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The Origins Behind the Limited Liability Company

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This Article documents the story behind and the complex origins of the Limited Liability Company (LLC). Using unpublished letters, memoranda, and other documents, this Article shows the inside story of the interest group activity responsible for inventing the first LLC statute in 1977, the initial battle fought by the early LLC proponents to secure partnership classification from the Internal Revenue Service, and the organized efforts of LLC proponents in the 1990s lobbying the IRS for more favorable partnership classification rules, while encouraging the states to enact statutes. Professor Hamill offers a unique perspective on the story of the LLC through her experience as an attorney with the Chief Counsel's Office of the Internal Revenue Service (from 1990–1994) during many of the events described in the Article.

This Article also offers insights into the origins of the LLC by analyzing how certain business and tax dynamics came together, resulting in the LLC entering into the American landscape. Focusing on the historical evolution of corporations, this Article traces the LLC's earliest origins to the first few decades of the nineteenth century when state law power over the incorporation process cemented. Focusing on the twentieth century, this Article identifies first the modern income tax of 1913 as the LLC's modern origin, and then explores how the effective income tax burden of doing business in the corporate versus partnership forms and how the development of the market for investments in independent oil and gas drilling ventures greatly affected the timing of the LLC's invention in the 1970s. An explanation of the LLC's rise to prominence in the 1990s concludes this Article.

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I. INTRODUCTION

The Wyoming Limited Liability Company (LLC), created in 1977,¹ represents the first domestic unincorporated business entity combining statutory limited liability protection with the ability to be taxed as a partnership for federal income tax purposes.² The LLC's creation and its swift acceptance as a mainstream business choice directly resulted from the radically different tax regimes imposed on corporations and partnerships.³ The partnership tax provisions only impose one level of tax at the owner level and offer a number of other advantages, including the ability to flexibly allocate profits and losses. The corporate tax provisions, generally regarded as inferior, either require all corporations to bear two levels of tax, once at the entity level and again at the shareholder level, or allow S corporations a flow-through regime with many restrictions not faced by partnerships.⁴ Corporations never qualify for partnership taxation⁵ and before the LLC's invention, corporations were the only domestic business entity offering complete statutory limited liability.

After the Internal Revenue Service (IRS) formally recognized the LLC's ability to be taxed as a partnership in 1988, interest in LLCs grew exponentially. By the close of 1996, all fifty states and the District of Columbia had passed statutes allowing formation of LLCs within their jurisdictions. In less than twenty years—a

¹ Wyoming Limited Liability Company Act, ch. 158, 1977 Wyo. Sess. Laws 537 (enacted March 4, 1977) (codified at WYO. STAT. ANN. §§ 17-15-101–17-15-144 (Michie 1997)).

² See Frank M. Burke & John S. Sessions, *The Wyoming Limited Liability Company: An Alternative to Sub S and Limited Partnerships?*, 54 J. TAX'N 232–35 (1981); Susan Pace Hamill, *The Limited Liability Company: A Possible Choice For Doing Business?*, 41 U. FLA. L. REV. 721 (1989) [hereinafter Hamill, *Possible Choice*] (early articles exploring LLCs).

³ See Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393, 399–410 (1996) [hereinafter Hamill, *Corporate Integration*].

⁴ See 26 U.S.C. §§ 701–761 (1994) (partnership tax rules); 26 U.S.C. §§ 301–385 (West 1988 & Supp. 1998) (corporate tax rules); 26 U.S.C. §§ 1361–1399 (1994 & Supp. II 1996) (subchapter S rules); Hamill, *Possible Choice*, *supra* note 2, at 748–57 (tax advantages of partnerships compared with the disadvantages of S corporations); Hamill, *Corporate Integration*, *supra* note 3, at 407–09 (1996 legislation fails to equalize LLCs and S corporations); *infra* note 221 (enactment and amendments of subchapter S).

⁵ See I.R.C. § 7701(a)(2) (1994) (definition of partnership excludes all corporations); I.R.C. § 7701(a)(3) (1994) (definition of corporations includes all corporations); *see also* Gen. Couns. Mem. 37, 953 (May 14, 1979) (citing Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819); Priv. Ltr. Rul. 79-21-084 (Feb. 27, 1979) (incorporation under state law results in *per se* corporate taxation regardless of the corporation's business characteristics); Gen. Couns. Mem. 37, 127 (May 18, 1977) (same); Hamill, *Corporate Integration*, *supra* note 3, at 397 n.20 (same); Susan Pace Hamill, *The Taxation of Domestic Limited Liability Companies and Limited Partnerships: A Case For Eliminating the Partnership Classification Regulations*, 73 WASH. U. L. Q. 565, 598–99 (1995) [hereinafter Hamill, *Partnership Classification*] (same).

meteoric pace unprecedented in the development of business organizations—this new business form grew from obscurity to a viable new alternative for doing business. Although superficially appearing to be an impermissible end run around the federal corporate income tax, in fact LLCs impose no material threat to these revenues.⁶ Instead, the invention of the LLC exemplifies the states responding to the inequities and distortions of the current federal business tax system. The power of the states, rather than of the federal government, to sanction the formation of business organizations made the rise of the LLC possible.

The invention of the LLC as a legitimate choice for doing business represents a new solution to an old problem. The debate addressing the wisdom of the two-tier tax imposed on corporations, known as the corporate integration issue, started many years before the LLC's creation. Moreover, the entity-level tax imposed on corporations and on those unincorporated forms similar to corporations, as compared to a flow-through regime for partnerships, has existed since 1913—the year Congress enacted the modern federal income tax. At the time of the LLC's birth in 1977 and throughout its entire first phase of development ending in late 1996, the partnership classification regulations, a set of federal rules administered by the IRS, imposed certain requirements on all unincorporated business organizations, including LLCs, seeking the benefits of partnership taxation.⁷ The LLC's battle to emerge as an independent, viable alternative for doing business revolved around convincing the IRS that it met the partnership classification requirements. The combination of the tenacity of the organized LLC proponents lobbying the IRS and the absence of organized opposition produced a successful outcome.

Using numerous unpublished reports and memoranda, this Article details the efforts to secure legitimacy for the LLC and then explores the LLC's historical origins⁸ in order to gain a broader perspective on the circumstances leading to the emergence of this new American business organization. Part II identifies two separate groups of LLC proponents, marking the IRS's recognition of the LLC's right to be taxed as a partnership in 1988 as the turning point in the LLC's development. In the mid 1970s, a few entrepreneurial-minded attorneys and accountants representing a U.S. independent oil and gas company invented the LLC, successfully persuaded the Wyoming legislature in 1977 to enact the first LLC statute, and asked the IRS to grant the new LLC favorable partnership status. The ensuing struggle, in which the IRS refused to acknowledge the LLC's partnership

⁶ See generally Hamill, *Corporate Integration*, *supra* note 3.

⁷ See Hamill, *Partnership Classification*, *supra* note 5.

⁸ "The rational study of law is still to a large extent the study of history. History must be a part of the study, because without it we cannot know the precise scope of rules which it is our business to know." Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897).

status despite its literal compliance with the partnership classification regulations, forced the IRS to directly confront the effect of statutory limited liability on the ability to qualify for partnership taxation. Part II then outlines the events that occurred during the 1990s as the LLC developed as a mainstream choice for doing business. A second group of LLC proponents lobbied the IRS to liberalize the partnership classification requirements so that, on a practical level, more businesses could use LLCs. These efforts accelerated the state statutory enactments, which in turn led to the IRS removing all barriers holding the LLC back by granting all domestic unincorporated businesses automatic partnership taxation.⁹

Part III explores the LLC's historical origins back to America's first few decades as the state and federal components of the new nation struggled to define their spheres of power. Because a federally based system of creating business organizations would have prevented the LLC's birth, its earliest origin can be traced back to the cementing of state power over the creation of corporations, the first American business organization requiring formal governmental recognition embodied in the corporate charter. Although Congress chartered two national banks in the late eighteenth century and contemplated a nationally planned transportation system in the early nineteenth century, federal control never played a prominent role in the earliest days of the American corporation, implicitly leaving the power to grant corporate charters with the individual states. Although criticism directed at the corporation mounted in the decades leading up to the Civil War, the wrath focused on the federally chartered Bank of the United States and the process of incorporation by special charter rather than the individual states' general authority over the corporation. Ultimately, the state-law-based corporation survived through the invention of general incorporation statutes during the late 1830s and 1840s. By the eve of the Civil War, general incorporation statutes were proliferating across the states, firmly cementing the primary power over the corporation with the states. By the early twentieth century, when lawmakers seriously discussed moving the incorporation process into the federal domain, the custom of incorporation under state statutes proved impossible to change.

From a tax and business angle, Part IV explains why the LLC first appeared in the 1970s and discusses the business interests generating the enthusiastic push for LLCs in the 1990s. Although the corporate tax theoretically set the stage in 1913, no safe path existed for the LLC's invention until 1960, the year the partnership classification regulations first allowed entities with statutory limited liability to

⁹ The author of this Article, Susan Pace Hamill, served as an attorney advisor from May 1990 to May 1994 in the Division of Passthroughs & Special Industries (which has subject jurisdiction over partnerships and LLCs) of the Chief Counsel's Office of the IRS in Washington D.C. As part of this employment, the author participated directly in, or had first hand knowledge of, many of the events described in this Article. Special effort has been made to portray these events in an impartial and scholarly manner.

qualify for partnership taxation. Moreover, actual income tax burdens faced by businesses using partnerships and corporations, which for the most part materially favored corporations, explain why businesses consistently producing taxable income had no motivation to invent or support the LLC until after the Tax Reform Act of 1986.¹⁰ Starting in the late 1960s, the increased presence of independent oil explorers and their desire to combine limited liability with the partnership's ability to pass-through tax losses to investors, best explains why it took until the mid 1970s to invent the LLC. By the time the LLC secured partnership status in 1988, changes made by the Tax Reform Act of 1986 eliminated the ability of most investors to utilize flow-through tax losses and materially increased the tax burden on corporate income. Thus, business ventures expecting to consistently recognize taxable income supported LLCs in the 1990s.

II. THE STORY OF THE LLC

A. *The LLC's Birth and Initial Fight for Survival*

The explanation behind the LLC's birth boils down to innovative professionals creating solutions when the current legal system fails to meet client needs.¹¹ The particular client whose needs sparked the invention of the LLC was an independent oil explorer experiencing increased opportunities in international oil and gas exploration during the turbulent 1970s, when the major producers struggled with problems related to the middle eastern oil supply.¹² In 1975, Frank M. Burke, and others representing the Hamilton Brothers Oil Company, which is headquartered in Denver, Colorado, attempted to persuade the Alaska State Legislature to enact the first domestic LLC statute and identified favorable partnership tax classification from the IRS as holding critical importance.¹³ Since the late 1960s, Hamilton Brothers Oil Company had been involved in international oil and gas exploration using foreign LLCs, primarily the Panamanian *limitada*. Unlike the U.S. entities available at that time, *limitadas* provided direct limited liability and the ability to secure partnership classification for U.S. income tax purposes.¹⁴

¹⁰ Pub. L. No. 99-514, 100 Stat. 2085 (1986).

¹¹ See generally DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE 12-37 (1991) (discussing the influence of interest groups on legislation).

¹² See *infra* notes 243-46 and accompanying text; see also William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855 (1995) (extensive discussion of the foreign *limitada* antecedents of LLCs).

¹³ See *infra* notes 17-24 and accompanying text.

¹⁴ Hamilton Brothers Oil Company considered using Brazilian *limitadas*, which received partnership taxation despite having limited liability, as the vehicle for the exploration ventures. See Priv. Ltr. Rul. T:1:1:2:2 (Jan. 30, 1970). However, certain features of the Brazilian law rendered that

The Hamilton Brothers Oil Company soon found that Panamanian limitadas posed administrative difficulties, and because no similar entity existed in the U.S., these limitadas also created uncertainty concerning the degree that U.S. courts would respect the limited liability characteristic.¹⁵ Because no viable domestic entity existed, like the foreign limitada, which combined limited liability and partnership taxation,¹⁶ the representatives of Hamilton Brothers Oil Company created an unincorporated domestic entity resembling the foreign limitada. This new entity met the literal requirements of the partnership classification rules while providing direct limited liability protection for all participants.¹⁷ The newly created LLC, presented to the Alaska legislature on April 8, 1975, offered for the first time¹⁸ the potential for a domestic entity to combine the tax advantages of a partnership with direct limited liability commonly associated with corporations. The sponsors understood that the Alaska bill posed a major breakthrough for U.S.

forum unsatisfactory for Hamilton Brothers Oil Company's needs, causing them to routinely use Panamanian limitadas. *See* Letter from Frank M. Burke to J. Richard Emens of Moyer, Tingley, Hurd & Emens (Nov. 4, 1972) (on file with author). Panamanian limitadas also received favorable partnership classification rulings. *See* Priv. Ltr. Rul. T:I:I:2:2 (Feb. 15, 1973) (on file with author); Priv. Ltr. Rul. T:I:I:2:4, at 2-3 (Dec. 30, 1974) (on file with author); Priv. Ltr. Rul. T:I:I:2:2 (Apr. 5, 1974) (on file with author); Letter from Frank M. Burke to J.W. Bullion of Thompson, Knight, Simmons, & Bullion (Apr. 1, 1974) (on file with author) (describing a number of Panamanian limitada rulings in process).

¹⁵ *See* Letter from Frank M. Burke to Claude Dodgen, Texas Pacific Oil Company (Aug. 30, 1973) (on file with author) (Panamanian limitadas cannot receive more than \$500,000 of capital and quota holders must be individuals); Letter from Frank M. Burke to Thomas E. Jenks of Lee, Toomey & Kent (Feb. 16, 1974) (on file with author) (same); Internal Distribution Memorandum from N.B. Glenn of Peat, Marwick, Mitchell, & Co. (Mar. 16, 1977) (on file with author) [hereinafter Mar. 16, 1977 Memo] (Wyoming LLC eliminates substantial administrative burdens); Request for Ruling on the Partnership Status of Wyoming Limited Liability Company from Frank M. Burke to Commissioner of IRS (May 20, 1977) (on file with author) [hereinafter May 20, 1977 Ruling Request] (burdensome capital and quota holder restrictions of the Panamanian limitada overcome by the Wyoming LLC).

¹⁶ Due to the high risk and speculative nature of their investments, Hamilton Brothers Oil Company's clients needed a flow-through entity to provide one level of tax and limited liability. *See* Letter from A.J. Miller, Executive Vice President, Hamilton Brothers Oil Company, to Walter Urbigkit, Chief Justice, Wyoming Supreme Court (June 5, 1992) (on file with author) [hereinafter June 5, 1992 Letter]; Open Letter By Frank M. Burke (March 25, 1993) (on file with author).

¹⁷ *See* June 5, 1992 Letter, *supra* note 16, at 1 ("Frank Burke . . . drafted the terms of the original proposal."); *see also* Request for Information Letter from Frank M. Burke to Lawrence B. Gibbs, Assistant Comm'r, IRS, at 3-5 (May 1, 1975) (on file with author) [hereinafter May 1, 1975 Letter] (requesting partnership classification of Alaska LLC while legislation pending).

¹⁸ *See infra* notes 205-08 and accompanying text (discussion of early partnership associations and their inability to secure partnership classification before 1960); *see also* Hamill, *Possible Choice*, *supra* note 2, at 722 n.9 (discussing business problems with later partnership associations).

business organizations and would likely be scrutinized as very tax-sensitive.¹⁹ After much debate and effort and two attempts, once in April of 1975²⁰ and once in April of 1976,²¹ the Alaska bills died, apparently for political reasons unrelated to the proposals.²²

Shortly after the failed legislative effort in Alaska, Hamilton Brothers Oil Company's advisors took an identical LLC bill to Wyoming and apparently secured enactment on March 4, 1977 without any struggle.²³ This success in Wyoming experienced by the first group of LLC proponents can be explained by the group's

¹⁹ See Letter from Miles S. Schlosberg to Robert Bradley, Chair of the House Commerce Committee, Alaska Legislature (May 5, 1975) (on file with author) (identifies IRS tax classification as important consideration). The sponsors of the Alaska bill sought guidance from the IRS. See Letters from Bob Bradley & Jalmar Kerttula, Alaska Legislature, to Lawrence Gibbs, Assistant Comm'r (Technical), IRS (Apr. 30, 1975) (on file with author) (information letters seeking partnership classification for the pending Alaska LLC legislation); see also Letter from Billy M. Hargett, Chief, Individual Income Branch, IRS, to Frank M. Burke (May 12, 1975) (on file with author) (IRS will only consider ruling after proposed legislation becomes final).

²⁰ See H.B. 403 (introduced by Rep. Richard K. Urion on Apr. 9, 1975); S.B. 354, 9th Leg., 1st Sess. (Alaska 1975) (introduced by Sen. Mike Colletta on Apr. 8, 1975); see also Letters from Robert L. Hartig of Cole, Hertig, Rhodes, Norman, Mahoney & Goltz, to Jim Parker, Hamilton Brothers Oil Company (May 9, 1975 & Apr. 18, 1975) (on file with author); Letter from Robert L. Hartig to Richard W. Coates, Hamilton Brothers Oil Company (Mar. 18, 1975) (on file with author) (describing efforts to marshal support for the Alaska LLC legislation).

²¹ See Letter from Bernard Dougherty of Cole, Hortig, Norman, Mahoney & Goltz, to Richard Coates, Esq., Hamilton Brothers Oil Company (Apr. 29, 1976) (on file with author) (referring to hearings on the Alaska LLC proposed legislation held before the House Commerce Committee on Apr. 27, 1976); Letter from Bernard Dougherty to Frank M. Burke (Mar. 26, 1976) (on file with author) (proposed LLC legislation passed the Alaska Senate 14-4, but was delayed in the House Commerce Committee); S. 9, 2d Leg. Sess., Senate Journal, at 355 (1976) (on file with author) (discussion of proposed LLC legislation states that a favorable ruling from the IRS is important and refers to potential fees Alaska might derive, drawing an analogy to Delaware's experience with corporation filings).

²² See Letter from R.L. Butts to Thomas N. Long (May 5, 1994) (on file with author) (the proposal in Alaska was never considered by the legislature because it did not get out of the committee prior to the legislature's adjournment). Apparently the sponsors supporting the legislation expected it to go through. See Letter from Frank M. Burke to A.J. Miller, Hamilton Brothers Oil Company (Mar. 18, 1976) (on file with author) (circulating for comment a draft private ruling request for the first Alaska LLC ready to be formed once the law passes).

²³ See Wyoming Limited Liability Act, ch. 158, 1977 Wyo. Sess. Laws 537 (codified at WYO. STAT. ANN. §§ 17-15-100-17-15-144 (Michie 1997)); Letter from Hugh M. Duncan, Attorney, to Richard Coates, Esq., Hamilton Brothers Oil Company (Feb. 3, 1977) (on file with author); Memorandum from J.W. Bullion to Mr. Burnett (Feb. 7, 1977); Letter from R.L. Butts, Hamilton Brothers Oil Company, to J.W. Bullion of Thompson, Knight, Simmons & Bullion (Feb. 2, 1977) (on file with author) (circulating comments of draft Wyoming legislation); Memorandum from Frank M. Burke & Paul Pommier to N.B. Glenn, (Mar. 15, 1977) (on file with author) (describing the Wyoming legislation as identical to the Alaska version).

high degree of organization and focus toward the goal of creating and securing the first LLC statute for their client, the Hamilton Brothers Oil Company. Although acting as a lobby group, the lawyers and accountants advising Hamilton Brothers Oil Company were hardly large and powerful, they faced no organized opposition and they only had to convince the legislators of one state to accept the proposed LLC statute. The states approached—first Alaska and then Wyoming—represent relatively small states with informal and accessible channels to the legislature. The combination of the tenacity of this first group of LLC proponents, the absence of organized opposition, and the existence of informal and relatively accessible state legislatures explains the successful lobby effort for the first LLC statute.²⁴

However, the first group of LLC proponents would soon face a far more powerful and less friendly obstacle before the new statute could be used by any client. Armed with the enacted LLC legislation, the Hamilton Brothers Oil Company, on May 25, 1977, filed a request with the IRS, the federal agency vested with the authority to determine which unincorporated businesses avoid association status,²⁵ asking for a favorable partnership classification ruling.²⁶ The IRS, reluctant to allow a domestic entity²⁷ with corporate limited liability partnership classification, predictably stalled the ruling process. After a great deal of correspondence between Hamilton Brothers Oil Company's representatives and the IRS,²⁸ an additional request for a ruling filed by the Wyoming Secretary of State

²⁴ See generally FARBER & FRICKEY, *supra* note 11, at 23, 37, 72, 141–42, 146. Alaska and Wyoming are not the only states with more easily accessible legislatures. Perhaps the state political position favoring major versus smaller oil producers factored into the choice of forum to receive the first LLC statute. Under this theory, states like Alaska and Wyoming presumably generated more support for smaller producers, while other states like Oklahoma and Louisiana generated more support for major oil producers.

²⁵ See I.R.C. § 7805 (1997) (IRS general rulemaking authority); see also Hamill, *Partnership Classification*, *supra* note 5, at 569 n.15 (discussing the IRS's general authority over the partnership classification area).

²⁶ See May 20, 1977 Ruling Request, *supra* note 15; Memorandum from R.E. Holloway to Frank M. Burke (May 25, 1977) (on file with author) (confirming the filing of the ruling).

²⁷ See Hamill, *Corporate Integration*, *supra* note 3, at 402 n.42 (IRS had issued favorable partnership classification regulations to foreign limitadas offering limited liability since the 1970s); *supra* note 14 (Brazilian and Panamanian limitadas offering limited liability protection, used by Hamilton Brothers Oil Company, received favorable partnership classification rulings in the 1970s).

²⁸ See Letter from Frank M. Burke to Bob Butts, Hamilton Brothers Oil Company (Sept. 22, 1977) (on file with author) (draft favorable ruling by next week); Letter from Frank M. Burke to A.J. Miller (Nov. 21, 1977) (on file with author) (IRS getting close to handling the case); Letter from Frank M. Burke to A. J. Miller (July 6, 1978) (on file with author) (“Without some outside encouragement, our ruling could be hung-up in the Chief Counsel’s office for months.”); Letter from Frank M. Burke to A. J. Miller (Sept. 28, 1978) (on file with author) (“Obviously the normal channels do not provide us an adequate means of expediting the ruling.”); Letter from Frank M.

and supported by the Governor,²⁹ as well as another correspondence involving the Commissioner of the IRS and Wyoming Senators,³⁰ the IRS finally issued a favorable private letter ruling to Hamilton Brothers Oil Company regarding its Wyoming LLC on November 18, 1980,³¹ more than three years after the initial request.³²

Also in 1980, on the eve of the private letter ruling's release, the IRS issued proposed amendments to the partnership classification regulations that would automatically tax all limited liability companies as corporations, revealing the

Burke to A.J. Miller (Jan. 15, 1979) (on file with author) (ruling available soon, but no indication of result); Letter from Frank M. Burke to Jerome Kurtz, Commissioner of IRS (July 20, 1979) (on file with author) (no justification for two-year delay; asking for resolution as soon as possible); Memorandum from Philip Wiesner to Frank M. Burke (Sept. 10, 1979) (on file with author) (public revenue ruling will be issued with the private letter ruling; IRS's present position believed to be favorable); Memorandum from Philip Wiesner to Frank M. Burke (Nov. 2, 1979) (on file with author) (private ruling held up while public ruling being reviewed); Memorandum from Philip Wiesner to Frank M. Burke (Nov. 21, 1979) (on file with author) (proposed revenue ruling has been pulled from list to be published); Memorandum from Philip Wiesner to Frank M. Burke (Dec. 17, 1979) (on file with author) (proposed revenue ruling not receiving priority attention); Memorandum from Philip Wiesner to Frank M. Burke (May 2, 1980) (on file with author) (no change in status); Memorandum from Philip Wiesner to Frank M. Burke (June 6, 1980) (on file with author) (virtually all issues resolved but no indication of outcome); Memorandum from Philip Wiesner to Frank M. Burke (June 24, 1980) (on file with author) (published ruling forthcoming); Memorandum from Philip Wiesner to Frank M. Burke (July 9, 1980) (on file with author) (no final deadline for a decision). Letter from Hugh Duncan, Attorney, to Richard Coates, Esq., Hamilton Brothers Oil Company (Feb. 21, 1980) (on file with author) (reasons for delay include "the usual buck passing . . . three month period before a successor was named . . . difficulty of question").

²⁹ The Wyoming Secretary of State initially issued press releases praising the LLC, but cautioning that it cannot be widely used without favorable partnership classification from the IRS. *See* Letter from Hugh Duncan, Attorney, to Frank M. Burke (Feb. 17, 1978) (on file with author). Later the Wyoming Secretary of State requested a ruling on behalf of her state to clarify the tax status of Wyoming LLCs, which was later supported by the Governor of Wyoming, Ed Herschler. *See* Request for Ruling to IRS from Thyra Thomson, Wyoming Secretary of State, to John L. Withers, Assistant Comm'r, IRS (Oct. 2, 1978) (on file with author); Letter from Wyoming Governor Ed Herschler to Comm'r of IRS (Oct. 30, 1978) (on file with author). Secretary of State Thomson was told that the pending published revenue ruling would clarify the tax status of Wyoming LLCs. *See* Letter to The Honorable Mrs. Thyra Thomson from Mario Lombardo, Acting Director, Individual Tax Division, IRS (Nov. 14, 1978) (on file with author).

³⁰ Letters from Clifford P. Hansen, U.S. Sen., to Jerome Kurtz, Comm'r of IRS (Oct. 26, 1978) (on file with author); Letter from Malcolm Wallop, U.S. Sen., to Jerome Kurtz, Comm'r of IRS (Nov. 3, 1978) (on file with author) (urging a quick resolution of the ruling request sent by the Wyoming Secretary of State); Letter from John A. Withers, Ass't Comm'r (Technical) IRS, to Sen. Hansen (Nov. 14, 1978) (ruling will not be issued directly to the state; every effort being made to publish a general revenue ruling).

³¹ *See* Priv. Ltr. Rul. 8106082 (Nov. 18, 1980).

³² *See* May 20, 1977 Ruling Request, *supra* note 15.

conflicting views that undoubtedly existed among IRS officials.³³ Although clearly devastating to the Wyoming LLC,³⁴ the proposed regulations received the strongest criticism from representatives of equipment leasing trusts and U.S. persons participating in foreign enterprises, who had received favorable partnership classification despite having limited liability protection.³⁵ Despite the firestorm

³³ See 45 Fed. Reg. 75,709–75,710 (1980) (codified at 26 C.F.R. pt. 301); see also Hamill, *Partnership Classification*, *supra* note 5, at 576, 580 (discussion of the 1980 proposed regulations).

³⁴ See Peat, *Marwick Calls for Withdrawal of Proposed Regulations on Limited Liability Companies*, 13 TAX NOTES (1981) (Frank M. Burke, the principal author, urging the withdrawal of the regulations as an improper interpretation of judicial and administrative precedents); see also Letter from Frank M. Burke to Hugh Duncan, Attorney, at 1 (Dec. 2, 1980) (on file with author) (“[The regulation] would have a substantial adverse impact on the Wyoming Limited Liability Company Act.”).

³⁵ See I.R.S. News Release IR-82-145 (Dec. 16, 1982). The 1980 regulations spawned a firestorm of criticism. See *Leasing Industry Opposes Proposed Regulations on Grantor Trusts*, 12 TAX NOTES 168 (1981) (excerpt from comments by Bernard J. McKenna, American Association of Equipment Lessors; major departure from long-established tax rules); *Effect of Proposed Amendments on “Leasing Trusts” Deplored*, 12 TAX NOTES 288 (1981) (summary of comments from Harry E. White of Millbank, Tweed, Hadley & McCoy; greatly affect all existing leasing trusts); *id.* at 288 (summary of comments from Robert J. Casey, Attorney with Finley, Kumble, Wagner, Heine, Underberg & Casey; concerned about grantor trusts); *id.* at 288 (summary of comments from Jerry L. Oppenheimer & Robert H. Swart, attorneys for Continental Illinois Leasing Corp.; threatens grantor trusts for multi-party equipment leases); *Effect of Proposed Amendments on Leverage Lease Financing Questioned*, 12 TAX NOTES 415 (1981) (summary of comments by T.F. Quinn, V.P. American Airlines; airline industry affected); *Attorney Urges Proposed Regulations Not Be Applied to Existing Equipment Trusts*, 12 TAX NOTES 415 (1981) (summary of comments from Colin E. Harley of Davis Polk & Wardwell; proposed regulations will destroy leverage lease industry); *Effect of Proposed Regulations on Leasing Trusts is Criticized*, 12 TAX NOTES 645 (1981) (summary of comments from Richard A. Crowley of Sullivan & Cromwell; broadly apply to leasing trusts and violate established tax policies); *id.* at 645 (summary of comments from American Bar Association Tax Section; adverse impact on foreign business); *Taxing Leasing Partnerships as Corporations Seen to Have Serious Impact on Leasing Industry*, 14 TAX NOTES 658 (1982) (summary of comments from Leonard E. Kust & Daniel J. Mulcahy of Caldwell, Wickersham & Taft); *Equipment Lessors Seek Modification of Proposed Regulations on Limited Liability Companies*, 17 TAX NOTES 815 (1982) (summary of comments from Michael Fleming, Director, American Association of Equipment Lessors; will end the long-established treatment of equipment leasing trusts as partnerships); *Corporations Protest Proposed Reclassification of Limited Liability Organizations as “Corporations” for Tax Purposes*, 12 TAX NOTES 289 (1981) (summary of comments by David A. Brady, Dow Chemical Company; severe hardship to foreign entities); *id.* at 289 (summary of comments from Robert J. Chait, senior tax counsel for Litton Industries; seriously affect foreign organizations); *Attorneys Foresee Harmful Effect of Proposed Regulations on U.S. Investors Abroad*, 12 TAX NOTES 415, 415–16 (1981) (summary of comments from Robert A. Aland & Frederick E. Henry of Baker & McKenzie; severe impact on foreign business interests); *Attorneys Urge Service to Scrap Proposed*

surrounding these proposed regulations, which rendered the LLC useless on a practical level, Florida enacted an LLC statute in 1982, presumably to lure capital into the state.³⁶ Although the power to issue the 1980 regulations clearly fell within the IRS's authority,³⁷ the IRS withdrew its position in early 1983 and stated that it would study the effect limited liability should have on entity classification.³⁸ That study took over five years and predictably, while its tax status remained in limbo, further growth in LLC legislation and businesses using LLCs stopped; no other states enacted statutes and few businesses (less than one hundred) chose to become LLCs.³⁹ As long as its ability to be taxed as a partnership remained questionable, the LLC stood no chance of expanding throughout the country.

B. *The LLC's Struggle to Emerge Free of IRS Control*

On September 2, 1988, the IRS issued Revenue Ruling 88-76,⁴⁰ a public interpretation of the law all taxpayers can rely upon, permitting the Wyoming LLC

Regulations Making Some Partnerships Taxable as Corporations, 12 TAX NOTES 288 (1981) (summary of comments from Tax Section of the New York State Bar Association; adverse impact on foreign organizations and equipment leasing trusts); *Attorneys Claim Proposed Regulations on Limited Liability Companies Depart Improperly from Current Law*, 12 TAX NOTES 415 (1981) (summary of comments from James F. Gordy of Miller & Chevalier; regulations violate *Morrissey* and twenty-year regulatory precedent); *Accountants Urge Withdrawal of Amendments on Classification of Entities as Corporations*, 12 TAX NOTES 467 (1981) (summary of comments from Arthur Young & Co.; criticizing taxing limited liability companies as corporations); *Lawyers Continue to Urge Withdrawal of Proposed Regulations on Entity Classification*, 12 TAX NOTES 547 (1981) (summary of comments from David Sachs, Chairman of the Tax Section of the New York State Bar Association; adverse impact on foreign interests and leasing trusts); *Comments Continue on the Effect of Proposed Regulations on Leasing Trusts*, 12 TAX NOTES 960 (1981) (summary of comments from Richard E. Murphy, Jr., Federal Tax Section of the Illinois State Bar Association; regulations counter to the correct interpretation of the Internal Revenue Code); *Peat, Marwick Calls for Withdrawal*, *supra* note 34, at 718 (summary of comments from Frank M. Burke; notes that Treasury has received over 60 negative comments to proposed regulations).

³⁶ See Florida Limited Liability Company Act, 1982 Fla. Laws ch. 82-177 (enacted Apr. 21, 1982); see also Letter from Shepard King of Steel, Hector & Davis to John S. Sessions (May 15, 1981) (describing Florida's plans to introduce LLC legislation).

³⁷ See 26 U.S.C. § 7805 (1994 & Supp. II 1996) (IRS's general authority to issue interpretative regulations). The Code defines corporation to include "associations" and the Supreme Court in *Morrissey v. Commissioner*, 296 U.S. 344 (1935), interpreted the term "association" as based on resemblance to the corporation, while explicitly identifying limited liability as a corporate characteristic. See *id.* at 357-60. Therefore, the IRS clearly had (and still has) authority to tax business organizations with limited liability as corporations.

³⁸ See Announcement 83-4, 1983-2 I.R.B. 30.

³⁹ See Hamill, *Corporate Integration*, *supra* note 3, at 402 & n.46.

⁴⁰ 1988-2 C.B. 360.

to secure partnership classification despite the presence of limited liability. By concluding that the presence of corporate limited liability protection did not by itself mandate corporate taxation for unincorporated entities, the IRS released its total control over the LLC's future viability and allowed the states to realistically consider the LLC form. The revenue ruling clearly stated that the four corporate characteristics, continuity of life, centralized management, free transferability of interests, and limited liability, each had equal weight. The Wyoming LLC lacked continuity of life because the Wyoming statute triggered a potential dissolution of the LLC upon the death, retirement, resignation, insanity, bankruptcy, or expulsion of any member. In order to avoid an actual dissolution, all remaining members had to agree to continue the business. The Wyoming LLC lacked free transferability of interests because no member could transfer a complete interest, covering both voting and economic rights without the unanimous consent of all members in the LLC.⁴¹ Although a clear watershed in the LLC's development, the Wyoming Revenue Ruling's requirements, rendering interests in an LLC very difficult to transfer and the LLC itself highly dissolvable, limited the practical use of LLCs to small, closely held businesses and joint ventures.⁴²

After the IRS's landmark decision to recognize the LLC's right to be taxed under the partnership provisions, the states slowly and cautiously started to enact legislation allowing for the formation of LLCs. It took until 1990—the year Colorado and Kansas both passed LLC statutes—for any states to step forward and recognize the creation of LLCs in light of the IRS's revenue ruling.⁴³ In 1990, two subcommittees, sponsored by the American Bar Association (ABA)—one under the Section of Business Law and the other under the Section of Taxation—began to study the potential of the newly available LLC.⁴⁴ Despite the IRS's revenue ruling

⁴¹ See *id.* at 361. In addition to limited liability, the Wyoming LLC possessed centralized management because the operating agreement designated three of the twenty-five members as managers. The ruling failed to disclose the percentage of the LLC owned by the three managers or discuss the possible relevance this ownership percentage might have on the LLC's ability to lack centralized management. See also Hamill, *Possible Choice*, *supra* note 2, at 731–32 (member-managed LLCs should lack centralized management; manager-managed LLCs should be eligible to lack centralized management under the same standards applicable to limited partnerships if the managers own more than 20% of the LLC).

⁴² See Hamill, *Possible Choice*, *supra* note 2, at 747–48 & n.168; *infra* notes 45, 49.

⁴³ See Colorado Limited Liability Act, ch. 58, 1990 Colo. Sess. Laws 414 (enacted Apr. 18, 1990); Kansas Limited Liability Act, ch. 80, 1990 Kan. Sess. Laws 585 (enacted May 11, 1990). The lack of legal precedent and experience using LLCs probably contributed to the states' initial slow reaction. See Hamill, *Possible Choice*, *supra* note 2, at 744, 771.

⁴⁴ See General Letter from Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee (July 27, 1990) (on file with author) [hereinafter July 27, 1990 Letter]; General Letter from Robert R. Keatinge, Chair of LLC Subcommittee under the Section of Business Law's Committee on Partnerships and Unincorporated Business

conferring partnership taxation for Wyoming LLCs, both subcommittees quickly identified several major issues faced by LLCs when applying the detailed mechanical web of the partnership classification regulations.⁴⁵ Although these subcommittees spearheaded other important tasks, including the formation of a working group to draft a prototype LLC statute,⁴⁶ the solicitation of the Uniform Law Commissioners to open a study project for a Uniform LLC Act,⁴⁷ and the development of a clearinghouse of information to encourage and assist state LLC

Organizations (July 12, 1990) (on file with author) [hereinafter July 12, 1990 Letter].

⁴⁵ Of the seven issues on the list attached to the July 27, 1990 letter, four directly dealt with the partnership classification regulations: (1) Could an LLC lack continuity of life if the members contractually bound themselves to continue upon a dissolution event or if the LLC failed to state a term of years; (2) Could the LLC lack free transferability of interests if existing members were statutorily prohibited from unreasonably withholding consent; (3) Can a one-person LLC still receive flow through treatment; and (4) Could an LLC receive partnership classification if the statute was modeled after a close corporation statute. *See* July 27, 1990 Letter, *supra* note 44. One of the issues was labeled "Procedural Issues" and questioned whether the IRS would review or rule on draft LLC legislation to assist other states trying to enact statutes. *See id.* The July 12, 1990 letter identified the "progress of the revenue ruling request" as a topic for discussion. *See* July 12, 1990 Letter, *supra* note 44, at 2.

⁴⁶ *See* Memorandum from Robert R. Keatinge, Stuart Levine, & Matthew P. Feeney to Distribution List of 17 Attorneys (Dec. 12, 1990) (on file with author) (soliciting participation in the development of a Prototype Limited Liability Company Act in order to discuss business and tax issues and assist legislative drafters). The working group on the Prototype Limited Liability Company Act (Matthew P. Feeney, Stuart Levine, Larry E. Ribstein, Michael L. Gravelle, Donald J. Hess, Robert R. Keatinge, Marshall B. Paul, James W. Reynolds, Dale G. Schedler, and James J. Wheaton) met every Saturday morning by conference call, producing numerous drafts which culminated in a final draft on November 19, 1992. *See* LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES at app. B (1995).

⁴⁷ *See* Letter from Robert R. Keatinge, Chair of LLC Subcommittee under the Section of Business Law's Committee on Partnerships and Unincorporated Business Organizations, to Richard C. Hite, Chairman, Scope and Programs Committee, National Conference of Commissioners on Uniform State Laws, 6-7 (Dec. 14, 1990) (on file with author) (urging study to open a drafting project for a Uniform Limited Liability Company Act); Letter from Richard C. Hite to Robert R. Keatinge (Dec. 27, 1990) (on file with author) (suggestion on meeting agenda); Letter from Richard C. Hite to Robert R. Keatinge (Feb. 19, 1991) (on file with author) (study committee appointed); Letter from Robert R. Keatinge to Edward I. Cutler of the Uniform Law Commissioners 3 (Nov. 27, 1991) (on file with author) (urging a drafting project); Letter from Edward I. Cutler to Dwight A. Hamilton, President, National Conference of Commissioners on Uniform State Laws, and Richard C. Hite and Bion M. Gregory of the Uniform Law Commissioners 1 (Dec. 19, 1991) (on file with author) (study committee unanimously recommends opening a drafting project); Memorandum from Dwight A. Hamilton to Edward I. Cutler, Richard E. Ford, Harry J. Haynsworth IV, Charles G. Kepler, Wayne C. Kreuzscher, Reed L. Martineau, Richard F. Mutzebaugh, Glee E. Smith, and Howard J. Swibel 1 (May 6, 1992) (on file with author) (recipients of letter appointed to the drafting committee to produce a Uniform LLC Act; Edward I. Cutler named Chair).

drafting committees,⁴⁸ the partnership classification issues consistently remained at the center of their focus.⁴⁹

After much internal discussion,⁵⁰ members of both subcommittees submitted

⁴⁸ See General Letter from Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee, to LLC Subcommittee, at 2 (Sept. 13, 1990) (on file with author) [hereinafter Sept. 13, 1990 Letter] (acting as a clearinghouse for LLC information a task for subcommittee; all Bar Association presidents received a LLC survey in the spring of 1990); Letter from Barbara C. Spudis to LLC Subcommittee Members (Dec. 7, 1990) (on file with author) [hereinafter Dec. 7, 1990 Letter] (attached results of limited liability questionnaire show few states with statutes, only a few more with pending legislation, but most expressing interest in receiving more information); ABA Section of Taxation Subcommittee on Limited Liability Companies, Survey of Limited Liability Legislation (Nov. 12, 1991 update) (on file with author); ABA Section of Taxation Subcommittee on Limited Liability Companies, Survey of Limited Liability Legislation (July 9, 1992 update) (on file with author) [hereinafter July 9, 1992 Letter] (for each state identifying whether an LLC law exists or has been proposed and whether there is interest in LLC issues; includes name and address of contact person).

⁴⁹ See *supra* notes 45, 49; see also File Memorandum from John Maxfield (May 22, 1990) (on file with author) (telephone conversation between John Maxfield, Robert Keatinge, and Tom Hines, IRS attorney, concerning LLC partnership classification issues); Letter from Robert R. Keatinge, Chair of LLC Subcommittee under the Section of Business Law's Committee on Partnerships and Unincorporated Business Organizations, to Members of LLC Subcommittee, at 3 (Feb. 6, 1991) [hereinafter Feb. 6, 1991 Report] (attached minutes of Nov. 8, 1990 LLC Business Law Section Subcommittee meeting, "several members of the subcommittee suggested that until the transferability issue is resolved, limited liability companies will not be of much use"); Sept. 13, 1990 Letter, *supra* note 48 (coordination with the IRS on LLC taxation issues and development of a position paper to address these issues are major tasks of the subcommittee); Letter from Allan G. Donn of Willcox & Savage, to Members of the Joint Committee on Limited Liability Companies of the Virginia Bar Association (Nov. 15, 1990) (on file with author). The letter states:

Our committee will have to decide whether to recommend unanimous consent or majority consent. The advantage of the unanimous consent requirement is that we know that the Service will find that it is sufficient to cause the LLC to lack the corporate characteristic of free transferability of interests. The disadvantage 'of course' is the lack of flexibility that results. Do we want to be the pioneer in this field or do we want to take the approach that carries with it considerable assurance of a favorable revenue ruling?

Id. at 3; see *infra* notes 51, 52, 57, 61, 62, 64-71, 79-86 and accompanying text.

⁵⁰ See Sept. 13, 1990 Letter, *supra* note 48, at 1 (soliciting comments for November meeting with IRS); Letter from Stuart Levine, Member of Section of Taxation's LLC Subcommittee, to Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee, at 1 (Aug. 1, 1990) (on file with author) (the issue list for the IRS November meeting should urge that LLCs can still lack free transferability if more than two-thirds, rather than all the members, consent to the transfer); Memorandum from Theodore Z. Gelt of Gelt, Fleishman & Sterling, to LLC Subcommittee Members under the Section of Taxation's Partnership Committee, at 1 (Oct. 3, 1990) (on file with author) (the committee should reevaluate the issue list in order to

to the IRS a list of tax issues posed uniquely by LLCs⁵¹ and on November 8, 1990, met informally with IRS attorneys.⁵² This meeting, the first contact between members of the private bar and the IRS to discuss LLCs in almost ten years,⁵³ was destined to be one of many encounters over the next several years as LLCs grew from obscurity to prominence.⁵⁴ At this first meeting, the partnership classification issues dominated the discussion. Despite the existence of the Wyoming Revenue Ruling,⁵⁵ the IRS, through its ability to interpret how the partnership classification regulations applied to LLCs, still possessed a great deal of power over the future viability of LLCs. The subcommittee members asked if LLCs could lack free transferability of interests with a lesser threshold of consent (majority instead of unanimity) and received encouraging comments, but no promises from the IRS attorneys.⁵⁶ Business lawyers knew that LLCs could not be utilized on any large scale if the IRS insisted on requiring unanimous consent to transfer a complete interest.⁵⁷

In 1991, new LLC legislation only increased modestly when compared to 1990 activity.⁵⁸ Although only four more states enacted LLC statutes,⁵⁹ approximately

avoid prompting the IRS to reevaluate its position on LLCs).

⁵¹ Letter from Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee, to Richard Manfreda, Deputy Assistant Chief Counsel, Passthroughs & Special Industries Branch, IRS (Oct. 22, 1990) (on file with author) (listing nine issues for November meeting—five of which addressed partnership classification).

⁵² See Dec. 7, 1990 Letter, *supra* note 48 (describing issues discussed and the responses received from the IRS attorneys). The persons attending from the ABA were Barbara C. Spudis, Richard Levine, Stuart Levine, Bob Keatinge, and Alan Donn. The persons attending from the IRS were Paul F. Kugler (Assistant Chief Counsel, Passthroughs & Special Industries), Richard Manfreda (Deputy Assistant Chief Counsel, Passthroughs & Special Industries), Arthur B. Ernst (Chief Counsel, Passthroughs & Special Industries), J. Thomas Hines (Attorney, Branch 2), and Susan Hamill (Attorney, Branch 1).

⁵³ See *supra* notes 25–32 and accompanying text.

⁵⁴ See *infra* notes 72–78 and accompanying text.

⁵⁵ See Rev. Rul. 88-76, 1988-2 C.B. 360.

⁵⁶ See Dec. 7, 1990 Letter, *supra* note 48, at 6.

⁵⁷ See Feb. 6, 1991 Report, *supra* note 49, at 1, 3.

⁵⁸ In addition to important unresolved partnership classification issues, the question whether the LLC's limited liability protection would be recognized beyond the borders of the state authorizing formation probably hindered state enactments in the three years immediately following the IRS's Revenue Ruling 88-76. See Hamill, *Possible Choice*, *supra* note 2, at 744; Robert R. Keatinge, et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 447–56 (1992).

⁵⁹ See The Texas Limited Liability Company Act, ch. 901, § 46, 1991 Tex. Gen. Laws 3161, 3192 (enacted June 16, 1991); The Utah Limited Liability Company Act, ch. 258, 1991 Utah Laws 991 (enacted Mar. 18, 1991); The Virginia Limited Liability Company Act, 1991 Va. Acts ch. 168 (enacted Mar. 12, 1991); Act of June 25, 1991, ch. 442, 1991 Nev. Stat. 1184, 1292 (enacted June

1,700 new LLC filings displayed a clear, unmistakable trend upwards.⁶⁰ In order to increase the number and kinds of businesses that could use LLCs, the two ABA subcommittees continued their work, which focused largely on convincing the IRS to resolve unanswered partnership classification questions favorably toward LLCs.⁶¹ After several drafts among subcommittee members,⁶² on March 12, 1992, the ABA's Section of Taxation officially submitted comments to the IRS entitled, *Comments on Limited Liability Companies: Tax Classification and Application of Partnership Tax Rules*.⁶³

Six of the seven major points in the March 12, 1992 comments urged the IRS to apply the partnership classification rules less restrictively than applied under the Wyoming Revenue Ruling of 1988.⁶⁴ The comments opined that LLCs should still lack continuity of life even if a dissolution event with respect to only some of the

25, 1991).

⁶⁰ See Hamill, *Corporate Integration*, *supra* note 3, at 440.

⁶¹ See Memorandum from Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee to Subcommittee Members (May 13, 1991) (on file with author) (announcing preparation of first draft of LLC comments for the IRS; soliciting internal comments); Memorandum from Barbara C. Spudis to Subcommittee Members (July 16, 1991) (on file with author) (circulating the draft for comment); Letter from Robert R. Keatinge, Chair of LLC Subcommittee under the Section of Business Law's Committee on Partnerships and Unincorporated Business Organization, to Subcommittee Members (Oct. 3, 1991) (on file with author); Transcript of Meeting of the Subcommittee on Limited Liability Companies 7-14 (Nov. 7, 1991) (on file with author) (discussion of the partnership classification regulations, mainly how far the business provisions addressing dissolution and transferability could stray from the Wyoming Revenue Ruling without jeopardizing partnership classification, dominated the meeting).

⁶² See Letter from Robert R. Keatinge, Chair of LLC Subcommittee under the Section of Business Law's Committee on Partnerships and Unincorporated Business Organizations, to Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee (July 23, 1991) (on file with author) (IRS undecided on issue of majority rather than unanimous consent for transfers); Letter from Stuart Levine, Member of Section of Taxation's LLC Subcommittee, to Barbara C. Spudis (Nov. 25, 1991) (on file with author) (manager-managed LLCs should only possess centralized management when their power and authority matches that of corporate directors; the effect of withdrawals and bankruptcy of a member on the LLC lacking continuity of life should be brought up at a later time); Letter from Dale G. Schedler of Lewis, Rice, & Fingersh, to Barbara C. Spudis (Nov. 25, 1991) (on file with author) (pre-agreements allowing members to transfer to identifiable transferee should not prevent the LLC from lacking free transferability of interests).

⁶³ See Letter from Peter L. Faber, Chair, ABA's Section of Taxation, to Shirley D. Peterson, Comm'r of the IRS (Mar. 12, 1992) (on file with author); Report from ABA Section of Taxation Committee on Partnerships to IRS (Feb. 27, 1992) (on file with author) [hereinafter 1992 Comments].

⁶⁴ See 1992 Comments, *supra* note 63, at 2; Rev. Rul. 88-76, 1988-2 C.B. 360.

members, the manager for example, trigger a dissolution.⁶⁵ Moreover, a majority, rather than all the members, should be able to agree to continue the business without jeopardizing continuity of life.⁶⁶ LLCs should still lack free transferability of interests even if the manager or a majority of the members, rather than all the members, can consent to a complete transfer.⁶⁷ These standards sought for LLCs were based on the IRS's current treatment of limited partnerships⁶⁸ and were necessary to use LLCs for larger, complex, and often investment-oriented transactions that needed to minimize the dissolution potential and maximize the ability to freely transfer interests.⁶⁹ Finally, the comments asked the IRS to issue a revenue procedure setting out general guidelines for LLCs seeking favorable partnership classification private letter rulings,⁷⁰ publish for each state a partnership classification revenue ruling similar to Wyoming's, and provide state drafting committees informal non-binding guidance on partnership classification points.⁷¹

From 1992 through 1996, LLC legislation swept across the country. In 1992 ten additional states, including Delaware, passed legislation recognizing LLCs, bringing

⁶⁵ See 1992 Comments, *supra* note 63, at 3.

⁶⁶ See *id.* at 3–4.

⁶⁷ See *id.* at 4–5. The comments also asked for further guidance concerning the LLC's ability to lack centralized management. The comments implied that LLCs with managers owning a significant interest in the LLC—20% being the threshold for general partner ownership in a limited partnership—should be able to lack centralized management. See *id.* at 5.

⁶⁸ IRS practice at that time allowed limited partnerships to lack continuity of life even when the dissolution events only applied to the general partner; moreover, a majority in interest of the limited partners could continue the business if such dissolution event occurred. Limited partnerships also lacked free transferability of interests even though the general partner, or alternatively a majority of the limited partners, provided consent for transfers. See Hamill, *Partnership Classification*, *supra* note 5, at 581–87.

⁶⁹ See Feb. 6, 1991 Report, *supra* note 49, at 3 (“[U]ntil the transferability issue is resolved, limited liability companies will not be of much use.”); Letter from Barbara C. Spudis, Chair of the LLC Subcommittee under the Section of Taxation's Partnership Committee, to Brian L. Schorr (Jan. 14, 1992) (on file with author) (“If the IRS rules that an LLC lacks continuity of life when events of dissolution are tied to only one member, this will greatly increase our practical ability to use LLCs.”); see also Hamill, *Partnership Classification*, *supra* note 5, at 591–98 (after the IRS issued Revenue Procedure 95-10, essentially applying the partnership classification rules to LLCs in the same manner as limited partnerships, LLCs can effectively be used for transactions currently done as limited partnerships).

⁷⁰ The Section of Taxation's LLC Subcommittee based this request on Revenue Procedure 89-12, which sets out guidelines for limited partnerships to safely obtain a partnership classification ruling. See Rev. Proc. 89-12, 1989-1 C.B. 789, 799. See also Hamill, *Partnership Classification*, *supra* note 5, at 569, 585, 586, 588 (describing the details of Revenue Procedure 89-12 and generally noting that the partnership classification regulations failed to make any significant distinctions between limited partnerships and corporations).

⁷¹ See 1992 Comments, *supra* note 63, at 7–8.

the total to eighteen.⁷² In 1993, the year showing the greatest number of state enactments, eighteen additional states passed LLC legislation, bringing the total to thirty-six.⁷³ By the end of 1994, twelve additional states,⁷⁴ including New York and

⁷² See Limited Liability Company Act, ch. 113, 1992 Ariz. Sess. Laws 394 (enacted June 2, 1992) (codified at ARIZ. REV. STAT. §§ 29-601 to 29-854); Limited Liability Company Act, ch. 434, 68 Del. Laws 1329 (enacted July 22, 1992) (codified at DEL. CODE ANN. tit. 6, §§ 18-101 to 18-1109 (1993 & Supp. 1998)); Limited Liability Company Act, Pub. Act. 87-1062, 1992 Ill. Laws 2529 (enacted Sept. 11, 1992) (codified at 805 ILL. COMP. STAT. ANN. 180/1-1 to 180/60-1 (West Supp. 1998)); Limited Liability Companies, ch. 1151, 1992 Iowa Act 238 (enacted April 27, 1992) (codified at IOWA CODE ANN. §§ 490A.100-490A.1601 (West Supp. 1998)); Limited Liability Company Act No. 780, 1992 La. Acts. 2083 (enacted July 7, 1992) (codified at LA. REV. STAT. ANN. §§ 1301-1369 (West 1994 & Supp. 1999)); Maryland Limited Liability Company Act, ch. 536, 1992 Md. Laws 3286 (enacted May 26, 1992) (codified at MD. CODE ANN., CORPS. & ASS'NS §§ 4A-101 to 4A-1103 (1993 & Supp. 1998)); Act of Apr. 29, 1992, ch. 517, 1992 Minn. Laws 1168 (enacted Apr. 29, 1992) (codified at MINN. STAT. ANN. §§ 322B.01-322B.960 (West 1995 & Supp. 1999)); Oklahoma Limited Liability Company, ch. 148, 1992 Okla. Sess. Laws 483 (enacted May 1, 1992) (codified at OKLA. STAT. ANN. tit. 18, §§ 2000-2060 (West 1999)); Rhode Island Limited Liability Company Act, ch. 280, 1992 R.I. Pub. Laws 1108 (enacted July 21, 1992) (codified at R.I. GEN. LAWS §§ 7-16-1 to 7-16-75 (1992 & Supp. 1998)); West Virginia Limited Liability Company Act, ch. 41, 1992 W. Va. Acts 305 (enacted March 6, 1992) (codified at W. VA. CODE §§ 31B-1-101 to 31B-13-1304 (1996 & Supp. 1998)).

⁷³ See Alabama Limited-Liability Company Act, Act No. 93-724, 1993 Ala. Acts 1425 (enacted May 20, 1993) (codified at ALA. CODE §§ 10-12-1 to 10-12-61 (1995)); Small Business Entity Tax Pass Through Act, Act 1003, 1993 Ark. Acts 2928 (enacted Apr. 12, 1992) (codified at ARK. CODE ANN. §§ 4-3-101 to 4-32-1401 (Michie Supp. 1997)); Connecticut Limited Liability Company Act, Pub. Act No. 93-267, 1993 Conn. Acts 884 (enacted June 23, 1993) (codified at CONN. GEN. STAT. §§ 34-100 to 34-242 (West 1997)); Act of Apr. 5, 1993, No. 174, 1993 Ga. Laws 123 (enacted Apr. 5, 1993) (codified at GA. CODE ANN. §§ 14-11-100 to 14-11-1109 (1994 & Supp. 1998)); Act of Mar. 26, 1993, ch. 224, 1993 Idaho Sess. Laws 760 (enacted Mar. 26, 1993) (codified at IDAHO CODE §§ 53-601 to 53-672 (West 1994 & Supp. 1998)); Act of May 13, 1993, P.L.8-1993, § 301, 1993 Ind. Acts 1694, 1970 (enacted May 13, 1993) (codified at IND. CODE ANN. §§ 23-18-1-1 to 23-18-13-1 (West 1994 & Supp. 1998)); Michigan Limited Liability Company Act, No. 23, 1993 Mich. Pub. Acts 138 (enacted Apr. 14, 1993) (codified at MICH. COMP. LAWS ANN. §§ 450.4101-450.5200 (West Supp. 1998)); Act of July 2, 1993 §§ 359.700-359.832, 1993 Mo. Laws 965, 975-1003 (enacted July 2, 1993) (codified at MO. ANN. STAT. §§ 347.010-347.187 (West Supp. 1999)); Montana Limited Liability Company Act, ch. 120, 1993 Mont. Laws 269 (enacted Mar. 18, 1993) (codified at MONT. CODE ANN. §§ 35-8-101 to 35-8-1307 (1997)); Act of June 2, 1993, LB 121, §§ 1-45, 1993 Neb. Laws 333, 335-50 (enacted June 2, 1993) (codified at NEB. REV. STAT. §§ 21-2601 to 21-2653 (1997)); New Jersey Limited Liability Company Act, ch. 210, 1993 N.J. Laws 1215 (enacted July 30, 1993) (codified at N.J. STAT. ANN. §§ 42:2B-1 to 42:2B-70 (West Supp. 1998)); Act of Apr. 7, 1993, ch. 280, §§ 1-74, 1993 N.M. Laws 2752, 2753-828 (enacted Apr. 7, 1993) (codified at N.M. STAT. ANN. §§ 53-19-1 to 53-19-74 (Michie Supp. 1998)); Act of June 23, 1993, ch. 313, 1993 N.H. Laws 323 (enacted June 23, 1993) (codified at N.H. REV. STAT. ANN. §§ 304-C:1 to 304-C:85 (1995 & Supp. 1998)); Act of July 15, 1993, ch. 354, § 1, 1993 N.C. Sess. Laws 1080, 1080-1135 (enacted July 15, 1993) (codified at N.C. GEN. STAT. §§ 57C-1-01 to 57C-10-07 (1997)); Limited Liability

California, authorized the formation of LLCs under their laws. Only three remaining states were without LLC legislation, and by the close of 1996, they had passed statutes establishing the LLC in all U.S. jurisdictions.⁷⁵ The rise in the number of business organizations filing to operate as LLCs mirrored the meteoric pace of the state statutes. In 1992, approximately seven thousand new LLC filings took place, roughly four times the number of 1991 filings.⁷⁶ From 1993 through 1995, new LLC filings continued to grow explosively, numbering approximately 23,000 in 1993, 64,000 in 1994, and 115,000 in 1995.⁷⁷ In sum, as of December 31, 1995 over 210,000 business ventures had chosen the LLC form since the IRS recognized the

Companies, ch. 92, 1993 N.D. Laws 390 (enacted Apr. 12, 1993) (codified at N.D. CENT. CODE §§ 10-32-01 to 10-32-156 (1995 & Supp. 1997)); Oregon Limited Liability Company Act, ch. 173, 1993 Or. Laws 435 (enacted June 24, 1993) (codified at OR. REV. STAT. ANN. §§ 63.001-63.990 (Supp. 1998)); An Act to Provide for Limited Liability Companies, ch. 344, 1993 S.D. Laws (enacted Mar. 13, 1993) (codified at S.D. CODIFIED LAWS §§ 47-34A-101 to 47-34A-1207 (Michie Supp. 1998)); Act of Dec. 13, 1993, No. 112, 1993 Wis. Laws 708 (enacted Dec. 13, 1993) (codified at WIS. STAT. ANN. §§ 183.0102-183.1305 (West Supp. 1998)).

⁷⁴ See Limited Liability Company Act, 1994 Alaska Sess. Laws 1 (enacted June 8, 1994) (codified at ALASKA STAT. §§ 10.50.010 to 10.50.995 (1998)); California Limited Liability Company Act, 1994 Cal. Legis. Service 6009, 6025, ch. 1200, § 27, (West) (enacted Sept. 30, 1994) (codified at CAL. CORP. CODE §§ 17000-17705 (West Supp. 1999)); D.C. Stat. 310-50 (enacted May 18, 1994); 1994 Ky. Acts 1087 (enacted Apr. 11, 1994) (codified at KY. REV. STAT. ANN. §§ 275.001-275.455 (Michie Supp. 1996)); Maine Limited Liability Company Act, 1993 Me. Laws 2168 (1994) (enacted Apr. 20, 1994) (codified at ME. REV. STAT. ANN. tit. 31, §§ 601-762 (West 1996 & Supp. 1998)); Mississippi Limited Liability Company Act 1994 Miss. Laws 215 (enacted Mar. 15, 1994) (codified at MISS. CODE ANN. §§ 79-29-101 to 79-29-1204 (1996 & Supp. 1998)); New York Limited Liability Company Law, 1994 N.Y. Laws 3240 (enacted July 26, 1994) (codified at N.Y. LTD. LIAB. CO. LAW §§ 101-1403 (McKinney Supp. 1999)); 1993-94 Ohio Laws 634 (enacted Apr. 15, 1994) (codified at OHIO REV. CODE ANN. §§ 1705.01-1705.58 (Banks-Baldwin 1993 & Supp. 1998)); Limited Liability Act, 1994 Pa. Laws 703 (enacted Dec. 7, 1994) (codified at 15 PA. CONS. STAT. ANN. §§ 8901-8998 (West 1995 & Supp. 1998)); South Carolina Limited Liability Company Act, 1994 S.C. Acts (enacted June 16, 1994) (codified at S.C. CODE ANN. §§ 33-43-101 to 33-43-1409 (Law Co-op. Supp. 1998)); Tennessee Limited Liability Act, 1994 Tenn. Pub. Acts 654 (enacted Apr. 22, 1994) (codified at TENN. CODE ANN. §§ 48-201-101 to 48-248-606 (1995 & Supp. 1998)); 1994 Wash. Laws 1018 (enacted Apr. 1, 1994) (codified at WASH. REV. CODE ANN. §§ 25.15.005-25.15.902 (West Supp. 1999)).

⁷⁵ See 1996 Haw. Sess. Laws 181 (enacted June 7, 1996) (codified at HAW. REV. STAT. §§ 428-101 to 428-1302 (Supp. 1997)); An Act Relative to Business Organizations in the Commonwealth, 1995 Mass. Acts 1000 (enacted Nov. 28, 1995) (codified at MASS. ANN. GEN. LAWS ch. 156C, §§ 1-68 (Law. Co-op. & Supp. 1998)); An Act Relating to Nonprofit Corporations: Limited Liability Companies: and Fraudulent Transfers, 1996 Vt. Acts and Resolves 567, 645-94 (enacted May 22, 1996) (codified at VT. STAT. ANN. tit. 11, §§ 3001-3162 (1997 & Supp. 1998)).

⁷⁶ See Hamill, *Corporate Integration*, *supra* note 3, at 441.

⁷⁷ See *id.* at 442-45.

LLC's ability to be classified as a partnership in 1988.⁷⁸ In an incredible stampede that took less than twenty years, most of it occurring from 1990 through 1996, LLCs traveled from an obscure unknown business form in 1977 to a well-recognized alternative for doing business.

The activity level of the ABA LLC subcommittees grew and intensified in 1992 and 1993. On May 14, 1992, ABA representatives from the LLC Subcommittee conducted a second informal meeting with IRS attorneys, this time to discuss the comments submitted on March 12, 1992. Although the IRS attorneys were receptive to preparing a general revenue procedure to guide LLCs through the private letter ruling process, they gave no clear answers to the substantive partnership classification questions.⁷⁹ The sentiment on the LLC's ability to lack continuity of life and free transferability of interests under the relaxed standards applicable to limited partnerships received a lukewarm, but not a hostile response.⁸⁰ The IRS attorneys were not receptive to LLCs lacking limited liability, even if a member assumed all liabilities.⁸¹ Nor were they prepared to recognize an LLC as lacking centralized management under any circumstances if managers had been appointed.⁸²

After much discussion,⁸³ on September 14, 1993, the Section of Taxation of the American Bar Association again submitted comments to the IRS in the form of a draft revenue procedure for LLCs seeking partnership classification private letter rulings.⁸⁴ Prepared by the Limited Liability Task Force, these suggested guidelines

⁷⁸ See *id.* at 446.

⁷⁹ See Memorandum from Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee, to Sanford C. Present, Stefan F. Tucker, Phillip L. Mann, and Richard M. Lipton 2-3 (June 30, 1992) (on file with author) (IRS attorneys receptive to one, rather than all the dissolution events, applying to the members and also a majority threshold of consent to continue the business; IRS response to free transferability questions vague and response to centralized management and limited liability questions negative).

⁸⁰ See *id.* at 2-3.

⁸¹ See *id.* at 3.

⁸² See *id.*

⁸³ See Memorandum from Stuart Levine, Member of Section of Taxation's LLC Subcommittee, to Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee (May 4, 1993) (on file with author); Memorandum from Rich Blau of Snell & Wilmer, to Distribution (Jan. 28, 1993) (on file with author); Letter from Richard E. Levine to Barbara C. Spudis (Apr. 19, 1993) (on file with author) (comments and suggestions for the draft revenue procedure).

⁸⁴ See Section of Taxation, American Bar Association, Draft Revenue Procedure: Ruling Guidelines For Determining Whether a Limited Liability Company is a Partnership or an Association Taxable as a Corporation (Sept. 14, 1993) (on file with author) [hereinafter 1993 Comments].

treated LLC managers as general partners for purposes of lacking continuity of life, free transferability of interests, and centralized management.⁸⁵ These comments proposed that LLCs with at least one member assuming all personal liability should lack limited liability.⁸⁶

From 1992 through 1994, IRS participation on LLC projects grew in frequency and viability. IRS attorneys appeared in numerous public discussions and subcommittee meetings concerning LLCs. The questions posed to IRS attorneys tended to revolve around how the partnership classification rules applied to LLCs. The practicing Bar consistently asked whether LLCs could satisfy the partnership classification rules under standards urged by the ABA's comments submitted in 1992 and 1993. Without promising that LLC managers would be categorically treated as general partners, IRS attorneys were more receptive to looser standards for continuity of life and free transferability of interests, but would not contemplate LLCs ever lacking limited liability or centralized management if managers were appointed.⁸⁷ IRS attorneys also assured the Bar that state-by-state LLC revenue rulings⁸⁸ and a general revenue procedure for LLCs would be forthcoming,⁸⁹ and

⁸⁵ See *id.* at 4–8. The Draft Revenue Procedure allowed the LLC to lack continuity of life if one event of dissolution with respect to one identified member (who did not have to be the manager) triggered an actual dissolution, unless a majority in interest (defined as capital and profits ownership) of the remaining members agreed to continue. See *id.* at 6 (text of Draft Revenue Procedure). LLCs could lack centralized management if the managers owned at least 20% of the LLC or the members still had agency powers despite the presence of managers (an internal management committee). See *id.* at 6 (text of Draft Revenue Procedure). The LLC could still lack free transferability of interests if the members had to obtain consent from a majority of the managers before transferring a complete interest. See *id.* at 7 (text of Draft Revenue Procedure).

⁸⁶ See 1993 Comments, *supra* note 84. The assuming member had to meet certain net worth requirements imposed on general partners in limited partnerships seeking to lack limited liability. See *id.* at 3, 6–7 (text of Draft Revenue Procedure).

⁸⁷ See *LLC Boosters Blitz Passthroughs Sessions*, 55 TAX NOTES 1019 (1992); Catherine Hubbard & Lee A. Sheppard, *Guidance Forthcoming on LLC Classification, Practitioners Told*, 58 TAX NOTES 824, 826; Susan Pace Hamill, *Clarification of Remarks*, 58 TAX NOTES (1993) 1385 [hereinafter Hamill, *Clarification of Remarks*]; *Use of Limited Liability Companies Seen Not Jeopardizing Corporate Tax Base*, [Special Reports] Daily Tax Rep. (BNA) No. 59, at J-4 (Mar. 30, 1993) [hereinafter March 30, 1993 Report]; see also Letter from Barbara C. Spudis, Chair of LLC Subcommittee under the Section of Taxation's Partnership Committee, to Task Force on LLC Members (July 9, 1992) (noting IRS participation on plenary session panel on LLCs for the Tax Section of the American Bar Association's 1992 annual meeting in San Francisco); Memorandum from Robert R. Keatinge, Chair of LLC Subcommittee under the Section of Business Law's Committee on Partnerships and Unincorporated Business Organizations, to Subcommittee Members, at 2 (July 2, 1992) (noting IRS participation at April 1992 Business Law Subcommittee meeting in Orlando, Florida).

⁸⁸ See Hubbard & Sheppard, *supra* note 87, at 824; March 30, 1993 Report, *supra* note 87, at J-4; *IRS May Issue More State-By-State Rulings on Limited Liability Companies, Official Says*, [Taxation, Budget and Accounting] Daily Tax Rep. (BNA) No. 88, at G-4 (May 10, 1993)

they regularly gave informal assistance to state drafting committees.⁹⁰ On December 29, 1994 the IRS fulfilled its promise by issuing Revenue Procedure 95-10, which provided the long awaited general guidelines for LLCs seeking a favorable partnership classification ruling. For purposes of applying all four partnership classification characteristics, including centralized management and limited liability, this revenue procedure essentially allowed LLCs to enjoy the same flexible standards applicable to limited partnerships.⁹¹

In 1992, to further its goal of obtaining a favorable partnership classification ruling for the Uniform LLC Act,⁹² the National Conference of Commissioners on Uniform State Laws invited IRS representatives to attend the drafting meetings. The representatives were to informally guide partnership classification sensitive areas—mainly the dissolution, transferability, and management provisions.⁹³ Throughout

[hereinafter May 10, 1993 Report]. By early 1993, the IRS issued state-by-state revenue rulings on a regular basis; by the time the IRS proposed to eliminate the partnership classification regulations, seventeen states had already received LLC rulings.

⁸⁹ See Hubbard & Sheppard, *supra* note 87, at 824; March 30, 1993 Report, *supra* note 87, at J-4; *Treasury Official Outlines Possible Changes to Allocation, UBIT Proposals*, [Taxation, Budget, and Accounting] Daily Tax Rep. (BNA) No. 142 at G-5 (July 27, 1993); *IRS Likely to Issue Limited Liability Guidelines Early This Year, Official Says*, Daily Tax Rep. (BNA) No. 7, at G-3 (Jan. 11, 1994).

⁹⁰ See Hubbard & Sheppard, *supra* note 87, at 824 (“The IRS is encouraging everyone working on LLC statutes to call in and get advice . . . ‘It’s’ better to draft a statute properly and get the tax aspects correct than have to go back and amend or deal with a possible unfavorable ruling.”); Hamill, *Clarification of Remarks*, *supra* note 87; Letter from H. Bryan Ives III to Susan Pace Hamill, IRS Attorney, at 6 (Sept. 23, 1992) (on file with author) (“We would appreciate it if you could take a look at our legislation in this regard [numerous partnership classification questions] and give us your informal, off-the-record comments.”); Letter from Stuart Levine, Member of Section of Taxation’s LLC Subcommittee, to J. Thomas Hines, Attorney, IRS, at 1 (Oct. 24, 1990) (enclosing the Maryland LLC bill for informal comments on partnership classification points).

⁹¹ See Rev. Proc. 95-10, 1995-1 C.B. 501. See generally Hamill, *Partnership Classification*, *supra* note 5, at 589-98 (detailed discussion, noting minor discrepancies between the LLC and limited partnership standards).

⁹² See Memorandum from Edith O. Davies, Executive Secretary, National Conference of Commissioners on Uniform State Laws, to ABA Sections and Committee Chairmen, at 4 (Dec. 30, 1992) (on file with author) (“[U]pon completion, the [Uniform Limited Liability Company] Act will be submitted to the Internal Revenue Service for a favorable ruling.”).

⁹³ See Letter from Edith O. Davies, Executive Secretary, National Conference of Commissioners on Uniform State Laws, to Susan P. Hamill, IRS, at 1 (Sept. 4, 1992) (on file with author) (welcoming IRS participation in the drafting process); Letter from Edward I. Cutler, Chair, NCCUSL, Drafting Committee on Limited Liability Company Act to Dianna Miosi, IRS (Aug. 31, 1993) (on file with author) (expressing appreciation for assistance during the drafting process); Letter from Richard C. Hite, Chair, Executive Committee, National Conference of Commissioners on Uniform State Laws, to Edith O. Davies, Executive Secretary, National Conference of

the entire process, compliance with the partnership classification regulations remained a top priority⁹⁴ and the relationship between the Uniform Law Commissioners and the IRS remained cooperative and professional.⁹⁵ On July 26, 1993, in time for the first reading, which was held in August of 1993, the IRS provided the drafting committee with an informal nonbinding⁹⁶ opinion letter

Commissioners on Uniform State Laws (Dec. 10, 1992) (on file with author); *see also* Memorandum from Steven G. Frost, Section of Taxation Adviser, NCCUSL Drafting Committee on Limited Liability Company Act, to Members of ABA Section Task Force on Limited Liability Companies (Jan. 26, 1993) [hereinafter Jan. 26, 1993 Memo] (on file with author). The Memorandum states:

Susan Hamill of the Service attended and participated at the last drafting committee meeting. She indicated that persons at the Service are very interested in the evolution of the LLC act and will participate with the drafting committee in reaching positions as the act is drafted. As a result, we have an unusual opportunity to shape provisions of the act as they are drafted and receive approval from the Service before the act is adopted and passed by any states.

Id.

⁹⁴ *See* Jan. 26, 1993 Memo, *supra* note 93 (setting out specific classification questions and the general issue of whether the statute should require LLC business participants to meet the IRS's guidelines); Letter from Robert R. Keatinge, ABA Advisor, NCCUSL Drafting Committee on Limited Liability Company Act, to Richard M. Phillips, Chair, ABA Section of Business Law, at 2-3 (Dec. 21, 1993) (on file with author) (articulating the current policy issues, several of which are partnership classification bases); Memorandum from Steven G. Frost, Section of Taxation Adviser, NCCUSL Drafting Committee on Limited Liability Company Act, to Robert R. Keatinge, ABA Advisor, NCCUSL Drafting Committee on Limited Liability Company Act (Nov. 3, 1993) (on file with author) [hereinafter Nov. 3, 1993 Memo] (general list of important tax issues to raise with the IRS; indicating that the partnership classification issues are the most important); Memorandum from Steven G. Frost to Carter Bishop, Professor, William Mitchell College of Law (July 14, 1994) (on file with author) [hereinafter July 14, 1994 Memo] (including a lengthy discussion of meeting continuity of life with a majority in interest of the members agreeing to continue the business).

⁹⁵ *See* Letter from Dwight A. Hamilton, President, NCCUSL, to Stuart L. Brown, Associate Chief Counsel (Domestic), IRS (Apr. 9, 1993) (on file with author) [hereinafter Apr. 9, 1993 Letter] (expressing thanks for IRS assistance at the Uniform LLC Act Drafting Committee meetings); Hamill, *Clarification of Remarks*, *supra* note 87.

⁹⁶ The President of the Uniform Law Commissioners urged "an early and speedy ruling by the service on the proposed Act so that when it is promulgated by the Conference in August of 1994, it will be immediately available to the states for enactment." Apr. 9, 1993 Letter, *supra* note 95, at 2. The drafters were concerned that states which had already secured their own partnership classification revenue rulings would be unwilling to consider the Uniform Act without similar assurances from the IRS concerning the Uniform Act. In response, the IRS Associate Chief Counsel expressed willingness to continue helping the drafting committee, but firmly stated that the IRS "cannot . . . provide assurances as to the tax consequences of the proposed statute until it has been officially reviewed by all the offices within the IRS and Treasury Department whose approval is required in order to make such a determination." Letter from Stuart L. Brown,

analyzing the partnership classification consequences of the draft Uniform LLC Act.⁹⁷ After additional meetings and correspondence between representatives of the Uniform LLC Act and the IRS that were necessary to clear up several open issues, many of which involved partnership classification,⁹⁸ the Uniform LLC Act became final at its second reading in August of 1994.⁹⁹ After the IRS issued Revenue Procedure 95-10, the drafters amended the Uniform LLC Act in order to incorporate the revenue procedure's more favorable standards into the statutory default provisions addressing dissolution and transferability of interests.¹⁰⁰

The novelty of the long-anticipated Revenue Procedure 95-10 did not last.¹⁰¹

Associate Chief Counsel (Domestic), IRS, to Dwight A. Hamilton, President, NCCUSL (Apr. 26, 1993).

⁹⁷ See Letter from Paul F. Kugler, Assistant Chief Counsel (Passthroughs & Special Industries), IRS, to Edward I. Cutler, Chair Uniform LLC Act Drafting Committee, at 2-4 (July 26, 1993) (on file with author) [hereinafter July 26, 1993 Letter] (analyzing the partnership classification rules under the draft provisions). The letter states that the provision of the Uniform Act allowing a majority in number to continue the business fails to follow the regulations; LLCs with business succession agreements as authorized by the draft may not lack continuity of life; an LLC may not lack centralized management if certain members' agency authority is limited in the articles; ambiguity concerning "manifestly unreasonable" restrictions may result in the LLC possessing free transferability of interests. See *id.*

⁹⁸ See Nov. 3, 1993 Memo, *supra* note 94, at 1 (outlining agenda for meeting with IRS attorneys concerning the Uniform LLC Act; "I think the classification issues are most pressing right now"); Memorandum from Robert R. Keatinge to Dianna K. Miosi and Jerry E. Holmes, IRS, at 2-4 (Nov. 9, 1993) (on file with author) (stating the agenda for meeting concerning current status of Uniform LLC Act); Memorandum from Robert R. Keatinge, ABA Advisor, NCCUSL Drafting Committee on Limited Liability Company Act, to Paul F. Kugler, Assistant Chief Counsel (Passthroughs and Special Industries), IRS (Mar. 7, 1994) (outlining final classification questions before the second reading in August of 1994 and expressing great concern over uncertain definition of majority in interest, the necessary consent threshold under continuity of life, and the ability to eliminate agency authority for real estate transactions only while still lacking centralized management); July 14, 1994 Memo, *supra* note 94 (discussing ways to define majority in interest in the draft).

⁹⁹ See Uniform Limited Liability Company Act (1994).

¹⁰⁰ See Letter from Carter G. Bishop, Uniform LLC Act Reporter, to John M. McCabe, Legal Counsel, NCCUSL (Jan. 1, 1995) (urging amendments to dissolution and transferability provisions to reflect Revenue Procedure 95-10). Those amendments were made on January 20, 1995. See also Robert R. Keatinge & James W. Reynolds, *Advisors Report on the Uniform Limited Liability Company Act* (Mar. 13, 1995), reprinted in RIBSTEIN & KEATING, *supra* note 46, at 1-2 (noting that the 1995 amendments to take advantage of the standards in Revenue Procedure 95-10 added considerable complexity to the Uniform LLC Act).

¹⁰¹ See Lee A. Shepard, *Officials Explain LLC Revenue Procedure*, 66 TAX NOTES 932 (1995) (quoting an IRS official saying a meaningful possibility of dissolution must exist to lack continuity of life, which contemplates a legal possibility but not necessarily a factual possibility) Juliann Avakian Martin, *Official Discusses Standards for Classifying LLCs as Partnerships*, 61

On March 30, 1995, the IRS announced a proposal to eliminate the partnership classification rules by allowing certain unincorporated businesses, including domestic LLCs, to elect partnership or corporate taxation, and the rise of the LLC contributed greatly to this development.¹⁰² The public overwhelmingly favored the proposal.¹⁰³ Almost a year later, on May 13, 1996, the IRS issued proposed regulations,¹⁰⁴ and on December 17, 1996, the final regulations, dubbed the "Check-the-Box" regulations, permanently eliminated all partnership classification considerations for LLCs and all other domestic unincorporated entities. All persons filing under an LLC statute automatically receive partnership taxation.¹⁰⁵ The elimination of all partnership classification issues allows those using LLCs the freedom to craft the dissolution, transferability and management provisions to satisfy business goals alone.¹⁰⁶

TAX NOTES 1767 (1995).

¹⁰² See I.R.S. Notice 95-14, 1995-1 I.R.B. ("The existing classification regulations are based on the historical differences under local law between partnerships and corporations . . . [A]lmost all states have enacted statutes allowing the formation of limited liability companies . . ."); see also Rod Garcia & Nancy Loube, *LLCs, or How the Government Got to Check-the-Box Classification*, 67 TAX NOTES 1139 (1995). Garcia & Loube note:

Three years ago . . . sponsors of the limited liability company structure peddled their product at several committee sessions . . . Now it's 1995, and times have indeed changed. Almost every state in the nation has a statute dealing with LLCs . . . The IRS has set up guidelines for assuring that an LLC is classified as a partnership and not as a corporation for federal income tax purposes . . . With Notice 95-14 . . . the government proposed to throw in the towel on trying to define the lines that distinguish partnerships from corporations . . . [N]o single entity is more responsible for Notice 95-14 than the LLC, which just a few years ago was a new idea to many practitioners.

Id.

¹⁰³ See Garcia & Loube, *supra* note 102; Rod Garcia, *Treasury Officials Address Check-the-Box Entities*, 67 TAX NOTES 1009 (1995) ("There's nothing to complain about."); Sheryl Stratton, *IRS Proposes Check-the-Box Entity Classification Procedure*, 67 TAX NOTES 26 (1995); Sheryl Stratton et. al., *Check-the-Box Regulations Dominate Discussions at Several Meetings*, 67 TAX NOTES 685 (1996); *ABA Lawyers Embrace "Check-the-Box" Proposal and Say Extend it to Foreign Organizations*, 68 TAX NOTES 550 (1995). On July 20, 1995 the IRS held a public hearing. See Rod Garcia, *Let Foreign Entities Check-the-Box Too, Witnesses Tell IRS*, 68 TAX NOTES 375 (1995) (overwhelming support on the substantive merits).

¹⁰⁴ See Prop. Treas. Reg. §§ 301.7701-1-4 (1996).

¹⁰⁵ See Treas. Reg. §§ 301.7701-1-4 (1996).

¹⁰⁶ See *LLCs May be Much Easier to Set Up*, 95 LAW. WKLY. U.S.A. 318 (1995) ("The proposal is 'revolutionary.'") (comment on Notice 95-14). In response to the elimination of the partnership classification regulations, in July of 1996 the Uniform LLC Act was amended to eliminate dissolution upon a member's dissociation. See UNIF. LLC ACT §§ 603, 801 (amended 1996), 6A U.L.A. 475 (Supp. 1998). See also RIBSTEIN & KEATINGE, *supra* note 46, at app. C.

The close of 1996, with all states possessing LLC statutes no longer shackled by partnership classification concerns, marked the conclusion of the LLC's first phase of development. The work of two distinct groups of LLC proponents, both focusing on the needs of their clients, instrumentally contributed to the LLC's rise. Although the first group's efforts superficially appear unsuccessful, its early efforts forced the IRS to address the partnership classification of LLCs, thus paving the way for the second group to encourage widespread LLC statutory enactments and to fight the secondary partnership classification issues holding the LLC back. By forcing the IRS either to rule favorably or openly treat limited liability as a corporate superfactor, the efforts of the first group planted the seeds that led to the Wyoming Revenue Ruling and ultimately to the LLC's future growth. The second group's success, turning the LLC's raw potential into a mainstream choice for doing business, can be explained by the widespread participation in the LLC cause by many lawyers and other professionals from all over the country, the coordination of these efforts by a few individuals, and the presence of little organized opposition.¹⁰⁷

III. THE LLC'S EARLIEST HISTORICAL ORIGINS

A. Development of the Early Nineteenth Century Corporation Under State Law Control

The opportunity to create the LLC as a new business form directly resulted from the fact that the individual states, rather than Congress, enjoy primary jurisdiction over the legitimacy of business organizations. Because the LLC exposes the shortcomings of the current business tax system, Congress, if approached, undoubtedly never would have allowed the LLC to secure legitimacy.¹⁰⁸ For as long as America has existed, the primary authority over the creation of business organizations has resided with the individual states. At America's beginnings, only two business forms existed: the general partnership, which requires no formal sovereign recognition, and the corporation, which has always required formal recognition by a sovereign person or government.¹⁰⁹ The earliest origin of the LLC

¹⁰⁷ See FARBER & FRICKEY, *supra* note 11, at 19–20, 23–24, 70 (discussing interest group influence and the role of organized opposition); see also Hamill, *Corporate Integration*, *supra* note 3, at 396 n.17, 397 nn. 23 & 24 (examples of isolated critics attacking the LLC in the early 1990s).

¹⁰⁸ See Hamill, *Corporate Integration*, *supra* note 3, at 407–09 (discussing plan in early 1993 to hold hearings on LLCs and changes made to relax standards for S corporations, largely prompted by LLCs). By exposing the inequities of the business tax system, LLCs undoubtedly caused congressional discomfort.

¹⁰⁹ See 1 JOSEPH S. DAVIS, *ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS* 91 (1917) (explaining that during the colonial period partnerships existed alongside corporations);

can be traced to the point in America's past when the power to authorize corporations vested under state rather than federal control, which lead to the states irreversibly assuming general authority to create new business organizations.

Corporations have existed in America since the earliest colonial days.¹¹⁰ The first colonial corporations obtained charters directly from the King of England. The colonial assemblies, once established, granted corporate charters under the implicit authority of the Crown,¹¹¹ thus establishing precedent for the future individual states to retain the power over the corporate charter. However, at the dawn of America's independence, the framers contemplated Congress having some authority to issue corporate charters. Toward the end of the American Revolution, a committee established by the first Congress started to investigate the possibility of establishing a national bank with a congressionally issued charter.¹¹² Although the Articles of Confederation, ratified on July 9, 1778, failed to grant to Congress the power to issue corporate charters,¹¹³ on December 31, 1781, by special ordinance based on Alexander Hamilton's elaborate plan,¹¹⁴ Congress incorporated the Bank of North America.¹¹⁵ Because the bank's directors also secured charters from

see also UNIF. PARTNERSHIP ACT § 6(1), 6 U.L.A. 256 (1995) (giving the definition of partnership); ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIPS §§ 2.01, 2.13 (1996) (stating that, unlike corporations, partnerships require no formalities). Predecessors of the modern corporation, existing long before the American colonies appeared on the map, required formal recognition by a sovereign individual or government. *See* 1 DAVIS, *supra*, at 3 n.1; JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 2 (1970).

¹¹⁰ *See* 1 DAVIS, *supra* note 109, at 6-7 (the Crown issued charters directly to the earliest colonial corporations); *id.* at 329 (business corporations existed prior to the revolution); HURST, *supra* note 109, at 7-15 (explaining that English chartered companies were prominent in establishing North Atlantic colonies, that royal governors and colonial legislatures chartered some business corporations in the colonial years, and that trading companies that founded colonies existed under royal charters); RONALD E. SEAVOY, THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION 1784-1855, at 9-32 (1982) (discussing early colonial corporate charters).

¹¹¹ *See* 1 DAVIS, *supra* note 109, at 7.

¹¹² The establishment of the bank was proposed on June 21, 1780, in Congress, and the committee consisted of Mr. Ellsworth, Mr. Duane, and Mr. Scott. *See* LEGISLATIVE AND DOCUMENTARY HISTORY OF THE BANK OF THE UNITED STATES 9 (M. St. Clair Clarke & D.A. Hall eds., A.M. Kelley reprint 1967) (1832) [hereinafter U.S. BANK].

¹¹³ *See* ART. OF CONFED. (1778); *see also* 2 DAVIS, *supra* note 109, at 10.

¹¹⁴ Robert Morris, the Superintendent of Finance, officially proposed the Congressional Bank, using a plan more than likely provided by Alexander Hamilton a few weeks before. *See* 2 DAVIS, *supra* note 109, at 35; 2 THE PAPERS OF ALEXANDER HAMILTON 1779-1781, at 645 (Harold C. Syrett & Jacob E. Cooke eds., 1961) [HAMILTON PAPERS]; U.S. BANK, *supra* note 112, at 14.

¹¹⁵ *See* 2 DAVIS, *supra* note 109, at 10 n.2; U.S. BANK, *supra* note 112, at 12-14.

several states,¹¹⁶ it appears that they believed Congress's authority to be suspect.¹¹⁷

The issue of whether Congress should have power over the corporate charter arose during the 1787 Convention, which replaced the weaker Articles of Confederation with the Constitution that continues to serve as America's final authority. James Madison and others proposed that the new Congress be given explicit power to grant corporate charters. The proposal, which was never adopted, would have empowered Congress "to grant charters of incorporation in cases where the Public good may require them, and the authority of a single State may be incompetent."¹¹⁸ Although the Constitution failed to identify explicitly the source of governmental power over corporate charters,¹¹⁹ in 1790, dissatisfied with the progress of the Bank of North America,¹²⁰ Alexander Hamilton, then Secretary of

¹¹⁶ In 1782 the directors of the Bank of North America secured a corporate charter from Pennsylvania, Rhode Island, Connecticut, Massachusetts, and New York. Moreover, North Carolina and New Jersey validated the ordinance without actually granting the bank a charter. *See* 2 DAVIS, *supra* note 109, at 38. Despite all these validations, the Bank of North America appeared to operate exclusively under the Pennsylvania charter. *See* U.S. BANK, *supra* note 112, at 25. Several years later, in 1785, when Pennsylvania revoked the Bank's charter, the directors quickly secured a replacement charter from the Delaware legislature. *See* 2 DAVIS, *supra* note 109, at 42–43.

¹¹⁷ *See* ART. OF CONFED. art II (1778) (stating that congressional power must be explicitly provided for). The Articles' powers left the central government with weak taxing authority and no ability to regulate commerce. *See* DANIEL A. FARBER & SUZANNA SHERRY, A HISTORY OF THE AMERICAN CONSTITUTION 24–25 (1990); ANDREW C. MCLAUGHLIN, A CONSTITUTIONAL HISTORY OF THE UNITED STATES 140–41 (1935); *see also* 2 DAVIS, *supra* note 109, at 10 (quoting a letter written by James Madison to Edmund Pendleton on January 8, 1782, which stated that the Articles of Confederation did not empower Congress to incorporate a bank but a congressional charter provided prestige with an understanding that the states would validate the bank within their respective jurisdictions). *See generally* MERRILL JENSEN, THE ARTICLES OF CONFEDERATION: AN INTERPRETATION OF THE SOCIAL-CONSTITUTIONAL HISTORY OF THE AMERICAN REVOLUTION 1774–1781, at 241 (1940) (discussing the distribution of power between the states and the federal government under the Articles of Confederation).

¹¹⁸ THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 325 (Max Farrand ed., 1937); *see also id.* at 614–17 (Madison noting the proposal of Congressional powers to establish corporations was referred to committee); *id.* at 362, 375–76 (Madison and Baldwin mention that the proposed enumerated power of Congress to erect corporations was debated and struck out); Alexander Hamilton, *Opinion on the Constitutionality of an Act to Establish a Bank*, 8 HAMILTON PAPERS, *supra* note 114, at 97, 99–100; 2 DAVIS, *supra* note 109, at 12 (discussing Madison's proposal).

¹¹⁹ *See* 2 DAVIS, *supra* note 109, at 13–14.

¹²⁰ The Pennsylvania legislature's reinstatement of the Bank of North America's charter restricted the amount of stock in the bank to two million dollars, as opposed to the original limit of ten million. Hamilton's proposal cites these restrictions as a reason for creating the Bank of the United States. *See* U.S. BANK, *supra* note 112, at 25.

the Treasury, drafted a report urging Congress to charter another national bank.¹²¹ After much debate addressing whether the Constitution empowered Congress to do so,¹²² on February 25, 1791 President Washington signed into law the charter for the Bank of the United States.¹²³

Despite the early congressional charters issued for banks, the state legislatures, apparently by default,¹²⁴ assumed the general power to grant corporate charters in the years following the American Revolution. No evidence exists documenting an explicit discussion by the framers addressing the general power to issue corporate charters.¹²⁵ This lack of explicit discussion can be explained by the relative unimportance of corporations at that time.¹²⁶ During America's colonial period and

¹²¹ See *id.* at 15–35.

¹²² See *id.* at 35–86. The Senate created a committee to study Hamilton's bank proposal. The President solicited opinions addressing whether the Constitution supported a congressional charter from Attorney General Edmund Randolph, Secretary of State Thomas Jefferson, and Secretary of the Treasury Alexander Hamilton. Randolph and Jefferson, strictly construing the powers of the Constitution, believed a congressional charter to be unconstitutional. Hamilton wrote a lengthy response favoring a congressional charter for the bank. See *id.* at 89–113. The House voted 39 to 20 for the charter and the Senate also passed the charter. Apparently "[t]he Senate Proceedings [did] not indicate the strength of the opposition." 2 DAVIS, *supra* note 109, at 14–15.

¹²³ See U.S. BANK, *supra* note 112, at 85.

¹²⁴ See JOHN W. CADMAN, JR., THE CORPORATION IN NEW JERSEY 3–4 (1949) ("[I]n the absence of express designation of incorporating authority, the power to incorporate was an implied and exclusive right of the legislature."); HURST, *supra* note 109, at 139–41 (discussing how the federal role was limited, not by formal Constitutional bounds, but by working tradition).

¹²⁵ While the Articles of Confederation remained in effect, any attempt by Congress to take general jurisdiction over corporate charters would have been unconstitutional. See *supra* note 117. Apparently the degree to which Congress possessed limited powers under the Constitution to issue corporate charters was discussed at the Constitutional Convention, with many believing that Congress did have the power to incorporate based upon its power "to legislate in cases where the states should not be severally competent." 4 DAVIS, *supra* note 109, at 13–14. This issue also came up a few years after the Convention in connection with the congressional charter for the Bank of the United States. In a letter written to George Washington, Alexander Hamilton stated that Congress did have limited powers to incorporate because no language reserved these powers exclusively to the states. On the other hand, Thomas Jefferson, who took a strict constructionist view of the Constitution, believed no such power existed and that the Bank's charter was unconstitutional. See U.S. BANK, *supra* note 112, at 95–112. These discussions fail to address directly the more important issue concerning which branch possessed general authority to issue corporate charters.

¹²⁶ See LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 188 (2d ed. 1985) (stating that corporations were uncommon before 1800). Several critical issues occupied the Constitutional Convention, including the details of establishing a strong federal government, see THE FEDERALIST NO. 9 (Alexander Hamilton); MCLAUGHLIN, *supra* note 117, at 163, representation in Congress, see FARBER & SHERRY, *supra* note 117, at 112, and, most importantly, the slavery issue, including future limitations on trade and the extent to which slaves would be counted (ultimately slaves

for a few years thereafter,¹²⁷ the vast majority of the people in America's agriculturally based society labored on family farms producing the goods necessary for their own survival and occasional surplus to be bartered.¹²⁸ The manufacture of goods produced by artisans in small shops and the business of merchants engaged in importing and exporting grew steadily around the cities clustered at the seaboard, with the sole proprietorship and the partnership serving as the legal forms for conducting these businesses.¹²⁹ The crude and undeveloped state of transportation made any large-scale movement of goods from the cities prohibitively expensive and kept business at small levels.¹³⁰ Business discrepancy had not yet evolved to a point where the legal benefits¹³¹ of forming a corporation proved useful.¹³² The

counted only three-fifths for every white man) for representation purposes. *See id.* at 147–49, 164–65.

¹²⁷ Of the more than three hundred business corporations chartered in America by 1800, most of them secured their charters after 1789. *See* 2 DAVIS, *supra* note 109, at 8; *see also* SEAVOY, *supra* note 110 at 53–65 (discussing early business corporations); HURST, *supra* note 109, at 17 (giving statistics on business corporations after 1780).

¹²⁸ *See* STUART BRUCHEY, *THE ROOTS OF AMERICAN ECONOMIC GROWTH, 1607–1861*, at 23 (1965) (stating that land was the most important capital in the agricultural colonial economy); ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 17, 51 (1977) (noting that in 1790 the American population numbered 3,930,000 with only 202,000 living in towns or villages, close to 90% of the workers laboring on farms); SEAVOY, *supra* note 110, at 258 (explaining that due to abundance of land, shortage of capital and technological backwardness, the United States appeared to be one of the least likely nations to industrialize); CAROLINE F. WARE, *THE EARLY NEW ENGLAND COTTON MANUFACTURE: A STUDY IN INDUSTRIAL BEGINNINGS 1–8* (1931) (discussing how agriculture possessed such great potential that few in the late 18th century contemplated that America's future would be in industry rather than agriculture).

¹²⁹ *See* CHANDLER, *supra* note 128, at 28 (stating that merchants operated in partnerships for shipping and financial ventures); *see also id.* at 51–52 (describing business practices of artisans in American seaboard cities of late 18th century).

¹³⁰ *See id.* at 32 (stating that colonial roads limited, with “travel over them a bone-shaking experience,” and although most passengers and nearly all freight moved by water, the colonial period saw no common carrier water routes except a small number of ferries); CHARLES SELLERS, *THE MARKET REVOLUTION* 5 (1991) (discussing how roads beyond seaboard cities were few, badly maintained, and often impassible, making hauls beyond 30 or 40 miles more expensive than the goods).

¹³¹ The principal legal benefits of forming early corporations arose from the formation of a separate entity that existed beyond the natural life of the owners and was able to pool large amounts of capital and own property. *See* 1 DAVIS, *supra* note 109, at 5; *see also* Robert L. Raymond, *The Genesis of the Corporation*, 19 HARV. L. REV. 350, 354–58 (1906). The legal benefit of limited liability protection developed later at an uneven pace across the states. *See generally* CADMAN, *supra* note 124, at 36–40 (discussing charters being issued without opposition and without mentioning limited liability); EDWIN MERRICK DODD, *AMERICAN BUSINESS CORPORATIONS UNTIL 1860*, at 272–390 (1954) (discussing the evolution of limited liability);

colonial assemblies and the early state legislatures granted corporate charters primarily for public purposes, including the establishment of towns, churches, cemeteries, colleges, and charities.¹³³

Especially after 1790, state-issued corporate charters for banks proliferated in order to supply credit to the nation's rapidly growing business economy.¹³⁴ State-chartered banks, which numbered over two hundred by 1815,¹³⁵ played a prominent role in the nation's economy through the circulation of bank notes that served as a medium of exchange within the nation's currency.¹³⁶ During the decades leading up to and just after the War of 1812, the number of state-issued corporate charters increased rapidly because canals and turnpikes increased rapidly, representing the first step in America's transportation revolution.¹³⁷ Unlike the majority of purely private business enterprises,¹³⁸ which still operated in the partnership form,¹³⁹

HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW 1836-1937*, at 49-55 (1991) (discussing the development of limited liability noting that it generally became entrenched during the Jacksonian period); SEAVOY, *supra* note 110, at 68-72 (discussing early 19th century case law addressing limited liability).

¹³² Only seven business corporations existed in the colonies. *See* 2 DAVIS, *supra* note 109, at 331 app. A.

¹³³ *See id.* at 329; *see also* SEAVOY, *supra* note 110, at 1-32 (discussing the earliest American corporations in the colonial days and the years immediately following the Revolution); Simeon E. Baldwin, *American Business Corporations before 1789*, 8 AM. HIST. REV. 449 (1903) (investigating the features of the nation's earliest corporations).

¹³⁴ *See* CHANDLER, *supra* note 128, at 28-31; SELLERS, *supra* note 130, at 15, 18, 23.

¹³⁵ *See* CHANDLER, *supra* note 128, at 30 (stating the number climbed to 307 by 1820); SELLERS, *supra* note 130, at 46.

¹³⁶ *See* CHANDLER, *supra* note 128, at 29 (discussing the role of state-chartered banks and how their notes came to serve as a medium of exchange because of the limited amount of coin and bills of exchange and the lack of government-issued paper money).

¹³⁷ *See* SELLERS, *supra* note 130, at 40-43 (describing early boom in canal and turnpike state-issued corporate charters); *id.* at 391-92 (describing early efforts to build railroads in the late 1830s and early 1840s). *See generally* GEORGE ROGERS TAYLOR, *THE TRANSPORTATION REVOLUTION 15-31* (1951) (roads and bridges); *id.* at 32-55 (canals).

¹³⁸ Although many of the corporate charters granted after 1800 for canals, turnpikes, and banks technically went to private business entrepreneurs, these corporations did not operate as private businesses in the same sense as the unincorporated businesses. In order to encourage these badly needed improvements, the early special charters normally granted privileges in the form of monopolies or franchises, causing these early corporations to resemble more closely towns or public bodies than private competitive businesses. *See* MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780-1860*, at 116-18 (1977); SELLERS, *supra* note 130, at 45, 53 (discussing the blurred line between public and private purpose in early transportation and banking corporations); HOVENKAMP, *supra* note 131, at 113 (setting out Justice Story's discussion of the difference between corporate charters granted with monopolies and franchises and those involving common rights which should not confer monopolies or franchises).

banks and transportation projects needed the legal advantages offered by the corporate form, specifically the ability to pool large amounts of capital and to exist beyond the natural life of the owners.¹⁴⁰

The only constitutional impediment to the development of state-chartered corporations might have been holdings by the Supreme Court that the federal government enjoyed exclusive power over interstate commerce and that the chartering of business corporations constituted interstate commerce. The Supreme Court, led by Chief Justice John Marshall, considered the general question of whether federal power over interstate commerce was exclusive or concurrent with the states, opting for an interpretation of concurrent powers.¹⁴¹ State enjoyment of concurrent rights with Congress over interstate commerce implicitly legitimized state corporate charters, allowing them to continue without serious question or analysis.¹⁴² Thus, the Marshall Court gave the states a powerful head start toward permanently assuming primary jurisdiction over the incorporation process.

¹³⁹ See CHANDLER, *supra* note 128, at 36 (noting that despite the increased use of corporations throughout the first half of the 19th century, for purely commercial enterprises the partnership remained the standard business form until well after 1840); TONY A. FREYER, *PRODUCERS VERSUS CAPITALISTS* 4 (1994) (stating that the majority of adult white males in Antebellum America were self-employed in an unincorporated enterprise).

¹⁴⁰ See CHANDLER, *supra* note 128, at 28, 32, 34; SELLERS, *supra* note 130, at 44.

¹⁴¹ Of the members of the Marshall Court, only Justice Story wanted federal powers over commerce to be exclusive, but he could never muster a majority to support his position. See 3–4 G. EDWARD WHITE, *HISTORY OF THE SUPREME COURT OF THE UNITED STATES* 491, 498–501 (1988) (summarizing Story's desire for a partnership relation between Congress and federal courts in order to keep the federal government sovereign, and discussing negative reaction to Story's position by others who feared elimination of state sovereignty. Justice Marshall, who generally favored strong interpretations of commerce powers when Congress chose to act, equivocated, thus paving the way for commerce powers to be shared concurrently with the states); see, e.g., *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824) (Marshall reserving concurrent state powers to regulate interstate commerce despite upholding federal regulation under the particular facts of the case); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264 (1821) (Marshall recognizing the sovereignty of the people forming the foundation of residual state powers); *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819) (Marshall employing a coterminous power theory); 3–4 WHITE, *supra*, at 458–594 (Marshall believing in a strong federal government, but also conceding that the states must retain some powers).

¹⁴² Although the states continued to exercise the general power to issue corporate charters, Congress did charter specific corporations during the Antebellum period. See *supra* notes 115, 123 and accompanying text (discussing federal incorporation of the Bank of North America and the Bank of the United States); see also Act of Feb. 25, 1791, ch. 10, 1 Stat. 191 (“An Act to incorporate the subscribers to the Bank of the United States”); Act of Mar. 3, 1825, ch. 52, 4 Stat. 802 (Acts of the states of Virginia, Pennsylvania, and Maryland, and of the Congress of the United States, incorporating the Chesapeake and Ohio Canal Company); Act of May 24, 1828, ch. 86, 4 Stat. 293 (“An Act authorizing the subscription to the stock of the Chesapeake and Ohio Canal Company”) (examples of Antebellum congressional charters).

In order to coordinate the piecemeal transportation efforts being undertaken by the states, during the Fourteenth Congress John C. Calhoun attempted to start a national transportation plan,¹⁴³ embodied in the Bonus Bill. The Bonus Bill, which passed by a two vote margin, would have launched a massive federally sponsored effort “to bind the Republic together with a perfect system of roads and canals,” funded by a \$1.5 million bonus from the Second Bank of the United States.¹⁴⁴ Because of serious disagreements over Congress’s constitutional powers to undertake this project, President Madison vetoed the Bonus Bill in 1817.¹⁴⁵ This defeat left America’s transportation development almost completely under state control, and the states continued to issue corporate charters for transportation projects in greater numbers.¹⁴⁶

The constitutional debate that killed the Bonus Bill focused on the word “necessary” in the clause empowering Congress to make all necessary and proper laws related to its constitutional powers. The power to regulate commerce among the states is the major tool for regulating business and commercial activity. Those in favor of Alexander Hamilton’s strong interpretation of congressional powers read “necessary” to mean conducive, useful, or convenient, while those favoring Thomas Jefferson’s more restrictive view read “necessary” to require far more.¹⁴⁷ Despite Madison’s concerns, the failed Bonus Bill probably would have passed constitutional muster. When Congress chose to act, the Marshall Court defined the federal Commerce Clause strongly enough to control not only commercial action among the states, but also to control those intrastate activities having interstate

¹⁴³ The first suggestions of a national transportation plan came from Thomas Jefferson’s Treasury Secretary, Albert Gallatin, but the coming of the War of 1812 shelved the idea. *See* SELLERS, *supra* note 130, at 62.

¹⁴⁴ *See id.* at 76, 78.

¹⁴⁵ *See id.* at 79 (explaining how Madison vetoed the Bonus Bill the day before he left office in March 1817); *id.* at 82–83 (describing how efforts by President Monroe to secure a constitutional amendment to support the Bonus Bill killed by House Speaker Henry Clay over a petty political slight). Although the federal government participated in transportation by providing support through military engineers at West Point, the veto of the Bonus Bill and the defeat of the constitutional amendment ended any real chance for Congress to take the lead. The commanding force for these improvements largely stayed within state-chartered corporations. *See id.* at 83–84; *see also id.* at 150–52 (describing national support for transportation under President Monroe); FREYER, *supra* note 139, at 44 (describing Madison’s veto as a “turning point”).

¹⁴⁶ Immediately after Madison’s veto of the Bonus Bill, New York chartered the Erie Canal. *See* SELLERS, *supra* note 130, at 79; *see also id.* at 316 (telling how national transportation support died with Jackson’s veto of Maysville road bill); CHANDLER, *supra* note 128, at 32–35 (citing examples of state-chartered projects).

¹⁴⁷ *See* SELLERS, *supra* note 130, at 77. Debate over the meaning of the word “necessary” goes back to the dispute between Alexander Hamilton and Thomas Jefferson over the constitutionality of the charter for the Second Bank of the United States. *See supra* notes 122–25.

effect. This early broad interpretation of Congress's commerce powers first emerged in the language of *Gibbons v. Ogden*,¹⁴⁸ a 1824 case holding that an exclusive license granted by the New York Legislature covering movement of goods by steamboat between New York City and New Jersey fell within the boundaries of federal regulation under the Commerce Clause because the license's effect on interstate commerce.¹⁴⁹

During the 1820s, undoubtedly fueled by protective tariffs adopted a few years earlier,¹⁵⁰ state-issued corporate charters for manufacturing companies grew rapidly.¹⁵¹ Although America's real Industrial Revolution remained several decades away,¹⁵² for most of the 1820s business and commerce steadily grew and the business corporation experienced little overt controversy.¹⁵³ However, within the

¹⁴⁸ 22 U.S. (9 Wheat.) 1 (1824).

¹⁴⁹ See *id.* (holding that a New York statute granting exclusive rights of navigation between New Jersey and New York City to certain steamboat navigators was unconstitutional because it conflicted with a federal statute; Johnson's concurring opinion broadly discusses the commerce powers); see also *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819) (holding that Congress had power to establish Second Bank of the United States as a necessary and proper means of regulating commerce); *United States v. Deveaux*, 9 U.S. (Mem.) 61 (1809) (finding the Bank of the United States, for jurisdictional purposes, to be a citizen and thus able to sue in federal court); see also, 3 WHITE, *supra* note 141, at 547–52 (explaining that Marshall's decision in *McCulloch* was structured so that the constitution sanctioned Congress to establish a national bank); *id.* at 568–80 (noting that Marshall broadly interpreted the Constitution's grant of congressional power to regulate "commerce among the states," giving the federal government extensive power of commerce regulation).

¹⁵⁰ See SELLERS, *supra* note 130, at 74–75 (describing the adoption of the first tariff act by the fourteenth Congress in 1815 to protect American manufacturers from being driven out of business by British competition); *id.* at 80–81 (describing support by President Monroe for the continuation of and the strengthening of legislation protecting American manufacturers).

¹⁵¹ See *id.* at 133; FREYER, *supra* note 139, at 45 (noting large increase in factories operating in corporations from 1800 to 1860); ARTHUR M. SCHLESINGER, JR., *THE AGE OF JACKSON* 9 (1945) (discussing percentage increase of persons in manufacturing); SELLERS, *supra* note 130, at 133.

¹⁵² See CHANDLER, *supra* note 128, at 3, 14, 35, 49, 50–51, 77 (explaining that although the widespread use of the corporate form to pool capital represented the most significant institutional development, it did not spawn the industrial revolution. As long as power remained limited to traditional sources of animal, wind, and water, large scale industrialization could not occur; the availability of coal and iron provided the necessary power for large scale industrialization starting in the 1850s.).

¹⁵³ See CADMAN, *supra* note 124, at 36–37 (explaining that there was little opposition to corporations until the late 1830s); HURST, *supra* note 109, at 30 (identifying the period from 1830 to 1860 as the time in which anti-charter feelings flourished); SELLERS, *supra* note 130, at 85–90 (discussing legal developments essentially protecting corporations); *id.* at 198 (discussing undercurrents of disaffection in the 1820s undetected among the elite).

shadows of businesses' progress, the seeds of discontent were present.¹⁵⁴ America's transformation from an agricultural and mercantile economy to a market economy displaced and negatively affected many individuals.¹⁵⁵ The rhetoric surrounding Andrew Jackson's election in 1828 as the sixth President of the United States¹⁵⁶ denounced federal powers and harshly criticized banks, business corporations, and other instruments of power oppressing the large majority of farmers and workers.¹⁵⁷ Underneath these simple messages, the policies of Jackson's administration and the goals shared by proponents of Jacksonian Democracy reflected a more complex agenda that in many ways accommodated the very business interests being criticized.¹⁵⁸ The wrath directed at banking focused exclusively on the Bank of the

¹⁵⁴ See FREYER, *supra* note 139, at 20 (noting social tensions caused by the rise of corporations); SCHLESINGER, *supra* note 151, at 30 (characterizing the 1820s as a decade of discontent); SELLERS, *supra* note 130, at 163 ("Frustrated and angry, a populace that had ignored entrepreneurs and their little-understood projects in times of piping prosperity moved into political revolt."); *id.* at 172 (citing a warning by Secretary Calhoun to Secretary Adams in 1820 of a "general mass of disaffection" without direction in search of a leader); *id.* at 198 (describing John Quincy Adams and Henry Clay as having no clear idea of the dissatisfaction of the average people).

¹⁵⁵ See SELLERS, *supra* note 130, at 23 (generally noting that the commercial boom made nine out of ten urban dwellers who worked with their hands worse off); *id.* at 137-39 (describing the general misery following the Panic of 1819); sources cited at *supra* note 154.

¹⁵⁶ See SELLERS, *supra* note 130, at 298-99 (describing Jackson's election with return numbers showing a popular vote unmatched until the twentieth century).

¹⁵⁷ See FREYER, *supra* note 139, at 48 (noting rhetoric identifying "the system of corporations" as "nothing more nor less than a moneyed feudalism"); SELLERS, *supra* note 130, at 173 (noting that before his election Jackson made flat statements that he opposed all banks on principle); *id.* at 321 (describing Jackson's states' rights politics); *id.* at 301 (describing popular enthusiasm along Jackson's inauguration route).

¹⁵⁸ See FREYER, *supra* note 139, at 81 (noting that an attack on banks occurred as states chartered more banks in order to provide badly needed credit); *id.* at 92-104 (explaining that opposition to corporations was not unequivocal and discussing the taxing of corporations as a means of keeping them accountable to the community); SCHLESINGER, *supra* note 151, at 190 (referring to the Democratic opposition to Whig monopoly which allowed bank charters for deserving Democrats); *id.* at 306-21 (asserting that the intellectual position behind the Jacksonian position was a complex conflict between producing and nonproducing classes); SELLERS, *supra* note 130, at 359, 363 (describing how by 1840 "democracy proved safe for capitalism"); Reeve Huston, *The Nineteenth-Century Political Nation: A Tale of Two Syntheses*, 23 REVIEWS AM. HIST. 413 (1995) (reviewing SELLERS, *supra* note 130, which identifies capitalist development as the defining issue of Jacksonian politics). See generally WILLIAM J. NOVAK, *THE PEOPLE'S WELFARE* (1996) (discussing vast areas of state regulation during Antebellum nineteenth century and refuting the label of the period as being completely *laissez faire*); EDWARD PESSEN, *JACKSONIAN AMERICA* (1985) (discussing the period of exploring the extent of true democratic reform during an era of *laissez faire*).

United States,¹⁵⁹ ignoring the large number of state banks, many of which engaged in questionable financial practices.¹⁶⁰ Despite the sound credit practices and stabilizing effects the Bank of the United States contributed to America's economy,¹⁶¹ President Jackson vetoed the reissuance of the Bank's charter in 1832.¹⁶²

Jacksonians did not oppose corporations *per se*. Rather, they objected to the special privileges obtained in the special legislative charters.¹⁶³ Prominent

¹⁵⁹ See SCHLESINGER, *supra* note 151, at 74–87, 163 (general discussion of opposition to the Bank of the United States); *id.* at 89 (quoting Andrew Jackson as saying, “The bank . . . , is trying to kill me, but I will kill it”); *id.* at 231–32 (citing commentary of the day which suggested the real issue lay “not between the people and the Bank of the United States, but between the people and all incorporated institutions”); SELLERS, *supra* note 130, at 312–13 (describing how Jackson emphasized the power of state government and urged Congress to consider alternatives to the Bank of the United States).

¹⁶⁰ See CHANDLER, *supra* note 128, at 30–31 (noting that state-chartered banks numbered over 200 by 1815 and over 300 by 1820; after Jackson vetoed the charter for the Bank of the United States, state-chartered banks continued to grow, numbering 506 by 1834 and 901 by 1840); FREYER, *supra* note 139, at 82 (noting that Jackson's opposition to the Bank of the United States undercut resistance to state-chartered banks); SCHLESINGER, *supra* note 151, at 123 (claiming banks engaged in the most flagrant abuses of corporate privilege); *id.* at 172 (describing an alarming increase in ratio of paper money to specie from 1828 to 1833); SELLERS, *supra* note 130, at 133 (describing questionable state bank practices and explaining that the desire to control these practices was a major reason to recharter the Bank of the United States in 1815); *id.* at 161 (asserting that hard times were triggered by state-enforced debt collection and by the depreciated notes of state-chartered banks).

¹⁶¹ See CHANDLER, *supra* note 128, at 30 (noting that during the late 1820s and early 1830s the Second Bank of the United States provided excellent services and operated on an international scale; the number of state-charted banks leveled off). Before enjoying success in the 1820s, the Bank experienced controversy embodied in the 1811 defeat of its charter—primarily because it diverted profits away from the state-chartered banks—followed by the charter's reissuance in 1815 by a large majority. See SCHLESINGER, *supra* note 151, at 74 (describing the workings of the Second Bank of the United States); *id.* at 218 (stating that the Bank of United States provided “a valuable brake on credit expansion” and that its destruction “accelerated the tendencies toward inflation”); SELLERS, *supra* note 130, at 62–63, 71–72; *id.* at 313 (describing benefits provided by the Bank of the United States).

¹⁶² See FREYER, *supra* note 139, at 83 (discussing Jackson's veto of the “monster” Bank); SCHLESINGER, *supra* note 151, at 90 (explaining that the veto message, written broadly as a defense of the essential rights of the common man against an unjust government, was careful to avoid the issue of hard versus soft currency that would also jeopardize the position of state banks); SELLERS, *supra* note 130, at 332–37 (describing unsuccessful efforts of the Bank's supporters to resurrect the charter following Jackson's veto); *id.* at 326 (discussing outrage of business community at the veto and Jackson's easy reelection because of popular support of the veto).

¹⁶³ See FREYER, *supra* note 139, at 25 (noting that corporations, as a condition to receiving the special privileges of the charter, often were subject to taxes to fund public education and the expenses of government); SCHLESINGER, *supra* note 151, at 126 (quoting Jackson emphasizing

Jacksonians, wanting to cure the evils of special privileges conferred by the special corporate charters, advocated the creation of general incorporation laws that would allow equal access to the corporate form to all those meeting the statutory requirements.¹⁶⁴ After President Jackson left office in 1836, state law general incorporation statutes appeared in two states.¹⁶⁵ During the 1840s the idea caught on as six additional states passed general incorporation statutes.¹⁶⁶ By the eve of the Civil War, sixteen additional states enacted statutes, bringing the total to well over fifty percent of the existing states.¹⁶⁷

By focusing on states rights and at least superficially, on equality, Jacksonian

that exclusive privileges of corporations were a mischief of power); *id.* at 175 (quoting a Jacksonian who called the special privileges a “legislative evil”).

¹⁶⁴ See SCHLESINGER, *supra* note 151, at 48 (describing early attempts ahead of his time made by Martin Van Buren—a prominent Jacksonian, in his capacity as Governor of New York in 1817—to create general incorporation statutes for banks); *id.* at 188–89 (discussing writings of Theodore Sedgwick in 1834, which attacked the exclusive privileges granted by special corporate charters and urged the creation of general incorporation laws allowing any group of individuals to form a corporation). The rise of general incorporation laws throughout the nineteenth century failed to spell the end of incorporation by special charter. A complete discussion of corporate evolution away from special charters to a system marked by exclusive incorporation under general statutes is beyond the scope of this Article and will be explored in a follow-up article.

¹⁶⁵ See 1836 Pa. Laws ch. CCCCLX, § 1 (authorizing corporate formation without a special charter “for the purpose of making or manufacturing iron from the raw material, with coke or mineral coal”); CONN. GEN. STAT. tit. XIV, ch. II, § 1 (1839) (authorizing corporate formation without a special charter for the purpose of “engaging in and carrying on any kind of manufacturing or mechanical or mining or quarrying or any other lawful business”). Although the Pennsylvania and Connecticut statutes, clearly Jacksonian creations, marked the beginning of the nationwide movement toward general incorporation statutes, New York, more than twenty years earlier, technically enacted the first general incorporation statute. See 1811 N.Y. Laws ch. LXVII, § 1 (authorizing corporate formation without a special charter for the purpose of “manufacturing woollen [sic], cotton, or linen goods . . .”). The motive behind New York’s general incorporation statute, to promote U.S. manufacturing enterprises and minimize the United States’ dependence on British imports, sets it apart from the early Jacksonian statutes. See SEAVOY, *supra* note 110, at 63–68.

¹⁶⁶ See 1847 N.J. Laws tit. V, ch. 6, § 1 (“any . . . lawful manufactures”); 1843 Mich. Pub. Acts No. 148 (“mining and manufacturing iron, copper or other materials”); Ohio Stat. ch. 29, § 80 (Derby 1854) (“manufacturing . . . or mining”); 1847 Iowa Laws ch. 81, § 1; 1848 La. Acts §§ 1–26; Wis. Rev. Stat. ch. 51, §§ 1–3 (1849).

¹⁶⁷ See 1853 Cal. Stat. ch. 65, § 1; 1850 Tenn. Pub. Acts ch. 179, §§ 1–2; 1851 Mass. Acts ch. 60–61; 1853 Vt. Acts & Resolves 60, §§ 1–2 (on file with author); ALA. CODE § 1473 (1852); 1852 Fla. Laws ch. 490; 1852 Ill. Laws § 1; 1852 Ind. Laws ch. 66, § 1; 1852 Md. Laws 44–46 ch. 322, §§ 1–2; 1852 N.C. Sess. Laws ch. LXXXI, § 1; 1854 Ky. Acts 179–180 ch. 1012, §§ 1–2; 1853–1854 Va. Acts 32 ch. 46, §§ 1–2; 1853–1854 Ga. Laws. 24; 1857 Miss. Code ch. 35, § 1; 1858 Minn. Laws ch. 1, § 1; 1859 Kan. Sess. Laws 305, 315–16 ch. 36, § 34. By 1859, twenty-five out of the then existing thirty-eight states or territories enacted general incorporation statutes. See *id.* and *supra* notes 166–67.

policies started the trend toward the creation of general incorporation statutes and set in motion the legal landscape that cemented state law primary control over the business corporation.¹⁶⁸ The states rights focus in the Jacksonian political arena made any possibility of redirecting the state-centered-power over the corporation toward federal control illusory. The Supreme Court, as led by Chief Justice Roger Taney, who was appointed by Jackson in 1836, would have held unconstitutional any federal attempts to stop or control the developing state general incorporation statutes. The Taney Court substantially narrowed the scope of Congress's powers under the Commerce Clause to cover only actual movement of commerce among the states.¹⁶⁹ Consequently, the Jacksonian period, by establishing the state law legislative forum over corporations critical for the LLC's birth more than a century later, marks the earliest point of the LLC's origins.

B. State Law Control Over Corporation Entrenched by Early Twentieth Century

The stampede of state general incorporation enactments continued after the Civil War.¹⁷⁰ During the 1860s, fourteen states passed general incorporation laws.¹⁷¹ The pace continued through the 1870s and 1880s, with nine additional states recognizing general incorporation as an option to securing a special charter by 1890, bringing the total percentage of states with statutes to well over ninety percent.¹⁷² Following the Civil War, as the corporation experienced a vast legal

¹⁶⁸ See HOVENKAMP, *supra* note 131, at 2, 36–39 (identifying the modern business corporation as a Jacksonian product) SCHLESINGER, *supra* note 151, at 336–37 (discussing how general incorporation laws were a Jacksonian creation to attack bank monopolies).

¹⁶⁹ See HOVENKAMP, *supra* note 131, at 80; *see also* *Pennsylvania v. Wheeling & Belmont Bridge Co.*, 59 U.S. 421 (1855) (holding Pennsylvania act requiring bridges to be a certain height did not impose on federal Commerce Clause power); *Cooley v. Board of Wardens*, 53 U.S. 299 (1851) (holding federal Commerce Clause power no longer exclusive of states' rights to control commerce, provided that such state power does not interfere with the federal power); *New York v. Miln*, 36 U.S. 102 (1837) (holding New York statute requiring vessel masters, originating from other countries or states, to report the names of foreign passengers did not violate the federal Commerce Clause power); HENRY ABRAHAM, *JUSTICES AND PRESIDENTS* 87 (1974) (discussing states' rights posture of the Taney Court).

¹⁷⁰ During the Civil War six states enacted statutes. *See* 1862 Me. Acts 118 ch. 152, §§ 1–2; ORE. REV. STAT. § 1 (1862); 1863 W. Va. Acts ch. 83, §§ 1–10; 1864 Mo. Laws ch. 69, § 1; 1864 Laws, Jt. Resol. & Mem. of the Territory of Neb. ch. 2, § 1; 1864–1865 Nev. Stat. ch. CXI, § 1.

¹⁷¹ *See supra* note 170; *see also* 1871 Territory Laws of Ariz. ch LI, § 1; 1866 N.H. Laws ch. 4224, § 1; 1866 Wash. Laws 55, 57–58, §§ 1–4; Colo. Rev. Stat. ch. 18, § 1 (1868); 1867–1868 N.M. Laws ch. III, §§ 1–2; 1869 Ark. Acts No. 92, 180; 1871 S.C. Acts, art. XIV, § 1; 1869 Wyo. Sess. Laws 234, 234–35 tit. 1, ch. 8, §§ 1–2.

¹⁷² *See* 1870 Utah Laws 136, 136–37, §§ 1–5; 14 Del. Laws ch. 152, § 1 (1871); 1872 Laws,

transformation¹⁷³ while business activity grew geometrically,¹⁷⁴ evidence shows no federal attempts to regulate corporate activity until the Sherman Antitrust Act of 1890.¹⁷⁵ Although the deliberations leading to the Sherman Act involved discussions of federal incorporation, the Sherman Act itself addressed corporate conduct that restrained trade, leaving the state's incorporation powers in tact. Around 1890, state law still appeared adequate to regulate corporations, rendering a wholesale replacement of the state charter system with one of federal control seemingly unnecessary. After the Sherman Act, big business continued to grow, and thousands of consolidations encouraged firms to merge rather than collude.¹⁷⁶

Mems., & Resols. of the Territory of Mont. § 1; 1822–1897 Tex. Gen. Laws 120, 120–123 ch. XCVII, §§ 1–10 (1898); 1875 Ida. Laws § 1; C.L. of Dakota Territory 1887, ch.3, art. 1, § 2900; 1877 Dakota R.S. art. 1, § 384; 1890 Laws of Hawaii ch. 43, § 1; Okla. Stat. ch. 18, art. I, § 12 (1891); 1896 R.I. Pub. Laws ch. 1200, § 2, cl. 5; Alaska Stat. ch. 37, §§ 798, 799 (1913). Hawaii and Alaska enacted general incorporation statutes before organizing as a territory. By 1903, all fifty states or territories enacted general incorporation statutes. *See id.* and *supra* notes 170–71.

¹⁷³ *See* HOVENKAMP, *supra* note 131, at 14–19 (identifying three broad jurisprudential categories of corporations over the course of the nineteenth century).

¹⁷⁴ A detailed discussion of business growth beyond the Jacksonian period is beyond the scope of this Article and will be explored in a follow-up article.

¹⁷⁵ Codified at 15 U.S.C. §§ 1–7 (1995); *see* HOVENKAMP, *supra* note 131, at 191, 207, 215, 219, 226–38, 241–47 (discussing the Sherman Act); *see also id.* at 137–38, 144–46, 207, 230 (discussing the Interstate Commerce Act of 1887, a comprehensive federal statute designed to regulate railroads; statute did not seek to regulate by removing power to issue corporate charters from the states). Although the states still issued the vast majority of corporate charters, after the Civil War, Congress chose to federally charter a number of specific corporations, including railroad, telegraph, and navigation corporations whose business activities greatly affected commerce among the states. *See, e.g.,* Act of Mar. 1, 1869, Res. 15, 15 Stat. 346 (incorporating the Northern Pacific Railroad Company; approved July 2, 1864); Act of Mar. 29, 1869, ch. 5, 16 Stat. 3 (incorporating the National Junction Railway Company); Act of May 4, 1870, ch. 75, 16 Stat. 97 (incorporating the Washington and Boston Steamship Company); Act of June 29, 1870, ch. 168, 16 Stat. 168 (incorporating the National Bolivian Navigation Company); Act of July 8, 1870, ch. 224, 16 Stat. 192 (incorporating the United States Freehold Land and Emigration Company); Act of Mar. 3, 1871, ch. 122, 16 Stat. 573 (incorporating the Texas Pacific Railroad Company); Act of Jan. 21, 1873, ch. 45, 17 Stat. 412 (incorporating the Loomis Aerial Telegraph Company); Act of June 15, 1878, ch. 214, 20 Stat. 135 (incorporating the National Fair Grounds Association); Act of Aug. 2, 1882, ch. 372, 22 Stat. 185 (incorporating the Oregon Short-Line Railway Company to cover the Territories of Utah, Idaho, and Wyoming); Act of July 29, 1892, ch. 322, 27 Stat. 326 (incorporating the Washington and Great Falls Electric Railway Company).

¹⁷⁶ *See* HOVENKAMP, *supra* note 131, at 241–49; *id.* at 148 (stating that, because cartels worked poorly, the railroad industry mergers would have occurred among railroads even absent the Sherman Act); Lowe Watkins, *Federalization of Corporations*, 13 TENN. L. REV. 89, 92–93 (1935). In the years following the Civil War, the Supreme Court decided mostly Reconstruction cases. The commerce cases continued to focus on the movement of goods establishing the line allowing federal regulation. *See Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899) (holding private contracts related to manufacture, sale, and transportation of goods among several

In the early twentieth century, in response to increasing criticism directed at the immense expansion of corporate power, commentators,¹⁷⁷ as well as the administrations of Presidents Theodore Roosevelt, William Howard Taft, Woodrow Wilson, and Franklin D. Roosevelt, supported proposals requiring corporations to obtain a federal license or a federal charter.¹⁷⁸ Despite substantial support, none of these bills became law. Instead Congress chose again to regulate corporate conduct with the Clayton Act of 1914, the Securities Act of 1933, and the Securities and

corporations covered by Sherman Act under authority of Commerce Clause due to direct affect on interstate commerce encompassed by the movement of goods across state lines); *United States v. E.C. Knight*, 156 U.S. 1 (1895) (holding corporation's sugar manufacturing is local and therefore outside the reach of the Sherman Act); *Kidd v. Pearson*, 128 U.S. 1 (1888) (holding state statute prohibiting alcohol manufacture is constitutional because the Commerce Clause covers regulation of transportation not transformation); FELIX FRANKFURTER, *THE COMMERCE CLAUSE* 74 (1937); see also *Paul v. Virginia*, 75 U.S. 168 (1868) (holding Virginia statute requiring insurance companies to obtain state licenses constitutional, but implying that corporations doing interstate business need no permission from individual states—thus, constituting the first sign of Commerce Clause strength).

¹⁷⁷ See I. MAURICE WORMSER, *FRANKENSTEIN INCORPORATED* (1931) (analogizing the growth of corporate power to Mary Shelley's artificially created monster, Frankenstein); J. Newton Baker, *The Evil of Special Privilege*, 22 *YALE L. J.* 220, 234 (1913) (arguing for mandatory federal incorporation); Winston S. Brown, *The Federal Corporate Licencing Bill: Corporate Regulation*, 27 *GEO. L. J.* 1092, 1116–17 (1939) (discussing federal licensing bill and criticizing predatory corporate practices); James B. Dill, *National Incorporation Laws for Trusts*, 11 *YALE L. J.* 273 (1902) (Address Before the Seminary in Economics of Harvard University, Mar. 10, 1902; supporting permissive federal incorporation law); Joseph O'Mahoney, *Federal Charters to Save Free Enterprise*, 1949 *WIS. L. REV.* 407 (contending that by eliminating the need to regulate corporate conduct, federal incorporation and licensing proposals will effectively reduce the size of the federal government); *Watkins*, *supra* note 176, at 89 (discussing the federalization of corporations); H.L. Wilgus, *Need of a National Incorporation Law*, 2 *MICH. L. REV.* 358, 382 (1904) (arguing for a national incorporation law that gives the federal government the unequivocal power to control incorporation); Comment, *A Federal System of Licenses and Charters*, 25 *GEO. L. J.* 700 (1937) (discussing federal licensing bill and speculating that the bill can limit corporate abuses) [hereinafter *Federal System*].

¹⁷⁸ See *Federal System*, *supra* note 177, at 704 (discussing Theodore Roosevelt's ardent support of federal regulation of corporations and Woodrow Wilson's endorsement of federal licensing); *Watkins*, *supra* note 167, at 93 (describing Taft's proposal for optional federal incorporation, known as the Taft-Wickersham bill); Joel F. Henning, *Federal Corporate Chartering for Big Business: An Idea Whose Time Has Come?*, 21 *DEPAUL L. REV.* 915, 919 (1972) (stating that Presidents Roosevelt, Taft, and Wilson all supported federal incorporation or licensing); see also *Compilation Prepared by Federal Trade Commission of Views for and Against Federal Incorporation and Licensing of Corporations*, 70th Cong., 1st Sess., Doc. 92 Part 69-A, at 32 (Sept. 15, 1934). Between 1903 and 1914, twenty bills were proposed in Congress, over half of which would have required federal chartering. See *id.* at 42–43. Between 1914 and 1932, eight bills were proposed, only one of which required compulsory federal incorporation or licensing, all other bills regulated corporate conduct in various ways at the margins. See *id.*

Exchange Act of 1934.¹⁷⁹ The federal licensing bills would have left state corporation law in tact, requiring all corporations operating in interstate commerce to obtain a license. Federal chartering would have replaced state corporation law with federal corporation law.¹⁸⁰ If successful, these proposals probably would have passed constitutional muster.¹⁸¹ In 1905, the Supreme Court held in *Swift v. United States*¹⁸² that price fixing among cattle dealers who were operating solely intrastate fell within the range of regulation under the Commerce Clause because the purchases fell within the “current of commerce,” thereby affecting interstate commerce.¹⁸³ The Supreme Court perfected the “current of commerce” theory before the 1920s,¹⁸⁴ paving the way for virtually all economic and commercial activity to fall within reach of federal regulation under the commerce clause.¹⁸⁵

¹⁷⁹ Clayton Act of 1913, 15 U.S.C. §§ 12–27; 29 U.S.C. §§ 52, 53 (1994); Securities Act of 1933, 15 U.S.C. §§ 77(a)–77(bbb) (1994); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78l (1994); see HOVENKAMP, *supra* note 131, at 246; Watkins, *supra* note 176, at 92–93.

¹⁸⁰ See Donald E. Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972) (giving an overview of the major policy consideration involved in a study of federal incorporation).

¹⁸¹ See Harris Berlack, *Federal Incorporation and Securities Regulation*, 49 HARV. L. REV. 396, 396–403 (1936); Brown, *supra* note 177, at 1117; H.W. Chaplin, *National Incorporation*, 5 COLUM. L. REV. 415, 415–16 (1905); Victor Morawetz, *The Power of Congress to Enact Incorporation Laws and to Regulate Corporations*, 26 HARV. L. REV. 667, 667 (1913); Wilgus, *supra* note 177, at 358. *But see* E. Parmalee Prentice, *Congress, and Regulation of Corporations*, 19 HARV. L. REV. 168 (1906) (arguing that commerce power insufficient to permit federal regulation of corporations).

¹⁸² 196 U.S. 375 (1905).

¹⁸³ See *id.* at 399.

¹⁸⁴ See *Houston, East & West Texas Ry. Co. v. United States*, 234 U.S. 342 (1914) (regulation of discriminatory rates technically occurring only intrastate within reach of commerce clause); *Southern Ry. Co. v. United States*, 222 U.S. 20, 26–27 (1911) (holding that the use of defective railway cars was not engaging in interstate hauls within reach of federal regulation under the commerce clause). *But see* *Child Labor Tax Case*, 259 U.S. 20 (1922) (holding unconstitutional Federal Child Labor Tax Law); *Hammer v. Dagenhart*, 247 U.S. 251, 277 (1918) (federal law prohibiting the shipment of interstate goods manufactured by child labor unconstitutional).

¹⁸⁵ *Russell v. United States*, 471 U.S. 858, 862 (1985) (finding a federal law reaching individual intrastate fire destruction activities in rental property constitutional); *Hodel v. Virginia Surface Mining & Reclamation Ass’n, Inc.*, 452 U.S. 264, 304–05 (1981) (finding a federal law regulating mining activities conducted intrastate constitutional); *Perez v. United States*, 402 U.S. 146, 149–57 (1971) (holding Consumer Credit Protection Act prohibiting intrastate extortionate credit transactions is constitutional); *Katzenbach v. McClung*, 379 U.S. 294, 300–05 (1964) (Civil Rights Act as applied to a restaurant which bought food in interstate commerce is constitutional); *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 249–62 (1964) (holding Civil Rights Act, as applied to a motel which accepted out-of-state guests, is constitutional); *Wickard v. Filburn*, 317 U.S. 111, 118–29 (1942) (holding Agricultural Adjustment Act regulating personal

If successful, the federal licensing and chartering proposals probably would have prevented the LLC's invention. Congress would have possessed the ability to either refuse to legitimize the LLC or, at least, deny the LLC a license, thus confining LLCs to local businesses. These proposals failed because the states' power over the incorporation process had become irreversibly entrenched. By the time serious discussion of enhanced federal control took place, state law had been chartering corporations without interruption since America's beginnings and general incorporation statutes had been around for almost one hundred years. Moreover, in the early twentieth century, the states further strengthened their hold over the incorporation process by competing to produce the most business friendly general incorporation statute.¹⁸⁶ This competition among the states, a phenomenon known in later literature as the "race to the bottom,"¹⁸⁷ made general incorporation statutes materially more attractive to business interests. By the second decade of the twentieth century, the state general incorporation statute evolved to a commanding position, with Delaware, still in a position it currently enjoys, emerging as the corporate statutory leader.¹⁸⁸ The defeat of the early twentieth century federal licensing and chartering proposals and the perfection of the state law general

wheat farming has an "indirect" effect on commerce and therefore is constitutional); *United States v. Darby*, 312 U.S. 100, 111 (1941) (holding Fair Labor Standards Act regulating intrastate wages is a valid exercise of Commerce Clause); *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 37 (1937) (holding legislation protecting union members from discrimination and preserving collective bargaining rights is a valid exercise of the Commerce Clause due to "substantial relation" test).

¹⁸⁶ In the late 1880s and early 1890s, a string of amendments, starting with the first authorization of holding companies, established New Jersey as the early favorite for incorporation and commenced the heated competition among the states. In 1888, New Jersey passed groundbreaking legislation allowing for the first time corporations to own stock in other corporations. By 1893, this legislation was perfected by allowing efficient accumulations of capital without the use of trusts. In 1896, further revisions to New Jersey's statute produced the first modern liberal incorporation law. See Edward Q. Keasbey, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 207-08 (1899).

¹⁸⁷ For general discussions of the competition among the states to produce the most business-friendly general incorporation statute, see HORWITZ, *supra* note 138, at 83-84; HOVENKAMP, *supra* note 131, at 258; Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1445-46 (1992); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); FRIEDMAN, *supra* note 126, at 523-25; HURST, *supra* note 109, at 147-48.

¹⁸⁸ In 1913, new provisions to curtail antitrust activities resulted in New Jersey losing its position, and Delaware quickly emerging as the favorite state for incorporation. See William E. Kirk, III, *A Case Study in Legislative Opportunism: How Delaware Used the Federal-State System to Attain Corporate Pre-Eminence*, 10 J. CORP. LAW 233, 255-58 (1984); see also RUSSELL CARPENTER LARCOM, *THE DELAWARE CORPORATION 155-79* (1937) (corporate charters for public companies clearly favored Delaware in 1915).

incorporation statutes allowed the states to continue exercising the primary power over the creation of corporations, leaving the state law forum in place, which made the LLC's invention possible approximately fifty years later.¹⁸⁹

IV. TAX AND BUSINESS CONDITIONS OF THE TWENTIETH CENTURY THAT LAUNCHED THE LLC

If the LLC's most distant seeds originated in special corporate charters issued by state legislatures and early general incorporation statutes, its more direct roots can be traced to the first modern income tax,¹⁹⁰ enacted within months of Congress'

¹⁸⁹ Although the states never lost the principal authority over the incorporation process, throughout the twentieth century, Congress issued corporate charters for specific purposes. *See, e.g.*, Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (incorporating the Resolution Trust Corporation and the Resolution Funding Corporation to provide funds from public and private sources to bail out failed depository institutions); 29 U.S.C. § 1302 (1974) (incorporating the Pension Benefit Guaranty Corporation to encourage voluntary private pension plans and provide for timely and uninterrupted payment of benefits); 12 U.S.C. § 1716(b) (1968) (incorporating the Government National Mortgage Association, separate from the Federal National Mortgage Association, to establish and encourage secondary markets for mortgage-backed securities); 47 U.S.C. § 396 (1967) (incorporating the Corporation for Public Broadcasting to encourage the growth and development of public radio and television to address the needs of the unserved and under-served); 15 U.S.C. § 714 (1948) (incorporating the Commodity Credit Corporation to stabilize, support, and protect farm income and prices and to facilitate orderly distribution of agricultural commodities); 12 U.S.C. § 1811 (1933) (incorporating the Federal Deposit Insurance Corporation to insure the deposits of banks and savings associations); 16 U.S.C. § 831 (1933) (incorporating the Tennessee Valley Authority to operate and maintain land in the interest of agricultural and industrial development, improve navigation in the Tennessee River, and control destructive flood waters); 36 U.S.C. § 2 (1947) (incorporating the American Red Cross to provide volunteer aid in times of war and to mitigate suffering caused by disasters in times of peace).

¹⁹⁰ In 1861, Congress enacted the first income tax to finance the Civil War. *See* Act of Aug. 5, 1861, ch. 45, 12 Stat. 292 (repealed 1872), *discussed in* RANDOLPH E. PAUL, *TAXATION IN THE UNITED STATES* 27 (1954). The Revenue Act of 1894 imposed the first peacetime income tax assessing a two percent income tax on individuals and corporations. *See* Act of Aug. 27, 1894, ch. 349, 28 Stat. 509, 553-54 (1894). Interestingly, an unenacted part of the proposal focused on limited liability as the sole criteria for determining which entities faced the corporate tax. *See* 26 CONG. REC. 1594-95 (1894) (proposed amendment § 59). The Supreme Court subsequently held the 1894 income tax to be unconstitutional. *See* *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 583, *modified*, 158 U.S. 601, 637 (1895). Congress structured the Revenue Act of 1909 as an "excise tax" in order to avoid constitutional problems. *See* Act of Aug. 5, 1909, ch. 6, 36 Stat. 11. Throughout the nineteenth century the states imposed many different kinds of taxes on property and income which affected corporations as well as individuals. *See generally* EDWIN E. A. SELIGMAN, *THE INCOME TAX* 388-429 (1911); FREYER, *supra* note 139, at ch. 3 (big picture discussion of state taxation of business during Antebellum period).

ratification of the Sixteenth Amendment¹⁹¹ in 1913. In 1913 the choices among business entities were the general partnership and the corporation, both available since America's beginnings, as well as the limited partnership and the business trust. Limited partnerships, first appearing in New York in 1822,¹⁹² required a state law filing and allowed limited partners, as passive investors, to enjoy limited liability protection. The general partner managed the limited partnership's business or assets and under the earlier statutes sometimes enjoyed limited liability protection.¹⁹³ Business trusts, which involve no formal state law filings providing statutory limited liability to the participants, first enjoyed widespread recognition by courts as a legitimate entity for doing business in the late nineteenth century.¹⁹⁴ The first modern income tax, the Revenue Act of 1913, which carries forward to the present day, taxed the net income of "every corporation, . . . or association . . . organized in

¹⁹¹ U.S. CONST. amend. XVI (creating broad congressional powers to tax).

¹⁹² In 1822, New York enacted the first limited partnership statute as an alternative to the business corporation. The New York statute envisioned two classes of partners: the general partners who were fully liable and limited partners who only had their capital contribution at risk. Over the following twenty-year period, most states enacted similar statutes as an attempt to slow the increased use of the business corporation. However, the early limited partnership statutes were seldom used. See SEAVOY, *supra* note 110, at 97-98.

¹⁹³ See *infra* note 203.

¹⁹⁴ Business trusts date back to seventeenth century English trust law and pre-Civil War references to business trusts in America can be found in *Foster v. Goree*, 4 Ala. 440 (Ala. 1842) (trust, executed to secure a debt related to a sale of slave, held valid despite failure to appoint substitute trustee) and *Attorney General v. Proprietors of the Meetinghouse*, 69 Mass. 1 (1854), *writ of error dismissed*, 66 U.S. 262 (1861) (business trust mentioned in dicta). Massachusetts became the mainstay for business trusts in the nineteenth century, thus donning them with the name "Massachusetts trusts." In the late nineteenth century, Massachusetts and other state courts steadily began to recognize the usefulness and validity of business trusts, most courts considering whether the creditors of a business trust could hold the shareholders liable for judgments obtained. See *Mayo v. Moritz*, 24 N.E. 1083, 1083 (Mass. 1890) (trust set up by assignees of an invention was held to be a separate entity); *Phillips v. Blatchford*, 137 Mass. 510, 516 (1884); *Whitman v. Porter*, 107 Mass. 522, 524 (1871); *Ricker v. American Loan and Trust Co.*, 5 N.E. 284, 288 (Mass. App. Ct. 1885) (considered how to tax an association dealing with railroad stock). Other state decisions held business trusts valid. See *generally* *Gindrat v. Montgomery Gas Light Co.*, 2 So. 327 (Ala. 1887) (sale of land to business trustee held valid in ejectment action); *Wells-Stone Mercantile Co. v. Grover*, 75 N.W. 911 (N.D. 1898) (debtor and creditors could form business trust without creditors becoming real proprietors to the trust property); *Connally v. Lyons*, 18 S.W. 799 (Tex. 1891) (trustee of mercantile business trust held personally liable for the price of goods absconded); *Robey v. Smith*, 30 N.E. 1093 (Ind. 1892) (citizens cannot be denied the right to take property in trust). Despite these court decisions, the Massachusetts legislature, until 1912, did not accept business trusts as a separate entity. See Massachusetts House Resolves, ch. 56, Resolve to Provide for an Investigation of Voluntary Associations Organized or Doing Business in this Commonwealth under Written Instruments or Declarations of Trusts (April 15, 1911); H.R. 1788, Report of the Special Commission to Investigate Voluntary Associations (January 5, 1913).

the United States . . . not including partnerships.” Corporations, as well as unincorporated organizations deemed associations, would bear an entity level tax just like individuals while partnerships would bear no tax, creating flow-through taxation to the partners.¹⁹⁵ Congress viewed the corporation as an appropriate target for an income tax due to its formal creation by and recognition as a separate entity by state issued charters.¹⁹⁶ The ordinary general partnership, viewed as an inappropriate target for the tax, involved no state law filing and constituted a mere aggregate of the partners, each facing personal liability exposure with management and dissolution powers over the partnership.¹⁹⁷

Although it took until 1918 for the definition of corporation to clearly articulate that associations constituted a distinct category needing their own definition,¹⁹⁸ the modern income tax as enacted in 1913, by creating an entity level tax on all state law corporations and on at least some unincorporated forms along with no entity level tax on partnerships, set up the legal foundation eventually leading to the birth of the LLC more than half a century later. Two principal factors, the IRS’s movement away from imposing the corporate tax if the unincorporated business offered limited liability dovetailing with the growth of independent oil producers and their desire to secure limited liability in a partnership business form, explain why the LLC emerged in the middle 1970s rather than earlier. Before 1960, the legal requirements imposed by the IRS’s regulations simply did not permit business organizations offering limited liability to qualify for partnership taxation. Moreover, an analysis of the effective income tax burden from doing business in a corporation

¹⁹⁵ See Revenue Act of 1913, ch. 16, 38 Stat. 114.

¹⁹⁶ See 26 CONG. REC. 6866–67 (1894) (articulating corporation’s status as a legal entity with government protection and privileges as justification for imposing an income tax) (statement of Sen. Vest); see also Patrick E. Hobbs, *Entity Classification: The One-Hundred Year Debate*, 44 CATH. L. REV. 437, 441, 446 (1995) (speculating that the separate income tax on corporations was implemented solely to “soothe the psyche of the American public”).

¹⁹⁷ See *supra* notes 128–29 (discussing early uses and characteristics of partnerships); see also LARRY E. RIBSTEIN, BUSINESS ASSOCIATIONS 1-2 to 1-5, 3-1 to 3-3, 3-10 to 3-21 (1983) (discussing partnership law as it existed in 1914, the time of the Uniform Partnership Act’s codification); EDWARD H. WARREN, CORPORATE ADVANTAGE WITHOUT INCORPORATION 17–28 (1929) (comparing and contrasting partnerships to corporations at the turn of the century).

¹⁹⁸ The concept of association clearly constituting a separate category first appeared in the War Profits Excess Tax of 1917. See War Revenue Act, ch. 63, § 200, 40 Stat. 302 (1917) (defining “corporation” to include “joint-stock companies or associations and insurance companies. . .”). The Revenue Act of 1918 continued with this approach, defining “corporation” to include “associations, joint-stock companies, and insurance companies.” Revenue Act of 1918, ch. 18, 40 Stat. 1057 (1919). The Revenue Act of 1932 completed the circle of definitions clearly separating partnerships from associations by defining “partnership” to include “a syndicate, group, pool, joint venture or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation.” Revenue Act of 1932, ch. 209, § 1111(a)(3), 47 Stat. 169.

versus a partnership shows that businesses consistently producing taxable income had no motivation to secure limited liability outside the corporate form until after the Tax Reform Act of 1986. Before the 1986 Act, only business ventures needing to pass-through tax losses to investors would benefit from adding the limited liability feature to a business organization qualifying for partnership taxation, and a widespread market for these investments did not develop until the early 1970s. Ultimately, the business conditions of the oil and gas industry leading to an increased presence of independent producers using partnerships to conduct oil exploration activities sparked the market for investments, producing flow-through tax losses, and helped explain the invention of the LLC.

A. *Limited Liability Mandated Corporate Taxation Until 1960*

Although the modern income tax failed to spell out which business characteristics distinguished associations from partnerships, until 1960 the presence of limited liability, evidenced by a state law filing similar to articles of incorporation, served as regulatory benchmark mandating association treatment. Other than the corporation, only the limited partnership form offered limited liability protection by virtue of a state law filing. Undoubtedly, due to the statutory limited liability protection enjoyed by at least all the limited partners, the first definition of association as promulgated by Regulation 33 in 1914 simply stated without explanation that all limited partnerships would be taxed as corporations.¹⁹⁹ Starting in 1921 with Regulation 45 through all regulatory amendments until 1940, limited partnerships could qualify for partnership taxation if the general partner remained personally liable under state law for the partnership's obligations, and if a number of other partnership characteristics were present.²⁰⁰ However, the strong presumption in the regulations, treating all doubtful cases as associations, caused limited partnerships in states statutorily providing general partners limited liability protection to always be classified as associations thereby subjecting them to the corporate tax.²⁰¹ Because limited partnerships granting all partners limited liability

¹⁹⁹ See Treas. Reg. No. 33, art. 86 (1914).

²⁰⁰ See Treas. Reg. No. 45, art. 1505 (1921). For additional regulations containing the same substantive standards as Regulation 45 for testing limited partnerships as partnerships, see Treas. Reg. 62, art. 1505 (1922); Treas. Reg. 65, art. 1505 (1924); Treas. Reg. 69, art. 1505 (1926); Treas. Reg. 74, art. 1315 (1929); Treas. Reg. 77, art. 1315 (1933); Treas. Reg. 86, art. 801-6 (1935); Treas. Reg. 94, art. 1001-6 (1936); Treas. Reg. 101, art. 901-6 (1939). Because limited partnerships acting as separate entities would be treated as associations, few limited partnerships would qualify as partnerships. See also Stephen B. Scallen, *Federal Income Taxation of Professional Associations and Corporations*, 49 MINN. L. REV. 603, 656-57 (1965) (noting that few limited partnerships would qualify for partnership taxation).

²⁰¹ See Treas. Reg. 45, art. 1506 (1921) (defining association characteristics as including limited liability for the general partner, freely transferable shares, limited partnership's ability to

protection could not secure partnership taxation, until 1940 the partnership classification regulations directly imposed formidable obstacles to any new experimentation that may have resulted in the invention of the LLC.

Starting with Regulation 103 in 1940 through all regulatory amendments until 1960, the criteria distinguishing limited partnerships from associations stopped using limited liability as a relevant factor. Moreover, the regulations made it easier for limited partnerships to secure partnership taxation by removing the language requiring all doubtful cases to be associations. Rather, the regulations focused on the presence of continuity of existence beyond the life of the original partners, free transferability of partnership interests and centralized management, as pointing to association status without explicitly tilting doubtful cases one way or the other.²⁰² The regulations probably stopped discussing limited liability as a factor for limited partnerships because, by 1940, state law had evolved to a point where general partners consistently faced personal liability exposure.²⁰³ Because state law routinely required general partners to bear personal liability and techniques, such as setting up a minimally capitalized corporate general partner, to substantively undermine that liability exposure had not yet developed, the limited liability factor no longer proved useful for testing limited partnerships.²⁰⁴

hold title and bring suits—with all doubtful cases resolved in favor of an association classification). For additional regulations containing the substantive legal standards that appeared in Regulation 45 related to limited partnerships being classified as associations, see Treas. Reg. 62, art. 1506 (1922); Treas. Reg. 65, art. 1506 (1924); Treas. Reg. 69, art. 1506 (1926); Treas. Reg. 74, art. 1316 (1929); Treas. Reg. 77, art. 1316 (1933); Treas. Reg. 86, art. 801-5 (1935); Treas. Reg. 94, art. 1001-5 (1936); Treas. Reg. 101, art. 901-5 (1939). Limited partnerships offering the general partner limited liability protection had virtually no chance of securing partnership taxation. The combination of the liability protection establishing at least one association characteristic and the “all doubtful cases” language, essentially giving the IRS heavy leeway to impose association status, made it impossible for these limited partnerships to comfortably rely on being taxed as partnerships even if other facts negated other association traits.

²⁰² See Treas. Reg. 103, art. 19.3797-5 (1940) (“If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if [management is centralized], it is taxable as a corporation.”); Treas. Reg. 111, art. 29.3797-5 (1943); Treas. Reg. 118, art. 39.3797-5 (1951/54).

²⁰³ During the period from 1940 to 1960, most limited partnership statutes enacted provided that the general partner was personally liable. See 43 ALA. CODE § 7 (1940); CAL. CORP. CODE §§ 15501–15531 (West 1954); 6 DEL. CODE ANN. §§ 1701–1712 (1953); FLA. STAT. ch. 620.01–620.32 (1949); KAN. STAT. ANN. §§ 56–101 to 56-121 (1949); MASS. GEN. LAWS ANN. ch. 109, §§ 1–31 (1933 & Supp. 1957); MICH. COMP. LAWS §§ 20.51–20.81 (1936 & supp. 1957); N.J. REV. STAT. §§ 42:2-1 to 42:2-30 (1937 & Supp. 1941); N.Y. LAWS art. 8 § 90-119 (1938 & Supp. 1943); OHIO REV. CODE ANN. §§ 8036–8058 (1940); WIS. STAT. §§ 124.01–124.30 (1941).

²⁰⁴ See Hamill, *Corporate Integration*, *supra* note 3, at 410–11 (discussing the use of minimally capitalized corporate general partners to achieve complete limited liability protection for a limited partnership); Hamill, *Partnership Classification*, *supra* note 5, at 585–87, 604–05

Moreover, from 1940 through 1960, the regulations created a different category for state law partnership associations in order to apply a separate standard. Without explicitly referring to any corporate criteria, the regulatory language applicable to partnership associations clearly state that the statutory provisions of partnership associations mandate association status.²⁰⁵ Like shareholders of corporations, by virtue of a state law filing, all members of partnership associations enjoy limited liability protection.²⁰⁶ Apparently, from 1940 until 1960 the presence of limited liability served as the major dividing point,²⁰⁷ requiring state law partnership associations to be in a different category than limited partnerships.²⁰⁸ Because they no longer offered complete limited liability protection, limited partnerships enjoyed a realistic opportunity to secure partnership taxation while partnership associations always faced the corporate tax. Although the post-1940 regulations contain no direct language to this effect, until 1960 the presence of statutory limited liability nevertheless remained a critical factor pointing to association status, rendering the legal environment unsuitable for the LLC.

Although limited liability played a fundamental role in the classification of limited partnerships and partnership associations, the pre-1960 regulations placed substantially less weight on limited liability when testing general partnerships and business trusts for association status. The first definition of association in Regulation 14 simply stated that all general partnerships avoided association classification,²⁰⁹ and without mentioning limited liability, deemed all common law trusts—organized for commercial or industrial purposes, with shares of interests based on capital or profits—as corporations for federal income tax purposes.²¹⁰ Although subsequent regulatory amendments starting in 1921 lasting until 1960 contemplated taxing

(same).

²⁰⁵ See Treas. Reg. 103, art. 19.3797-6 (1940) (providing that “a partnership association . . . is taxable as corporation”); Treas. Reg. 111, art. 29.3797-6 (1943); Treas. Reg. 118, art. 39.3797-6 (1951/54).

²⁰⁶ See 59 PA. STAT. ANN. §§ 171–484 (1936); N.J. REV. STAT. §§ 42:3-1 to 42:3-30 (1937 & Supp. 1941); MICH. COMP. LAWS §§ 20.91–20.106 (1936 & Supp. 1957); OHIO REV. CODE ANN. §§ 8059–8078 (1940); sources cited at *supra* notes 199–201 (pre-1940 regulations refer to partnership association statutes in these four states); see also Letter from Robert L. Hartig to Tom Fink, Alaska state representative (Mar. 14, 1975) (referring to the above four statutes in support of the pending Alaska LLC legislation).

²⁰⁷ See *supra* notes 205, 206 (partnership associations automatically taxed as associations and enjoy limited liability protection under state law).

²⁰⁸ Prior to 1940, state law partnership associations were lumped into the rules that tested limited partnerships for association status, leaving open the theoretical, but not practical, possibility of securing partnership status. See *supra* notes 199–201.

²⁰⁹ See Treas. Reg., art. 94 (1914).

²¹⁰ See Treas. Reg. 33, arts. 57, 58 (1918). This Regulation, promulgated in 1914, failed to discuss the classification of business trusts.

some general partnerships as associations, limited liability never appeared as an explicit factor relevant to association status.²¹¹ Starting in 1921 and continuing until 1935, the regulations, although still not discussing limited liability, allowed trusts holding property for the collection and distribution of rents, where the trustee possessed no other significant managerial powers, to enjoy a safe harbor avoiding association status. All other business trusts still conclusively faced the corporate tax.²¹² Although Regulation 86, in 1935 and all subsequent amendments until 1960, revised the standards for classifying business trusts by adding limited liability to the relevant factors, the presence of limited liability never became a critical feature mandating association classification for business trusts.²¹³

The IRS's failure to refer to limited liability as the most important association factor in the context of general partnerships and business trusts does not negate the central importance of limited liability for determining association status in the pre-1960 period. The IRS undoubtedly deemed it unnecessary to explicitly treat general partnerships offering limited liability as associations because state law exposes all general partners to personal liability for the debts of the partnership and techniques, such as the creation of corporate intermediaries, undermining that liability exposure had not yet developed.²¹⁴ Similarly, in the earliest regulations, the IRS probably deemed it unnecessary to use limited liability to any degree when classifying business trusts due to the personal liability exposure of the trust participants under state law. However, once the use of business trusts became more sophisticated by the early 1920s, the IRS undoubtedly noticed contractual mechanisms providing partial limited liability protection to trust participants. This technique, which was ineffective against involuntary creditors, for example tort creditors, contractually required the trust itself to bear all debts and not to hold the trust participants

²¹¹ See Treas. Reg. 45, art. 1503 (1921) (focusing on free transferability and centralized management; limited liability never a factor); Treas. Reg. 62, art. 1503 (1922); Treas. Reg. 65, art. 1503 (1924); Treas. Reg. 69, art. 1503 (1926); Treas. Reg. 77, art. 1313 (1933); Treas. Reg. 86, art. 801-4 (1935); Treas. Reg. 94, art. 1001-4 (1936); Treas. Reg. 101, art. 901-4 (1939); Treas. Reg. 103, art. 19.3797-4 (1940); Treas. Reg. 111, art. 29.3797-4 (1943); Treas. Reg. 118, art. 39.3797-4 (1951/54).

²¹² See Treas. Reg. 45, art. 1504 (1921) (focusing on trustee's role as a business manager; limited liability never mentioned); Treas. Reg. 62, art. 1504 (1922) (same); Treas. Reg. 65, art. 1504 (1924) (same); Treas. Reg. 69, art. 1504 (1926) (same); Treas. Reg. 74, art. 1314 (1929) (same); Treas. Reg. 77, art. 1314 (1933) (same).

²¹³ See Treas. Reg. 86, art. 801-3 (1935); Treas. Reg. 94, art. 1001-3 (1936); Treas. Reg. 101, art. 901-3 (1938); Treas. Reg. 103, art. 19.3797-3 (1940); Treas. Reg. 111, art. 3797-3 (1943); Treas. Reg. 118, art. 39-3797-3 (1953-1960).

²¹⁴ See Uniform Partnership Act § 15(b) (1914) (all partners personally liable); see also Hamill, *Corporate Integration*, *supra* note 3, at 410-11 (discussing corporate intermediaries creating limited liability protection for partners).

personally liable.²¹⁵ The increased presence of this technique explains why limited liability appeared as a relevant factor for classifying trusts by 1935. However, because the contractual protection only partially covered the trust participants, the IRS perhaps deemed it unnecessary to make limited liability a superfactor requiring association status for trusts. Consequently, despite the minor role played by limited liability in classifying general partnerships and business trusts, the pre-1960 partnership classification regulations would have nevertheless conclusively taxed the LLC as a corporation due to the absolute limited liability protection provided by the state law filing.

Ironically, by overhauling the partnership classification regulations in 1960, the IRS forged the legal path that led to the LLC's invention less than twenty years later. In order to deny professional groups the association status necessary for pension benefits, available at that time only to businesses taxed as corporations, the IRS radically changed the regulations to make it considerably more difficult for unincorporated organizations to come under the association category.²¹⁶ The 1960 regulations mechanically gave each of the four corporate characteristics, among them limited liability, equal weight. The literal terms of the 1960 regulations permitted an unincorporated business offering limited liability to secure partnership classification provided that at least two of the remaining three corporate characteristics were not present.²¹⁷

²¹⁵ Trust participants generally can be held personally liable either in their capacity as owners or managers (for example, trustees with no beneficial interest). *See generally* GUY THOMPSON, *BUSINESS TRUSTS AS SUBSTITUTES FOR BUSINESS CORPORATIONS* 36 (1920) (citing *Taylor vs. Davis*, 110 U.S. 330 (1884)); sources cited at *supra* note 194. By the 1920s, a contractual technique providing partial liability protection evolved where the trustee uses the trust instrument to formally declare (while giving proper notice) the trust to be solely liable for all business debts. *See id.* at 36–37. Interestingly enough, this same advice exists today. *See generally* Sheldon A. Jones et al., *The Massachusetts Business Trust and Registered Investment Companies*, 13 DEL. J. CORP. L. 421 (1988). Moreover, unlike corporate statutes covering directors, many business trust statutes do not explicitly permit the trustee to be indemnified for bad business decisions. *See id.* at 433 (citing Mass Gen. Laws Ann. ch. 182); *see also* Richard F. Barrett & Jean E. deValpine, *Taxation of Business Trusts and Other Unincorporated Massachusetts Entities with Transferable Shares*, 40 BOST. U. LAW REV. 329 (1960) (discussing business advantages offered by the Massachusetts business trust that, under pre-1960 law, were often outweighed by tax uncertainties, especially at the federal level).

²¹⁶ *See* Hamill, *Partnership Classification*, *supra* note 5, at 573 (discussing 1960 regulations as a response to *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954), where a group of physicians operating in a state law partnership secured association status under the 1953 regulations with the court upholding the classification and the desired pension benefits. Subsequently, the states widely adopted professional incorporation statutes to allow these groups to directly receive the pension benefits).

²¹⁷ *See supra* note 41 and accompanying text (discussing Wyoming LLC statute that literally complies with the requirements of the 1960 regulations).

B. *Effective Income Tax Burdens Largely Favored Corporations Until 1986*

In order to analyze the timing of the LLC's invention following the 1960 regulations, the perspective of two groups of business activities must be considered. Some business ventures expect to incur tax losses in the early years of operation and prior to the Tax Reform Act of 1986, the need to pass-through these losses to investors effectively necessitated securing partnership classification for the business entity. Corporations subject to the two-tiered tax will always be unsuitable because the early losses will be trapped at the corporate level. The S corporation, offering a pass-through regime with superficial appeal, will also be an unsuitable choice for these business ventures due to its many restrictions, the most devastating being the rules denying shareholders of S corporations an increase in stock basis for shares of the corporation's third party debt.²¹⁸ The needs of business ventures expecting to consistently recognize taxable income, making the pass-through of early losses irrelevant, are far more complex. The comparative income tax burden between doing business in a partnership or corporation greatly affects the business entity choice. Because of the flow-through model of taxation, the income tax burden on individuals globally represents the tax cost of doing business in a partnership or S corporation, while the income tax burden on corporations measures the tax cost of doing business in a C corporation. Despite the technical presence of the corporate tax, the combination of lower corporate rates and preferential treatment of capital gains, as well as other corporate oriented preferences, may actually result in businesses consistently recognizing taxable income bearing less tax from operating in a C corporation.²¹⁹

Until 1958, the comparative income tax burdens faced by individuals and corporations discouraged many businesses recognizing significant taxable income from choosing partnerships or S corporations. A comparison of the effective income tax rates²²⁰ from 1913 until 1958 indicates that the C corporations consistently enjoyed greater tax savings than individuals reporting distributive shares of income

²¹⁸ See Hamill, *Possible Choice*, *supra* note 2, at 754 (discussing advantages of partnership taxation over subchapter S taxation); ROBERT E. SWANSON & BARBARA MARDINLY SWANSON, *TAX SHELTERS: A GUIDE FOR INVESTORS AND THEIR ADVISORS* 40-41 (1982) (subchapter S corporation fails to provide an appropriate form for tax shelter investments).

²¹⁹ See *infra* notes 222-28; see also BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* § 5.01[5] (1994) (stating that the corporate form may be advantageous over pass-through entities when the maximum corporate tax rate is lower than the maximum individual rate and capital gains preferences exist).

²²⁰ See the Appendix to this Article for a discussion of mechanical calculations and assumptions made when interpreting the data related to the effective income tax burdens borne by individuals and corporations.

from partnerships and S corporations.²²¹ For most of the years²²² following the Revenue Act of 1918,²²³ individuals faced a top nominal income tax rate exceeding fifty percent and, from 1944 until the early 1960s, the highest nominal rate on individual income exceeded ninety percent.²²⁴ Despite tax planning opportunities mitigating the actual tax rates, individuals still suffered a significantly higher overall effective income tax rate than the comparable rate imposed on corporations.²²⁵ On

²²¹ As already noted, partnerships have always offered flow-through taxation. Congress enacted subchapter S in 1958 to provide parity between partnerships and small business corporations. Although the flow-through treatment to shareholders generally achieved this goal, S corporations faced many restrictions not applicable to partnerships. *See* S. Rep. No. 1983, 85th Cong., 2nd Sess. 87 (1958), *reprinted in* 1958-3 CB 922, 1137. In 1982 Congress overhauled subchapter S. *See* Pub. L. No. 85-866, 72 Stat. 1606, 1658 (1982). In 1996 Congress made additional changes. *See* Small Business and Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755. Both pieces of legislation greatly improved subchapter S but failed to provide parallel treatment with partnerships.

²²² *See generally* Appendix to this Article. For the years 1925 to 1931, the highest individual nominal income tax rate was 25%, while the highest nominal corporate tax rate averaged less than 13%. Although the differential between the individual and corporate nominal rates equaled approximately 12%, the differential between the individual and corporate effective rates only amounted to a little more than 4%. *See* STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1925-1931, CORPORATION INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1925-1931, INDIVIDUAL INCOME TAX RETURNS (each year in separate books).

²²³ *See generally* Appendix to this Article. For the years 1913 to 1917, the highest nominal rate for individuals was 7%, 7%, 7%, 15%, and 67%, respectively. The highest effective rate for these years was approximately 1%, 1%, 1.5%, 11%, and 35.5%, respectively. *See* STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1913-1917, INDIVIDUAL INCOME TAX RETURNS (each year in separate books).

²²⁴ *See* STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1944-1963, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); *see also* Appendix to this Article.

²²⁵ *See generally* Appendix to this Article. From 1913 to 1916, the highest effective rates for corporations averaging approximately 1.25% showed a lower overall burden than the comparable rate on individuals showing an approximate 3.5% average. *See* STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1913-1916, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1913-1916, CORPORATION INCOME TAX RETURNS (each year in separate books). This pattern continued in 1917 as corporations rose to 20% while individuals rose further to 36%. *See* STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1917, INDIVIDUAL INCOME TAX RETURNS; STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1917, CORPORATION INCOME TAX RETURNS. From 1918 to 1924, corporations averaging approximately 18% continued to bear less tax burden than individuals averaging approximately 49%. *See* STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1918-1924, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1918-

the corporate side,²²⁶ for most of the years²²⁷ from 1918 to 1958, the highest effective rate remained well under fifty percent, and in many years dipped below fifteen percent.²²⁸ Because the C corporation actually offered lower costs when measuring the actual tax burden, than the comparable burden faced by individuals using partnerships, until 1958 businesses expecting to produce significant taxable income had no motivation to look beyond the corporate form to obtain limited liability and therefore were highly unlikely to invent or support the LLC.

From 1958 until 1973, the comparative effective tax burdens borne by individuals and corporations shifted with corporations shouldering a slightly higher burden. During this time, the highest effective tax rates on individuals remained between forty-four and forty-eight percent, with the highest corporate effective tax rates consistently higher by approximately three percentage points.²²⁹ From 1974

1924, CORPORATION INCOME TAX RETURNS (each year in separate books). See *supra* note 222, for the effective rate comparison for the years 1925 to 1931. From 1932 to 1949, the pattern continued with corporations averaging approximately 31% while individuals averaged approximately 61%. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1932–1949, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1932–1949, CORPORATION INCOME TAX RETURNS (each year in separate books). From 1950 to 1957, corporations still bore less of a tax burden averaging approximately 48% with individuals averaging approximately 58%. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1950–1957, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1950–1957, CORPORATION INCOME TAX RETURNS (each year in separate books). In 1958, for the first time in modern income tax history, corporations incurred a higher effective income tax rate than individuals. From 1958 to 1963, the highest effective rates for corporations averaged approximately 51% while the individuals' highest effective rates averaged approximately 48%, giving an average rate differential of 3%. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1958–1963, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1958–1963, CORPORATION INCOME TAX RETURNS (each year in separate books).

²²⁶ See generally Appendix to this Article.

²²⁷ See generally Appendix to this Article. The effective rate for corporations went above 50% in 1940, 1943 to 1944, and 1951 to 1953. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1940, 1943–1944, 1951–1953, CORPORATION INCOME TAX RETURNS (each year in separate books).

²²⁸ See generally Appendix to this Article. The effective rate for corporations fell below 15% for the years 1922 to 1939. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1922–1939, CORPORATION INCOME TAX RETURNS (each year in separate books).

²²⁹ See generally Appendix to this Article. From 1958 to 1973, the highest effective rates for corporations averaged approximately 48.5% while the individuals' highest effective rates averaged approximately 45.5%, giving an average rate differential of a mere 3%. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1958–1973, INDIVIDUAL INCOME TAX

until the Tax Reform Act of 1986, the highest effective tax rates shifted again, causing individuals to bear a higher tax burden. During these years, the corporate effective rates remained between thirty-five and forty-five percent with the individual effective rates consistently higher, but only by approximately four percentage points.²³⁰ Because from 1958 through 1986 the gap between the individual and corporate highest effective tax rates remained consistently narrow, the overall tax burdens of doing business neither encouraged nor discouraged the use of C corporations over partnerships or S corporations. Because the corporation represented a well established and understood choice for doing business and posed a tax burden roughly commensurate with the partnership forms, businesses expecting to recognize significant taxable income still had no motivation to obtain limited liability outside the corporate form by inventing or supporting the LLC.

C. Business Prototypes Contributing to the Development of LLCs

As already noted, until Congress enacted the Tax Reform Act of 1986, only business ventures expecting significant tax losses in the early years of operation had any motivation to create and support the LLC, and until the 1960s the IRS's regulations posed a legal barrier to the LLC achieving partnership taxation. Although business activity producing flow-through tax losses can be traced all the way back to the first modern income tax, a significant market for these investments did not fully develop until the early 1970s.²³¹ Fueled by an enormous demand for crude oil erupting in the early 1970s, the significant market for investments featuring early tax losses started with sales of partnership interests in oil and gas ventures sponsored by independent oil producers. Partnership interests in

RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1958–1973, CORPORATION INCOME TAX RETURNS (each year in separate books).

²³⁰ See generally Appendix to this Article. From 1974 to 1986, the highest effective rates for corporations averaged approximately 39.5% while the individuals' highest effective rates averaged approximately 43.5%, giving an average rate differential of a mere 4%. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1974–1986, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1974–1986, CORPORATION INCOME TAX RETURNS (each year in separate books). Although during this period corporations incurred lower effective rates than individuals by a differential of approximately 4%, this differential was well below the advantages corporations faced in their glory years prior to 1958, when their effective tax rates were significantly lower than the comparable rates on individuals. See *supra* notes 222–28.

²³¹ See SWANSON & SWANSON, *supra* note 218, at 2–5 (investments featuring flow-through tax losses traced back to the Sixteenth Amendment have always been available; fervent use of these investments in the 1960s and early 1970s brought to the spot light). See generally *Orrisch v. Comm'r*, 55 T.C. 395 (1970) (discussing 1966 and 1967 taxable years where IRS successfully invalidated special allocations of depreciation to a partner due to no economic effect).

independent oil exploration ventures were the most popular securities offering in the early 1970s, promising both flow-through tax losses in the early years and the possibility of tremendous profits, provided that the exploration activity resulted in a substantial oil find.²³² Although LLCs could have theoretically appeared any time after 1960, the spotty market for partnership investments rendered any significant LLC experimentation highly unlikely until the early 1970s. Moreover, because an independent oil producer, Hamilton Brothers Oil Company created the LLC in 1975, the business conditions of the oil and gas industry, particularly the growth of independent producers conducting oil exploration in partnerships, greatly contribute towards understanding the LLC's invention from a global perspective.

Oil and gas exploration went through a number of developments throughout the twentieth century leading to the substantial growth of independent oil explorers operating in partnerships by the early 1970s. The rapidly changing business climate in the early twentieth century involved heavy increases in the consumption of energy, causing the oil and gas industry to rise in importance.²³³ For example, the growth of the automobile and the electrical power industries²³⁴ fueled the early twentieth century economy after World War I²³⁵ up to the Depression of the 1930s.²³⁶ From World War II through the 1970s, industries requiring greater

²³² See Lewis G. Mosburg, Jr., *Regulation of Tax Shelter Investments*, 25 OKLA. L. REV. 207 (1972); ALAN J.B. ARONSON, PARTNERSHIP INCOME TAXES 9–11 (1978); Jerome Kurtz, *Commissioner's Remarks on Abusive Tax Shelter Issues*, 55 TAXES 774 & n.12 (1977); Madlyn M. Harrell & Richard J. Stricof, *Overview of An Oil and Gas Tax Shelter*, 28 OIL & GAS TAX Q. 496 (discussing IRS tax shelter audit program beginning in 1973 aimed particularly at oil and gas tax exploration ventures that later expanded to include other business activities producing flow through tax losses).

²³³ See HAROLD F. WILLIAMSON ET AL., THE AMERICAN PETROLEUM INDUSTRY, THE AGE OF ENERGY 1899–1959, at 648–72, 795–821 (1963) (discussing the growing importance of the oil and gas industry).

²³⁴ See GARY M. WALTON & HUGH ROCKOFF, HISTORY OF THE AMERICAN ECONOMY 456–58 (6th ed. 1990). The economy of the 1920s thrived with the automobile leading the way. From 1921 to 1929 car production rose from 1.5 million to 4.8 million cars, resulting in one out of every six Americans owning an automobile. Additionally, a rise in electrical appliance use further stimulated the economy. Homes with radios increased from 3 million in 1922 to nearly 10 million by the end of the decade, resulting in mass advertising. The increase in advertising, coupled with the growth of installment purchasing, further fueled the economy as consumer consumption boomed. *See id.*

²³⁵ *See id.* at 441–45, 518 (stating that American business enjoyed great profitability supplying wartime goods to Europe at the beginning of World War I, and by the close of the war, the country's days as a debtor had ended; in particular, the manufacturing industry reaped large profits as it supplied the war efforts).

²³⁶ *See id.* at 454–74, 478–95 (stating that U.S. business enjoyed prosperity during the 1920s as the world continued to change and technological advances introduced a new array of consumer goods, including widespread availability of the automobile).

consumption of oil and gas, especially the transportation industry, steadily increased, thus resulting in a steady rise in demand for crude oil throughout that period.²³⁷ Participants in the oil and gas industry used both the corporate and partnership forms. The major oil producers conducted worldwide operations and, at least until the late 1960s, engaged in all phases of the industry, including oil exploration, refining, and marketing.²³⁸ The major oil producers used corporations with multiple subsidiaries to conduct their business activities.²³⁹ The independent oil producers,²⁴⁰ whose primary business activity involved exploring for and developing oil and gas reserves to sell to third parties, used flow-through business forms qualifying for partnership taxation to conduct oil exploration activities.²⁴¹

Although the independent oil and gas explorers discovered a number of oil and gas deposits over the course of the twentieth century, prior to the late 1960s no widespread market supported a large number of independent drillers because the

²³⁷ See *id.* at 456–57, 618–20, 637 (stating that increases in the automobile industry fueled other related industries including steel, rubber, plate glass, and petroleum. The Post-War period also saw tremendous growth in the airline industry as the number of federal flight routes increased from 57,000 miles in 1949 to 220,000 miles by 1960. The percentage of GNP for transportation industry as a whole grew from approximately 7.6% in 1959 to 9.2% by 1979); WILLIAMSON, *supra* note 223, at 796, 804–06 (stating that during the fifteen year period following World War II, demand for petroleum products exploded, increasing by 80%).

²³⁸ Traditionally, the oil and gas industry divides the participants into either the major oil companies which produce, refine, and market oil and gas or independent oil and gas companies, which basically explore for and produce oil and gas for sale to third parties. See JOHN M. BLAIR, *THE CONTROL OF OIL*, at ix–xi, 235–37 (1976) (discussing the structure of the oil industry and integrated firms which engage all levels of industry activity and can be classified as production, refining, and marketing). See generally ANTHONY SAMPSON, *THE SEVEN SISTERS: THE GREAT OIL COMPANIES AND THE WORLD THEY MADE* (1975) (providing the history of the largest major oil companies—known as the Seven Sisters and their involvement in the world oil markets).

²³⁹ See SAMPSON, *supra* note 238, at 5–17 (discussing the operations of the Seven Sisters as corporations); BLAIR, *supra* note 238, at 128–51 (discussing general references to the corporate operations among the large players in the oil industry).

²⁴⁰ Independent oil producers do not normally engage in refining or marketing. As a group, independent oil producers have made several important discoveries throughout the twentieth century and are most closely identified with “independent wildcatters.” See BLAIR, *supra* note 238, at 125–28. See generally JEAN-FRANCOIS G. LANDEAU, *STRATEGIES OF INDEPENDENT OIL COMPANIES ABROAD* (1977) (discussing and analyzing oil producers which were among the largest oil producers moving abroad following World War II).

²⁴¹ See *supra* notes 14–24 and accompanying text; *supra* notes 231, 232 and accompanying text; see also Exhibits A & E to Frank M. Burke, Jr. Letter Dated March 25, 1993 Regarding History of Internal Revenue Service Ruling Position Regarding Limited Liability Companies (discussing desire of oil and gas exploration activities to be conducted in a flow through partnership form with limited liability).

worldwide crude oil supply needs were largely being met by other sources.²⁴² The primary purchasers of crude oil, the major oil producers, either conducted their own exploration activities or secured their supply from foreign sources. Because the foreign oil supply steadily became easier and less expensive to obtain, the major oil producers of the United States grew increasingly dependent on foreign oil from the 1940s through the 1970s.²⁴³ Although throughout this period the government imposed quotas and other rules in order to limit the amount of foreign source oil imported into the U.S.,²⁴⁴ rather than purchase additional supplies from independent producers, many of the major oil producers obtained the bulk of their crude oil needs from their own exploration after exceeding their foreign quota. However, by the late 1960s, when many of the major producers had scaled back their drilling operations because they could obtain virtually all their supply needs from foreign sources at a lesser cost,²⁴⁵ the relationship with the Middle Eastern governments

²⁴² See BLAIR, *supra* note 238, at 129 (stating that as late as 1973, 93.6% of all domestic proved oil reserves were held by twenty major oil companies with almost 66% held by the top eight and 37% held by the top four).

²⁴³ Before 1940 the major oil producers secured most of their crude oil needs by conducting their own domestic drilling projects. In the 1940s, for the first time, crude oil supply needs heavily relied on foreign sources. See WILLIAMSON, *supra* note 233, at 810, 818–19 (stating that total world oil supply from U.S. fields decreased from 67% in 1945 to less than 40% by 1959, while in 1948, the U.S., for the first time, became a net minerals oils importer as the percentage of imports compared to total oil supply began a steady increase over the next fifteen year period); SAMPSON, *supra* note 238, at 58–86 (stating that prior to 1940, operations focused upon self sufficiency).

²⁴⁴ Oil policies consistently revolved around ensuring an adequate supply for domestic consumption. Fears of impending oil shortages resulted in government policies that encouraged domestic companies to move overseas for exploration and oil production. From the late 1920s throughout the 1930s, discoveries of large domestic oil fields, including the East Texas oil field, led to a change in government policy encouraging domestic companies to stop relying on foreign sources. As the U.S. faced World War II, the government once again changed its policy and encouraged the use of foreign oil sources to fulfill wartime demand. Throughout the 1940s and the early 1950s, the largest oil producers voluntarily limited their oil production from all sources to avoid excess supply flooding the market. By the mid 1950s, voluntary restraints on production clearly failed to be effective as evidenced by a tremendous increase in the number of oil companies going overseas and resulting in further increases of foreign source oil in the U.S. markets. By 1959, President Eisenhower implemented a mandatory import control program that essentially remained in place, experiencing a number of changes overtime. See *generally* ARTHUR M. JOHNSON, *THE CHALLENGE OF CHANGE: THE SUN OIL COMPANY, 1945–1977*, at 99–124 (1983); BLAIR, *supra* note 238, at 171–81.

²⁴⁵ See BLAIR, *supra* note 238, at 218–20, 246–48 (discussing the changing market, which results in greater concentration on the marketing and refining end of operations and focused less on the crude production end, and providing a general discussion of vertical integration and the ability of the major producers to achieve self sufficiency); see also SIAMACK SHOJAI & BERNARD S. KATZ, *THE OIL MARKET IN THE 1980S: A DECADE OF DECLINE* 116–20 (1992) (discussing

controlling the foreign oil sources deteriorated, culminating in the Oil Embargo Crisis of 1973, which led to severe limits on oil supplies from foreign sources throughout the 1970s.²⁴⁶

The increasing level of dependence on foreign oil throughout the last half of the twentieth century, followed by the abrupt and severe reduction of that supply by the early 1970s, forced the major oil producers and other participants in the oil industry to seek crude oil from alternative sources.²⁴⁷ This need for oil outside traditional Middle Eastern sources created a market for greater numbers of independent oil producers than had ever existed in prior years. From the late 1960s through the 1970s, the number of independent oil producers engaging in oil exploration activities to meet the general increase in demand for crude oil in the United States and the world grew rapidly.²⁴⁸ In order to secure the necessary capital to conduct drilling operations, many of these independent producers sold partnership interests to investors which, in addition to meeting the oil supply needs created by the foreign sources drying up, started the widespread market for partnership syndications in the early 1970s.²⁴⁹

Hamilton Brothers Oil Company, being an independent oil producer, had the incentive to seek a business form that combined limited liability and partnership

changes in the operations of major oil companies including the increased emphasis on the marketing and refining end of operations as compared to the upstream operations, which is the production end).

²⁴⁶ See WALTON & ROCKOFF, *supra* note 234, at 614–15. Due to OPEC gaining the dominant share of the world oil market in 1973, it began attempting to influence oil prices. Following the Arab-Israeli War of 1973, an embargo was implemented as Arab producers halted oil sales to countries backing Israel, resulting in a sharp increase in oil prices. During the period beginning in 1978 and carrying into 1979, Iran reduced oil output pushing oil prices higher. A conflict between Iran and Iraq followed extending the upward trend in oil prices. During the eighteen month period encompassing these events, the price of oil increased by approximately 140%. See SHOJAI & KATZ, *supra* note 245, at 31–32.

²⁴⁷ See SHOJAI & KATZ, *supra* note 245, at 75–76. United States oil production reached its apex in 1970 even as old wells began to run dry and a strict system of price controls discouraged any new exploration and development. During the first three years of the 1970s, United States production declined somewhat resulting in the Soviet Union supplanting the United States as the world's largest oil producer by 1973. However, the price increase resulting from the 1973 embargo spurred mass investment into Alaska—the new hope for American oil. See *id.*

²⁴⁸ By the early 1970s, the independent oil companies' share of United States existing wells being explored and developed had clearly exploded to new high levels with the independents drilling the majority of the domestic wells. By 1985, the dominance enjoyed by the independent oil drillers reached an apex as the independents accounted for 84% of the exploratory and developed domestic wells. It has been estimated that during this period of increased independent activity, the number of independents actively drilling peaked at approximately 15,000 separate enterprises. See *id.* at 116–18.

²⁴⁹ See *supra* notes 231, 232 and accompanying text.

taxation. Although the rise of independent oil producers in the early 1970s best explains the invention of the LLC from a global perspective and bears a close relationship to the actual facts, theoretically a number of other business interests also could have invented the LLC. By the late 1970s and early 1980s, other business activities, for example the development of real estate, had assumed a significant presence in the market of offering interests in partnerships promising flow-through tax losses in the early years of operation.²⁵⁰ If Hamilton Brothers Oil Company had not already invented the LLC, the real estate syndication industry might have had this first opportunity. However, by the time these other types of business ventures visibly entered the partnership syndication market, Hamilton Brothers Oil Company had already invented the LLC, but was unable to secure the necessary partnership classification from the IRS.²⁵¹ Ultimately, the LLC provided no benefit to the independent oil producers or any other business interests offering flow-through tax losses. By the late 1970s and early 1980s, most of these syndications obtained limited liability on a substantive level by using a limited partnership with a minimally capitalized corporate general partner.²⁵² Investments where the flow-through of tax losses constituted a material feature remained popular until the Tax Reform Act of 1986 enacted the passive activity loss rules, which materially limited the ability of most investors to use flow-through losses and destroyed the market for these investments.²⁵³

Although the spark igniting the LLC's birth came from an independent oil and gas company seeking U.S. partnership tax status and limited liability under circumstances where the ability to pass-through losses carried importance, the support responsible for its later rise following the 1988 Wyoming Revenue Ruling came from business ventures expecting to consistently recognize taxable income. The Tax Reform Act of 1986, in addition to destroying the market for partnership syndications, materially increased the tax burden imposed on corporations.²⁵⁴ From 1987 until 1992, the highest individual effective tax rates stayed between twenty-four and twenty-eight percent, while the comparative corporate rates remained well over thirty percent. This significant gap, peaking in 1990 with a spread of over eleven percent, strongly discouraged business ventures from operating in C corporations.²⁵⁵ Business ventures expecting significant taxable income, which also

²⁵⁰ See *supra* notes 231, 232; see also Hamill, *Partnership Classification*, *supra* note 5, at 574.

²⁵¹ See *supra* notes 28, 33 and accompanying text.

²⁵² See Hamill, *Partnership Classification*, *supra* note 5, at 573-74.

²⁵³ See General Explanation of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) [hereinafter 1986 Act Bluebook]; see also Hamill, *Partnership Classification*, *supra* note 5, at 575-77; Hamill, *Corporate Integration*, *supra* note 3, at 427, n.164.

²⁵⁴ See 1986 Act Bluebook, *supra* note 253, at 209-50, 271-74, 328-55.

²⁵⁵ See generally Appendix to this Article. From 1987 to 1992, the highest effective rates for

wished to obtain direct statutory limited liability without facing the restrictions inherent in a subchapter S election,²⁵⁶ had, for the first time, strong reasons to support the LLC. On behalf of many clients conducting business in ventures recognizing substantial taxable income, the second group of LLC proponents pushed for more flexibility on the partnership classification front and encouraged the states to enact statutes.²⁵⁷ By the time changes in the tax rates in 1993 mitigated the burden faced by corporations,²⁵⁸ the race among the states to enact LLC statutes was well underway. By the end of 1992, the furor to pass an LLC statute stampeded across the country, strongly resembling the movement of the states to enact general incorporation statutes during the middle decades of the nineteenth century and the competition among the states to produce the best general incorporation statute in the early twentieth century.²⁵⁹

V. CONCLUSION AND EPILOGUE

The origins of the LLC can be traced to several sources. The earliest origin goes back to the cementing of the American corporation under state, rather than federal, control during the Jacksonian period of Antebellum America. Throughout America's legal history, federal and state power to incorporate business has always been concurrent, with state exercise overwhelmingly prevalent. This state prevalence materially contributed to the state legislature forum to receive the LLC in the last quarter of the twentieth century. The triumph of state law control over

corporations averaged approximately 34.5% while the individuals' highest effective rates averaged approximately 25.5%, giving an average rate differential of 9%. This was clearly more significant than the 3% and 4% spreads between 1958 and 1973. For years 1986 to 1992, the highest effective rate for corporations was approximately 36%, 36%, 33%, 33%, 35%, 34%, and 34%, respectively. The highest effective rate for individuals these years was approximately 38%, 28%, 25%, 24%, 24%, 26%, and 27%. See STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1986-1992, INDIVIDUAL INCOME TAX RETURNS (each year in separate books); STATISTICS OF INCOME DIV., INTERNAL REVENUE SERVICE, STATISTICS OF INCOME: 1986-1992, CORPORATION INCOME TAX RETURNS (each year in separate books).

²⁵⁶ Of the many restrictions distinguishing S corporations from partnerships, the single class of stock requirement and the general shareholder restrictions probably cause the most trouble for complex business ventures expecting to recognize significant taxable income. See Hamill, *Corporate Integration*, *supra* note 3, at 407-09.

²⁵⁷ See *supra* notes 44-100 and accompanying text.

²⁵⁸ The Revenue Reconciliation Act of 1993 increased the highest nominal rate for individuals to 39.6% while leaving the corporate rate at 34%. See Revenue Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 416.

²⁵⁹ See *supra* notes 167, 170-72 (discussing states enacting their first general incorporation statutes in the nineteenth century); *supra* notes 186-88 (discussing the early twentieth century "race to the bottom" among the states to enact the most business-friendly general incorporation statute).

corporations was not inevitable. Had the process of issuing colonial charters stayed with the British Crown, rather than passing to the colonial assemblies, the experience of issuing corporate charters may not have started the tradition leading to state rather than federal control. If James Madison's proposal at the Constitutional Convention, explicitly recognizing some congressional powers to issue corporate charters, had been passed, he may have been comfortable with the constitutionality of the Bonus Bill of 1817. The failed Bonus Bill was the last chance for Congress to assume general powers over corporate charters. Had the Bonus Bill passed, corporate history might have taken a different turn, imagining an implementation involving massive congressional charters steering the general practice to federally-based charters. Finally, the invention of the state law based general incorporation statutes during the Jacksonian period was not preordained. The true representatives of the farmers and the laborers, rather than attacking incorporation by special charter, could have attacked the legitimacy of the corporation itself, which would have radically redirected business development in ways difficult to imagine given the corporation's dominant place in American business by the early twentieth century.

The LLC's more recent origins come from the twentieth century's disparate business tax regime accorded partnerships and corporations, the comparative tax burdens of doing business in those forms arising out of that system, and the peculiar policies of the IRS concerning the impact of statutory limited liability on the ability to achieve partnership classification. The IRS singlehandedly prevented LLC experimentation before 1960, and, through its own regulations, set the legal stage for the LLC's invention after 1960. Once the legal landscape allowed for the combination of limited liability and partnership classification, the LLC could emerge. Before the 1986 Tax Reform Act, business ventures—where the ability to pass-through tax losses constituted a major goal—were significantly more likely to experiment with the LLC. After the 1986 Act, only those business ventures expecting to recognize substantial taxable income would be motivated to promote LLCs. From a global perspective both types of business ventures materially contributed to the LLC developing as the mainstream choice for doing business. The first type in fact made the first move by inventing the LLC and forcing the IRS to openly deal with the LLC's ability to be taxed as a partnership while the second type, after the 1988 Wyoming Revenue Ruling, pushed the IRS to free the LLC from the technical partnership classification rules and carried the LLC movement across the states.

Both Congress and the IRS have always possessed the power to tax LLCs as corporations.²⁶⁰ Rather than stop the use of LLCs by explicitly deeming statutory limited liability a superfactor mandating corporate taxation, Congress and the IRS

²⁶⁰ See *supra* note 37; see also Hamill, *Corporate Integration*, *supra* note 3, at 428–29, 435, 438 (discussing 1987 language conclusively taxing publicly traded partnerships as associations).

have allowed LLCs to enjoy maximum use through the elimination of all technical requirements to secure partnership classification. The ability of well-advised, smaller businesses to obtain the LLC's benefits indirectly, combined with barriers within the corporate tax system preventing the LLC from materially encroaching on larger businesses,²⁶¹ offers one explanation for Congress's and the IRS's lack of interference after the LLC movement began. Another explanation looks to the firestorm of criticism following the 1980 proposed regulations, which attempted to require all business organizations offering statutory limited liability to bear the corporate tax.²⁶² Perhaps Congress and the IRS simply did not want to face the political pressure that inevitably would have followed any wholesale attack on LLCs in the 1990s.

Ultimately from the broadest perspective, the origins behind the LLC involve the power of the individual states to experiment with business organizations meshing with the conditions of the twentieth century, rendering it advantageous for interest groups to harness this power in order to create and perfect the LLC. Throughout U.S. legal history in the context of many areas, the phenomena of state law experimentation and competition has always been a familiar part of the relationship between the states and the federal government. Policy arguments both praising and criticizing the substantive results generated from state law experimentation and competition have addressed a variety of issues including the early twentieth century development of corporation law.²⁶³ Whether or not the rise of the LLC should be praised or criticized as a sound example of state experimentation and competition raises a legitimate question within the broader debate asking whether state versus federal regulation achieves the best results. Because the LLC exposes and mitigates the inequities of the federal business tax regime imposed on partnerships and corporations, a strong argument can be made that the LLC represents a positive product resulting from the ability of the states to create new business organizations.²⁶⁴

²⁶¹ See Hamill, *Corporate Integration*, *supra* note 3, at 410–29.

²⁶² See *supra* notes 34–35.

²⁶³ See *supra* notes 187–89 and accompanying text (discussing sources which praise and criticize the results generated by the competition among the states to produce the best general incorporation statute); see also Edward L. Rubin, *The Fundamentality and Irrelevance of Federalism*, 13 GA. ST. L. REV. 1009, 1059–62 (1997); Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on a National Neurosis*, 41 UCLA L. REV. 903, 910–14 (1994) (Using a variety of regulatory issues as examples, Rubin argues that the real question behind the state versus federal balance of power controversies looks to whether optimal policy results can be best achieved through state experimentation and competition or federal regulation.); Harry N. Scheiber, *American Federalism and the Diffusion of Power: Historical and Contemporary Perspectives*, 9 U. TOL. L. REV. 619 (1978) (reviewing balance of power between state and federal branches throughout America's history).

²⁶⁴ See generally Hamill, *Corporate Integration*, *supra* note 3.

Although the LLC won huge battles in the tax arena, its future viability will largely revolve around business issues that pose a greater challenge to its ability to survive as an independent business entity. The rise of the LLC has contributed greatly to the spawning of several other unincorporated forms for doing business, creating an unwieldy number of business entities from which to choose. The presence of these new forms of business, including the limited liability partnership, known as the LLP, and the limited liability limited partnership, known as the LLLP,²⁶⁵ also resulted because the individual states possess the power to create new business organizations. Recently, a body of scholarship has appeared criticizing this morass of choices as confusing and inefficient. Some of these scholars argue for the merger of all business entities into one form.²⁶⁶ The debate at the academic level will intensify while practitioners continue to vote informally on which of these entities offers the best alternative through their advice to business clients. The ability of the states to experiment and create new business organizations, which made the LLC's birth and initial success possible, may ultimately lead to the LLC's demise. Having won the battle at the tax level, the LLC now faces the crucial war—can it continue to survive as a distinct business form or will it disappear as part of a unified business organization?

APPENDIX

To better understand the choice of business entity, the income tax burden borne by individuals in partnerships and S corporations must be compared to the tax burden borne by corporations. The amount of income tax paid by these entities greatly influences the decision whether to incorporate. A simple analysis of the individual income tax rate versus the corporate tax rate, however, is not an adequate measure of the true tax burden borne by these groups. Because of the presence of

²⁶⁵ See Robert W. Hamilton, *Registered Limited Liability Partnerships: Present At The Birth (Nearly)*, 66 COLO. L. REV. 1065, 1065–66 (1995) (describing the impetus for Texas's enactment of the first domestic LLP in 1991); see also ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 1.01(b)(5) (1997) (noting that following Texas's LLP statute a number of additional states added LLP provisions to their partnership statutes); Robert R. Keatinge, *Corporations, Unincorporated Organizations and Unincorporations: Check the Box and the Balkanization of Business Organizations*, 1 J. OF SMALL & EMERGING BUS. LAW 201, 206 (noting that the types of business entities have grown dramatically since 1988 including the LLC, LLP, and the LLLP).

²⁶⁶ See John H. Matheson & Brent A. Olsen, *A Call For a Unified Business Organization Law*, 65 GEO. WASH. L. REV. 1, 30–48 (1996); Dale A. Osterle & Wayne M. Gazur, *What's in a Name? An Argument For a Small Business "Limited Liability Entity" Statute (With Three Sets of Default Rules)*, 32 WAKE FOREST L. REV. 101 (1997). For an earlier argument along this same theme, see Harry Haynsworth, *The Need For a Unified Small Business Structure*, 33 BUS. LAW. 849 (1978).

certain tax preferences and deductions available to individuals and corporations, the nominal income tax rates do not reflect the "actual" tax burden borne by each group. The best approach in this regard is to subtract these preferences and deductions from the income tax rates in order to derive the "effective" income tax rate paid by individuals and corporations. These effective income tax rates are superior indicators of the actual income tax burdens being borne by individuals and corporations and therefore provide a more accurate picture of the precise factors affecting the choice of business entity.

For the purposes of this Article, the methods for calculating the effective income tax rates are noted below. It should be noted, however, that due to differences in the historical reporting techniques by the Treasury Department/Internal Revenue Service throughout the period covered, fluctuations in the effective rates are partly caused by the inconsistent reporting techniques. These differences are evident in our formulas for calculating the effective tax rates.

For the years 1913 to 1915 and 1954 to 1992, the effective rate for individuals was derived by dividing "income taxes paid after credits" by "adjusted gross income." For the years 1916 to 1953, the effective rate was provided in *Statistics of Income*. The effective rate for corporations from 1913 to 1957 was derived by dividing "income taxes paid after all credits except the foreign tax credit" by "net income." The effective rate for corporations from 1958 to 1992 was derived by dividing "income taxes paid after all credits except the foreign tax credit" by "income subject to tax." The effective rate for corporations from 1958-1992 was derived by dividing "income taxes paid after all credits except the foreign tax credit" by "income subject to tax." The corporate effective rates do not factor in the foreign tax credit in order to accurately reflect the true tax burden. Because both the "net income" and "income subject to tax" figures include worldwide income, inconsistency is achieved by including worldwide taxes.

In addition, war profits and/or excess profit tax rates imposed on corporations are not included in our nominal tax rate figures. However, the revenue produced by these taxes was added to the corporate "income taxes paid" figure in computing the effective tax rates. Therefore, for the years in which either one or both of these taxes were imposed, it is difficult to measure the degree to which corporations successfully reduced their nominal rates through tax planning. Additionally, because the nominal income tax rates did not include these taxes, the war profits and excess profits taxes had the effect in some years of "creating" higher effective tax rates than the nominal tax rates. The years in which the war profits tax and or the excess profits tax was imposed includes 1917 to 1922, 1933 to 1946, and 1950 to 1954.