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## Wyoming Limited Liability Companies: Limited Liability and Taxation Concerns in Other Jurisdictions

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## COMMENT

### WYOMING LIMITED LIABILITY COMPANIES: LIMITED LIABILITY AND TAXATION CONCERNS IN OTHER JURISDICTIONS

The Wyoming Limited Liability Company (LLC), hailed by many as an optimal business form, combines the limited liability of a corporation with the pass through tax characteristics of a partnership. Indeed, as long as a Wyoming LLC operates within the borders of Wyoming, the LLC may be the best of both worlds. However, it is a big world, and when the Wyoming LLC extends its business beyond the borders of Wyoming, the members and managers of the Wyoming LLC need to seriously consider whether another state (host state) will recognize the Wyoming LLC as an authorized business form. While such recognition may be likely if the state has a LLC statute, recognition is less certain if the host state does not have a LLC statute.

The purpose of this comment is to examine the potential problems that a Wyoming LLC may face if it extends its operations into foreign jurisdictions. This comment will proceed in the following manner. First, the comment will introduce the concept of a LLC. Second, the comment will review the historical development of modern LLC's and similar entities. Third, the comment will compare the existing Wyoming LLC statute with the LLC statutes of other states. Fourth, the comment will identify and discuss specific problems the Wyoming LLC may encounter in other states. Finally, although the resolutions to many of the problems are presently unknowable, this comment will suggest how the courts of other jurisdictions may attempt to resolve these issues.<sup>1</sup>

#### INTRODUCTION

The Wyoming LLC is a relatively unknown business form. Is it a corporation or is it a partnership? In simplest terms, the LLC is a business form which has the pass-through tax advantages of a partnership, and the limited liability protection of a corporation.<sup>2</sup> "The LLC is a three-part hybrid which exhibits some corporate characteristics, some partnership characteristics, and some characteristics peculiar to LLC's."<sup>3</sup> "Despite its borrowed characteristics, the LLC is a

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1. The author would like to thank Thomas N. Long of Cheyenne, Wyoming, for his suggestions in the preparation of this comment.

2. 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, 524 (1988).

3. *Id.* at 524.

truly discrete business form.”<sup>4</sup> “Until it gains wide-spread acceptance, the Wyoming LLC may be best suited for family or closely held enterprises, such as farming, real estate, hotels, and restaurants, that hold significant assets, and subject the owner to potential liability for breach of contract or tortious behavior.”<sup>5</sup>

### HISTORICAL DEVELOPMENT

The concept of a corporation-partnership hybrid is not a new idea. Similar business forms have been around for many years. The LLC had its origins in the last half of the nineteenth century, with predecessors appearing in Michigan, New Jersey, Ohio, and Pennsylvania.<sup>6</sup> In Pennsylvania and Michigan statutes creating a partnership association were passed in 1874 and 1877 respectively.<sup>7</sup> In 1880, New Jersey passed a statute which created an LLC-like, entity called a limited partnership association.<sup>8</sup> Ohio adopted the New Jersey limited partnership association statute the following year.<sup>9</sup>

Unlike the LLC, these early associations were not created for tax advantages.<sup>10</sup> The United States had no federal income tax at the time that these statutes were enacted.<sup>11</sup> The early association statutes, under which these entities were created, provided the members of the entity with the corporate characteristic of limited liability at a time when it was very difficult to incorporate<sup>12</sup> because of extremely restrictive, formal registration requirements.<sup>13</sup> The requirements to form a partnership association or a limited partnership association were more flexible and less restrictive than the existing incorporation statutes.<sup>14</sup>

The partnership associations and the limited partnership associa-

4. *Id.* at 524.

5. Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387, 470-71 (1991); [hereinafter Gazur & Goff, *Assessing the Limited Liability Company*].

6. MICH. COMP. LAWS ANN. §§ 449.301 to .316 (West 1989); N.J. STAT. ANN. §§ 42:3-1 to 3-30 (West 1940); OHIO REV. CODE ANN. §§ 1783.01 to .12 (Baldwin 1989); PA. STAT. ANN. tit. 59 §§ 341 to 461 (1964) (repealed by Act of 1988, Dec. 21, P.L. 1444, No. 177, § 302(e)(1) effective Oct. 1, 1989).

7. MICH. COMP. LAWS ANN. §§ 449.301 to .316 (West 1989); PA. STAT. ANN. tit. 59 §§ 341 to 461 (1964) (repealed by Act of 1988, Dec. 21, P.L. 1444, No. 177 § 302(e)(1) effective Oct. 1, 1989). The Pennsylvania statute was repealed in the middle 1960's. Testimony by Bernard Dougherty, Before the House Commerce Committee of the Alaska House of Representatives (April 24, 1975) (transcript on file with the author) [hereinafter *Dougherty testimony*].

8. N.J. STAT. ANN. §§ 42:3-1 to 3-30 (West 1940).

9. OHIO REV. CODE ANN. §§ 1783.01 to .12 (Baldwin 1989).

10. Gazur & Goff, *Assessing The Limited Liability Company*, *supra* note 5, at 393.

11. S. SURREY ET AL., *FEDERAL INCOME TAXATION* 3 (1986) (historical account of the development of federal income tax).

12. 2 CAVITCH, *BUSINESS ORGANIZATIONS* § 40.01 (1984).

13. *Dougherty testimony*, *supra* note 7, at 5.

14. *Id.*

tions were statutorily created hybrid business organizations which possessed some of the characteristics of both partnerships, (pass through of income), and corporations, (limited liability).<sup>16</sup> The Pennsylvania and Michigan partnership associations closely resembled the traditional corporation in that; (1) each was created by statute, (2) the capital of each was represented by transferable shares, (3) each was a separate legal entity, (4) the members of each could only act in the name of the firm, (5) upon formation, each had to file a certificate similar to a certificate of incorporation with the appropriate state agency, (6) each did not dissolve upon a member's transfer of interest, death, or insolvency, and (7) the control was vested in a centralized board of managers who had sole power to incur corporate liability.<sup>16</sup> In Pennsylvania the partnership association statutes were repealed in the middle 1960's,<sup>17</sup> while the Michigan statute is still in effect.<sup>18</sup> No new limited partnership associations can be formed in New Jersey, but those already in existence can continue to operate as limited partnership associations.<sup>19</sup> The Ohio limited partnership statutes still remain in effect.<sup>20</sup>

The Michigan partnership association, as well as the New Jersey and Ohio limited partnership associations, were classified as the equivalent of partnerships by the legislatures,<sup>21</sup> but the statutes limited liability for the debts of the association to the amount of capital subscribed.<sup>22</sup> These provisions gave the partnership association and the limited partnership association the limited liability of a corporation.

In 1913, the United States instituted a federal income tax.<sup>23</sup> The Internal Revenue Service (IRS) classified the Michigan partnership association as a partnership for federal income tax purposes because it lacked the corporate characteristics of continuity of life, and free transferability of interests.<sup>24</sup> However, the IRS ruled that Ohio limited partnership associations would be classified as corporations for federal income tax purposes.<sup>25</sup>

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15. *Hill-Davis Co. v. Atwell*, 10 P.2d 463 (Cal. 1932).

16. *Thomas, LTD. v. Department of the Treasury*, 298 A.2d 285 (N.J. 1972) (proceeding by a limited partnership association for a refund of corporate franchise taxes).

17. The original partnership association laws were repealed by Act of 1988, Dec. 21, P.L. 1444, No. 177 § 302(e)(1) effective Oct. 1, 1989.

18. MICH. COMP. LAWS ANN. §§ 449.301 to .316 (West 1989).

19. N.J. STAT. ANN. § 42:3-1 (West Supp. 1991).

20. OHIO REV. CODE ANN. § 1783.01 (Baldwin 1989).

21. *Gazur & Goff, Assessing the Limited Liability Company*, *supra* note 5, at 393.

22. MICH. COMP. LAWS ANN. § 449.301 (West 1989); N.J. STAT. ANN. § 42.3-1 (West 1940); OHIO REV. CODE ANN. § 1783.01 (Baldwin 1989). Subscribing is the act of promising, in writing, to furnish capital in return for an interest in the entity. BLACK'S LAW DICTIONARY 1426 (6th ed. rev. 1990). The amount of capital subscribed relates to the amount of capital contributed, by the members, in the formation of the entity. N.J. STAT. ANN. § 42:3-1 (West 1940).

23. U.S. CONST. amend. XVI.

24. Priv. Ltr. Rul. 7505290310A (May 29, 1975).

25. Rev. Rul. 71-434, 1971-2 C.B. 430, 431-32. The IRS found that the limited

The LLC concept is not restricted to the United States.<sup>26</sup> A similar limited liability entity now exists in Panama and bears the name of Limitada, meaning a company with limited liability.<sup>27</sup> The Panamanian Limitada is the Latin American version of the LLC.<sup>28</sup> The Panamanian statute allows a company to be formed for a specified duration, that offers the limited liability of a corporation for its quota holders.<sup>29</sup> The interests of the quota holders are not freely transferable.<sup>30</sup> The Limitada is therefore taxed as a partnership for federal income tax purposes, in the United States, because it lacks the corporate characteristics of continuity of life, and free transferability of interests.<sup>31</sup>

Massachusetts also enacted statutes which created a hybrid business form commonly referred to as a Massachusetts Business Trust (MBT).<sup>32</sup> The MBT is fundamentally different from a corporation. This entity is created as a trust and then managed by trustees. The trustees manage the trust for the benefit of the unit holders who have invested in the trust.<sup>33</sup> Unlike the stockholders of a corporation, the unit holders of a business trust may not have mutual rights and obligations (voting rights), and may not be able to control the management of the organization.<sup>34</sup>

The business trust has also been distinguished from a partnership.<sup>35</sup> Uncertainty exists as to whether the creation of a MBT relieves the trustees and unit holders from liability as partners. A partnership is, in effect, a contract of mutual agency, each partner acting as a principal on his own behalf and as agent for his co-partner. In some MBT's, the unit holders retain control over the trustees and

partnership association possessed the corporate characteristics of continuity of life, limited liability, and centralized management.

26. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 394.

27. *Dougherty testimony*, *supra* note 7, at 7.

28. Sociedad de Responsabilidad Limitada Law Number 24 of 1966, of the Republic of Panama.

29. Letter from the Acting Chief of the Individual Income Tax Branch of the Internal Revenue Service to the quota holders of International Petroleum Trading Company Sdad. Ltda. 2 (Dec. 30, 1974) (reply to a letter requesting rulings concerning the federal tax consequences of the organization and operation of International Petroleum Trading Company Sdad. Ltda., a Panamanian Limitada) The quota holders of the Panamanian Limitada are those parties who have invested capital and hold an interest in the company. *Id.* at 3.

30. *Id.* at 3. This means that the Limitada lacks one of the corporate characteristics used to determine whether the Limitada will be federally taxed as a partnership or a corporation. See tax discussion *infra* pp. 558-559.

31. Letter from the Acting Chief of the Individual Income Tax Branch of the Internal Revenue Service to the quota holders of International Petroleum Trading Company Sdad. Ltda. 3 (Dec. 30, 1974) (reply to a letter requesting rulings concerning the federal tax consequences of the organization and operation of International Petroleum Trading Company Sdad. Ltda., a Panamanian Limitada).

32. See generally MASS. ANN. LAWS ch. 182, §§ 1-14 (Law. Co-op 1987).

33. In re Conover's Estate, 14 N.E.2d 980, 985 (Ill. App. 1924) (claim that Conover, deceased, was individually liable for an obligation as a partner).

34. *Id.* at 985.

35. *Id.*

have authority to control the management of the business. This suggests the partnership relation exists in a business trust.

In the other cases, the MBT gives the trustee full control of the management of the business, and the unit holders have no control over the trustees. This indicates there is no liability as partners.<sup>36</sup> Thus while the unit holders may or may not retain control, the business trust will have the characteristic of being a partnership but still retain the limited liability of a corporation because the liability of the unit holders is limited to the amount of the trust. Under either circumstance, the IRS will tax the MBT as a corporation because it possesses the corporate characteristics of continuity of life, centralized management, and free transferability of interests.<sup>37</sup>

A Subchapter S Corporation, a competing business entity, is also similar to a Wyoming LLC. A corporation may elect to receive Subchapter S treatment under the Internal Revenue Code.<sup>38</sup> A Subchapter S election may be a useful method of obtaining pass through treatment for federal income tax purposes while retaining the corporate advantage of limited liability.<sup>39</sup>

If tax consequences were the sole consideration, the LLC would be preferable to the S Corporation for those types of transactions in which the partnership taxation rules hold more benefits than the S Corporation rules. Highly leveraged transactions, transactions with equity participants, such as a corporation or other non-individuals, and transactions which have more than 35 equity participants are poor circumstances for S corporation status.<sup>40</sup>

The Wyoming LLC offers a far less restrictive means of doing business than the S corporation. For example, many Wyoming LLC's would not even qualify to make the Subchapter S election. S corporations must have fewer than 35 shareholders.<sup>41</sup> Wyoming LLCs have no such restriction. The Internal Revenue Code also restricts who may be shareholders in a Subchapter S corporation, allowing only individuals, estates, and certain qualified trusts to be shareholders.<sup>42</sup> The Wyoming LLC act places few restrictions on who may be a member of a Wyoming LLC, and expressly provides that individuals, general partnerships, limited partnerships, LLC's, corporations, trusts, estates, and other associations may be members of a Wyoming LLC.<sup>43</sup>

However, state law uncertainty is another matter. "The S corpo-

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36. *Id.*

37. Priv. Ltr. Rul. 8507013 (Nov. 16, 1984).

38. See I.R.C. §§ 1361 to 1379 (1991).

39. WILLIAM H. PAINTER, *BUSINESS PLANNING: PROBLEMS AND MATERIALS* 147 (1984).

40. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 459.

41. I.R.C. § 1361(b)(1) (1991).

42. I.R.C. § 1361(b)(2) (1991).

43. WYO. STAT. § 17-15-102(a)(iv) (1989).

ration, a corporation under state law, is a more established form and benefits from years of practitioner experience."<sup>44</sup> It is debatable whether this experience makes the S Corporation preferable to the LLC in matters concerning state law. "The organizer of an LLC has a cleaner, if more uncertain, slate upon which to write, and the flexibility may prove advantageous."<sup>45</sup> The LLC will become truly preferable to the S corporation once it receives extraterritorial recognition.

### DEVELOPMENT OF LLCs

The modern establishment of limited liability company statutes began in Alaska during the early 1970's.<sup>46</sup> A Texas based oil company, wishing to conduct business in oil rich Alaska, sought to have a statute enacted that would enable it to conduct its business with less expense and fewer restrictions. The proposed Alaska Limited Liability Company Act was to provide more flexibility than any of the other state statutes.<sup>47</sup> The principal purpose for enactment of the act was to provide an additional source of revenue to Alaska through filing fees and annual taxes.<sup>48</sup> The prominent issue of debate was how the LLC would be treated for tax purposes.<sup>49</sup> A request for a private letter ruling was made to the Internal Revenue Service to clarify the federal tax treatment of the proposed Alaskan LLC.<sup>50</sup> No ruling was issued because the Alaskan legislature voted down the legislation before the Internal Revenue Service could respond. Even though the Alaskan statute was not enacted, because of the tax concerns, the Texas based oil company still thought the LLC form would be beneficial to its business. Wyoming, which is also rich in oil reserves, presented the Texas oil company with another opportunity. LLC legislation was introduced in Wyoming in 1977.<sup>51</sup> As had been the case in Alaska, the major legislative concern was how a statutorily created Wyoming LLC would be taxed for federal income tax purposes.<sup>52</sup> Wyoming passed the legislation in 1977, before the tax question had been resolved.<sup>53</sup> The enactment of this legislation created the Wyoming Limited Lia-

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44. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 459.

45. *Id.*

46. On April 8, 1975, the Limited Liability Company Act ("the Act") was introduced in the Alaskan Senate as Senate Bill 354 and in the Alaskan House as House Bill 403. Letter from Frank M Burke Jr. to the Commissioner of the Internal Revenue Service (May 1, 1975) (request for information letter concerning the proposed Alaskan Limited Liability Company Act) (on file with author) [hereinafter *Burke letter*].

47. *Dougherty testimony*, *supra* note 7, at 5-7.

48. *Burke letter*, *supra* note 46.

49. Thomas N. Long, *The Wyoming Limited Liability Company* (Feb. 15, 1989) (unpublished paper being distributed by the Secretary of State of the State of Wyoming) (on file with the author) [hereinafter *The Wyoming Limited Liability Company*].

50. *Burke letter*, *supra* note 46.

51. 1977 Wyo. Sess. Laws ch. 158, § 17-294.

52. There were no state tax concerns because the state of Wyoming does not have an income tax. See tax discussion *infra* pp. 557-560.

53. 1977 Wyo. Sess. Laws ch. 158, § 17-294.

bility Company Act.<sup>54</sup> After enactment of the LLC Act certain parties in Wyoming requested that the IRS issue a ruling on the federal tax treatment of the Wyoming LLC. As will be seen, when the ruling was finally issued, it created even more confusion.<sup>55</sup> Nevertheless, the state of Wyoming led the way for modern LLC statutes.<sup>56</sup> For various reasons, other states did not readily accept the LLC business entity created in Wyoming.

### THE WYOMING LIMITED LIABILITY COMPANY ACT

Before discussing how a Wyoming Limited Liability Company will be treated in another jurisdiction it is necessary to have a basic understanding of a Wyoming LLC. A Wyoming LLC is a legal entity treated as having an identity distinct and apart from that of its owners.<sup>57</sup> Under the Wyoming LLC Act, a LLC may be organized for any lawful purpose, except for the purposes of banking and insurance.<sup>58</sup> The Wyoming LLC may sue, be sued, own or dispose of property, lend money, make contracts, and exercise all powers necessary or convenient to effect any or all of the purposes for which the LLC is organized.<sup>59</sup> The name of a LLC must contain the words "limited liability company."<sup>60</sup> Two or more persons may form a limited liability company by signing, verifying and delivering in duplicate to the Secretary of State, articles of organization for the limited liability company.<sup>61</sup>

The members of a LLC enjoy limited liability under the Act.<sup>62</sup> Neither the members of a LLC nor the managers of a LLC are liable under a judgment, decree or order of a court, or in any other manner, for a debt, obligation or liability of the LLC.<sup>63</sup> Exactly who may manage a LLC is also governed by statute. The management of the LLC is vested in its members in proportion to the amount of capital contributed, or a manager or managers may be elected by the members.<sup>64</sup>

Another important consideration is the transferability of a member's interest. The interest of a member may be transferred or assigned as provided in the operating agreement. However, if all of the other members of the LLC do not approve the proposed transfer or assignment by unanimous written consent, the transferee of the mem-

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54. The Wyoming Limited Liability Company Act is codified at Wyo. STAT. §§ 17-15-101 to -136 (1989).

55. See tax discussion, *infra* pp. 557-560.

56. There are currently 361 LLC's registered in the state of Wyoming. Telephone interview with The Wyoming Secretary of State's office, (Feb. 6, 1992) (the statistics were through the end of January 1992).

57. *The Wyoming Limited Liability Company*, *supra* note 49, at 1.

58. WYO. STAT. § 17-15-103 (1989).

59. WYO. STAT. § 17-15-104(a) (1989).

60. WYO. STAT. § 17-15-105 (1989).

61. WYO. STAT. §§ 17-15-106 to -108 (1989).

62. WYO. STAT. § 17-15-113 (1989).

63. *Id.*

64. WYO. STAT. § 17-15-116 (1989).



ber's interest has no right to participate in the management and affairs of the LLC.<sup>65</sup> Finally, a Wyoming LLC may only be organized for a period not to exceed 30 years.<sup>66</sup>

#### COMPARISON OF THE WYOMING LLC ACT TO LLC STATUTES OF OTHER STATES

In 1982, Florida followed Wyoming's lead by enacting its own LLC statute.<sup>67</sup> Florida did not specifically adopt the Wyoming law, but the statutes are very similar. For several years Florida and Wyoming were the only states with LLC statutes. In 1990, Colorado and Kansas enacted statutes similar to the statutes existing in Wyoming and Florida.<sup>68</sup> By the end of 1991, four other states, Nevada, Texas, Utah, and Virginia, had enacted LLC statutes, which brings the total to eight states.<sup>69</sup> These new statutes generally resemble, but do not specifically adopt, the statutes previously enacted in Colorado, Florida, Kansas, and Wyoming.<sup>70</sup>

These states generally authorize a LLC to conduct or promote any lawful business or purpose. Kansas adds that a LLC may conduct any lawful business which a general corporation or partnership may conduct.<sup>71</sup> Utah uses the general corporation or partnership restriction, but also allows for any business which a professional corporation could promote.<sup>72</sup> Colorado does away with the partnership and general corporation restrictions by providing that a LLC may conduct only the lawful businesses that a limited partnership may conduct.<sup>73</sup> Virginia prohibits LLC's from conducting the business of professional services.<sup>74</sup> The only businesses off limits to a Nevada LLC, as with a

65. WYO. STAT. § 17-15-122 (1989).

66. WYO. STAT. § 17-15-107(a)(ii) (1989).

67. Florida Limited Liability Company Act. Codified at FLA. STAT. ANN. §§ 608.401 to 471 (Supp. 1992).

68. The Colorado statute is titled, "Colorado Limited Liability Company Act," and is codified at COLO. REV. STAT. ANN. §§ 7-80-101 to -910 (West. Supp. 1991); the Kansas Limited Liability Company Act is codified at KAN. STAT. ANN. §§ 17-7601 to -7651 (Supp. 1991).

69. The Nevada statute became effective October 1, 1991. 1991 Nev. Stat. ch. 442, § 363. The Texas statute became effective on August 26, 1991. 1991 Tex. Sess. Law Sec. ch. 901, § 86 (Vernon). The Utah statute became effective July 1, 1991. 1991 Utah Laws ch. 258, § 58. The Virginia statute became effective on March 12, 1991. 1991 Va. Acts ch. 168.

70. Texas and Nevada provide the newest statutes. The Nevada statute became effective October 1, 1991. This statute is codified at NEV. REV. STAT. ANN. §§ 86.010 to .571 available in WL. The Texas statute, enacted August 26, 1991, is titled the "Texas Limited Liability Company Act" and is codified at TEX. CORPS. & ASS'NS CODE ANN. §§ 15281.01 to 15289.02 (West 1991) available in WL. The Utah statute titled the "Utah Limited Liability Company Act" is codified at UTAH CODE ANN. §§ 48-2b-101 to -156 (Supp. 1991); the Virginia statute codified at VA. CODE ANN. §§ 13.1-1000 to -1069 (Supp. 1991) is titled the "Virginia Limited Liability Company Act."

71. KAN. STAT. ANN. § 17-7603 (Supp. 1991).

72. UTAH CODE ANN. § 48-2b-104 (Michie Supp. 1991).

73. COLO. REV. STAT. ANN. § 7-80-103 (West Supp. 1991).

74. VA. CODE ANN. § 13.1-1008 (Michie Supp. 1991).

Wyoming LLC, are those of banking or insurance.<sup>76</sup>

A LLC generally has the power to sue or be sued, to own real or personal property, to sell or convey such property, to make contracts, to lend money, incur liabilities, and to have all powers necessary to further its purpose. Texas is the only state that does not specifically delineate the powers of a LLC. The Texas LLC act confers general powers, providing that each LLC shall have the powers provided to Texas Corporations and the powers provided to Texas Limited Partnerships.<sup>76</sup>

Five states require two or more persons or entities to form a LLC.<sup>77</sup> Colorado and Virginia require one person to form a LLC.<sup>78</sup> The states differ on the issue of LLC management. Four states provide for management of a LLC to be vested in its members in proportion to the amount of contributions.<sup>79</sup> The Virginia statute simply provides that management of the LLC is vested in its members.<sup>80</sup> The remaining states call for the appointment of a designated manager or managers.<sup>81</sup> Some states, including Wyoming, give the LLC a choice and allow the LLC to be managed by the members or by designated managers.<sup>82</sup>

The ownership interest of LLC members is transferable. However, in most states, including Wyoming, the unanimous written consent of all the remaining members must be obtained before the transferee may participate in the management of the LLC.<sup>83</sup> The Utah

75. NEV. REV. STAT. ANN. § 86.141 (Michie Supp. 1991) *available in WL*; WYO. STAT. § 17-15-103 (1989).

76. TEX. CORPS. & ASS'NS CODE ANN. § 15282.02 (West 1991) *available in WL*. Texas corporations have the power to: sue or be sued; have perpetual life; to have a corporate seal; to buy and sell real property; to lend money; to own interests in other entities; to make contracts or incur liabilities; to indemnify officers or directors; and to pay pensions. TEX. BUS. CORP. ACT ANN. art. 2.02 (West Supp. 1992). The Texas Limited Partnership Act does not specifically list limited partnership powers, they are to be inferred from the act. *See generally* TEX. CIV. STAT. ANN. art. 6132b (West 1970 & West Supp. 1992).

77. KAN. STAT. ANN. § 17-7605 (Supp. 1991); FLA. STAT. ANN. § 608.405 (West Supp. 1992); NEV. REV. STAT. ANN. § 86.151 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-103 (Michie Supp. 1991); WYO. STAT. § 17-15-106 (1989).

78. COLO. REV. STAT. ANN. § 7-80-203 (West Supp. 1991); VA. CODE ANN. § 13.1-1010 (Michie Supp. 1991).

79. Those states which advocate this form of management of the LLC include Florida (FLA. STAT. ANN. § 608.422 (West Supp. 1992)); Kansas (KAN. STAT. ANN. § 17-7612 (Supp. 1991)); Nevada (NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1991) *available in WL*); and Utah (UTAH CODE ANN. § 48-2b-125(1) (Michie Supp. 1991)).

80. VA. CODE ANN. § 13.1-1022 (Michie Supp. 1991).

81. Colorado and Texas call for the appointment of a manager or managers. COLO. REV. STAT. ANN. § 7-80-401 (West Supp. 1991); TEX. CORPS. & ASS'NS CODE ANN. § 15282.13 (West 1991) *available in WL*.

82. KAN. STAT. ANN. § 17-7612 (Michie Supp. 1991); UTAH CODE ANN. § 48-2b-125(2) (Supp. 1991); FLA. STAT. ANN. § 608.422 (West Supp. 1992); VA. CODE ANN. § 13.1-1024(A) (Michie Supp. 1991); WYO. STAT. § 17-15-116 (1989).

83. Those states include COLO. REV. STAT. ANN. § 7-80-702 (West 1991); FLA. STAT. ANN. § 608.432 (West Supp. 1992); NEV. REV. STAT. ANN. § 86.351 (Michie Supp. 1991) *available in WL*; TEX. CORPS. & ASS'NS CODE ANN. §§ 15284.05, .07 (West 1991) *availa-*

statute provides that only a majority of the remaining members of the LLC need to approve the transfer before the transferee may participate in management.<sup>84</sup>

A statute comparison reveals certain provisions that are consistent in every act. In every state the words "limited liability company" must be included in the name of every LLC formed. The word "limited" may usually be abbreviated as "Ltd." and the word "company" may be abbreviated as "Co." Additionally, each state requires the LLC company to file articles of organization with the respective secretary of state. The articles of organization must include: the name of the company, the principal place of business of the company, and the duration of the LLC.<sup>85</sup> The statutes also require the LLC to appoint a registered agent to receive service of process on behalf of the LLC.

While none of the LLC acts are exactly the same, they achieve very similar results in their application. When a LLC operates within the state of its creation, its rights and duties within that jurisdiction are very clear. Questions arise, however, when the LLC ventures outside of the confines of its home state to do business in another jurisdiction. A primary question is whether the home state's or the foreign jurisdiction's law will govern. The answer to this question may adversely effect the advantages for which the LLC was formed.

#### LIMITED LIABILITY AND TAXATION CONCERNS IN OTHER JURISDICTIONS

A Wyoming LLC will be considered to be a foreign LLC when it operates in another state.<sup>86</sup> Among the problems raised are internal management and continued limited liability of the Wyoming LLC. Problems could arise if the host state requires a management structure which contravenes the Wyoming LLC's operating agreement. Additionally, members of the Wyoming LLC could be subject to personal liability if the host state does not recognize the Wyoming LLC's limited liability. Depending on the circumstances, the governing law may be either that of Wyoming or the law of the host state. The limited liability and taxation concerns that the Wyoming LLC may face will be analyzed first in regard to those states with LLC statutes, and second in regard to those states without LLC statutes.

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*ble in WL*; VA. CODE ANN. §§ 13.1-1039, -1040 (Michie Supp. 1991); WYO. STAT. § 17-15-122 (1989); KAN. STAT. ANN. § 17-7618 (Supp. 1991).

84. UTAH CODE ANN. § 48-2b-131 (Michie Supp. 1991).

85. The maximum period of duration for a limited liability company is usually 30 years. After this period of time has expired the limited liability company will no longer exist. COLO. REV. STAT. ANN. § 7-80-204(b) (West Supp. 1991); FLA. STAT. ANN. § 608.407(1)(b) (West Supp. 1992); KAN. STAT. ANN. § 17-7607 (Supp. 1991); NEV. REV. STAT. ANN. § 86.021 (Michie Supp. 1991) *available in WL*; TEX. CORPS. & ASS'NS CODE ANN. § 15283.02 (West 1991) *available in WL*. The "Acts" of Utah and Virginia place no time limit on the duration of the limited liability company.

86. COLO. REV. STAT. ANN. § 7-80-102 (West Supp. 1991); TEX. CORPS. & ASS'NS CODE ANN. § 15281.02(9) (West 1991) *available in WL*; UTAH CODE ANN. § 48-2b-102(4) (Michie Supp. 1991); VA. CODE ANN. § 13.1-1002 (Michie Supp. 1991).

*Limited Liability and Management of the Wyoming LLC in States with LLC Statutes*

In states having limited liability company acts, the Wyoming LLC is governed by both the law of the state in which the Wyoming LLC is doing business and Wyoming law. Every LLC Act, with the exception of the Wyoming and Florida statutes, provide for foreign LLC's doing business inside that state.<sup>87</sup> This shows that the other states which enacted LLC statutes after Wyoming and Florida recognized the need to provide for governance of a foreign LLC in their state.

The Wyoming LLC statute, perhaps because no other state provided for LLC's at the time, omitted a provision dealing with the treatment of foreign LLC's. The Wyoming LLC act only goes so far as to state that the provisions of the act apply to commerce with foreign nations and among several states as permitted by law.<sup>88</sup> This provision simply means that the Wyoming LLC is authorized to "conduct its business, carry on its operations, and have and exercise the powers granted by this act in any state, territory, district, or possession of the United States."<sup>89</sup>

Generally, LLC statutes provide that the law of the jurisdiction from which the foreign LLC came will govern the issues of internal management and limited liability.<sup>90</sup> A Wyoming LLC, therefore may not be denied registration as a LLC in another state by reason of any difference between their respective state statutes.<sup>91</sup> The Wyoming LLC can venture into any of the eight states that have LLC statutes to conduct business and be confident that the LLC will retain its internal management structure and limited liability just as those features exist under Wyoming law.

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87. COLO. REV. STAT. ANN. § 7-80-901 (West Supp. 1991); KAN. STAT. ANN. § 17-7636 (Supp. 1991); NEV. REV. STAT. ANN. § 86.051 (Michie Supp. 1991) *available in WL*; TEX. CORPS. & ASS'NS. CODE ANN. § 15287.02 (West 1991) *available in WL*; UTAH CODE ANN. § 48-2b-143 (Michie Supp. 1991); VA. CODE ANN. § 13.1-1051 (Michie Supp. 1991).

88. WYO. STAT. § 17-15-135 (1989).

89. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 428.

90. COLO. REV. STAT. ANN. § 7-80-901 (West Supp. 1991); KAN. STAT. ANN. § 17-7636 (Supp. 1991); TEX. CORPS. & ASS'NS CODE ANN. § 15287.01(A) (West 1991) *available in WL*; UTAH CODE ANN. § 48-2b-143(1) (Michie Supp. 1991); VA. CODE ANN. § 13.1-1051 (Michie Supp. 1991).

91. COLO. REV. STAT. ANN. § 7-80-901 (West Supp. 1991); TEX. CORPS. & ASS'NS CODE ANN. § 15287.02 (West 1991) *available in WL*; KAN. STAT. ANN. § 17-7636 (Supp. 1991); VA. CODE ANN. § 13.1-1051(ii) (Michie Supp. 1991). The provision of the Utah act while not explicitly stating so, implies that the law of the foreign state shall govern. UTAH. CODE ANN. § 48-2b-143 (Michie Supp. 1991).

*Limited Liability and Management of the Wyoming LLC in States without a LLC Statute*

The question of how the Wyoming LLC will be treated in jurisdictions without LLC statutes is less certain. It is doubtful that the LLC will attract substantial interest if LLC's are not protected. The Commerce Clause of the United States Constitution restricts the ability of states to exclude or regulate organizations if the organizations engage in interstate commerce.<sup>92</sup> However, the Commerce Clause is not a complete bar to the regulation of foreign companies.<sup>93</sup> This means that although a host state does not have the power to totally exclude a foreign company, the state does not have to let the foreign company conduct its business without regulation.

If a Wyoming LLC does business in a state which does not have a LLC act, the host state may not recognize the LLC business form. The host state can require the Wyoming LLC to comply with its laws and regulations. A main concern of the Wyoming LLC's members would be whether the limited liability of the Wyoming LLC will be retained.<sup>94</sup> In a worst case scenario, a host state may consider the partnership traits of a Wyoming to be so dominant so as to preclude a grant of limited liability. If the host state imposes partnership-type liability on the Wyoming LLC members, the members would become personally liable for all debts and obligations of the Wyoming LLC in that state.

### Choice of Law

A Wyoming LLC may transact business in a foreign state with no LLC statute. This presents a dilemma when a dispute arises and a subsequent suit ensues. "A conflict may exist between a statute of the forum state which prohibits LLC's and the LLC enabling legislation of the state of formation."<sup>95</sup> If the forum state does not apply Wyoming law, the Wyoming LLC members may be subjected to partnership liability. In such circumstances, a court would apply a choice of law analysis to decide whether the Wyoming LLC will be able to retain its limited liability in the host state.

A choice of law analysis considers which state's law to apply to a dispute.<sup>96</sup> When persons have acquired rights, incurred obligations, injuries or damages, or made contracts within the territory of two jurisdictions,<sup>97</sup> a choice must be made between two separate bodies of law.

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92. U.S. CONST. art. 1, § 8.

93. *Pike v. Bruce Church*, 397 U.S. 137, 142 (1970).

94. Susan Pace Hamill, *The Limited Liability Company: A Possible Choice For Doing Business*, 41 FLA. L. REV. 721, 722 (1989).

95. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 430.

96. BLACK'S LAW DICTIONARY 241 (6th ed. 1990).

97. *Id.* at 299-300.

If those separate bodies of law are the same or substantially similar, there is little concern over which law will be applied. The concern increases however when there are inconsistencies and differences between the bodies of law. In practice, a judicial choice of law analysis would be made only after a dispute arises and the Wyoming LLC becomes potentially liable for something it has done in the foreign state's jurisdiction.

Consider the following situation. A Wyoming LLC begins doing business in the fictional state of Blueacre. Blueacre does not have a LLC statute. As a result of its business activities in Blueacre, the Wyoming LLC is sued in a Blueacre state court. The Blueacre court must choose between Wyoming law and Blueacre law to determine if the Wyoming LLC will retain its limited liability.

In making this determination the Blueacre court may apply a significant relationship test.<sup>98</sup> The Blueacre court will look at the relationship between the Wyoming LLC and Blueacre to determine how significant that relationship is.<sup>99</sup> The factors to be considered are (1) the nature and extent of the organization's relationship with the state of formation, and (2) the nature and extent of the organization's relationship to the host state.<sup>100</sup> A significant relationship may be found, for instance, where a Blueacre citizen is injured by a Wyoming LLC that has moved the majority of its business out of Wyoming and into Blueacre. The extent of the Wyoming LLC's relationship with Wyoming is minimal while the extent of the Wyoming LLC's relationship with Blueacre is significant. Thus Blueacre law would apply. On the other hand, the Blueacre court may fail to find a significant relationship where, for example, a Blueacre citizen purchases a product made by a Wyoming LLC in Wyoming, and is injured while using the product. The extent of the relationship between the Wyoming LLC and Wyoming is significant, while the extent of the relationship between the Wyoming LLC and Blueacre is minimal. If the Blueacre court does not find a significant relationship between Blueacre and the Wyoming LLC, Wyoming law will likely be chosen over the law of Blueacre.<sup>101</sup>

If the Blueacre court has determined, that Wyoming law will be applied, the Wyoming LLC should receive the limited liability granted to it by the Wyoming LLC statutes. If the court finds a significant

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98. *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 312-313 (1981). The relatively specific rules for business entities are, however, subject to general conflict of law principles, including consideration of the relevant policies of the forum. *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 6(2)(b) (1971). This public policy provision is discussed in relation to the doctrine of comity.

99. *Hague*, 449 U.S. at 312-313.

100. *Mansfield Hardwood Lumber Co. v. Johnson*, 268 F.2d 317, 320 (5th Cir. 1959), *cert. denied*, 361 U.S. 885 (1959); *Western Airlines, Inc. v. Sobieski*, 12 Cal.Rptr. 719, 727 (1961).

101. *Ficor, Inc. v. McHugh*, 639 P.2d 385, 391 (Colo. 1982) (an action by creditors of a defunct corporation, the corporation appealed a money judgement against them).

relationship between the Wyoming LLC and Blueacre, then the law of Blueacre will probably be applied. If Blueacre law is applied the next problem is that Blueacre has no LLC law. The Blueacre court must decide whether to recognize the LLC as a corporation, and thereby allow the Wyoming LLC to retain its limited liability, or to apply partnership law. If partnership law is applied, the Wyoming LLC members would probably be held personally liable for all business debts and obligations.

The Blueacre court may consider the Wyoming LLC to be a corporation if it determines that the Wyoming LLC possesses sufficient corporate characteristics.<sup>102</sup> Should the Blueacre court determine the Wyoming LLC corporate characteristics to be insufficient as compared to the Wyoming LLC's partnership characteristics, the Wyoming LLC will probably be classified as either a partnership or a limited partnership. As discussed in the preceding paragraphs, this classification is significant because it will affect whether the Wyoming LLC members will be held to be personally liable.

### Comity

"In the absence of a statute or a constitutional provision addressing the status of foreign entities, the right of a corporation to do business in a jurisdiction outside of its state of formation is said to be governed by the law comity."<sup>103</sup> Under the doctrine of comity the Blueacre court could find a significant relationship between Blueacre and the Wyoming LLC, and still decide not to apply Blueacre law. In general, the principle of comity is that courts of one state or jurisdiction will give force and effect of laws and judicial decisions of another state or jurisdiction, not as a matter of obligation, but out of deference and mutual respect.<sup>104</sup> Under comity the courts of Blueacre could give force and effect to the laws of Wyoming which allow the Wyoming LLC to receive limited liability. The courts of Blueacre are not required to use the doctrine of comity, however, and may decide to stick solely with the choice of law analysis.

There is one significant exception to the doctrine of comity. This exception deals with the public policy considerations of Blueacre. Comity between different states does not require the courts of one

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102. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 298 (1971); *Hemphill v. Orloff*, 277 U.S. 537, 550 (1928) (Michigan was allowed to subject Massachusetts Business Trust to conditions imposed on foreign corporations doing business within the state). The corporate characteristics to be looked for include (1) limited liability, (2) centralized management, (3) a common seal, (4) the entity is not dissolved by the death of a shareholder, and (5) the interests are represented by shares of stock. *State v. United Royalty Co.*, 363 P.2d 397, 407, 408 (Kan. 1961) (Kansas treats Oklahoma Business Trust as a corporation).

103. *Gazur & Goff, Assessing the Limited Liability Company*, *supra* note 5, at 433.

104. BLACK'S LAW DICTIONARY 267 (6th ed. 1990).

state to give force and effect to the laws of another state when to do so would be against the public policy of the former state.<sup>106</sup> No state is bound to recognize, or enforce, contracts or activities which are injurious to the welfare of its citizens, or which are in violation of its own laws.<sup>106</sup> Trying to determine the public policy of a foreign state may be a very difficult task. There is no precise definition of public policy but the public policy of a state is generally found implicitly in its constitution and statutes. When cases arise concerning public policy matters upon which a state's constitution and statutes are silent, then judicial decisions and the constant practices<sup>107</sup> of government officials will determine public policy.<sup>108</sup>

In the absence of case law concerning the application of the doctrine of comity to a LLC, it may be helpful to look at the application of the public policy exception to the doctrine of comity by way of analogy to a similar business form. The Massachusetts Business Trust is similar to the Wyoming LLC.<sup>109</sup> In *Means v. Limpia Royalties*, a Texas court would not apply comity to a business trust.<sup>110</sup> The court said "the 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."<sup>111</sup> The court felt that it would be against public policy to allow the MBT to have the advantage of limited liability without having registered to do business in the state.<sup>112</sup> Registration would have put the citizens of Texas on notice that the MBT had limited liability.<sup>113</sup> By analogy, the doctrine of comity may be applied to give the Wyoming LLC the same limited liability in Blueacre as it has in Wyoming so long as to do so would not violate Blueacre's public policy.

### *Registering the Wyoming LLC as a LLC in States Without LLC Statutes*

It may be possible for the Wyoming LLC to register to do busi-

105. *Faulkner v. Hyman*, 6 N.E. 846, 848 (1886); *Fisher v. Lord*, 3 Atl. 927, 928 (1886); *Rhodes v. Missouri Savings and Loan Co.*, 50 N.E. 998, 1000 (1898).

106. *Hyman*, 6 N.E. at 848; *Rhodes*, 50 N.E. at 1000.

107. Constant practices of government officials refers to the history and tradition of classifying certain activities as violative of public policy. See *People ex rel. Stevens v. Fidelity and Casualty Co.*, 38 N.E. 752 (1894).

108. See *Shore Management Corporation v. Erickson*, 41 N.E.2d 972 (1984) (corporation dissolved for failure to file its annual report and pay franchise tax lacked legal capacity to sue).

109. Massachusetts Business Trust codified at MASS. ANN. LAWS ch. 182 §§ 1-14 (Law. Co-op 1987). The Business trust is similar to a Wyoming LLC because it offers the corporate advantage of limited liability but allows the conducting of business as a partnership.

110. *Means v. Limpia Royalties*, 115 S.W.2d 468, 475 (Tex. 1938). (unincorporated association operating under a declaration of trust were seeking enforcement of a mineral deed executed by the plaintiff).

111. *Id.*

112. *Id.*

113. *Id.*



ness as a LLC in a state without a LLC statute. Indiana, a state that does not provide for the creation of LLC's, has a statutory provision allowing for the registration of foreign LLC's. Before doing business in Indiana a foreign LLC may file, with the Indiana Secretary of State, an application for registration containing such things as the name of the foreign LLC, the state of its formation, and the nature of the foreign LLC's business in Indiana.<sup>114</sup> If the state of Blueacre has a statutory provision the same as or substantially similar to the Indiana provision the Wyoming LLC will be able to register as a Wyoming LLC doing business in Blueacre.

Blueacre, in such an instance, recognizes foreign entities that receive limited liability and pass through taxation, the Wyoming LLC. Allowing the Wyoming LLC to register as a LLC in Blueacre is beneficial to the citizens of Blueacre because it offers them some security in their dealings with organizations they may not be familiar with. Generally, registration by foreign businesses provides four public benefits: (1) to ensure that the citizens of Blueacre have adequate disclosure of information about the Wyoming LLC, (2) to put the Wyoming LLC on equal legal footing with Blueacre business with respect to disclosure of information, (3) to show the willingness of the Wyoming LLC to be subject to the jurisdiction of the Blueacre court by providing a registered place to receive service of process, and (4) to provide reasonable assurances that the Wyoming LLC exists.<sup>115</sup>

If Blueacre does not have a specific statutory provision allowing registration of LLC's problems could arise. The Blueacre Secretary of State may forbid the Wyoming LLC to register as a LLC in Blueacre. "In the absence of specific statutory acceptance by foreign jurisdictions, a LLC may attempt to register under foreign limited partnership or foreign corporation statutes."<sup>116</sup> The United States Supreme Court has stated that the MBT, an entity similar to a Wyoming LLC, is sufficiently similar to a corporation that it is subject to the state's power to control the MBT's admission into the state to do business.<sup>117</sup> The host state also has the authority to regulate the MBT once it begins doing business.<sup>118</sup> This may present a problem to the Wyoming LLC wanting to do business in Blueacre if the Blueacre court finds: (1) a significant relationship between the Wyoming LLC and Blueacre, and (2) decides that application of the doctrine of comity is against the public policy of Blueacre, then the Wyoming LLC has no guaranty of how Blueacre will classify the Wyoming LLC. Wyoming LLC's may prefer to be classified as a corporation in a situation ex-

114. IND. CODE ANN. § 23-16-10.1-1 (Burns Supp. 1991).

115. Thomas N. Long, Full Faith and Credit, (unpublished memorandum) (July 6, 1990) (on file with the author).

116. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 429.

117. *Orloff*, 277 U.S. at 548.

118. *Id.*

posing them to liability. However, other Wyoming LLC's may want to risk personal liability in exchange for the tax benefits of a partnership.

Rather than leave the classification by Blueacre to chance, the Wyoming LLC may seek another solution. A possible solution to this problem is for the Wyoming LLC to register to do business in Blueacre as another form of business entity on its own initiative. By so registering, the Wyoming LLC may be able to choose how the LLC will be treated in Blueacre. The courts of Blueacre would apply the law pertaining to only the form of business entity under which the Wyoming LLC is registered.<sup>119</sup> "Registration of the LLC in a foreign jurisdiction may be advantageous for other reasons. It not only may afford protection of LLC status by registration but, also may help to avoid the imposition of penalties if such registration is required."<sup>120</sup>

### *Registering the Wyoming LLC as a Foreign Limited Partnership*

Meeting the foreign limited partnership definitions would be difficult.<sup>121</sup> In general, a foreign limited partnership is defined as a limited partnership formed under the laws of another state, containing one or more general partners and one or more limited partners.<sup>122</sup> A Wyoming LLC is not a foreign limited partnership because it is not a limited partnership formed under the laws of another state (Wyoming). It would also be difficult to register the Wyoming LLC as a limited partnership in Blueacre because a limited partnership has to have at least one general partner who is liable for the debts and obligations of the limited partnership. A Wyoming LLC does not have partners, or differentiated interests corresponding to general or limited partners, all members of the Wyoming LLC enjoy limited liability.<sup>123</sup>

Even if it were possible for the Wyoming LLC to register in Blueacre as a foreign limited partnership, or even as a limited partnership, it may not be advisable. Generally the registration of the Wyoming LLC as a limited partnership in Blueacre would be very detrimental to the Wyoming LLC because of the loss of its limited liability. To conduct business in this form at least one member of the LLC would be subject to the liabilities and obligations the Wyoming LLC incurs while doing business in Blueacre. One of the reasons the Wyoming LLC was created was to give all of its members limited liability. Registration as a foreign limited partnership may, therefore, be unacceptable because limited liability will be lost, at least, to one

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119. If the Wyoming LLC were registered as a corporation in Blueacre, Blueacre would have to apply Blueacre corporation law in cases of disputes.

120. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 430.

121. *Id.* at 429.

122. 2 CAVITCH, *BUSINESS ORGANIZATIONS* § 39.04 (1984).

123. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 429 n.223.

member.

### *Registering a Wyoming LLC as a Corporation*

“An LLC might be able to register under state corporation statutes.”<sup>124</sup> There is some indication that the Panamanian Limitada and the MBT might be able to register as corporations in foreign jurisdictions.<sup>125</sup> The similarity of the Wyoming LLC to those entities might provide some basis for registration.<sup>126</sup> In order for a Wyoming LLC to conduct business in Blueacre as a corporation, the Wyoming LLC will have to follow the procedure required of any foreign corporation which registers in Blueacre.

If Blueacre follows typical procedure, the Wyoming LLC would file an application for registration or certificate of authority as a corporation with the Secretary of State of Blueacre.<sup>127</sup> “The issuance of certificate of authority memorializes successful registration in a foreign jurisdiction.”<sup>128</sup> If successfully registered, the Wyoming LLC will have the same rights and privileges, as well as the same duties, restrictions, penalties, and liabilities as would a domestic corporation.<sup>129</sup>

Therefore, the registration of a Wyoming LLC as a corporation would not have a detrimental effect upon liability and would not deter the LLC from doing business in a foreign state. The general corporate law of every state grants the corporate stockholders limited liability, and the members of the LLC, operating as a corporation, would have limited liability as well. However, the problem with registering as a corporation may affect the tax treatment of the Wyoming LLC. This potential problem will be discussed in a later portion of this comment.<sup>130</sup>

### *Registering the Wyoming LLC as a Partnership*

The question of the Wyoming LLC retaining its limited liability takes on a different complexion when the Wyoming LLC is registered as a partnership, subject to the general partnership law of Blueacre. Once registered<sup>131</sup> and operating as a partnership, the Wyoming LLC would be subject to the same laws and duties imposed upon a

124. *Id.* at 429.

125. The United States Supreme Court stated that a MBT is sufficiently similar to a corporation that it is subject to regulation as such. *Orloff*, 277 U.S. at 548.

126. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 429 n.224.

127. MODEL BUSINESS CORP. ACT § 112 (1971).

128. Gazur & Goff, *Assessing the Limited Liability Company*, *supra* note 5, at 429.

129. MODEL BUSINESS CORP. ACT § 112 (1971).

130. See tax discussion *infra* pp. 557-560.

131. The Wyoming LLC will attempt to register to do business as a partnership as if it were a partnership in Wyoming.

Blueacre partnership.<sup>132</sup> The option of registering a Wyoming LLC as a partnership may not be advantageous to a Wyoming LLC doing business in a foreign jurisdiction. While the Wyoming LLC would still have the pass through tax advantages for which it was formed, it would lose its limited liability. Under general partnership law each partner is jointly and severally liable for the debts and liabilities of the partnership.<sup>133</sup> Therefore the LLC would be losing its limited liability and its members would become jointly and severally liable for the debts and obligations of the LLC in Blueacre.

### TAX CONSIDERATIONS

#### *Federal Tax Considerations*

Originally, how the federal government would treat a LLC for income tax purposes was an unanswered question which limited the LLC's utility. It was not clear whether a LLC would be taxed as a corporation or a partnership. After the Wyoming legislature enacted the Limited Liability Company Act, the Texas firm, which advocated the statute, requested a private letter ruling concerning the classification of the LLC for federal tax purposes.<sup>134</sup> In response, the IRS ruled that, although a Wyoming LLC may be registered to do business in one or more states as a corporation, the LLC will be taxed as a partnership for federal income tax purposes.<sup>135</sup>

Unfortunately this ruling did not clear up the confusion. One day prior to the issuance of the private letter ruling, the IRS published proposed regulations which were inconsistent with the private letter ruling.<sup>136</sup> The proposed regulations provided that an organization in which no member has personal liability for the debts of the organization was to be classified as an association and taxed as a corporation.<sup>137</sup> The proposed regulations had a chilling effect on the acceptance of the Wyoming LLC Act. Only thirty Wyoming LLC's were formed in the eleven years following enactment of the Wyoming LLC Act.<sup>138</sup>

By 1988, much of the confusion caused by the inconsistency between the private letter ruling and the proposed regulations concerning the classification of a Wyoming LLC for federal tax purposes was

132. 2 CAVITCH, BUSINESS ORGANIZATIONS § 38A.03 (1984).

133. *Wheeler v. Green*, 593 P.2d 777, 792 (1979) (a professional trainer of racehorses brought suit against his former employer for a number of defamatory statements made after he had been discharged).

134. *The Wyoming Limited Liability Company*, *supra* note 49, at 12.

135. Priv. Ltr. Rul. 8106082 (Nov. 18, 1980).

136. 45 Fed. Reg. 75,709 (1980) (to be codified at 26 C.F.R. pt. 301) (proposed November 17, 1980) (proposing amendments including Prop. Treas. Reg. §§ 301.7701-2(a)(2), -2(a)(3), -2(a)(4)).

137. Proposed Amendments to Treas. Reg. §§ 301.7701-2 to -4; 45 Fed. Reg. 75,709 (1980) (proposed Nov. 17, 1980).

138. *The Wyoming Limited Liability Company*, *supra* note 49, at 12-13.

dispelled. In 1982, the IRS withdrew the proposed regulations, promising a study of the entity classification rules.<sup>139</sup> In 1988, the IRS issued Revenue Ruling 88-76, which stated that a Wyoming LLC, none of whose members or designated managers were personally liable for any debts of the company, was to be classified as a partnership for federal income tax purposes.<sup>140</sup> The revenue ruling specifically looked at the Wyoming Limited Liability Company Act,<sup>141</sup> and therefore, may not be applicable to LLC's formed in other states, or if the LLC varies from the specific fact pattern covered by the ruling.<sup>142</sup>

In making this determination the Internal Revenue Service looked at six characteristics of a corporation. Those six characteristics were (1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests.<sup>143</sup> Since the first two characteristics are common to both corporations and partnerships, they are not relevant. The remaining four characteristics are used to determine federal income tax treatment. As stated in Revenue Ruling 88-76, the Tax Court in *Larson v. Commissioner*<sup>144</sup> concluded that equal weight must be given to these characteristics.<sup>145</sup> Applying the *Larson* rationale to the Wyoming LLC, the IRS first found that the Wyoming LLC lacked the corporate characteristic of continuity of life.<sup>146</sup> Under the Wyoming LLC Act, unless the business of the LLC is continued by the consent of all the remaining members, the LLC is dissolved upon the death, retirement, resignation, expulsion, bankruptcy, or any other termination of a membership.<sup>147</sup> If a member of the LLC ceases to be a member for any reason, continuity is not assured, consequently the Wyoming LLC lacks the continuity of life characteristic.<sup>148</sup> Second, the IRS determined that a Wyoming LLC lacks the corporate characteristic of free transferability of interests.<sup>149</sup> A member's interest in a Wyoming LLC is not freely transferable because the assignee or transferee does not become a substitute member and does not acquire the transferring member's rights in the LLC without the consent of all remaining members.<sup>150</sup> Thus, the absence of

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139. I.R.S. Announcement 83-4, 1983-2 I.R.B. 31 (discussing I.R.S. News Release IR-82-145 (Dec. 16, 1982)).

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

141. *Id.* at 360.

142. LLC's of other states may request a ruling concerning the law of their own state. There is no guarantee that the LLC's will be taxed as a partnership, this will only be the case if the LLC lacks a preponderance of the corporate characteristics discussed in Revenue Ruling 88-76.

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

144. 66 T.C. 159 (1976).

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

146. *Id.*

147. WYO. STAT. § 17-15-123 (1989).

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

149. *Id.*

150. WYO. STAT. § 17-15-122 (1989).

two of the four corporate characteristics resulted in classification of the Wyoming LLC as a partnership for federal income tax purposes. This ruling answered many of the questions that had hung, like a black cloud, over the Wyoming Limited Liability Company.

The associated question of how a Wyoming LLC will be treated for tax purposes in other jurisdictions may be partially answered. It appears from the revenue ruling that no matter which jurisdiction the Wyoming LLC ventures into, or if the Wyoming LLC is registered as another business form, it would be reasonably assured of partnership status for federal income tax purposes.<sup>151</sup> Of course, this classification is conditional upon the LLC staying within the fact pattern discussed in the Revenue Ruling.<sup>152</sup> A variance from the facts and circumstances discussed in the Revenue Ruling may result in the LLC's being classified as a corporation for tax purposes. Although it would seem likely that the Wyoming LLC will retain the advantageous federal income tax classification as a partnership, the LLC may want to seek a private letter ruling before it ventures into a foreign jurisdiction to do business or varies from the structure of the LLC discussed in Revenue Ruling 88-76.

### *State Tax Considerations*

A Wyoming LLC should also check the state tax laws of the host state into which it wishes to venture. If a state's tax laws are based upon federal tax laws, no state corporate tax will likely be imposed upon the Wyoming LLC because the state will likely perform the same corporate characteristic analysis as did the IRS.<sup>153</sup> Under such circumstances, the state is not likely to find a preponderance of corporate characteristics present in the Wyoming LLC if the IRS failed to do so. However, if the state does not follow the federal tax scheme, a corporate tax may be imposed upon the income derived from the business activities conducted within the host state.

The need to investigate state tax law is evident. Wyoming has no state income tax. Florida provides that a Florida LLC is subject to the Florida state corporate tax.<sup>154</sup> In Colorado, all LLC's, both resident and foreign, are taxed as partnerships for Colorado income tax purposes.<sup>155</sup>

Although the Wyoming LLC will be taxed as a partnership for federal tax purposes it would be less attractive to do business in a

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

152. The fact pattern discussed involves a Wyoming LLC, none of whose members or designated managers are personally liable for any debts of the company.

153. John R. Maxfield, CLE presentation on limited liability companies cosponsored by the University of Wyoming Law School and the Business Law Section of the Wyoming State Bar (Nov. 10, 1990) (transcript on file with the author).

154. FLA. STAT. ANN. § 608.471 (West Supp. 1992).

155. COLO. REV. STAT. ANN. § 7-80-205(1) (West Supp. 1991).

jurisdiction that is going to tax it as a corporation for state income tax purposes. The Wyoming LLC would lose the pass through tax benefit, associated with partnership classification, for which it was created. Even so, if the Wyoming LLC is to be classified as a corporation in a foreign jurisdiction that does not have a LLC statute, it might be beneficial for the Wyoming LLC to conduct business in that jurisdiction. The Wyoming LLC would consider the increased taxes associated with the state's corporate classification to be a cost of doing business in the foreign jurisdiction. The Wyoming LLC should proceed with caution, the possible results in each particular jurisdiction should be considered before doing business in that jurisdiction.

### COST/BENEFIT ANALYSIS

A cost/benefit analysis may provide insight into whether the Wyoming LLC should do business in another state's jurisdiction. A cost/benefit analysis is a comparison of the costs associated with a particular action, and the benefits derived from the same action.<sup>156</sup>

If the Wyoming LLC is going to be taxed as a corporation in the state of Blueacre, then the Wyoming LLC should weigh the tax costs against the benefit of retaining limited liability in Blueacre. If the tax costs of being a corporation outweigh the benefits derived from receiving limited liability in Blueacre, the Wyoming LLC may want to do business in Blueacre as a partnership. Conversely, if the tax costs are not too great and are outweighed by the risk of liability, whether as a matter of amount or probability, then, it may be better to pay the taxes and keep limited liability.

For example, a Wyoming LLC manufacturing table saws in Blueacre may prefer the corporate form of business while operating in Blueacre. Manufacturing table saws involves a high risk of being subject to tremendous liability. A cost/benefit analysis will show that the benefit of limited liability in this situation greatly outweighs the costs of losing the pass through taxation. In such a case, the Wyoming LLC cannot afford to lose its limited liability. On the other hand, if a Wyoming LLC that manufactured doorstops in Blueacre conducted a cost/benefit analysis, it would probably determine that the tax benefits of the partnership form are more desirable than limited liability. Therefore, the benefits derived from pass through taxation would outweigh the costs of losing limited liability, making the partnership business form more attractive.

### CONCLUSION

Until all of the state legislatures consider and respond to the issues of limited liability and taxation involving foreign LLC's, the

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156. BLACK'S LAW DICTIONARY 158 (6th ed. 1990).

LLC's should proceed with caution when entering a foreign jurisdiction. The Wyoming LLC must consider if registering to do business in the foreign jurisdiction will allow them to retain limited liability and pass through taxation. If the Wyoming LLC decides that it cannot register as a LLC in the foreign jurisdiction, it may consider attempting to register as either a corporation, a limited partnership, or a general partnership in the foreign jurisdiction. The Wyoming LLC should also keep in mind how the courts of the foreign jurisdiction will apply the choice of law analysis and the doctrine of comity. All of these factors are important and should be considered, in relation to the issues of limited liability and taxation before a Wyoming LLC extends its business into a foreign jurisdiction.

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