule.

27. Priv. Ltr. Rul. 89-38-010 (Sept. 15, 1989). If, however, the LLC's articles of organization or operating agreement explicitly provide that the LLC should have continuity of life, then the LLC will probably be deemed to have this corporate characteristic.

28. Treas. Reg. § 301.7701-2(c)(1) (1983); *see also* Hamill, *supra* note 6, at 731.

29. Treas. Reg § 301.7701-2(c)(1); *see also* Hamill, *supra* note 6, at 731 (citing Treas. Reg. § 301.7701-2(c)(1)). *But see infra* notes 32-33 and accompanying text.

30. UTAH CODE ANN. § 48-2b-125 (1991) (emphasis added).

this statute, the management of the LLC is presumed to be controlled by the members in proportion to their rights to profits.[31] In other words, if an LLC's articles of organization are silent regarding the LLC's management, the owners are presumed to manage the company. But if a particular LLC desires to have centralized management, then it may so state in its articles of organization.

Having designated managers, however, does not automatically mean an LLC has centralized management. As one commentator states, the IRS "will probably treat LLCs that have designated managers as lacking centralized management if the designated managers own enough of an interest in the LLC."[32] For example, the IRS generally requires that general partners in a limited partnership own at least twenty percent of the partnership interest to meet the centralized management test.[33] From this example, one may cautiously conclude that the IRS will deem an LLC to lack centralized management if the designated managers own at least twenty percent of the LLC (or have the rights to at least twenty percent of the profits).

C. *Free Transferability of Interest*

An entity is deemed to have free transferability of interest when substantially all of its members have the power to transfer all attributes of ownership in the organization, without the consent of any other owner, to a person not a member of the organization.[34] For example, an unlimited right to assign only the rights to profits, but not the right to participate in management, is not considered to be free transferability of interest.[35]

---

31. It should be noted that the rights to the profits of the LLC are to be outlined in the operating agreement. Thus, if the articles of organization state that the LLC is *not* to have centralized management (or if the articles are silent on the issue), then the operating agreement must state how the profits are to be dispersed to the owners. This will then determine how management is vested in the members.

32. Hamill, *supra* note 6, at 734 (citing Rev. Proc. 89-12, 1989-7 I.R.B. 22, § 4).

33. Rev. Proc. 89-12, 1989-1 C.B. 798 (1989). This Revenue Procedure considers managers as "general partners" and nonmanagers as "limited partners." *Id.*; *see also* Larson v. Commissioner, 66 T.C. 159 (1976) (centralized management does not exist if a general partner has a "meaningful proprietary interest").

34. Treas. Reg. § 301.7701-2(e) (1983).

35. *Id.*; *see also* Rev. Rul. 88-76, *supra* note 5, at 361 (stating that free transferability of interest is lacking where the transferee does not acquire *all* the at-

Under Utah's statute, LLC members may transfer their interest as provided in the operating agreement *as long as* they obtain the consent of those entitled to receive a majority of the nontransferred profits.[36] In the event they do not consent, the transferee is entitled only to the profits or other income derived from the transferred interest; the transferee is specifically prohibited from participating in management.[37] Thus, this statute appears to specifically limit the transferability of interest, because "under no circumstances will the transferee have the right to participate in the business affairs or otherwise be a full member in the LLC unless *all* members consent to the transfer."[38]

D. Limited Liability

The final corporate characteristic listed in 26 C.F.R. § 301.7701-2(a)(1) is limited liability. "An organization possesses the corporate characteristic of limited liability if no member is personally liable for the debts or claims against the organization . . . . If an organization is to lack limited liability, at least one member must have unlimited liability for all the organization's debts."[39]

Utah's statute mandates that all LLCs possess limited liability.[40] The statute specifically states that no member (owner), manager, or employee is personally liable for the LLC's "debt, obligation, or liability."[41] Consequently, all Utah LLCs will possess this corporate characteristic for federal tax purposes.[42] This position is supported by Revenue Ruling 88-76, in which the IRS stated that the Wyoming LLC possessed the corporate characteristic of limited liability because the

---

tributes of the transferor's interest absent the unanimous consent of all remaining members).

36. UTAH CODE ANN. § 48-2b-131 (1991).

37. *Id.*

38. Hamill, *supra* note 6, at 739 (citation omitted).

39. *Id.* at 734-35 (citations omitted).

40. UTAH CODE ANN. § 48-2b-109. Exceptions to this general rule, however, do exist. For example, one who acts for an LLC without authority is held personally liable for obligations so incurred (§ 48-2b-110), and liability for rendering professional services is unaltered by the liability protection of an LLC (§ 48-2b-111). Nonetheless, the Utah statute requires that no member of an LLC be liable for *all* of the organization's debts.

41. *Id.* § 48-2b-111.

42. The question of whether other states will recognize this limited liability in civil actions will be discussed *infra* part III.

Wyoming statute did not make members of the LLC personally liable for all the LLC's debts.[43]

E. *Tax Advantages of LLCs*

Revenue Ruling 88-76 "classified an unincorporated organization operating under the Wyoming Limited Liability Company Act as a partnership for federal income tax purposes."[44] Because Utah's Limited Liability Company Act is similar to Wyoming's Act, the IRS should also classify a Utah LLC as a partnership for tax purposes.[45] Such a classification is advantageous to small businesses: a corporation's income is taxed before any earnings are distributed to the owners,[46] and the owners are then taxed on distributions at their individual tax rates. This creates "double taxation," which dissuades many small businesses from choosing the corporate form. On the other hand, an LLC is not taxed as a separate entity; rather, the LLC acts "as a conduit, passing through profits and losses to members. The members are taxed as if they had individually realized their respective shares."[47]

III. LIMITED LIABILITY IN FOREIGN JURISDICTIONS

The fact that the IRS has recognized an LLC as a partnership for tax purposes makes the LLC an attractive business entity. However, another beneficial feature of the LLC is that it protects the owners from the LLC's liabilities. But (as mentioned above) it is uncertain whether foreign jurisdictions (especially states that have not enacted LLC statutes) will recognize the limited liability aspect of LLCs.

---

43. Rev. Rul. 88-76, *supra* note 5, at 361.

44. Hamill, *supra* note 6, at 721-22.

45. Of course, this is dependent upon each LLC's articles of organization and operating agreement; poor planning or draftsmanship could result in loss of the pass-through tax advantages and double taxation. Drafters must be cautious not to include too many corporate characteristics.

46. BABETTE B. BARTON ET AL., TAXATION OF BUSINESS ENTERPRISES: 1990, at 129 (1989).

47. Curtis J. Braukmann, Comment, *Limited Liability Companies*, 39 KAN. L. REV. 967, 972 (1991) (citation omitted). Another reason partnership classification is advantageous for LLCs is the passive loss rule promulgated in the 1986 Tax Reform Act. *See* I.R.C. § 469 (1992). This rule allows passive losses to be deducted *only* from passive income. Thus, taxpayers with active income must invest in active investments to offset any losses. But most active investments do not offer limited liability. In an LLC, however, members enjoy the best of both worlds: active investments (through material participation in management) and liability protection.

In determining whether foreign jurisdictions will recognize the limited liability of LLCs, commentators have speculated that "courts are likely to apply the common law doctrine of piercing the corporate veil."[48] Others have suggested that sister states will apply judicial comity unless "the law of the foreign state is against the public policy of the forum state."[49]

Because case law provides no explicit guidance on the issue,[50] lawyers and business persons may be hesitant to create LLCs that will do business in other states for fear the owners may be subjected to personal liability. Given this uncertainty, understanding how courts are likely to rule may be helpful. A close analysis reveals that courts will probably rule one of three ways: (1) exercise complete comity and recognize the limited liability as written in the creating-state statute; (2) treat the LLC as a partnership and subject the owners to personal liability as general partners; or (3) treat the LLC as a corporation.

A. *Complete Comity*

Certain jurisdictions may exercise complete comity. "The general rule [of comity] is that a legal entity created in another state will be recognized by the host state to have all the powers and rights granted by its charter and the applicable laws of the creating state."[51] Judicial comity creates a presumption in favor of continued recognition of the legal entity. This presumption should be disregarded "only if the state has expressed in some affirmative way that [comity] should not exist as a consequence of the public policy of the state."[52]

Downey v. Swan[53] is an example of a case in which com-

---

48. Alson R. Martin, *Business and Tax Considerations*, 1990 KAN. B.J. 17, 19. Piercing the corporate veil is a common law doctrine that stems from the principle that shareholders should be personally liable for the corporate obligations when the recognition of the separate corporate entity would cause an injustice. *See* Amfac Mechanical Supply Co. v. Federer, 645 P.2d 73 (Wyo. 1982).

49. Braukmann, *supra* note 47, at 987.

50. To date, no case law has given explicit guidance. There is, however, case law that gives implicit guidance. *See infra* parts III.A to III.D.

51. Richard Johnson, Comment, *The Limited Liability Company Act*, 11 FLA. ST. U. L. REV. 387, 401 (1983); *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1969) (general choice-of-law rule).

52. Johnson, *supra* note 51, at 401 (citation omitted); *see also* Christian Union v. Yount, 101 U.S. 352, 356 (1879) (public policy of a state is deduced from general legislation or settled adjudication from the highest court in the state).

53. 454 N.Y.S.2d 895 (N.Y. App. Div. 1982).

plete judicial comity was applied. In *Downey*, a New York appellate court was faced with the issue of whether a member of a particular New Jersey partnership association could be sued for wrongful death. Under New Jersey law, individual members of this association were protected from the liabilities of the association. The court held that the liability protection afforded the association in New Jersey would be recognized in New York.

Following the reasoning in *Downey*, courts may reasonably conclude that the LLC's limited liability under the creating-state statute should also be recognized in the forum state. However, not all courts may be so accommodating.[54]

B. *Treating the LLC as a Partnership*

Foreign jurisdictions may treat LLCs as partnerships for liability purposes. As a general rule, general partners in a partnership are personally responsible for the liabilities of the partnership.[55] Because an LLC is an unincorporated association and closely resembles a partnership,[56] states that do not have LLC statutes may determine that LLCs should be treated as partnerships. Such was the holding of *Means v. Limpia Royalties*,[57] though the entity in question was an Oklahoma trust instead of an LLC.

In *Means*, the Texas Court of Civil Appeals was confronted with the question of whether a shareholder's limited liability from an Oklahoma specialized trust would be recognized in Texas. The court held that a shareholder's immunity from liability under Oklahoma law did not extend to liability that arose out of transactions in Texas.[58] The court reached a similar conclusion in 1976:

> [W]hen two or more persons associate themselves together for the purpose of carrying on a business enterprise for their mutual profit, the persons so associated are jointly and severally responsible for the debts incurred in the conduct of such business unless such business association is organized as a limited partnership or a corporation *under our statute* providing for such organizations.[59]

---

54. *See infra* parts III.B and III.D.
55. UNIF. PARTNERSHIP ACT § 15, 6 U.L.A. 174 (1914).
56. *See supra* part II.
57. 115 S.W.2d 468 (Tex. Civ. App. 1938).
58. *Id.* at 475.
59. Cherokee Village v. Henderson, 538 S.W.2d 169, 173-74 (Tex. Civ. App.

These two Texas cases stand as reminders that states without LLC statutes may treat LLCs as partnerships for liability purposes.[60]

Even if a foreign jurisdiction treats the LLC as a partnership, the Restatement (Second) of Conflicts of Law, section 295, indicates that liability of an individual LLC member will depend on the law of the jurisdiction having the most significant relationship to the parties and the transaction.[61] Thus, if an LLC conducts business in a foreign jurisdiction but has a more "significant relationship" with the creating state, the law of the foreign jurisdiction may be of little importance.[62]

C. *Treating the LLC as a Corporation*

Under the Restatement (Second) of Conflicts of Law, section 307, if the LLC is considered "a corporation, the law of the state of organization should govern the liability of the owners to third parties for the obligations of the entity."[63] Thus, if a foreign jurisdiction recognizes the LLC as a corporation, the LLC's members will enjoy the advantage of limited liability, provided that the foreign jurisdiction follows the Restatement (Second) of Conflicts of Law.[64]

If a foreign jurisdiction recognizes an LLC as a corporation for liability purposes, questions remain as to whether, and under what circumstances, owners of an LLC will be held personally liable. As mentioned above, some commentators have suggested that the common law doctrine of piercing the corpo-

---

1976) (quoting Thompson v. Schmitt, 274 S.W. 554, 560 (Tex. 1925)) (emphasis added).

60. Texas has since adopted an LLC statute; thus, these cases may be "judicially" weakened. *See* TEX. REV. CIV. STAT. ANN. art. 1528n (West 1992).

61. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 295 cmt. 3 (1914).

62. This assumes, of course, that the foreign jurisdiction adheres to the Restatement.

63. Edward J. Roche, Jr., et al., *Limited Liability Companies Offer Pass-Through Benefits Without S Corp. Restrictions*, 74 J. TAX'N 248, 253 (1991) (citation omitted).

64. If the state chooses to recognize the LLC as a corporation for liability purposes, it may also recognize the LLC as a corporation for state tax purposes. This, however, may be harmful to small businesses. Ideally, the foreign jurisdiction should recognize the LLC just as the LLC's creating state does (which would then be complete judicial comity). *See supra* part III.A.

rate veil may be applied.[65] If this is the case, obviously certain elements of that doctrine will not apply.[66]

D. *Other Policy Considerations*

Foreign jurisdictions could refuse to respect the limited liability of LLCs because they may violate the public policy of that jurisdiction. For example, the court in *Wells v. Mackay Telegraph-Cable Co.*[67] refused to recognize the shareholder limited liability of a Texas common law business trust:

> The public in its dealings with such business organizations has a right to the protection afforded them by our statutes regulating the formation of corporations. This protection would be greatly lessened if it should be held that by declaring and recording a declaration of trust persons can associate themselves together for business purposes, giving their organization all the powers of a corporation and limiting their individual liability, without complying with the statutes which require proof of the funds or assets of such an association before a charter will be granted it to conduct its business.[68]

With this in mind, it seems that a state will probably not recognize the limited liability of LLCs if doing so would violate a particular public policy of that state.

For states that currently have LLC statutes, it is important to determine whether certain types of business may be performed by LLCs. For example, in Utah an LLC "may conduct or promote any lawful business or purpose which a *partnership*, *general corporation*, or *professional corporation* may

---

65. Braukmann, *supra* note 47, at 991; *see also* Sylvester J. Orsi, Comment, *The Limited Liability Company: An Organizational Alternative for Small Business*, 70 NEB. L. REV. 150, 175-78 (1991).

66. For example, failure to comply with corporate formalities is an inherent and permissible characteristic of LLCs. However, failure to so comply in a corporation may lead to the piercing of the corporate veil. Nonetheless, other elements of the doctrine might still be important (e.g., undercapitalization). For more discussion on piercing the veil in the context of an LLC, see Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 442-46 (1992).

67. 239 S.W. 1001 (Tex. Civ. App. 1921).

68. *Id.* at 1007; *see also* Hibbs v. Brown, 82 N.E. 1108 (N.Y. 1907). These public policy arguments do, however, have some weaknesses. For example, proof of funds is no longer a requirement for small businesses to incorporate. *See* Orsi, *supra* note 65, at 176-79.

conduct or promote."[69] However, in Colorado an LLC may conduct business *only* "that a *partnership with limited partners* may lawfully conduct and may not conduct any business that is prohibited by law to such partnership."[70]

E. *Suggested Analysis*

With the above factors in mind, the following analysis (checklist) may assist an LLC in determining whether its liability protection will be recognized in a foreign jurisdiction.

☐ 1. Does the foreign jurisdiction have an LLC statute?
- ☐ If yes, see number 2 below.
- ☐ If no, see number 3 below.

☐ 2. Does the foreign jurisdiction's LLC statute prohibit your particular type of business from acting as an LLC?
- ☐ If yes, beware.
- ☐ If no, limited liability protection should be afforded.

☐ 3. Does the foreign jurisdiction have a public policy for or against judicial comity?
- ☐ If for, limited liability protection is more probable. See number 4 below.
- ☐ If against, limited liability is less probable. See number 4 below.

☐ 4. Does the foreign jurisdiction have a public policy against liability protection for owners of unincorporated organizations?
- ☐ If yes, beware.
- ☐ If no, limited liability protection should be afforded.

IV. CONCLUSION

LLCs have had a relatively slow beginning due primarily to the uncertainty of whether LLCs would actually be granted the tax advantages of a partnership and the liability protection

69. UTAH CODE ANN. § 48-2b-104 (1991) (emphasis added).
70. COLO. REV. STAT. § 7-80-103 (Supp. 1992) (emphasis added).

of a corporation. However, the IRS states in Revenue Ruling 88-76 that a particular organization will be classified as a partnership for federal taxation purposes if it possesses fewer corporate characteristics than noncorporate characteristics. Because LLCs are intended to have few corporate characteristics, this ruling has increased state movement toward LLCs.

Since not all states have enacted limited liability company statutes, uncertainty exists as to whether owners will be completely protected from the liabilities of the LLC. However, a close analysis shows that courts are likely to rule one of three ways: (1) exercise complete comity and recognize the limited liability as written in the creating-state statute; (2) treat the LLC as a partnership and subject the owners to personal liability as general partners; or (3) treat the LLC as a corporation. If a foreign jurisdiction exercises complete comity, then the law of the creating state will govern, assuring limited liability for LLC members. If a foreign jurisdiction treats the LLC as a partnership, the owners will be responsible for the LLC's liabilities just as general partners are responsible for a partnership's liabilities. Finally, if a foreign jurisdiction treats the LLC as a corporation, the liability protection afforded to stockholders should be afforded to owners of the LLC.

Even for states that have LLC statutes, liability protection for LLC members may still be uncertain. Some state LLC statutes mandate that only certain types of work may be performed by an LLC. Thus, if a foreign LLC conducts a type of business in a state that does not permit LLCs to perform that type of work, the liability protection may not be acknowledged.

Knowing how the IRS is likely to treat LLCs for tax purposes has increased the use of LLCs. The issue of liability protection in foreign jurisdictions is, however, less certain. Nonetheless, proper research and investigation by a prudent lawyer or business person should reveal how a particular state is likely to rule. If one determines that liability protection will be granted to LLCs as designed, use of LLCs should continue to rise. An LLC is well equipped to meet the needs of businesses by granting the liability protection of a corporation and the tax advantages and flexibility of a partnership.

Keen L. Ellsworth