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PARTNERSHIP LOST

Christine Hurt *

Say first, for Heav'n hides nothing from thy view
Nor the deep tract of Hell, say first what cause
Moved our grand parents in that happy state,
Favored of Heav'n so highly, to fall off
From their Creator, and transgress his will
For one restraint, lords of the world besides?
Who first seduced them to that foul revolt? **

ABSTRACT

A century ago, two distinct business entities existed that could best be defined by describing either one of them as simply not the other. The corporation and the general partnership were mirror images of one another and opposites on a spectrum of corporate governance, limited liability, and taxation. Partnerships, seen as small, livelihood enterprises between active-owner partners, had personal liability but pass-through taxation. Corporations, seen as larger, capital-intensive enterprises with passive-owner shareholders, had limited liability but double taxation. The tax distinctions survive today, but the stereotypical partnership does not; in fact, the modern partnership is more corporation-like than partnership-like.

Today, the corporation-partnership dichotomy has disappeared. "Tax partnerships" for federal tax purposes can be formed under various state statutes that mimic closely the traditional corporation: centralized management; freely transferable shares; limited liability; perpetual life; and even elimination of fiduciary duties. In response to requests by various constituencies, state legislatures

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** JOHN MILTON, PARADISE LOST 14 (William Kerrigan et al. eds., Modern Library Classics 2008) (1667).

have spent the past few decades creating hybrid business entities that boast the best characteristics of both corporations and general partnerships. As state lawmakers made the pass-through entity more corporation-like, federal lawmakers conceded the fight on which entities could have pass-through taxation. Now, any noncorporate entity receives pass-through taxation as a default classification, and even publicly traded partnerships with thousands of "partners" may qualify. The hybrid entity is more corporation-like than the corporation, for which nonwaivable duties still remain.

However, in December 2017, Congress passed and President Donald J. Trump signed the 2017 Tax Cuts and Jobs Act into law. This legislation, arguably the first major piece of tax legislation since 1986, reduces the top corporate tax rate, decreasing the "double tax" on corporate profits to nearly equal the partnership tax rate. The 2017 tax reforms present a perfect point in time to study why hybrid entities have gained in popularity so swiftly. Are these entities popular because of the freedom of the parties to contract for optimal governance mechanisms, mimicking the best parts of corporate governance without drawbacks of fiduciary duties? On the other hand, the popularity of the hybrid entities may be merely economic, based on these entities tax advantages. If entity tax rates have converged, perhaps federal taxation should rethink whether two types of entity taxation is necessary at all or, in the alternative, whether pass-through taxation should be granted to entities based on criteria other than state law classification, such as size, active ownership, or limited liability.

INTRODUCTION

A century ago, two distinct business entities existed that could best be defined by describing either one of them as simply not the other. The corporation[1] and the general partnership[2] were mirror images of one another and opposites on a spectrum of corporate

1. The history of the corporation in United States law is long and fascinating, but not the focus of this article. The modern leader in state corporate law, Delaware, passed its first corporation law in 1899. *See* Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 271–76 (1976) (chronicling how Delaware copied New Jersey's innovative and pro-manager corporate statute and won the competition for lucrative state charters). During this era, states began to enact corporation statutes that provided for automatic chartering of corporations instead of requiring legislatively granted special charters. *Id.* at 257–58.

2. The first Uniform Partnership Act was published in 1914. *See infra* Part I.A.1.

governance, limited liability, and taxation. Partnerships, seen as small, livelihood enterprises between active-owner partners, had personal liability but pass-through taxation. Corporations, seen as larger, capital-intensive enterprises with passive-owner shareholders, had limited liability but double taxation. The tax distinctions survive today, but the stereotypical partnership does not; in fact, the modern partnership is more corporation-like than partnership-like.

Historically, the corporation was seen as a distinct legal entity; the general partnership was often seen as an aggregation of its individual partners.[3] As such, the corporation had perpetual life,[4] but the partnership ended with the death, withdrawal, or incapacity of any of its partners.[5] The corporate form separated its owners from the managers who controlled the corporation,[6] but partners comanaged a partnership.[7] A corporation offered its passive owners limited liability for the debts of the corporate entity,[8] but partners were all personally liable for partnership debts.[9] Finally, corporate

3. *See* A. Ladru Jensen, *Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity?*, 16 VAND. L. REV. 377, 377–79 (1963).

4. DEL. CODE ANN. tit. 9, § 2(1) (1899) ("Every corporation created under the provisions of this Chapter shall have power . . . [t]o have succession, by its corporate name, for the time stated in its certificate of incorporation, and when no period is limited, it shall be perpetual.").

5. UNIF. P'SHIP ACT § 29 (UNIF. LAW COMM'N 1914) ("The dissolution of a partnership is the change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.").

6. *See* DEL. CODE ANN. tit. 9, § 9 (1899). The 1915 amendments to the Delaware corporate statute included section 5(8): "The certificate of incorporation may also contain any provision which the incorporators may choose to insert for the regulation of the business and for the conduct of the affairs of the corporation, and any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders, or any class of the stockholders; provided, such provisions are not contrary to the laws of this State." DEL. CODE ANN. tit. 9, § 5(8) (1915).

7. UNIF. P'SHIP ACT § 9(1) (UNIF. LAW COMM'N 1914) ("Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership . . . binds the partnership . . . ."); *id.* § 18(e) ("All partners have equal rights in the management and conduct of the partnership business.").

8. *Compare* DEL. CODE ANN. tit. 9, § 5(7) (1915) (requiring the articles of incorporation to include "[w]hether the private property of the stockholders shall be subject to the payment of corporate debts, and if so, to what extent"), *with id.* tit. 8, § 102(b)(6) (granting organizers the option of including in the articles of incorporation "[a] provision imposing personal liability for the debts of the corporation on its stockholders to a specified extent and upon specified conditions; otherwise, the stockholders of a corporation shall not be personally liable for the payment of the corporation's debts except as they may be liable by reason of their own conduct or acts").

9. UNIF. P'SHIP ACT § 15 (UNIF. LAW COMM'N 1914) ("All partners are liable . . .[j]ointly and severally for everything chargeable to the partnership under sections 13 and 14 . . .

managers owed duties to the corporate entity,[10] but shareholders did not. Partners owed duties both to the partnership and to one another. In addition, beginning with various revenue acts in the nineteenth century to the institution of a federal income tax in 1913, and continuing to present day, corporate profits have been subject to an entity-level tax and some sort of additional tax upon distribution to shareholders,[11] but partnership income was taxed once at the individual partner level.[12]

Today, this corporation-partnership dichotomy has disappeared. "Tax partnerships"[13] for federal tax purposes can be formed under various state statutes that mimic closely the traditional corporation: centralized management, freely transferable shares, limited liability, and perpetual life. In response to requests by various constituencies, state legislatures have spent the past few decades creating hybrid business entities that boast the best characteristics of both corporations and general partnerships. Attempting to achieve the perfect structure for organizing economic activity, new statutes added limited liability to entities that enjoy flow-through taxation, such as limited partnerships ("LPs"), limited liability partnerships

[and] [j]ointly for all other debts and obligations . . . ."); *id.* § 18(a) ("Each partner shall . . . share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied; and must contribute towards the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.").

10. Unlike the Model Business Corporation Act, which was not published until 1950, the Delaware act has never specified the duties owed by the directors of a corporation. *See* William M. Lafferty et al., *A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*, 116 PENN ST. L. REV. 837, 841 (2012). However, the Delaware Chancery Court has created a rich jurisprudence for corporate duties based on common law. *See* William B. Chandler, III, *The Delaware Court of Chancery and Public Trust*, 6 U. ST. THOMAS L.J. 421, 423 (2009) (describing the obligation of the Chancery Court judges to "carefully explain why a director or manager has not lived up to his or her fiduciary responsibility" with each case).

11. I.R.C. § 11(a) (2012) ("A tax is hereby imposed for each taxable year on the taxable income of every corporation."). As discussed in Part II.A, under the first iteration of the federal income tax, shareholders were able to apply a dividend exemption to income subject to the "normal" tax rate, but not income over that rate; however, by 1918, the double tax regime for corporate earnings was fully implemented. *See infra* note 156 and accompanying text.

12. I.R.C. § 701 (2012) ("A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.").

13. For purposes of this article, the term "tax partnerships" refers to any entity classified as a "partnership" under Treasury Regulation 301.7701-2(c): "For federal tax purposes . . . [t]he term *partnership* means a business entity that is not a corporation under paragraph (b) of this section and that has at least two members." Treas. Reg. § 301.7701-2(c) (2018). This term may apply to general partnerships, LPs, LLPs, and LLCs and requires these entities to be taxed under Subchapter K. *Id.* § 1.701-1.

("LLPs"), and limited liability companies ("LLCs"). The final evolution in the perfecting of these hybrid entities, such as LPs and LLC, is the elimination of fiduciary duties, either by default or by agreement.[14]

As state lawmakers made the pass-through entity more corporation-like, federal lawmakers conceded the fight on which entities could have pass-through taxation. Now, any noncorporate entity receives pass-through taxation as a default classification,[15] and even publicly traded partnerships ("PTPs") with thousands of "partners" may qualify.[16] These tandem efforts to create the perfect business beast proved successful, and to a modern-day manager, the modern hybrid entity is superior to a corporation from a governance standpoint and with only one level of tax. The hybrid entity is more corporation-like than the corporation, for which nonwaivable duties still remain.[17]

However, in December 2017, Congress passed and President Donald J. Trump signed the Tax Cuts and Jobs Act of 2017 into law.[18] This legislation, arguably the first major piece of tax legislation since 1986, reduces the top corporate tax rate to 21% from 35%.[19] However, the top individual tax rate is reduced by a much

14. *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-1101(d) (2018) ("To the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) to a LP or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by provisions in the partnership agreement; provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing.").

15. *See* Treas. Reg. §§ 301.7701-2(c), -3(b)(1) (2018) (making unincorporated domestic entities with two or more members tax partnerships by default).

16. I.R.C. § 7704(c) (2012) (creating exception for partnerships to retain partnership taxation even if publicly traded if 90% or more of annual gross income is "qualifying income").

17. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2018) (allowing the articles of incorporation to contain "[a] provision eliminating or limiting the personal liability of a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty . . . or (iv) for any transaction from which the director derived an improper personal benefit").

18. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended in scattered sections of 26 U.S.C). Originally titled, "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for the Fiscal Year 2018," the Act is referred to as the "Tax Cuts and Jobs Act of 2017," but because of Senate rules, the longer title could not be changed. *See* Naomi Jagoda, *Senate Parliamentarian Rules Against GOP Tax Bill's Name*, HILL (Dec. 19, 2017, 6:04 PM), https://thehill.com/policy/finance/365691-senate-parliamentarian-rules-against-gop-tax-bills-name [https://perma.cc/Q2U2-E95T].

19. *See* Tax Cuts and Jobs Act § 13001(b) (amending I.R.C. § 11(b) (2012)).

smaller amount, from 39.6% to 37%.[20] Combined with the recently reduced dividend income rate of 20%,[21] the "double tax" on corporate profits is now roughly equivalent to pass-through taxation at the individual rate. A pass-through deduction[22] available to some firms and sole proprietorships but not others selectively retains a small tax preference, but the availability of this deduction is unclear without clarifying regulations.[23] Whether the partnership tax preference has disappeared, is merely much smaller, or is only present in certain circumstances remains to be seen.

The 2017 tax reforms present a perfect point in time to study why hybrid entities have gained in popularity so swiftly. Are these entities popular because of the freedom of the parties to contract for optimal governance mechanisms, mimicking the best parts of corporate governance without the drawbacks of fiduciary duties? On the other hand, the popularity of the hybrid entities may be merely economic, based on these entities' tax advantages. Now, with the tax advantage arguably eliminated, the choice of entity for incorporators may not be as clear. In addition, if the tax advantage is arguably eliminated, and tax partnerships are substantively no different than corporations, perhaps rethinking the dual tax regimes is timely.

This article attempts to chronicle the convergence of partnership and corporate governance mechanisms through state law statutes at the same time that tax law has continued to grant preferential tax treatment to entities that may be "partnerships" by state law label only. Given these developments, this article asks whether tax classification has principled meaning anymore. Adding to this conundrum, recent tax reforms have equalized total corporate tax rates and partnership rates. If entity tax rates have converged, perhaps federal taxation should rethink whether two types of entity taxation is necessary at all or, in the alternative, whether pass-through taxation should be granted to entities based on criteria other than state law classification, such as size, active ownership, or limited liability.

20. *Id.* § 11001(j) (amending I.R.C. § 1 (2012)).

21. I.R.C. § 1(h)(11) (2012).

22. Tax Cuts and Jobs Act § 11011 (creating new I.R.C. § 199A).

23. *See* Shu-Yi Oei & Diane M. Ring, Is New Code Section 199A Really Going to Turn Us All into Independent Contractors? 1, 3, 6–7 (Jan. 12, 2018) (unpublished manuscript) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3101180 [https://perma.cc/S8KN-UZ47].

This article gives a background of the various partnership and hybrid entities from a governance standpoint in Part I, and from a taxation perspective in Part II. Part III will posit a new theory of the partnership entity; Part IV will posit a new theory of partnership taxation based not on form but on substance. Finally, Part V will explore whether the hybrid partnerships will lose popularity with their tax advantages, or whether contractarian theorists will be proven correct that hybrid entity participants value freedom of contract over tax advantages.

I. BACKGROUND—EARLY PARTNERSHIPS

A. *The General Partnership*

The partnership may be the oldest business form known to man. Partnerships as a form can be traced back to the Babylonians and then forward through classical Greece, Rome, Europe, and the United Kingdom.[24] Partnerships existed at common law in England and in the United States before partnership acts were promulgated in the 1800s.[25] The fundamental governance characteristics of a general partnership derive from agency law: partners have a right to comanage the partnership; partners are liable for the debts of the partnership; partners can bind the partnership in contract; and partners have fiduciary duties to the partnership and to each other.[26] The fundamental tax consequence of choosing the general partnership form has always been the single level of federal income taxation at the partner level, not the entity level.[27]

England codified rules governing partnerships in the Partnership Act of 1890,[28] and the United States would eventually follow suit and publish the first Uniform Partnership Act ("UPA") in 1914.

24. *See generally* CHRISTINE HURT & D. GORDON SMITH, BROMBERG & RIBSTEIN ON PARTNERSHIP § 1.02[A] (2d ed. Supp. 2018) (tracing the emergence of the partnership form through history); Roy Mersky, *The Literature of Partnership Law*, 16 VAND. L. REV. 389, 389 (1963) (noting important treatises and texts related to the evolution of the partnership form).

25. *See* Mersky, *supra* note 24, at 389–90.

26. *See* UNIF. P'SHIP ACT § 15 (UNIF. LAW COMM'N 1914); *see also id.* §§ 9(1), 15, 18(e), 21(1).

27. *See* I.R.C. §§ 701–02 (2012).

28. *See* Mersky, *supra* note 24, at 389.

1. The Uniform Partnership Act (1914)

The UPA was the product of over a decade of work begun by the Conference of Commissioners on Uniform State Laws, led by James Barr Ames, Dean of Harvard Law School and completed by William Draper Lewis, Dean of the University of Pennsylvania Law School.[29] The resulting 1914 UPA is hard to characterize as anything but a combination of provisions reflecting partnerships as aggregates of their partners and provisions reflecting partnerships as separate legal entities, which led to confusion by the courts in applying the UPA.[30] Ultimately, the entity theory largely prevailed: partnership could hold title to property,[31] the partners were characterized as agents of the (separate entity) partnership,[32] partners do not have rights to individual partnership assets,[33] and the partnership business can continue after dissolution in some instances.[34] However, the partnership retains joint and several liability of the partners[35] and undergoes technical dissolution of the partnership upon the dissociation of any partner.[36]

Even though the UPA partnership had characteristics of both a separate legal entity and an amalgamation of its partners, the general partnership form was the mirror opposite of the statutory corporation. Partners in general partnerships had personal liability for firm obligations;[37] every partner had the right to comanage the partnership;[38] partners had fiduciary duties to each other and the partnership;[39] partnerships did not have perpetual life but dissolved upon the dissociation of any partner; and partners were not able to transfer their ownership interests (though they could transfer their financial interests).[40]

29. *See* UNIF. P'SHIP ACT prefatory note (UNIF. LAW COMM'N 1916).

30. *See* Jensen, *supra* note 3, at 378–80, 384–87.

31. UNIF. P'SHIP ACT § 8(3) (UNIF. LAW COMM'N 1914).

32. *Id.* § 9.

33. *Id.* § 8.

34. *Id.* § 38(2)(b).

35. *Id.* § 15.

36. *Id.* § 29.

37. *Id.* § 15.

38. *Id.* § 18(e).

39. Section 4(3) states that the law of agency is incorporated into the partnership act. Because the act states that the partners are agents, courts were able to then infer that the partners had the same fiduciary duties as agents under the law of agency. *See id.* §§ 4(3), 21.

40. *Id.* §§ 27(1), 31.

2. The Revised Uniform Partnership Act (1994)

However, the UPA partnership has distinct disadvantages for modern firms, particularly with regards to its preference for dissolution upon the withdrawal or death of a partner, which requires substantial coordination and contracting to avoid.[41] In 1994, the Revised Uniform Partnership Act ("RUPA") was published, which fully embraced the entity theory of partnership,[42] allowing partnerships to continue after dissociation events when the partners agree to do so.[43] This change provides more stability to general partnerships than the aggregate theory allows. RUPA also gives more deference to the partnership agreement, allowing many provisions to be default provisions that could be altered by agreement.[44] Shortly after RUPA's publication, drafters were asked to amend its provisions to account for the emergence of the LLP[45] in many states, discussed below, and those amendments were published in 1997.[46]

B. *The Hybrid Partnerships: Limited Partnerships and Limited Liability Partnerships*

1. The Uniform Limited Partnership Act (1916)

Though the LP is a creature of statute and the general partnership is a gift of common law, the first uniform LP act was enacted at roughly the same time as the first. In addition, though the LP as an entity belongs in the same category of hybrid entities as the

41. *See id.* § 31.

42. Donald J. Weidner & John W. Larson, *The Revised Uniform Partnership Act: The Reporters' Overview*, 49 BUS. LAW. 1, 3 (1993).

43. UNIF. P'SHIP ACT § 803 (UNIF. LAW COMM'N 1994).

44. *Id.* § 103.

45. UNIF. P'SHIP ACT § 306 (UNIF. LAW COMM'N 1997). The 2013 amendments created new Article 9 dedicated to LLPs. *Id.* at art. 9 (amended 2013).

46. The 1997 version of RUPA was amended thoroughly in 2013, though most changes were to conform all of the uniform business acts into a unified "hub and spoke" system. UNIF. P'SHIP ACT prefatory note (UNIF. LAW COMM'N 1997) (amended 2013).

LLC,[47] LLP,[48] and limited liability limited partnership ("LLLP"),[49] it is a much older LP business form. The first major United States' state to promulgate an LP statute was New York, which passed its statute in 1822; and within a few decades, LP statutes were passed by most other states.[50] Because of this popular trend, the first Uniform Limited Partnership Act ("ULPA") was passed in 1916,[51] barely two years following the enactment of the UPA.

The LP form was the first business entity hybrid to try to capture the most popular features of corporations, limited liability for shareholders, with passthrough taxation, which had become more important after a new federal corporate income tax was established just prior to passage of the 1916 ULPA.[52] To avoid double

47. LLCs are entities organized under state statutes that allow members to elect to be managed by all the members or by specified managers and that provide limited liability for all members and managers, with flow-through taxation. *See* Sandra K. Miller, *What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?* 68 ST. JOHN'S L. REV. 21, 22–24, 32–36 (1994).

48. LLPs are general partnerships that have elected to shield all of their partners from personal liability from certain or all obligations of the partnership. The RUPA of 1997 contains a full-shield LLP provision in section 306(c): "A debt, obligation, or other liability of a partnership incurred while the partnership is a limited liability partnership is solely the debt, obligation, or other liability of the limited liability partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the limited liability partnership solely by reason of being or acting as a partner."

49. A LLLP is an LP that has made an election to shield the general partner from liability, achieving full limited liability. *See* UNIF. LTD. P'SHIP ACT § 201(a)(4) (UNIF. LAW COMM'N 2001) (requiring the certificate of an LP to state "whether the limited partnership is a limited liability limited partnership").

50. Eric Hilt & Katharine O'Banion, *The Limited Partnership in New York, 1822–1858: Partnerships Without Kinship*, 69 J. ECON. HIST. 615, 616 (2009) (noting that "Louisiana, which followed French civil law, was the only state to authorize the creation of LPs (known there as partnerships *in commendam*) before New York). This article reports that LPs were well-known for centuries prior to this time in civil law countries, including Italy and France. *Id.* at 619.

Connecticut also passed an LP act in 1822, and Pennsylvania in 1836. *See* Judson A. Crane, *Are Limited Partnerships Necessary? The Return of the Commenda*, 17 MINN. L. REV. 351, 355 (1933); Robert C. Brown, *The Limited Partnership in Indiana*, 5 IND. L.J. 421, 424 (1930) (stating that Indiana passed a LP act in 1859, but the form was not available for insurance firms).

51. UNIF. LTD. P'SHIP ACT (UNIF. LAW COMM'N 1916). The ULPA was completely revised in 1976 by the RULPA which was then amended in 1985. The most recent uniform LP act is the Uniform Limited Partnership Act of 2001, amended in 2013, which has been adopted in twenty-one states and the District of Columbia. Legislative Fact Sheet-Limited Partnership Act (2001) (last amended 2013), UNIFORM L. COMMISSION, http://www.uniform laws.org/LegislativeFactSheet.aspx?title=Limited%20Partnership%20Act%20(2001)%20(Last%20Amended%202013 [https://perma.cc/KX4T-REWJ]) (last visited Dec. 1, 2018). Draft legislation based on ULPA 2001 has been introduced for the current year in Vermont. *Id.*

52. *See* Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44

taxation, business entities could form as general partnerships, but with personal liability, most partnerships would remain small, with capital limited to a few owners, mostly connected by familial or friendship ties.[53] However, parties could invest in LPs as "special" partners and not be liable for the debts of the LP, though the manager, or "general" partner, remained liable.[54] Because of this feature, LPs could attract more capital and more partners than general partnerships.[55] Furthermore, LPs were more likely to be formed among nonrelatives than general partnerships.[56]

LPs combined the limited liability of the corporate form with the new tax advantage of partnership flow-through income taxation. However, for most of the twentieth century, LP owners had to carefully structure their firms (and states attempting to draft their limited partnership statutes) to be more partnership-like than corporation-like to avoid losing partnership classification for federal taxation purposes.[57] LP agreements with provisions that varied too far from the standard form ULPA LP would be taxed as a corporation. Beginning in 1960, the Internal Revenue Service ("IRS") distinguished between LPs that were tax "partnerships" and LPs that were tax "corporations" by focusing on four factors developed in a series of cases beginning with *United States v. Kintner*.[58] These so-called *Kintner* factors included two factors that ensured the firm was a business with multiple owners and four others: (1) continuity of life, (2) centralized management, (3) limited liability, and (4) free

CATH. U. L. REV. 437, 441 (1995).

53. *See* Hilt & O'Banion, *supra* note 50, at 631–32 (using data from New York partnerships and finding that most "ordinary" partnerships had two partners, while LPs had two general partners and one "special" partner and that the median capital of LPs was $40,000, twice that of the median capital of ordinary partnerships).

54. *See* UNIF. LTD. P'SHIP ACT §§ 1, 7, 9 (UNIF. LAW COMM'N 1916).

55. *See* Hilt & O'Banion, *supra* note 50, at 631–32.

56. *See id.* at 639 (finding that in their dataset, partners were related to at least one other partner in 54% of ordinary partnerships, but special partners were related to at least one general partner in only 19% of LPs).

57. Daniel J. Litvinoff, *Wisconsin's Limited Liability Company: Emerging Issues and Prospects for the Future*, 78 MARQ. L. REV. 757, 761 (1995).

58. 216 F.2d 418, 421–24 (9th Cir. 1954). In 1960, the IRS enacted regulations that codified this common law test. Treas. Reg. § 301.7701-2 (1996). Interestingly, Dr. Kintner wanted his firm of physicians to be classified as a corporation so it could adopt a tax-favored pension plan for the physician-owners. *Kintner*, 216 F.2d at 420–21. Montana law prohibited physicians from forming corporations under state law, so Dr. Kintner devised their partnership to look like a corporation. *Id.*

transferability of LP interests.[59] Entities could retain up to two of these corporate-like features and receive partnership taxation; entities with three or four of these features would be taxed as corporations.[60] LPs following the ULPA could have none of those characteristics because of intentional design, ensuring partnership taxation.[61] LPs that varied the statute by agreement or had an undercapitalized general partner jeopardized their partnership tax advantage.[62]

Note that the *Kintner* factors did not discuss fiduciary duties. In an LP, partners did not have fiduciary duties to one another or to the LP, allowing limited partners to invest in various LP entities, achieving diversification without creating conflicts of interest.[63] Because limited partners did not participate in management, were

59. *See* Treas. Reg. § 301.7701-2(a)(2) (1996). The regulations actually articulated six factors, with the other two factors being (1) the presence of associates and (2) an objective to carry on business. *Id.* § 301.7701-2(a)(1).

60. *See id.* at § 301.7701-2(a)(3) (1996).

61. *See* Louis J. Andrew Jr., Comment, *Wisconsin Professional Service Corporations Under the New* "Kintner" *Regulations*, 49 MARQ. L. REV. 564, 569 (1966). Under the then-existing Treasury Regulation section 301.7701-2, an entity did not have continuity of life if any partner had the right to dissolve the organization upon the death, insanity, bankruptcy, retirement, resignation or expulsion of a partner, did not have centralization of management unless the general partner had "continuing exclusive authority" to make all management decisions, did not have limited liability as long as one general partner had personal liability, and did not have free transferability of interests if partner could not transfer "all of the attributes" of his LP interest. *Id.* at 568–69, 571–72; *see also* UNIF. LTD. P'SHIP ACT § 20 (UNIF. LAW COMM'N 1916) (requiring that the partnership dissolve upon the "retirement, death or insanity of a general partner" unless all the remaining general partners continue the business); *id.* § 9 (designating the general partner or general partners as having all the "rights and powers" but also liabilities of a partner in a partnership without limited partners, except for a number of actions that required the written consent or ratification of all the limited partners); *id.* § 19 (requiring unanimous consent of partners to make an assignee of a limited partner a "substituted limited partner," and limiting assignees not substituted to only the financial rights of a limited partner). Limited partnerships with corporate general partners were in danger of meeting one *Kintner* factor. *See also* Rev. Rul. 74-320, 1974-2 C.B. 404 (LPs formed under ULPA lack the corporate characteristic of continuity of life).

62. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 78-04-058 (Oct. 27, 1977) (holding that a LP which allowed limited partners to substitute assignees without the consent of other partners would have the corporate characteristic of free transferability and might also have corporate limited liability if the general partner "does not possess substantial assets that could be reached by a creditor" of the partnership).

63. *See* UNIF. LTD. P'SHIP ACT § 305(a) (UNIF. LAW COMM'N 2001) ("A limited partner does not have any duty to the limited partnership or to any other partner solely by reason of being a limited partner.").

not agents of the partnership, and were not able to bind the partnership,[64] fiduciary duties were not necessary. However, the general partner had fiduciary duties to the partnership[65] because the general partner retained control over the assets of the firm.[66]

2. The Revised Uniform Limited Partnership Act (1976) and Uniform Limited Partnership Act (2001)

As the use of LPs evolved, so did the need for the next generation of state statutes. Perhaps reflecting the popularity of the LP form over the general partnership ("GP") form, the ULPA was amended twenty years before the UPA.[67] The National Conference of Commissioners on Uniform State Laws adopted the Revised Uniform Limited Partnership Act ("RULPA") in 1976 to modernize the 1916 version, to follow the *Kintner* factors, and to and embrace the "entity" concept of partnerships.[68] The 1976 version eliminated confusion over whether the LP was a separate legal entity that could sue and be sued through a registered agent, do business as a "foreign limited partnership" in states other than its state of organization, and have general partners be subject to "derivative" suits on its behalf brought by one or more limited partners.[69] In addition, the 1976 RULPA created a "safe harbor" detailing the types of actions a limited partner could take with respect to the LP without being considered a participant in the business so as to be personally liable like a general partner.[70] Because the 1976 version allowed partners to vary its default rules in the partnership agreement, partners could create uncertainty as to whether the LP satisfied the

64. *Id.* § 302.

65. *Id.* § 408(a) ("The only fiduciary duties that a general partner has to the limited partnership and the other partners are the duties of loyalty and care under subsections (b) and (c).").

66. *Id.* § 402(a) ("Each general partner is an agent of the limited partnership for the purposes of its activities. An act of a general partner, including the signing of a record in the partnership's name, for apparently carrying on in the ordinary course the limited partnership's activities or activities of the kind carried on by the limited partnership binds the limited partnership . . . .").

67. UNIF. P'SHIP ACT (UNIF. LAW COMM'N 2001); UNIF. P'SHIP ACT (UNIF. LAW COMM'N 1976).

68. Christine Hurt, *Private Ordering of Publicly Traded Partnerships: Evaluating Delaware's Dominance of Corporate Law*, *in* CAN DELAWARE BE DETHRONED? 201, 205 (Stephen M. Bainbridge et al. eds., 2018).

69. *Id.* at 205.

70. Joseph J. Basile, Jr., *Limited Liability for Limited Partners: An Argument for the Abolition of the Control Rule*, 38 VAND. L. REV. 1199, 1212 (1985).

Kintner factor test.[71] The revised act allowed this private ordering "in recognition of the principle that the LP agreement, not the certificate of LP, is the primary constitutive, organizational, and governing document of a limited partnership."[72] LPs organized under the 1976 RULPA generally lacked at least the corporate characteristics of continuity of life and limited liability[73] for general partners if not free transferability of shares; however, "limited partnership agreements could vary these terms to their taxation detriment."[74]

The uniform act was most recently amended in 2001. The 2001 ULPA most notably eliminated the clunky safe harbor for whether a limited partner "participated" in the business and faced general partner-type liability.[75] Under the new act, limited partners did not face personal liability for the obligations of the LP, even if they participated directly in management.[76]

3. The Delaware Revised Uniform Limited Partnership Act

The state of Delaware has long been recognized as the leader in corporation incorporations,[77] but it has also been a first-mover in governance reforms for LPs.[78] For example, Delaware made modern adjustments to its own Delaware Revised Uniform Limited

71. *See* Hurt, *supra* note 68, at 206, 209.

72. UNIF. P'SHIP ACT prefatory note (UNIF. LAW COMM'N 1976) (amended 1985).

73. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 85-29-008 (Apr. 11, 1985) (providing guidance that as long as the subject partnership were organized under a state statute that materially corresponded to the 1976 RULPA, it would lack continuity of life and limited liability); *see also* UNIF. LTD. P'SHIP ACT § 801 (1976) (amended 1985) (stating that a LP is dissolved upon the occurrence of several events, including the withdrawal of the last remaining general partner unless all the partners agree to continue the business of the LP); *id*. § 403 ("[A] general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to persons other than the partnership and the other partners.").

74. Hurt, *supra* note 68, at 206. "Limited partnerships could also have the corporate characteristic of limited liability if the general partner did not have sufficient assets or was a 'dummy agent' under regulation amendments enacted in 1993." *Id*. n.23; *see also* Treas. Reg. § 301.7701-2(d)(2) (1983).

75. Hurt, *supra* note 68, at 206.

76. UNIF. LTD. P'SHIP ACT § 303 (UNIF. LAW COMM'N 2001) ("A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership.").

77. Del. Div. of Corps., *About the Division of Corporations*, DELAWARE.GOV., https://corp.delaware.gov/aboutagency [https://perma.cc/3NLS-PSEC] (last visited Dec. 1, 2018) ("The State of Delaware is a leading domicile for U.S. and international corporations. More than 1,000,000 business entities have made Delaware their legal home. More than 66% of the Fortune 500 have chosen Delaware as their legal home.").

78. *See* David Rosenberg, *Venture Capital Limited Partnerships: A Study in Freedom of*

Partnership Act ("DRULPA") in 1985, which were even bolder than the 1985 amendments to the 1976 Act.[79] These 1985 Delaware amendments "clarified the prior law, codified practices that had developed in the limited partnership area, and increased flexibility in the structuring of limited partnerships."[80]

The trend of many of these amendments was to enable the LP to function much like a corporation, with different classes of limited partners with various rights[81] and the ability to have certificated LP interests, for ease of transfer.[82] In other words, LPs could be more corporation-like, with liquid partnership interests held by numerous limited partners with different financial and governance rights.[83]

Additional amendments by the Delaware legislature in 1988 targeted the growing number of PTPs, allowing for easy transfer of LP certificates without the use of depositary receipts.[84] Under the uniform act, incoming limited partners had to individually execute the partnership agreement, but Delaware allows the LP agreement to tailor its requirements to publicly-traded LP units.[85] To facilitate the trend of "rolling-up" small businesses into a master LP structure, the 1988 amendments provided for the first time a statutory basis for Delaware LPs to merge with other LPs, corporations, or other entities.[86] Also, the 1988 amendments allowed the LP agreement to create a mechanism for limited partners or a group of limited partners to take action without the vote of the gen-

Contract, 2002 COL. BUS. L. REV. 363, 366 (2002) ("The ability of the [venture capital] industry to rely on reputation as its primary enforcement mechanism depends largely on the unique nature of the limited partnership form and on the flexibility made available to the parties by Delaware's Revised Uniform Limited Partnership Act (DRULPA).").

79. DEL. CODE ANN. tit. 6, § 17-101 (1985)).

80. Craig B. Smith, *Limited Partnerships—Expanded Opportunities Under Delaware's 1988 Revised Uniform Limited Partnership Act*, 15 DEL. J. CORP. L. 43, 43 (1990).

81. *See* DEL. CODE ANN. tit. 6, § 17-302(a) (Supp. 1985).

82. *Id.* § 17-702(b).

83. *See* Joseph J. Basile, Jr., *The 1985 Delaware Revised Uniform Limited Partnership Act*, 41 BUS. LAW. 571, 573–74 (1986).

84. DEL. CODE ANN. tit. 6, § 17-101(10) (Supp. 1988); *see also* Smith, *supra* note 80, at 43.

85. DEL. CODE. ANN. tit. 6, § 17-101(10)(a) (Supp. 1988) ("A written partnership agreement . . . [m]ay provide that a person shall . . . become bound by the partnership agreement (i) if such person executes the partnership agreement . . . or (ii) without such execution, if such person . . . complies with the conditions for becoming a limited partner or assignee as set forth in the partnership agreement . . . .").

86. *Id.* § 17-211.

eral partner and for the general partner or group of general partners to take action without the vote of the limited partners,[87] but those rights ran afoul of the prohibition on management participation by limited partners. Statutes that allowed for such mechanisms would have to tailor their "safe harbor" provisions to avoid a challenge to limited liability.[88]

Following the passage of ULPA in 2001, Delaware amended its LP act gain in 2004, but not to adopt the 2001 ULPA's new provisions.[89] Instead, DRULPA was amended to allow LPs to do something quite bold: eliminate fiduciary duties between the general partner management and the limited partners.[90] In doing so, DRULPA created a so-called "partnership" that was more "corporate-like" than a corporation. Under the revised DRULPA, organizers could create an entity called a LP that had extremely centralized management (a group of partners could make decisions without the votes of other partners); free transfer of partnership interests; complete limited liability (through either a limited liability LP filing or having a corporation or limited liability company ("LLC") as general partner); and no fiduciary duties between the decision-making limited liability partners and the passive investor partners.[91] This entity's governance could separate ownership from control more completely than a corporation ever could. [92]

Note that what enabled Delaware to act this boldly was not state law or a uniform act. The changes to the LP form could have happened without concomitant changes in 1996 in the federal tax regime, discussed below.

87. *Id*. § 17-302(a).

88. *See id*. § 17-303(b)

89. *See* DEL. CODE. ANN. tit. 6, § 17 (2004)).

90. *See* DEL. CODE. ANN. tit. 6, § 17-1101(d) (2004) ("To the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) to a LP or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by provisions in the partnership agreement; provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing.").

91. DEL. CODE. ANN. tit. 6, §§ 17-211, -302, -303, -1101 (2004).

92. *See* Sandra K. Miller & Karie Davis-Nozemack, *Toward Consistent Fiduciary Duties for Publicly Traded Entities*, 68 FLA. L. REV. 263, 269 (2016) ("In an MLP, equity interest and control are wholly divorced.").

4. The Limited Liability Partnership

While legislators in Delaware were focused on perfecting the LP form to meet the needs of sophisticated business actors and financial firms, legislators in Texas attempted to improve the general partnership form to meet the needs of a different constituency: attorneys. Just as professionals such as attorneys and physicians had a voice in the adoption of the UPA in Texas, these same professionals spurred the creation of the LLP.[93] Though registered LLPs would still be general partnerships with partners retaining the incident rights to comanage and fiduciary duties, partners would be liable only for their own torts (generally professional malpractice) and not for the torts of their fellow partners that they did not supervise.[94] Following Texas's enactment of an LLP statute in 1991, with quick amendments added in 1993, twenty-five states, including Delaware, adopted similar statutes within the next four years.[95] The 2013 amendments to RUPA contain LLP-specific provisions, including a new Article 9 governing LLPs, which can now be formed in any United States jurisdiction.[96]

93. *See* Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1065–66 (1995) (noting that in the year following the enactment of an LLP statute in Texas, 1200 law firms in that state "including virtually all of the state's largest firms" registered as LLPs). Professor Hamilton also explained that the large accounting firms followed suit once New York passed a statute allowing foreign LLPs to do business in that state. *See id.* at 1066.

94. *See* Susan Saab Fortney, *Law as a Profession: Examining the Role of Accountability*, 40 FORDHAM URB. L.J. 177, 179, 210 (2012) (lamenting that in the rush to expand LLP statutes to further limit attorney liability there was little criticism or voiced concerns over diminishing accountability of the legal profession).

95. CHRISTINE HURT ET AL., LIMITED LIABILITY PARTNERSHIPS, THE REVISED UNIFORM PARTNERSHIP ACT, AND THE UNIFORM LIMITED PARTNERSHIP ACT (2001) 9–11 (2018); *see also* John W. Larson, *Florida's New Partnership Law: The Revised Uniform Partnership Act and Limited Liability Partnerships*, 23 FLA. ST. U. L. REV. 201, 203–04 (1995) ("Despite their fundamentally different character, limited liability partnerships have swept the nation in the past four years.").

96. *See* UNIF. P'SHIP ACT prefatory note (UNIF. LAW COMM'N 1997) (amended 2013).

Early versions of LLP statutes[97] provided for limited liability for torts, but not contractual obligations of the LLP.[98] Second-generation statutes allowed for limited liability for contractual obligations as well as tort obligations and were considered "full shield" statutes, quickly replacing most "partial shield" statutes.[99] Under a contract shield, no partner is personally liable for contract obligations, and contract claimants must be satisfied out of LLP assets.[100] Presently, most state statutes can be characterized as generally providing a full shield.[101] Though full-shield liability may seem to be a bridge too far for a general partnership,[102] commentators theorized that a partial shield created strange incentives for both plaintiffs and partners.[103]

97. Note these "LLP statutes" are really statutory provisions incorporated into existing general partnership statutes, both those modeled after UPA and those modeled after RUPA. By the 1990s, amendments to the UPA act were incorporated into RUPA. Section 306, which governs liability of partners, includes the statement that "[a] partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the limited liability partnership solely by reason of being or acting as a partner." UNIF. P'SHIP ACT § 306(c) (UNIF. LAW COMM'N 1997) (amended 2013). The 2013 amendments created a new section, Article 9, which includes more detailed provisions about LLPs. *See id*. § 901.

98. *See* TEX. REV. CIV. STAT. ANN. art 6132b, § 15(2) (West 1992) ("A partner in a registered limited liability partnership is not individually liable for debts and obligations of the partnership arising from errors, omissions, negligence, incompetence, or malfeasance committed in the course of the partnership business by another partner or a representative of the partnership not working under the supervision or direction of the first partner at the time the errors, omissions, negligence, incompetence, or malfeasance occurred . . . .").

99. In 1994, Delaware, New York, and Minnesota were the first states to extend the liability shield to some or all obligations, with some safeguards. *See* DEL. CODE ANN. tit. 6, § 1515(b) (1993); N.Y. P'SHIP LAW § 26(b) (1994) ("[n]o partner of a partnership which is a registered limited liability partnership is liable or accountable, directly or indirectly . . . for any debts, obligations or liabilities of, or chargeable to, the registered limited liability partnership or each other, whether arising in tort, contract or otherwise . . . ."); MINN. STAT. § 323.14(2) (1994). Delaware amended its LLP provisions to become "full shield" in 1997. *See* Del. Laws 228 (1957) (amending DEL. CODE ANN. tit. 6, § 1515(b) (1997)).

100. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 152.801 (West 2006).

101. *See* HURT ET AL., *supra* note 95, at 118, 166 (Table 3.1); UNIF. P'SHIP ACT § 306(c) (UNIF. LAW COMM'N 1997) ("An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, [including] by way of contribution or otherwise, for such a partnership obligation solely by reason of being or so acting as a partner."). The Pennsylvania statute, however, at first looks like a full shield statute, but is actually only a partial shield. *See* PA. CONS. STAT. § 8204(a) (2015) (stating first that partners are not liable for claims against the partnership "sounding in contract or tort or otherwise," but the claims must "arise from any negligent or wrongful acts or misconduct").

102. *See* Hamilton, *supra* note 93, at 1091 (describing the full-shield statute as "gross overreaching" by the legal profession).

103. For example, in a partial-shield jurisdiction, plaintiffs could repackage malpractice

The genesis of the LLP form lies in strange history regarding professionals forming corporations. Historically, professionals such as lawyers, physicians, accountants, and others were not allowed to organize as corporations.[104] Professional ethics seemed to counsel against allowing professionals to insulate themselves from their own malpractice by incorporating, thus shifting the risk of professional negligence to the unwitting public.[105] However, as professional firms such as law firms and accounting firms grew larger with branch offices across the globe, the theory that professionals chose their partners and accepted the risk of their negligence did not seem apt.[106] Partners had little opportunity to choose or monitor new partners, and had little leverage to affect firm policy.[107] To

claims into contract claims. *Id.* at 1079–80. In addition, in a partial-shield jurisdiction, innocent managing partners could use firm resources to pay contractual claims, leaving an amount insufficient to satisfy tort claims, which would then be the sole obligation of the responsible partners. *Id.*

104. *See* Robert W. Hillman, *Organizational Choices of Professional Service Firms: An Empirical Study*, 58 BUS. LAW. 1387, 1387, 1391 (2003) ("The ban on incorporated practices was supported under various rationales including the technical point that corporations, by their very nature as artificial entities, cannot provide personalized professional services, the ethical point that a professional employed by a corporation would have conflicting duties to the employer and the client, the enforcement point that a corporation is beyond the reach of professional discipline, and the culpability point that a corporate entity would shield the professional from liability for malpractice.").

Interestingly, professionals wanted to form corporations not for limited liability, but to be able to establish retirement plans for employees and partners. *See* David Paas, *Professional Corporations and Attorney-Shareholders: The Decline of Limited Liability*, 11 J. CORP. L. 371, 372–74 (1986) (detailing the rise in professional corporation statutes to attempt, sometimes unsuccessfully, to allow professionals, including lawyers, to find a business form that allowed them to practice in their profession, create tax-advantaged retirement plans, and limit personal liability). Of course, the taxation of the entity is also a concern. *Id.* at 372.

105. *See* First Bank & Tr. Co. v. Zagoria, 302 S.E.2d 674, 675 (Ga. 1983) ("The professional nature of the law practice and its obligations to the public interest require that each lawyer be civilly responsible for his professional acts. A lawyer's relationship to his client is a very special one. So also is the relationship between a lawyer and the other members of his or her firm a special one. When a client engages the services of a lawyer the client has the right to expect the fidelity of other members of the firm. It is inappropriate for the lawyer to be able to play hide-and-seek in the shadows and folds of the corporate veil and thus escape the responsibilities of professionalism."); Paas, *supra* note 104, at 381 (detailing cases in Ohio, New York, and Georgia that refused to interpret professional corporation statutes to create limited liability shields for attorneys).

106. The lack of partnershipwide voting power was at the forefront of an action against Sidley Austin Brown & Wood by the Equal Opportunity Employment Commission ("EEOC") for the demotion of thirty-two partners the EEOC deemed "employees." *See* EEOC v. Sidley Austin Brown & Wood, 315 F.3d 696, 699, 707 (7th Cir. 2002) ("The firm is controlled by a self-perpetuating executive committee" and that "[t]he only firm-wide issue on which all partners have voted in the last quarter century was the merger with Brown & Wood.").

107. *See* Hillman, *supra* note 104, at 1389 (noting that as professional service firms grow to "hundreds or even thousands of partners" that no true bargaining occurs between the partners and that the partnership agreement is a "take it or leave it document").

enable these firms to thrive and grow, the law would have to allow them to limit their partnership liability.[108]

At first glance, the LLP seems no more radical an idea than a corporation or a LP. However, the LLP statutes represented the first mass entrance into the field of the limited liability joint venture—an entity in which the ownership retains control but eliminates any vicarious liability to third parties for the use of that control.[109] However, at the same time the LLP was becoming commonplace, states were enacting statutes in which members could comanage but eliminate personal liability for all members, even managing members.[110] The only remaining uncertainty was whether innovation in the partnership and LLC spaces would continue to be granted pass-through taxation status by the IRS.

C. *The Limited Liability Company*

The LLC form is in some ways the most recent hybrid introduction, though Wyoming had enacted an LLC act in 1977.[111] After the IRS recognized the Wyoming LLC as a tax partnership in 1988, other states rushed to enact similar LLC statutes in the 1990s.[112] This new entity moved even closer to a tax-advantaged corporate form than the LP or LLP.[113] With a limited liability shield for all firm obligations for all investors and managers, an LLC could mimic a general partnership, with all members having the right to comanage the LLC, or it could mimic a corporation, with one manager managing the LLC without much input from the members.[114]

108. *See* William H. Clark, Jr., *Rationalizing Entity Laws*, 58 BUS. LAW. 1005, 1006 (2003) (describing how accounting firms, stunned by the malpractice-induced bankruptcy of Laventhol & Horwath, lobbied for the LLP statutes as an interim measure until LLC statutes were passed.). *But see* Hamilton, *supra* note 93, at 1069 (reporting that the LLP statutes were "a direct outgrowth of the collapse of real estate and energy prices in the late 1980s, and the concomitant disaster that befell Texas's banks and savings and loan associations," resulting in lawsuits against the financial institutions' lawyers and accountants).

109. *See* Clark, *supra* note 108, at 1010–11.

110. *Id.*

111. Fallany O. Stover & Susan Pace Hamill, *The LLC Versus LLP Conundrum: Advice for Businesses Contemplating the Choice,* 50 ALA. L. REV. 813, 815 (1999).

112. Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460 (1998).

113. *See* Thomas Earl Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part Two)*, 37 S.D. L. REV. 467, 494-503 (1991). *But see Stover & Hamill, supra* note 111, at 829.

114. *See* Clark, *supra* note 108, at 1010, 1012–13; Stover & Hamill, *supra* note 111, at 817–18, 828–29.

Once the Department of Treasury made clear all LLCs would receive partnership tax treatment, LLCs could enjoy freely transferable interests, perpetual life, centralized management, and limited liability.[115] Today, LLCs are far and away the most popular form for new incorporations.[116] Though there are more existing corporations than LLCs, over time this fact may change.[117]

As discussed above, under Delaware law, organizers of a LP can waive all fiduciary duties that the general partner would have to the limited partners in the LP agreement.[118] However, if the agreement is silent, then a court would apply traditional duties of care and loyalty.[119] Currently, there is some question of whether there are default duties in an LLC from either the managers to the members in a manager-managed LLC or the members to one another in a member-managed LLC.[120] However, parties to an LLC may clearly waive fiduciary duties in the LLC operating agreement.[121]

115. Jonathan R. Macey, *The Limited Liability Company: Lessons for Corporate Law*, 73 WASH. U. L.Q. 433, 435 (1995).

116. *See* DEL. DIV. OF CORPS., ANNUAL REPORT (2017), https://corp.delaware.gov/stats/ [https://perma.cc/L933-FYPU] (reporting that in 2017, 143,996 LLCs were formed in Delaware, compared with 41,553 corporations and 11,517 LPs and LLPs combined). According to the Joint Committee on Taxation, the number of pass through entities tripled between 1986 and 2014. JOINT COMM. ON TAXATION, PRESENT LAW AND DATA RELATED TO THE TAXATION OF BUSINESS INCOME 39–40 (2017) [hereinafter JCT DATA]. In 2014, 3.6 million tax partnerships (general partnerships, LPs, LLPs, and LLCs) filed returns, compared to 1.6 million "C" corporations. *Id.* at 2; *see also* Harry J. Haynsworth, *The Unified Business Organizations Code: The Next Generation*, 29 DEL. J. CORP. L. 83, 85 (2004) (reporting that by 2002, 40% of all new businesses were formed as LLCs).

117. *See* JCT DATA, *supra* note 116, at 40 ("Since 1996, LLCs have grown at a rate of approximately 14 percent per year."). Though LLCs are unrivaled as the entity of choice for new formations, more corporations are still in operation, most having made a "Subchapter S" tax election. *See id.* at 38, 42 (reporting, for the most recent year that data is available, that in 2014 about 2.4 million LLCs filed tax returns, compared with 140,000 LLPs, 414,000 LPs, 575,000 GPs, 1.6 million "Subchapter C" corporations; and 4.3 million "Subchapter S" corporations).

118. *See* Mohsen Manesh, *Damning Dictum: The Default Duty Debate in Delaware*, 39 J. CORP. L. 35, 40–41 (2013).

119. *See id.* at 66 n.256.

120. Gatz Props., LLC v. Auriga Capital Corp., 59 A.3d 1206, 1218–19 (Del. 2012); Zimmerman v. Crothall, 62 A.3d 676, 702 n.145 (Del. Ch. 2013) ("The Delaware Supreme Court has not yet definitely determined whether the LLC statute imposes default fiduciary duties); Michael Despres, *Alternative Entities and Fiduciary Duty Waivers in Delaware*, 2015 BYU L. REV. 1347, 1359; Manesh, *supra* note 118, at 37–39 (2013).

121. *See* Manesh, *supra* note 118, at 40–41.

D. *The Master Limited Partnership*

The most extreme example of a partnership bearing no traditional partnership characteristics but still receiving federal pass-through taxation treatment is the PTP, also called a master limited partnership ("MLP"). The first MLP was formed in 1981.[122] During the first few years of the history of the MLP, many different kinds of operating entities formed this alternative vehicle, which offered the benefits of access to the capital markets and one level of taxation.[123] These entities were organized as LPs and presumably qualified for partnership taxation under the *Kintner* factors by lacking perpetual life and complete limited liability.[124] However, the 1986 tax reforms, aimed in part at the abuses of the LP form, introduced a new section 7704, which requires PTPs to be taxed as corporations unless 90% or more of the partnership's gross income consists of "qualifying income."[125] Though "qualifying income" is generally passive income, it also includes one category of operating income, which is income associated with "any mineral or natural resource."[126] Because of these restrictions, most post-1987 PTPs are in the oil and gas industry, real estate, or finance.[127]

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122. *See* J.T. Carpenter, *Master Limited Partnerships Shed a Tier*, 53 S. TEX. L. REV. 381, 383 (2011) (crediting Apache Petroleum Corporation with the first MLP, a "roll-up" of thirty LPs into one publicly traded entity).

123. *See id*. at 383–85, 388.

124. *See id*. at 383–85.

125. Existing PTPs were given special treatment. *See* I.R.C. § 7704(g) (2012).

126. *Id.* § 7704(d)(1). "Qualifying income" includes:

> (A) interest,
> (B) dividends,
> (C) real property rents,
> (D) gain from the sale or other disposition of real property (including property described in section 1221(a)(1)
> (E) income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), . . .
> (F) any gain from the sale or disposition of a capital asset (or property described in section 1231(b)) held for the production of income described in any of the foregoing subparagraphs of this paragraph, and
> (G) in the case of a partnership described in the second sentence of subsection (c)(3), income and gains from commodities (not described in section 1221(a) or futures, forwards, and options with respect to commodities.

127. MASTER LTD. ASSOC., PUBLICLY TRADED PARTNERSHIPS TRADING ON U.S. EXCHANGES [hereinafter MLPA DATA], https://www.mlpassociation.org/mlp-101/list-of-current-mlps/ [https://perma.cc/2W66-LJS6] (last updated Sept. 21, 2018).

Though the MLP asset class is small, the number of these types of LP was increasing until 2018.[128] In 2016, for example, 140 exchange-traded entities were classified as partnerships for tax purposes, most of which were LPs.[129] Because of the more liberal tax exception for those industries, 111 of the exchange-traded entities were in the oil, gas, coal, marine, and natural resources industries.[130] Four were real estate firms, and fourteen were financial firms.[131] Investors attracted to MLPs could also invest in eleven different master LP indexes.[132] The number of new PTPs entering the market reflects changes both in taxation and in the price of oil: Prior to 1996, it was normal for two PTPs to have an initial public offering in any given year.[133] "Following the "check-the-box" regulations, the number of public offerings of MLPs began to climb, reaching eighteen a year by 2006,[134] roughly following a pattern in crude oil prices.[135] Following a dip during the financial crisis, offerings rose again in 2011 (13); 2012 (15); 2013 (20); and 2014 (18)." Mirroring problems in the oil and gas industry, MLP initial offerings were low in 2015 (8), 2016 (2), and 2017 (5).[136] However, various factors resulted in a much lower number of MLPs by July 2018.[137]

128. *See* Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. CORP. L. 555, 557 (2012) (noting that PTPs are an "increasingly significant part of the business world").

129. Hurt, *supra* note 68, at 211. Interestingly, the publicly held LLCs differ from the standard MLP model, with some of them mirroring corporations, with a board of directors that stands for election and has director-type fiduciary duties. *See* John Goodgame, *New Developments in Master Limited Partnership Governance*, 68 BUS. LAW. 81, 87–91 (2012).

130. Hurt, *supra* note 68, at 211.

131. "In the mid-1990s, several private equity firms went public, including Apollo Global Management LLC, KKR & Co. LP, Fortress Investment Group, and The Blackstone Group LP. The Carlyle Group, L.P. went public in 2012. Six of the ten LLCs that are publicly traded are in the financial sector: Apollo, Compass Diversified Holdings LLC, Ellington Financial LLC, JMP Group LLC, Oaktree Capital Management LLC, and Och-Ziff Capital Management Group LLC." *Id.* at n.51.

132. *Id.* at 211.

133. *See History of MLP IPOs*, ALERIAN, www.alerian.com/education/figures-and-tables [https://perma.cc/NJY3-6T6S] (last visited Dec. 1, 2018).

134. *See id.*

135. At the same time, oil prices were on a gradual climb during the first decade of the 2000s, reaching over $60 per barrel by the beginning of January 2005 to a high of over $150 per barrel in 2008. *See Crude Oil Prices 70-Year Historical Chart*, MACROTRENDS, http://www.macrotrends.net/1369/crude-oil-price-history-chart [https://perma.cc/SR95-SZVL] (last visited Dec. 1, 2018).

136. Hurt, *supra* note 68, at 211. Oil prices fell from a modern high of over $100 per barrel in July 2014 to temporarily below $30 per barrel in June 2016. *See id.*

137. 2017 saw a wave of consolidations and mergers in the MLP industry, with the MLP merging with the related general partner. As discussed below, the 2017 tax reforms and

Even in growing numbers, MLPs are a small asset class.[138] Ten times as many corporations launch Initial Public Offerings ("IPOs") per year;[139] however, MLPs control a large amount of public capital. As of early 2017, the market capitalization of MLPs was $428 billion, up from $14 billion in 2000.[140] Another sign of a robust asset class is a high level of institutional investment. Institutional investors hold only about one-third of the market,[141] though institutional investors invest heavily in publicly held corporations and other alternative entities, such as REITs.[142]

LP "units" in MLPs seem more like preferred stock, stock appreciation rights, or possibly even corporate bonds. The general partner in a MLP usually holds a small percentage, for example 2%, of outstanding equity.[143] The public is offered common units while a related entity, the sponsor, holds a large percentage of subordinated units.[144] The LP agreement may provide various incentives to the sponsor-owned general partner to distribute available cash

changes in energy regulation may have also contributed to the decline. *See* Stuart Cartner & Shawn Amini, *FERC Issues Final Rule on Pipeline Tax Policy*, OPPENHEIMERFUNDS (July 19, 2018), https://www.oppenheimerfunds.com/advisors/article/ferc-issues-final-rule-on-pipeline-tax-policy [https://perma.cc/MRG8-GG2W]. By September 2018, there were 139 PTPs (12 LLCs and the rest LPs), with 91 in the oil and gas industry, 4 in real estate, and 12 in finance. *See* MLPA DATA, *supra* note 127.

138. At of the end of 2017, there were 3671 publicly held companies in the U.S.; in 2016, PTPs make up only 140 of them. *See* Steven Davidoff Solomon, *A Dearth of I.P.O.s, but It's Not the Fault of Red Tape*, N.Y. TIMES, (Mar. 28, 2017) https://www.nytimes.com/2017/03/28/business/dealbook/fewer-ipos-regulation-stock-market.html [https://perma.cc/YL3Q-27TW].

139. For comparison, Professor Jay Ritter compiles and publishes data on the number of IPOs per year of operating companies, excluding American Repository Receipts ("ADRs"), unit offers, closed-end funds, Real Estate Investment Trusts ("REITS"), small best efforts offers, banks and savings and loans, and stocks not listed on NYSE, NASDAQ, or Amex. *See* JAY R. RITTER, *Table 15: How Many IPOs Are There? 1980–2017*, *in* INITIAL PUBLIC OFFERINGS: UPDATED STATISTICS 39–40 (July 11, 2018), https://site.warrington.ufl.edu/ritter/files/2018/09/IPOs2017Statistics_July11_2018.pdf [https://perma.cc/D6QZ-4N88]. This data also excludes master LPs. *Id*. In 2016, 74 such companies had IPOs; in 2015, 115 companies; in 2014, 206 companies. *Id*.

140. Hurt, *supra* note 68, at 211.

141. *See* Goodgame, *supra* note 129, at 98 (reporting a 31% ownership rate among institutional investors, noting that "[f]rom 2004 through 2012, the MLP equity marketplace has gone from completely retail to a market with significant participation by institutional investors").

142. In 2010, institutional investors held 67% of the market capitalization of United States public corporations, and owned 73% of the market capitalization of the largest publicly held corporations. *See* Marshall E. Blume & Donald B. Keim, Institutional Investors and Stock Market Liquidity: Trends and Relationships 4–7, 19 (Aug. 21, 2012) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2147757 [https://perma.cc/8XQ7-RDCZ].

143. *See* Goodgame, *supra* note 129, at 83.

144. Hurt, *supra* note 68, at 213.

to the limited partners, such as the ability to convert subordinated units to common units and incentive distribution rights ("IDRs"), which will increase the general partner's percentage to as much as 50% upon the meeting of various cash distribution benchmarks.[145] Not all PTPs adhere to the traditional model of subordinated units and IDRs as innovation and variation have emerged.[146] However, the common feature of MLP agreements is that contractual provisions must replace fiduciary duties and attempt to align management interests with investor interests. But, at the end of the day, the limited partners can only rely on their contractual duties.

Again, the MLP form is the Frankenstein's monster of the partnership form,[147] combining the most management-friendly parts of a corporation and a partnership, with the result being a tax-advantaged financial product more like debt than equity.[148]

II. BACKGROUND—PARTNERSHIP TAXATION

The proliferation of hybrid entities, and the move to more corporation-like features, seems to emanate from the changes in state business entity statutes. However, these corporation-like characteristics could never have been adopted without the relaxation of federal regulations that restricted partnership taxation to the most partnership-like entities. The following section traces the changes in federal taxation that were happening parallel to the state law governance changes.

A. *Origins of Partnership Taxation*

The origins of United States entity taxation reflect a distinction between taxation of certain types of businesses. Civil War-era in-

145. *Id*.

146. *See* Goodgame, *supra* note 129, at 94–97.

147. One of the most surreal aspects of the PTP is that investor-owners cannot sue to enforce rights in federal court because for diversity purposes, any type of LP or LLC is a resident of every state in which any of its partners/members are residents. *See* Grupo Dataflux v. Atlas Glob. Grp., L.P., 541 U.S. 567, 579 (2004); Carden v. Arkoma Assocs., 494 U.S. 185, 195–96 (1990); Caren v. Collins, 689 Fed. Appx. 75, 76 (2d Cir. 2017) ("For purposes of diversity jurisdiction, a LP has the citizenship of each of its general and limited partners."); Grynberg v. Kinder Morgan Energy Partners, L.P., 805 F.3d 901, 905–08 (10th Cir. 2015) (acknowledging that such a rule precludes diversity jurisdiction over PTPs, but that Congress would need to address that issue, not the courts).

148. *See* Hurt, *supra* note 68, at 201–03, 221, 224.

come taxes distinguished between types of businesses along industry lines, with larger, capital-intensive businesses receiving entity-level taxation.[149] However, by the 1894 Act, all corporations were subject to an entity-level tax.[150] Other businesses, formed as partnerships or sole proprietorships, were taxed as a conduit only, meaning that business profits were attributed to the owners of the business and taxed at that level.[151] The passage of the Sixteenth Amendment to the United States Constitution[152] and the subsequent adoption of a permanent federal income tax in 1913 solidified the difference in taxation between corporations and associations on the one hand, and partnerships on the other.[153]

For most of the previous century then, corporate profits have not only been taxed at the entity level, but again if and when those profits were distributed to owners as dividends.[154] If a corporation does not distribute dividends, then the value of those shares should

149. *See* Act of July 1, 1862, ch. 119, §80, 12 Stat. 432, 468–69 (requiring individuals or businesses operating railroads, steamboats, ferry boats, and toll bridges to pay a three percent tax on the gross amount of their receipts and ferryboats to pay 1.5 percent); Act of June 30, 1864, ch. 173, §§ 120–22, 13 Stat. 223, 283–84 (adding banks, trusts, savings institutions, insurance companies, turnpikes, canals, canal navigation businesses, and slackwater businesses to the list of taxed businesses and increasing the tax rate to five percent); *see also* Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 455–57 (2001) (explaining the way that the first separate income tax has had lasting effects of taxing corporations and partnerships differently).

150. Tariff Act of 1894, ch. 349, § 32, 28 Stat. 509, 556; *see also* Bank, *supra* note 149, at 460–62 (noting the differences between the House and Senate versions of the 1894 Act and the unprecedented nature of a federal corporate income tax). The portion of this act that provided for taxation of dividends paid to individuals was found to be unconstitutional as a "direct" levy on income. Pollock v. Farmer's Loan & Tr. Co., 157 U.S. 429, 431, 583 (1895). The holding of *Pollock* was not extended to corporate excise taxes, and so a different corporate tax was enacted in 1909. Act of August 5, 1909, ch. 6, § 38, 36 Stat. 11, 112–13. However, Congress refrained from passing another individual income tax prior to amending the Constitution to definitively allow such a tax. *See* Sheldon D. Pollack, *Origins of the Modern Income Tax, 1894–1913*, 66 TAX LAW. 295, 311, 316–17, 320–22 (2012) (chronicling the political climate surrounding the passage of the Sixteenth Amendment).

151. *See* Act of August 27, 1894, ch. 349, §§ 27, 32, 28 Stat. at 509, 553, 556 (imposing an income tax on both "every citizen of the United States", and "all . . . corporations, companies, or associations doing business for profit in the United States, no matter how created and organized, but not including partnerships," meaning that income from businesses organized as partnerships would be taxed only as income of the individuals).

152. U.S. CONST. amend. XVI ("The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.").

153. *See* Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44 CATH. U. L. REV. 437, 459–64, 468–77 (1995) (detailing the word choice in each of the entity taxation statutes that led to the distinction between corporations and partnerships and the difficulty in categorization).

154. Steven A. Bank, *Is Double Taxation a Scapegoat for Declining Dividends? Evidence from History*, 56 TAX L. REV. 463, 465 (2003).

increase, creating a capital gain if and when the shareholder sells the shares.[155] Therefore, corporations are essentially taxed twice: once at the corporate rate and then either (1) again at the dividend rate if the profits are distributed to the shareholder or (2) again at the capital gains rate if the appreciated shares are sold by the shareholder.[156] In the second half of the twentieth century, until 2003, dividend income was included in the definition of "ordinary income" and taxed at individual income rates.[157] Therefore, corporate profits taxed once at the corporate rate then again at the individual rate would always be taxed more than partnership profits taxed only once at the pass-through rate (individual or corporate, depending on the profile of the partner).[158] Partners in a partnership, however, enjoy basis adjustment to their ownership interests that precludes profits from being taxed once at allocation and again at transfer.[159] The difference between corporate taxation and partnership taxation, depending on the rates of taxation of individuals and corporations, can be, and historically has been, substantial.

Though the distinction between the two entity types has persisted in various forms for a century, the reason for the distinction is a bit hazier. Two reasons are related and intertwined: the rise of the large corporation[160] and the desire to create a progressive tax

155. *See id.* at 463–65 (describing the tax effects of corporations retaining earnings as opposed to distributing dividends to shareholders).

156. Pre-1920 versions of the federal income tax created a weak version of a "double tax." *Id.* at 465–66 (stating that the double tax emerged after World War I). Corporations paid an entity-level tax and dividends were exempted from the "normal" tax. *Id.* at 463–65. However, because individuals had a generous personal exemption, significant amounts of partnership and sole proprietorship income was not taxed at all, unlike corporate profits which were taxed from the first dollar. *See* Carl C. Plehn, *The Income Tax as Applied to Dividends*, 9 AM. ECON. REV. 771, 771–72 (1919).

157. *See* Bank, *supra* note 154, at 465; Michael Doran, *Managers, Shareholders, and the Corporate Double Tax*, 95 VA. L. REV. 517, 542 (2009).

158. *See* Doran, *supra* note 157, at 519, 524–25. A simplified example that is a staple of textbooks and classroom lectures portrays the difference (in 1999 rates): Corporation X earns $100 in profits and pays $35 in tax. Corporation X has $65 remaining to pay in dividends to its shareholders. If shareholders are in the 36% bracket, then they will pay an additional $23.40 in tax, amounting to a total tax rate on corporate earnings of $58.40. If Corporation X were a partnership, then the $100 profit would be taxed once at 36%. Beginning in 2001, dividends have been taxed at a lower rate, narrowing somewhat the partnership tax advantage.

159. *See* Bradley T. Borden, *The Allure and Illusion of Partners' Interest in a Partnership*, 79 U. CIN. L. REV. 1077, 1077, 1082, 1085 (2011).

160. *See* Ajay K. Mehrotra, *American Economic Development, Managerial Corporate Capitalism, and the Institutional Foundations of the Modern Income Tax*, 73 LAW & CONTEMP. PROBS. 25, 41–48 (2010) (connecting the institution of a corporate-level tax with the "great merger movement" of 1895 to 1904 that created large, monopolistic firms with huge market power).

that fell mainly on the wealthy.[161] Though the income tax was originally conceived as a tax on the few,[162] by the end of World War I, the federal income tax was approaching a universal tax.[163]

Commentators have criticized the difference in taxation of different business entities as distorting the flow of capital.[164] In the absence of taxation differences, capital would flow to the most deserving projects, regardless of entity form.[165] However, double taxation of corporations might distort investor choices, and dividend taxation might distort corporate choices to distribute or reinvest earnings.[166] For example, partnerships tend to distribute profits regularly because partners are taxed on the profits each year

161. *See id.* at 40–41 (arguing that the corporate income tax was designed to reach the "new managerial class of business executives" and their "industrial enterprises"); Pollack, *supra* note 150, at 301–04 (the corporate income tax and individual income tax were seen as progressive attempts to tax accumulated wealth, in contrast to the high tariffs they replaced, which burdened consumers and protected the manufacturing industry).

162. Because of the large initial personal exemption ($3000 for individual filers; $4000 for married couples), over 71% of filers paid only 4% of the taxes collected. *See* U.S. INTERNAL REVENUE, TREAS. DEP'T, STATISTICS OF INCOME COMPILED FROM THE RETURN FOR 1916, at 5–6 (1918) [hereinafter 1916 TAX STATISTICS], https://www.irs.gov/pub/irs-soi/16soirepar.pdf [https://perma.cc/GNN8-AT3N]. Only 1.5% of filers reported over $100,000 of income, but those filers accounted for nearly 75% of the taxes collected. *See id.* at 6.

163. *See id.*; Roy G. Blakey & Gladys C. Blakey, *The Revenue Act of 1918*, 9 AM. ECON. REV. 213, 217–18 (1919) (noting that from 1913 through 1916, the first $3000 ($4000 for married couples) of income was exempt from taxation, but by 1919, only the first $1000 ($2000 for married couples) was exempt). In addition, under the 1913 rates, individuals were taxed at the 1% "normal" rate, with a surtax beginning at $20,000 of income that increased to 6% at the $2 million level. By contrast, the 1919 "normal" rates began at 6% and increased to 12%, with a surtax beginning at $5000 of income, increasing to 63% at $2 million).

164. *See* TREAS. DEP'T, INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS: TAXING BUSINESS INCOME ONCE, at v, vii–viii (1992), https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Integration-1992.pdf [https://perma.cc/G8VL-SFUB]; Doran, *supra* note 157, at 519–24 (chronicling the various arguments and movements toward corporate tax integration). *But see* Walter Hellerstein et al., *Constitutional Restraints on Corporate Tax Integration*, 62 TAX L. REV. 1, 3–4 (2008) (arguing that solutions to the taxation of dividend income create problems with cross-border dividends); Jeffrey L. Kwall, *The Uncertain Case Against the Double Taxation of Corporate Income*, 68 N.C. L. REV. 614, 616–17(1990) (arguing against integration because of the loss of tax revenue, which would then have to be recouped with higher rates, leading to inefficient and inequitable results).

165. *See* SCOTT GREENBERG, TAX FOUND., CORPORATE INTEGRATION: AN IMPORTANT COMPONENT OF TAX REFORM 5, 8, 12 (2016), https://files.taxfoundation.org/legacy/docs/TaxFoundation-FF506.pdf [https://perma.cc/WS2B-TP5K].

166. *See* Jennifer Arlen & Deborah M. Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L.J. 325, 327–28 (1995) (arguing that agency problems create an environment in which corporate managers lobby for the continued existence of dividend taxation because it allows managers to reinvest profits in new projects rather than distribute earnings).

whether distributed or not.[167] Corporations can postpone the second level of taxation by not distributing dividends.[168] Proposals to eliminate the tax distortion and integrate the corporate tax into the individual tax have been introduced at various points in the history of the corporate tax.[169] However, other commentators have defended double taxation on the basis of the advantages historically given to corporations, such as limited liability.[170] As with other corporate characteristics, this historically important aspect of the corporate form is no longer a salient distinction in 2018; limited liability is as much a hallmark of the modern partnership as it is of the corporation.

B. *Partnership Classification and Check-the-Box*

The history of LPs can best be told as a history of partnership tax. The ability to eliminate the corporate double tax and to also arbitrage salient features of pass-through taxation have directly influenced the popularity of the LP form. For example, investments in LPs grew in the second half of the twentieth century because of their use in particular types of tax shelters.[171] Congress responded to these perceived abuses by enacting the Tax Reform Act of 1986,

167. *Id.* at 328.

168. *See* Bank, *supra* note 154, at 465–67, 676 (recognizing arguments that double taxation creates incentives for managers to retain earnings and positing that managers have other incentives to do so in the absence of dividend taxation).

169. During discussions surrounding the Tax Reform Act of 1986, various deductions were proposed that would decrease taxation of dividends. The House version of the Tax Reform Act of 1986 contained a 10% deduction for dividends paid, but it was not included in the final act. *See* Emil M. Sunley, *Corporate Integration: An Economic Perspective*, 47 TAX L. REV. 621, 622 (1992). Prior to the Jobs and Growth Tax Relief Reconciliation Act of 2003, President George W. Bush proposed bills to exclude dividends from taxation. *See* H.R. 178, 108th Cong. (2003); H.R. 49, 108th Cong. (2003); Edmund L. Andrews, *Bush Budget Plan Would Eliminate Tax on Dividends*, N.Y. TIMES (Jan. 6, 2003), https://www.nytimes.com/2003/01/06/us/bush-budget-plan-would-eliminate-tax-on-dividends.html [https://perma.cc/RNN6-6XNN]. Most recently, Senator Orrin Hatch has proposed integrating corporate tax in 2016 and again in 2017. *See, e.g.*, *Navigating Business Tax Reform, Hearing Before the S. Comm. on Fin.,* 114th Cong. 1–2 (2016) (statement of Sen. Orrin Hatch, Chairman, S. Fin. Comm.).

170. *See, e.g.*, Herwig J. Schlunk, *I Come Not to Praise the Corporate Income Tax, but to Save It*, 56 TAX L. REV. 329, 338–39 (2003) ("Since the sovereign enacts the legislation that makes such limited liability possible, it conceivably could levy a tax, perhaps even an income tax, as a 'fee' for the provision of such benefit." (footnotes omitted)).

171. Andrew A. Samwick, *Tax Shelters and Passive Losses After the Tax Reform Act of 1986, in* EMPIRICAL FOUNDATIONS OF HOUSEHOLD TAXATION 193, 194 (Martin Feldstein & James M. Poterba eds., 1996) (showing that sales of LP interests under a Regulation D exemption "fell from $13.1 billion in 1986 to $7.6 billion in 1989 to $2.6 billion in 1992 after 15 prior years of growth").

which severely limited the tax advantages of certain LP structures, causing the popularity of LP to wane.[172] The targeted amendments limited the deductibility of passive losses and the deduction of interest, and expanded "at-risk" loss limitation rules to previously popular real estate investments.[173] The amendments also stalled the nascent MLP industry by restricting the types of income that would qualify a publicly traded LP for partnership taxation.[174] Following these tax reforms, LPs were used less frequently, particularly as the LLC form[175] became established. However, LPs still play a significant role in estate planning as family LPs,[176] in the financial industry as the entity choice for investment funds,[177] and in the PTP space.[178]

However, the explosion of LLCs actually had an unintended benefit for LPs because of the tax classification problems associated with LLCs.[179] Classification of an ever-growing array of partnership-like forms became administratively impractical,[180] and the

172. *See* 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, 566, 577 (1995) ("[T]his legislation effectively shut down the tax shelter industry."); *see also* James F. Peltz, *Caution Advised for Limited Partnerships: Investors Shift Their Focus to Steady Income*, L.A. TIMES, Dec. 3, 1989, at R13 ("Few investments carry a worse reputation these days than the limited partnership. Tax-law changes, troubles at many partnerships, and the resulting bad publicity have sent partnership sales tumbling the past two years, notably in real estate partnerships—the industry's biggest player.").

173. *See* Robert J. Peroni, *A Policy Critique of the Section 469 Passive Loss Rules*, 62 S. CAL. L. REV. 1, 101 (1988); Gordon Young Allison, Comment, *The Tax Reform Act of 1986 and its Effect on Real Estate Tax Shelters*, 40 ARK. L. REV. 567 (1987) ("The Tax Reform Act of 1986 ('the Act') deals a severe blow to both real estate limited partnerships and partnerships. The most notable provisions of the Act which adversely affect these types of real estate tax shelters are the amended at risk requirements.").

174. *See* I.R.C. § 7704 (2012).

175. *See supra* notes 111–12 and accompanying text. By 1997, all fifty states had passed similar statutes.

176. Troy Renkeymeyer, *The Family Limited Partnership: An Effective Estate Planning Tool*, 64 UMKC L. REV. 587, 587 (1996).

177. *See* Winnifred A. Lewis, *Waiving Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 82 FORDHAM L. REV. 1017, 1020 (2013) ("Limited partnerships are increasingly the organization of choice for private equity firms, venture capital firms, and hedge funds.").

178. *See* Manesh, *supra* note 128, at 557.

179. The first wave of LLC statutes can be described as either "bulletproof" statutes designed to create tax partnerships and "flexible" statutes that created uncertainty for tax classification. *See* Karen C. Burke, *The Uncertain Future of Limited Liability Companies*, 12 AM. J. TAX POL'Y 13, 40 (1995).

180. *See, e.g.*, Rev. Rul. 95-2, 1995-1 C.B. 220–21 (listing state versions of RULPA that satisfied the classification test in Treasury Regulation section 301.7701-2 and superseding similar Revenue Rulings in 1994); Rev. Rul. 93-93, 1992-2 C.B. 323 (issuing guidance that an Arizona LLC may be classified as a corporation or a partnership depending on the structure adopted in the operating agreement); Rev. Rul. 88-76, 1988-2 C.B. 361 (classifying an

IRS adopted regulations in 1996 that allowed entities with two or more owners that were not incorporated under a corporate statute to choose whether to be taxed as "partnerships" under Subchapter K or corporations.[181] In other words, any entity that was not a corporation would automatically receive tax partnership status, regardless of whether the entity created by statute and agreement looked more like, or exactly like, a corporation.[182] At the same time that states, led by Delaware, were giving LPs ultimate governance flexibility, federal tax law gave them advantageous taxation, regardless of how much governance flexibility they exploited.

The so-called "check-the-box" regulations can be seen as acknowledging the reality that business organizations, by choosing which of the *Kintner* factors to satisfy, were already able to opt in or out of partnership taxation.[183] However, by allowing an LP or LLC to be classified as a tax partnership without regard to the factors, the federal tax regime opened the door to the possibility that a hybrid entity could have advantageous tax treatment with centralized management, limited liability, free transferability of shares, and continuity of life, but without background fiduciary duties of the managers.[184] The differences between LPs, LLCs, and corporations would become very formalistic and quite thin, until modern pass-through entities would look more like 1913 corporations than 1913 partnerships.

C. *Toward Convergence: The Jobs and Growth Tax Relief Reconciliation Act of 2003 and the Tax Cuts and Jobs Act of 2017*

1. The Bush Tax Cuts

The effects of double taxation are most pronounced when the combination of the dividend taxation rate and the corporate tax rate diverge from the individual tax rate. Prior to 2003, dividends

LLC organized under the Wyoming statute as a partnership).

181. Treas. Reg. § 301.7701-1 to -3 (1996). Victor E. Fleischer, Note, *"If It Looks Like a Duck": Corporate Resemblance and Check-the-Box Elective Tax Classification*, 96 COLUM. L. REV. 518, 518, 530 (1996).

182. Treas. Reg. § 301. 7701-3(a) (1996); Susan Kalinka, *The Louisiana Limited Liability Company Law After "Check-the-Box,"* 57 LA. L. REV. 715, 719, 759 (1997).

183. *See* Fleischer, *supra* note 181, at 526–27.

184. *See* Jeffrey L. Burr, *Entity Choice: Just Check-the-Box*, 5 NEV. LAW. 12, 12 (1997) ("The change in the law will allow business organizations such as LLCs and LPs to enjoy all of the beneficial characteristics of a corporation but still be taxed as partnerships.").

were taxed at the individual rate, creating a sizeable gap between the maximum combined corporate tax and the maximum partnership (individual) tax.[185] For example, in 2000, prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 that reduced the maximum individual rate, the maximum combined corporate tax was 60.74% and the maximum rate for partnership income earned by an individual was 39.6%, representing a 21.14% differential.[186]

However, in 2003, President George W. Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003, which provided for a maximum tax rate of 15% for qualifying dividends and also for capital gains.[187] In 2003, then the maximum combined corporate tax was 44.75%, compared to the 35% maximum rate for partnership income earned by an individual, representing a 9.75% differential.[188] Though President Barack Obama extended these tax cuts for two years, the American Taxpayer Relief Act of 2012 increased the maximum dividend rate[189] and the maximum capital gains rate to 20%,[190] but also increased individual tax rates.[191] Therefore, in 2013, the maximum combined corporate tax was 48%, compared to the 39.6% maximum individual rate, representing an 8.4% differential.[192] These differentials vary depending on the tax

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185. I.R.C. §§ 1(a)–(d), (h)(1), 11(a)–(b), 61(a)(7) (2000).

186. The highest individual tax rate was 39.6% and the corporate tax rate was 35%. IRS, CORPORATION INCOME TAX BRACKETS & RATES, 1909-2002: TABLE 1: U.S. CORPORATION INCOME TAX: TAX BRACKETS AND RATES, 1909-2002 (2013), https://www.irs.gov/pub/irs-soi/02corate.pdf [https://perma.cc/Q88A-2RN6]; TAX FOUND., U.S. FEDERAL INDIVIDUAL INCOME TAX RATES HISTORY 3 (2013), https://taxfoundation.org/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets/ [https://perma.cc/8P3B-NP6W].

187. Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752, 760. Though dividends continue to be listed as constituting "gross income," which would lead them to be taxed at the ordinary income rate, a new provision defines "qualified dividend income" as constituting "net capital gain" and therefore taxed at the capital gain rate. *See* I.R.C. § 61(a)(7) (2000); *id.* § 1(h)(11) (Supp. IV 2004). "Qualified dividend income" means dividends received form domestic corporations and "qualified foreign corporations." *Id.* § 1(h)(11)(B)(i) (Supp. V 2005).

188. *See* I.R.C. § 11(b), (h)(11) (2000 & Supp. III 2003).

189. *See* American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 102, 126 Stat. 2313, 2318 (codified at I.R.C. § 1(h)(11)) (providing that "qualified dividend income" is included in "net capital gain," and therefore taxed at applicable capital gain rate instead of the ordinary income rate).

190. *See id.* (codified at I.R.C. § 1(h)(1)(B),(C)–(D)) (providing for graduated capital gains rates of up to 20% on adjusted net capital gain).

191. *Id.*

192. This differential ignores the possibility that the 3.8% Medicare surtax may apply to the pass-through income at the individual level. *See* James R. Repetti, *The Impact of the 2017 Act's Tax Rate Changes on Choice of Entity*, 21 FLA. TAX. REV. 686, 695–97 (2018).

In addition, these types of calculations ignore the fact that some income that is passed bracket of the specific partner in a partnership and the tax bracket of the corporation.[193]

2. The Trump Tax Cuts

Though proposals for corporate tax integration via dividend exclusion were never adopted, the lowering of the dividend rate results in a corporate-partnership tax differential of less than half.[194] Another way to reduce the differential without full integration is to lower the corporate tax rate.[195] The Tax Cuts and Jobs Act of 2017 may have accomplished just that.[196]

The 2017 reforms affect the differential between pass-through taxation and corporate taxation in various ways. Combined, the changes make the differential between partnership and corporate taxation much closer, but also much harder to predict, even at the firm level.[197] Though most proponents of entity taxation parity have argued that one benefit would be ease of administration, the 2017 tax reforms seem to increase the transaction costs of choice-of-entity decisions.[198]

First, individual rates, the rates at which pass-through income is taxed, are reduced; the maximum individual rate is temporarily reduced to 37%.[199] By itself, this change would increase the differential between pass-through taxation and corporate taxation. However, the 2017 reforms permanently eliminate the graduated

through from a partnership to a partner is capital gain, which is taxed at the partner's capital gain rate, now 20%. If a firm has capital gains only, such as an investment fund, then the differential between pass-through taxation and corporate taxation is much larger, particularly because the corporate capital gains rate is 35%.

193. *See id.*

194. *See* I.R.C. 1(h)(11) (Supp. IV 2017). *Compare id.* § 1(a)–(d), *with id.* § 11(b).

195. *Compare id.* § 1(a)–(d), *with id.* § 11(b) (lowering the corporate tax rate decreases the differential between partnership taxation and corporate taxation without full integration).

196. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054.

197. *See* Repetti, *supra* note 192, at 688, 714 (arguing that because the pass-through deduction creates so much uncertainty, the 2017 reforms do not elevate the corporate form to the obvious entity choice but impose additional planning costs at the choice-of-entity stage).

198. *See* Bradley T. Borden, *Choice-of-Entity Decisions Under the New Tax Act* 1, 6, 7 (Brooklyn Law Sch. Legal Studies, Paper No. 5506, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3119829 [https://perma.cc/ZU76-R2PE].

199. Several tax cuts in the 2017 reforms are "temporary," meaning that they will expire on December 31, 2025. *See, e.g.*, I.R.C. § 1(j) (Supp. IV 2017). The reduction in individual tax rates is temporary; however, the reduction in the corporate tax rates is permanent. *Id.* § 11021(a)(7).

corporate tax brackets[200] and replace them with a universal 21% corporate rate.[201] Both the 20% maximum dividend rate and capital gain rates remain unchanged.[202] The reduction in the maximum individual tax rate and the new universal corporate tax rate, taken in tandem with each other but in isolation from other provisions altering business deductions, decrease the difference between pass-through taxation (37%) and corporate taxation (36.80%) to 0.20% in favor of corporations.[203] Without granting corporations pass-through taxation or a dividend exclusion, these rate changes have accomplished what integration supporters had not.[204]

a. New Section 199A: The Pass-Through Deduction

However, before corporations are named the ultimate winner of the 2017 reforms, note that the reforms also add a new section 199A, which creates a new deduction for "a taxpayer other than a corporation,"[205] presumably individuals and tax partnerships, for income that is from a "qualified trade or business" ("QTB").[206] A QTB "is any trade or business other than . . . a specified service trade or business," or "the trade or business of performing services as an employee."[207] Therefore, individuals who receive income from a QTB (either earned directly as an independent contractor/sole proprietor or through a pass-through entity), may receive a 20% deduction of that income.[208] For purposes of determining the differential between forming a corporation and forming a pass-

200. Note that the policy rationale for having a graduated corporate tax are fairly weak. *See* Steven A. Bank, *Taxing Bigness*, 66 TAX L. REV. 379, 381–82 (2013) (arguing that purportedly progressive graduated tax rates are symbolic as a "poorly targeted benefit for small business[es]" but are a tool for targeting large corporations).

201. *Compare* I.R.C. § 11 (Supp. IV 2017), *with* I.R.C. § 11 (Supp. I 2013). Note that under previous law, corporate tax rates were graduated, with the first $50,000 of taxable income being taxed at 15%, the next $25,000 at 25%, taxable income between $75,000 and $10 million at 34%, and any taxable income over $10 million at 35%. A universal tax of 21% benefits all corporations except for those with less than $50,000 of taxable income. According to the Joint Committee on Taxation, 32.56% of "C" Corporations in 2014 had less than $50,000 in receipts (not income). *See* JOINT COMM. ON TAXATION, PRESENT LAW AND DATA RELATED TO THE TAXATION OF BUSINESS INCOME 48 (2017).

202. I.R.C. § 1(b)(1)(D) (Supp. V 2018).

203. *Id.* § 1(h), (j).

204. *See supra* text accompanying note 195 (demonstrating that lowering corporate tax rate is a way to decrease the partnership-corporation differential without full integration).

205. I.R.C. § 199A(a) (Supp. V 2018).

206. *Id.* § 199A(b)(2)(A).

207. *Id.* § 199A(d)(1) (defining "qualified trade or business").

208. *See id.* § 199A(a)(1)(b).

through entity, if the 20% deduction is available, then the pass-through rate is potentially 29.6%, compared to the corporate rate of 36.8% (7.2% differential).[209] In that case, the differential is smaller in 2018 than it was in 2017, but it is a nonzero differential.

Any partnership tax advantage, therefore, rests on whether the 20% deduction or any part is available to the owners of the partnership interests. For certain types of businesses, the deduction seems to be generally available.[210] Qualified REIT dividends and qualified PTP income allocations receive the deduction without limitation.[211] For other business income, that income must be "qualified business income" ("QBI") from a QTB.[212] Businesses that are not QTBs include "specified service trade or businesses" ("SSTB"),[213] which refers to an existing definition in section 1202(e)(3)(A),[214] with the following changes as marked:

> any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any other trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees [*or owners*].[215]

Also included as an SSTB are "services that consist of investing and investment management, trading, or dealing in securities . . . partnership interests, or commodities."[216] According to the Joint Committee on Taxation, two-thirds of all tax partnerships operate in three industries: (1) real estate and rental and leasing; (2) finance and insurance; and (3) professional, scientific, and technical

209. *See* Tony Nitti, *The 20% Pass-Through Deduction: Where Do We Stand Now?*, FORBES (June 20, 2018, 9:30 AM), https://www.forbes.com/sites/anthonynitti/2018/06/20/the-20-pass-through-deduction-where-do-we-stand-now/ [https://perma.cc/KJR9-FV3D].

210. I.R.C. § 199A(d) (Supp. V 2018).

211. *Id.* § 199A; *see also* William Baldwin, *2018 Tax Guide to MLPs*, FORBES (Feb. 14, 2018, 9:03 PM), https://www.forbes.com/sites/baldwin/2018/02/14/2018-tax-guide-to-mlps/ [https://perma.cc/MVA5-YJQ9] (noting that at least for tax years 2018 to 2025, investors in MLPs will get "20% off" income tax owed).

212. *See* I.R.C. § 199A(c)(1) (Supp. 2018).

213. *Id.* § 199A(d)(2).

214. *Id.* § 199A(d)(2)(A).

215. *Id.* § 1202(e)(3)(A). Proposed regulations attempt to flesh out these categories, including what it means for an enterprise to have as its primary asset the "reputation or skill" of one or more employees or owners. *See* 83 Fed. Reg. 159 (Aug. 16, 2018) (narrowing this category to individuals who endorse products and services, appear in the media, and license use of the individual's image, likeness, name, voice, and trademarks).

216. I.R.C. § 199A(d)(2)(B) (Supp. V 2018).

services.[217] The first of those industries, "real estate and rental and leasing" would seem to include QTBs, but the other two would seem to be SSTBs.[218] Looking at the Joint Committee's data on tax partnership returns, many partnerships operate in SSTB categories, while QTB categories besides real estate are generally small in terms of percentage of returns.[219]

To further complicate matters, deductions are allowed even for pass-through income from SSTBs if the taxpayer has income less than the "threshold amount" ($157,500) plus $50,000,[220] though if the taxpayer's income is more than the threshold amount, the deduction is phased out.[221] Therefore, whether the deduction is available may vary from partner to partner and from year to year.

The 199A deduction, even if derived from QBI from a QTB, can be limited if the 20% amount is less than the greater of (1) 50% of the QTB's W-2 wages or (2) 25% of those wages plus 2.5% of the unadjusted basis of depreciable tangible property.[222] Therefore, if the pass-through business did not have significant wage expenses or property, the 20% deduction would be limited.[223] At least one commentator has stated that this limitation should not apply to many businesses.[224] However, one category of business that the limitation would apply to would be MLPs, which often own no property and have no employees.[225] However, MLP distributions, like REIT dividends, are not subject to this limitation.[226]

217. JCT DATA, *supra* note 116, at 58. Real Estate and Rental and Leasing as a category constitutes 50.31% of all tax partnership returns. *Id.* at 54.

218. *See id.*

219. SSTB categories such as Health Care and Social Services (2.35%); Arts, Entertainment, and Recreation (2.05%); Professional, Scientific, and Technical Services (6.09%) (except for engineering and architecture); and Information (1.17%) may not receive a pass-through deduction. *See* JCT DATA, *supra* note 116, at 54. Because of the "reputation" catchall, it is hard to classify other businesses that are categorized as Accommodation and Food Services (3.83%) and Educational Services (.80%). *Id.* Categories that seem to be QTBs are Agriculture (3.97); Mining (.87%); Utilities (.14%); Construction (3.95%); Manufacturing (1.85%); Wholesale Trade (2.28%); Retail Trade (4.67%); Transportation and Warehousing (1.29%); and Waste Management (1.84%). *See id.*

220. I.R.C. § 199A(e)(2)(A) (Supp. V 2018). For a joint return, the threshold amount is $315,000, with the deduction phased out for income between $315,000 and $415,000. All amounts are automatically adjusted for inflation. *See id.* § 199A(e)(2)(B).

221. *Id.* § 199A(d)(3).

222. *Id.* § 199A(d)(3)(A)(ii); *see* Repetti, *supra* note 192, at 694.

223. *See* Repetti, *supra* note 192, at 694.

224. *Id.* ("[T]he wage limitations in § 199A(b)(2) will often not be a major barrier.").

225. *Id.* at 695.

226. Michael Bresson et al., *Tax Reform Act—Impact on Master Limited Partnerships*,

b. Corporate Partners

Note that the deduction is not available for corporate taxpayers who otherwise receive QTB income from a pass-through entity.[227] For example, if a corporation held an ownership interest in a partnership, then QTB income would be taxed at the corporate income rate.[228] The corporate rate, of course, has already been lowered to 21%, so any further deduction would be quite liberal.[229] When corporations own stock in other corporations, but not in partnerships, they receive a dividend received deduction ("DRD") to ensure that the double-level tax is not a triple-level tax.[230] The DRD was reduced "to reflect lower corporate income tax rates" from a minimum of 70% to 50%.[231]

One interesting question is whether the 2017 reforms change the preferences of a corporate owner of an interest in an MLP. MLPs thrive as PTPs with a single level of tax, thereby creating a tax advantage over corporate publicly traded entities.[232] However, under the 2018 regime, the corporate investor faces two new choices. One option is to invest in a publicly held corporation, which pays a corporate-level tax of 21%, and any distributions would be taxed at another 21%, after a DRD of probably 50%.[233] The effective tax rate on that investment would be 29.29%.[234] If the corporation invested in an MLP, the tax liability should be at the corporate rate of 21%, thus preserving the pass-through advantage.[235]

BAKER BOTTS (Dec. 20, 2017), http://www.bakerbotts.com/ideas/publications/2017/12/tax-reform-act---mlp/ [https://perma.cc/7HLH-XV95].

227. Nitti, *supra* note 209.

228. I.R.C. § 11(b) (2012 & Supp. V 2018).

229. *See supra* note 201 and accompanying text.

230. I.R.C. § 243(a)–(b) (2012 & Supp. V 2018).

231. Act of Dec. 22, 2017, Pub. L. No. 115-97, § 1302, 131 Stat. 2054, 2100 (codified as amended at 26 U.S.C. § 243) (amending current regime of a 70% deduction for corporate owners of less than 20% of a corporation; an 80% deduction for owners of 20% or more of a corporation; and a 100% deduction for owners of 80% or more of a corporation to a regime of 50%, 65%, and 100% deductions for the corresponding categories).

232. *See supra* note 123 and accompanying text.

233. I.R.C. §§ 11(b), 243(a) (2012 & Supp. V 2018) (discussing corporate tax rates and DRD rates).

234. *See id.* (applying corporate tax rate of 21% with a DRD rate of 50% to investment income corporate profits already taxed at corporate tax rate of 21%).

235. *Id*. § 7704(c)(1)–(2) (2012) (outlining pass-through exception for PTPs like MLP's); *id*. § 701 (specifying pass through tax status of partnerships). Noncorporate owners of partnership interests in MLP's receive the 205 pass-through deduction, but corporate owners who have a much lower tax rate anyway, do not. *Id*. § 199A(a).

3. *Corporation v. Partnership in Absence of Tax Advantages*

In an environment in which corporations and partnerships are taxed approximately identically, organizers would choose an entity based on corporate governance and transaction costs. From a transaction cost standpoint, the corporation would be the clear choice for most business organizers. Corporations are relatively simple to create, while pass-through entities such as LPs and LLCs require, often lengthy partnership agreements with tax sections that (hopefully) are drafted or reviewed by tax attorneys or accountants. Shareholders in corporations can easily calculate their tax liability when they sell their shares or receive dividends.[236] However, partners or members in pass-through entities receive K-1s each tax year that require far more accounting expertise.[237] And, most importantly, closely held corporations are able to time distributions to shareholders in order to gain deferral on the second level of tax.[238] Income in a pass-through entity immediately passes through to the owners, regardless of whether cash distributions are made.[239] Therefore, all other things being equal (though none of them are), rational organizers of new businesses would form corporations.

III. TOWARD A THEORY OF PARTNERSHIP

Entity law needs a theory of partnership law that can respond to what has become a reversal of traditional concepts of "corporate" characteristics and "partnership" characteristics. Today, the majority of partnership-type entities have the ability to eliminate all or nearly all of the partnership characteristics.[240] To many commentators, these hybrids are preferential to corporations precisely because parties can contract for the governance that they choose.[241]

236. *See How to Figure How Much Tax Is Owed on a Stock You Sold*, ZACKS, https://finance.zacks.com/figure-much-tax-owed-stock-sold-1324.html [https://perma.cc/GH8D-Z2WJ] (last visited Dec. 1, 2018).

237. Valeriya Avdeev, *The Need for Tax Reform: Schedule K-1 Document Matching Program and Effective Revenue Collection*, 59 N.Y. L. SCH. L. REV. 341, 357 (2014).

238. TAX POLICY CTR., *Is Corporate Income Double-Taxed?*, https://www.taxpolicycenter.org/briefing-book/corporate-income-double-taxed [https://perma.cc/ZX7D-K3C8] (last visited Dec. 1, 2018).

239. *Pass Through Entity*, WEST'S TAX LAW DICTIONARY (2018).

240. *See supra* notes 42–44, 54–57, 94–96, 118, 125 and accompanying text.

241. LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 214–16, 218–21 (2010).

This contractarian approach[242] suggests that the popularity of hybrid entities, particularly LPs and LLCs, stems from their governance flexibility. Of course, the contractarian approach also assumes that the participants in the "uncorporation" bargain for the resulting governance; if the managers choose the governance and participants unwittingly make choices against their interest without pricing in their preferences, then the resulting governance merely reflects opportunism.[243]

Arguably, the presence of some of those partnership characteristics served as necessary backstops to managerial opportunism, and made other agency safeguards present in corporations unnecessary for investor-partners.[244] When those hallmarks of partnership governance are eliminated, then investor-partners do not have the same background of protections necessary for good governance that corporations have.[245] The *Kintner* factors separated the universe of business entities into two types: corporations which had centralized management, limited liability, free transferability of shares, and perpetual life and partnerships.[246] General partnerships generally had none of those characteristics, and hybrid entities, which could have only two.[247] The *Kintner* factors attempt to isolate the fundamental tension in corporate law: the separation of ownership and control.[248]

242. The Delaware LP and LLC acts are generally seen as the standard-bearers for the contractarian approach. *See* DEL. CODE ANN. tit. 6, § 17-1101(c) (2018) ("It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."); *id.* § 18-1101(b) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.").

243. *See* Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 DEL. J. CORP. L. 465, 482, 483–84 (2009) (using PTPs as an example of a breakdown in the contractarian assumptions that investors in noncorporations are sophisticated, have an opportunity to negotiate governance terms, and own nontransferable shares).

244. *See* Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 142–43 (arguing that participants in noncorporate forms can constrain agency costs without fiduciary duties because managers are owners with significant stakes in the enterprise).

245. *See* Manesh, *supra* note 243, at 503–05 (positing that if LPs can effectively become publicly held corporations without fiduciary duties, then the corporate form will become obsolete); Larry E. Ribstein, *The Uncorporation's Domain*, 55 VILL. L. REV. 125, 128 (2010) (theorizing that partnerships control agency costs by requiring managers to distribute available cash, substituting for fiduciary duties and voting).

246. *See supra* text accompanying notes 59–61.

247. *See supra* text accompanying notes 37–40, 61–62.

248. *See supra* text accompanying notes 58–60.

A. *Separation of Ownership from Control*

1. Corporations

Modern corporate theory relies heavily on the theory of the firm, which describes the tensions between managers and owners as stemming from the separation of ownership from control, with manager-agents creating agency costs by not completing aligning their behaviors with owner interests.[249] The costs of monitoring managers and losses created by imperfect decision-making are agency costs, which can be reduced but not eliminated.[250] In a corporation, the owner-shareholders delegate such control to the Board of Directors, who in turn delegate management of day-to-day affairs to the officers of the company, who then delegate to the subordinate employees, and so on.[251] In a corporation, shareholders suffer from the separation of ownership and control and are unable to monitor perfectly, but have a small bundle of protections.[252]

First, shareholders have some statutory rights that may substitute for monitoring. Shareholders are able, at least theoretically and in the absence of an agreement otherwise, to cast votes at an annual meeting for the directors,[253] who must be individual human directors with ultimate liability, to remove directors,[254] and to vote

249. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976); Eric W. Orst, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 275 (1977).

250. Jensen & Meckling, *supra* note 249, at 308; Orst, *supra* note 249, at 275–76.

251. Grant M. Hayden & Matthew T. Bodie, *The Bizarre Law and Economics of* Business Roundtable v. SEC, 38 J. CORP. L. 101, 115 (2012).

252. In a market for shares of a corporation, minority shares may be discounted to reflect this lack of control.

253. DEL. CODE ANN. tit. 8, § 211(b) (2018) (providing for election of directors at an annual meeting of stockholders or by written consent); MODEL BUS. CORP. ACT § 8.03 (2017) (providing for election of directors by shareholders at annual meeting or by written consent).

254. DEL. CODE ANN. tit. 8, § 141(k) (2018) (providing for removal of directors by the holders of a majority of shares entitled to vote for directors); MODEL BUS. CORP. ACT § 8.08(a) (2017) (providing for removal of directors with or without cause unless the articles of incorporation provide that directors may be removed only for cause).

on extraordinary events such as amendment of articles of incorporation,[255] mergers,[256] disposition of assets,[257] and dissolution.[258] Shareholders also may have a limited ability to call shareholder meetings[259] or act by written consent.[260] By statute, shareholders have the ability to request access to the books and records of the corporation.[261]

2. Partnerships

This separation of ownership from control takes place in any entity comanaged by more than one person; however the general partnership, with equal rights to comanagement, personal liability, and fiduciary duties, constrains agency problems more effectively than the corporate structure.[262] However, the structure of the hybrid entities, including the LP and the LLC, particularly manager-managed LLCs, creates agency problems similar to those

255. DEL. CODE ANN. tit. 8, § 242(b) (2018) (providing that amendments to the articles of incorporation approved shareholders at an annual or special meeting); MODEL BUS. CORP. ACT § 11.04(c) (2017) (providing that the vote of a majority of shares entitled to vote is required for mergers and share exchanges).

256. DEL. CODE ANN. tit. 8, § 251(c) (2018) (requiring action by shareholders party to mergers).

257. *Id.* § 271 (requiring action by a majority of shares entitled to vote to sell all or substantially all of the corporation's assets); MODEL BUS. CORP. ACT § 12.02(a) (2017) (requiring shareholder vote if "disposition would leave the corporation without a significant continuing business activity").

258. DEL. CODE ANN. tit. 8, § 275 (2018); MODEL BUS. CORP. ACT § 14.02 (2017).

259. DEL. CODE ANN. tit. 8, § 211(c) (2018) (providing a mechanism by which shareholders may ask the Court of Chancery to call a shareholder meeting if the board of directors fails to do so within thirteen months of the last shareholder meeting); MODEL BUS. CORP. ACT § 7.03 (2017) (providing a mechanism by which shareholders may apply to a court to order a shareholder meeting if the board of directors had not held a meeting within six months of the end of the fiscal year or fifteen months after the last shareholder meeting).

260. DEL. CODE ANN. tit. 8, § 228(a) (2018) ("Unless otherwise provided in the certificate of incorporation, any action required by this chapter to be taken at any annual or special meeting of stockholders of a corporation, or any action which may be taken at any annual or special meeting of such stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting . . . ."); MODEL BUS. CORP. ACT § 7.04(a) (2017) ("Action required or permitted by this Act to be taken at a shareholders' meeting may be taken without a meeting if the action is taken by all the shareholders entitled to vote on the action.").

261. DEL. CODE ANN. tit. 8, § 220 (2018) (giving record stockholders the right to inspect certain books and records for any proper purpose); MODEL BUS. CORP. ACT § 7.20(b) (2017) (granting shareholders the right to inspect list of shareholders entitled to notice of upcoming meeting); MODEL BUS. CORP. ACT § 16.02 (2017) (giving shareholders the right to inspect and copy certain records upon written notice five days in advance).

262. *See supra* note 26 and accompanying text.

in a corporation.[263] In the LP context, day-to-day management is delegated to the general partner or a group of general partners, similar to centralization of management in a corporation.[264] However, LPs and LLCs do not have backstops against managerial opportunism that corporations do.[265]

Under the 2001 ULPA, the general partner must have the consent of the limited partners for a few extraordinary events, but the list is even smaller than the events that shareholders in corporations must approve.[266] However, the LP agreement may vary or eliminate the types of events that require the vote of the limited partners under the 2001 ULPA.[267] The DRULPA does not provide for even a default consent of partners for general partner actions.[268]

LP statutes do not provide many of the other monitoring mechanisms to allow limited partner-owners to reduce agency costs. For example, limited partners may not have a right to vote on even extraordinary events by default.[269] In addition, the limited partners do not have the right to elect the general partner annually or at any other interval, though they have the default right to vote on

263. One might also argue that in large LLPs, which are governed by the general partnership statute, partnership agreements centralized management power in various executive committee structures so as to separate ownership from control as well, even though the "owners" participate in the work of the firm and are able to monitor the managing partners.

264. Historically, LP agreements created regimes with very restricted LP control because of the control rule under RULPA, also found in DRULPA section 17-303, which conditions limited liability for limited partners on not participating "in the control of the business." DEL. CODE ANN. tit. 6, § 17-303 (2018). However, with the lengthy safe harbor of activities that do not constitute participating in the control of the business in RULPA, this argument seems rather weak. In addition, it seems surprising that the Delaware legislature, which prides itself on being responsive to trends in modern entity law, would not amend this provision along the lines of ULPA section 303, which states that limited partners have no liability for obligations of the LP, "even if the limited partner participates in the management and control of the limited partnership." UNIF. LTD. P'SHIP ACT § 303 (UNIF. LAW COMM'N 2001).

265. UNIF. LTD. P'SHIP ACT § 408 (UNIF. LAW COMM'N 2001).

266. *Id.* § 406(b) (listing the events that require unanimous consent of the partners as amending the partnership agreement; amending the certificate of LP to convert to or from a limited liability LP; and to sell all or substantially all of the LP's assets).

267. *Id.* § 110 (allowing a partnership agreement to vary any of the terms of the act except for those listed in section 110(b)).

268. DEL. CODE ANN. tit. 6, § 17-403 (2018).

269. *Id.* § 17-302(f) ("A limited partner and any class or group of limited partners have the right to vote only on matters as specifically set forth in this chapter, on matters specifically provided by agreement, including a partnership agreement, and on any matter with respect to which a general partner may determine in its discretion to seek a vote of a limited partner or a class or group of limited partners . . . A limited partner and any class or group of limited partners have no other voting rights.").

the admission of a new general partner, unless varied by the LP agreement.[270] Under the 2001 ULPA,[271] but not DRULPA,[272] limited partners have the right to seek a judicial determination that a general partner should be expelled; otherwise, the partnership agreement would have to provide a mechanism for expulsion.[273] At least as seen in public LP agreements with respect to PTPs, the right to expel the general partner is very limited and probably impossible where unknown limited partners cannot act in concert.[274] In addition, the general partner may be the same entity or an entity controlled by a controlling limited partner, making a potential expulsion of the general partner by the public limited partners impossible.[275]

Additionally, LP statutes do not provide for other monitoring mechanisms, such as annual meetings or the ability of limited partners to call for a meeting or act by written consent.[276] Limited partners do have inspection rights.[277] However, the end result is that limited partners have even less of a voice than a shareholder

270. UNIF. LTD. P'SHIP ACT § 401(b) (UNIF. LAW COMM'N 2001).

271. *Id*. § 603(5) (listing as reasons to determine judicial expulsion as engaging in "wrongful conduct that adversely and materially affected the limited partnership activities"; "willfully or persistently" committing a material breach of the partnership agreement or of a partnership duty; or engaging in conduct that "makes it not reasonably practicable to carry on the activities of the limited partnership with the person as a general partner").

272. DEL. CODE ANN. tit. 6, § 17-402; *see* Eames v. Quantlab Grp. GP, LLC, No. 2017-0792-JRS, 2018 Del. Ch. LEXIS 138, at *1–3 (May 1, 2018) (upholding a LP agreement provision that provided that limited partners could not remove the general partner unless there was a remaining general partner, but shareholders could not add a general partner unless the current general partner agreed and voiding an attempt to add a general partner and remove the current general partner in one day without the current general partner's consent).

273. UNIF. LTD. P'SHIP ACT § 603(3) (UNIF. LAW COMM'N 2001).

274. *See, e.g.*, Noble Midstream Partners LP, Registration Statement, (Form S-1), Oct. 22, (2015) investors.nblmidstream.com/sec-filings [https://perma.cc/S9JY-H86M] ("Unitholders have very limited voting rights and, even if they are dissatisfied, they will have limited ability to remove our general partner.").

275. *See* UNIF. LTD. P'SHIP ACT §§ 113, 603(3) (UNIF. LAW COMM'N 2001) (stating that the same person may be a general partner and a limited partner and that unanimous consent of the partners may be required to expel a general partner).

276. *See, e.g.*, John D. Chambliss, *Entity Overview of LLCs, LPs and LLPs*, DAVIS, MALM & D'AGOSTINE, P.C. 1, 14–15, http://www.davismalm.com/1BE153/uploadedDocuments/Articles/ChamblissPartnershipsLLCsand LLPs.pdf [https://perma.cc/B8CT-2Q45] (last visited Dec. 1, 2018).

277. *See* UNIF. LTD. P'SHIP ACT § 304(a)–(b)(1) (UNIF. LAW COMM'N 2001) (limited partners have the right to inspect "required information" and do not need "any particular purpose for seeking the information and limited partners have the right to inspect "information regarding the state of the activities and financial condition of the limited partnership and other information regarding the activities of the limited partnership . . . for a purpose reasonably related to the partner's interest as a limited partner").

in a publicly held corporation.[278] Finally, parties may agree in a LP agreement to indemnify and hold harmless general partners in a way that public policy has restricted in the corporate setting.[279]

B. *Fiduciary Duties*

Another safeguard against rampant agency costs are the imposition of fiduciary duties. If those managers in control may be subject to act in their self-interest and not in the interest of the owners, then background fiduciary duties can act as a replacement for costly monitoring devices.[280] The duty of care acts to ensure that agents manage property as a prudent property owner would, and the fiduciary duty of loyalty constrains an agent's self-dealing, conflicts of interest, and usurpation of corporate opportunities, among other things.[281]

1. Corporations

Corporate officers and directors owe these duties by default to the corporation, and by extension, the shareholders.[282] Admittedly,

278. *Compare id.* § 302(a) ("In this respect, a limited partner is analogous to a shareholder in a corporation . . . status as owner provides neither the right to manage nor a reasonable appearance of that right"), *with* MODEL BUS. CORP. ACT § 6.01(c)(1) (2016) ("The articles of incorporation may authorize one or more classes or series of shares that . . . have . . . no right to vote . . . .").

279. DEL. CODE ANN. tit. 6, § 17-108 ("[S]ubject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever."); *see also* Weil v. Vereit Operating P'ship, L.P., No. 2017-0613-JTL, 2018 Del. Ch. LEXIS 48, at *9 (Feb. 13, 2018) ("[Section 17-108] gives limited partnerships wider freedom of contract to craft their own indemnification scheme for a partnership's indemnitees than is available to corporations under § 145 of the Delaware General Corporations Law, which creates mandatory indemnification rights for corporate indemnitees in some circumstances and also bars indemnification in others.").

280. Meinhard v. Salmon, 164 N.E. 545, 546–48 (N.Y. 1928) (holding that there "may be no abuse of special opportunities growing out of a special trust as manager or agent" and that a "managing co-adventure" owed "the duty of the finest loyalty . . . . Not honesty alone, but the punctilio of an honor the most sensitive"); *see also* Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1049, 1053–54 (1991).

281. *See generally* Myron T. Steele, *The Moral Underpinnings of Delaware's Modern Corporate Fiduciary Duties*, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 3, 4 (2012) (discussing the historical evolution of fiduciary duties beginning with God making Adam and Eve his agents over Earth to modern day legal principles).

282. *See* Andrew S. Gold, *Dynamic Fiduciary Duties*, 34 CARDOZO L. REV. 491, 493–502 (2012) (arguing that there is a fluid nature to a directors fiduciary duty to individual shareholders, shareholders-generally, and the corporation as well as the costs and benefits of such

state statutes have also evolved during this same time to allow managers to limit liability for directors,[283] for the duty of care,[284] and to waive the corporate opportunity doctrine, which is part of the duty of loyalty.[285] However, a limitation of liability works only to avoid damages; shareholders would still have equitable remedies for a breach of the duty of care.[286] In addition, the remaining aspect of the duty of loyalty regarding self-dealing and conflicted transactions is nonwaivable in the corporate setting.[287]

2. Partnerships

LPs again have the same separation of ownership from control, but actually have less protection through fiduciary duties than originally conceived. Though one might argue that the quintessen-

dynamic relations); Celia R. Taylor, *The Inadequacy of Fiduciary Duty Doctrine: Why Corporate Managers Have Little to Fear and What Might Be Done About It*, 85 OR. L. REV. 993, 994–95 (2006) (discussing the emergence of fiduciary duties during the growth of corporate law and the gradual decline in effectiveness of the doctrine leading to its obsolescence); Julian Velasco, *Fiduciary Duties and Fiduciary Outs,* 21 GEO. MASON L. REV. 157, 165 (2013) (describing the fiduciary duties that directors owe to the shareholders). *But see* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 240–43 (2009) (arguing that for all practical purposes, corporate actors are no longer held to the standard of fiduciaries under common law.).

283. *See* DEL. CODE ANN. tit. 6, § 102(b)(7) (2018).

284. However, directors may not be exculpated from gross negligence, however rare. *See* H & N Mgmt. Grp. v. Couch, No. 12847-VCMR, 2017 Del. Ch. LEXIS 140, at *12–18 (Aug. 1, 2017) (denying a motion to dismiss based on allegation of gross negligence where the Compensation Committee met briefly as a formality, did not retain advisors, was conflicted regarding a termination decision, and received information, which it did not review, from the manager whose termination was at-issue).

285. DEL. CODE ANN. tit. 6, § 122(17) (2018) (giving every corporation the power to "[r]enounce, in its certificate of incorporation or by action of its board of directors, any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or specified classes or categories of business opportunities that are presented to the corporation or 1 or more of its officers, directors or stockholders"); Gabriel V. Rauterberg & Eric L. Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1076, 1112 (2017) (finding that most waivers add shareholder value by, for instance, allowing private equity shareholders to act as directors).

286. *See* Stephen J. Lubben & Alana J. Darnell, *Delaware's Duty of Care*, 31 DEL. J. CORP. L. 589, 590 (2006) ("Nonmonetary remedies, such as injunctions and rescissions, however, do not fall within the reach of DGCL section 102(b)(7)."); Julian Velasco, *A Defense of the Corporate Law Duty of Care*, 40 J. CORP. L. 647, 656 (2015) ("Although damages against directors are no longer an option, injunctive relief is.").

287. *See, e.g.*, DEL. CODE ANN. tit. 6, § 102(b)(7) (2018) ("Such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law . . . or (iv) for any transaction from which the director derived an improper personal benefit.").

tial characteristic of partnerships has traditionally been that partners, at least general partners, owe to one another "the duty of the finest loyalty,"[288] that has not been the path of the hybrid partnerships.[289] The hybrid partnerships have preferenced freedom of contract over mandatory duties.[290]

The amendment of DRULPA in 2004 to allow for the reduction or elimination of fiduciary duties in LP agreements created the possibility for partnerships in which general partners owe no duties to the limited partners.[291] The publicly available partnership agreements from PTPs reflect that most have taken the opportunity to either eliminate fiduciary duties or limit liability for breaches of those duties, or both.[292] Even a corporation with limits on liability for the duty of care and a business opportunity waiver would have some statutory substitutes for monitoring, but those are not available for limited partners.[293] Most importantly, corporate managers have a duty to avoid conflicts, but general partners in LPs that eliminate the duty of loyalty do not.[294] The "no duty"

288. Meinhard v. Salmon, 164 N.E. 545, 546–48 (N.Y. 1928) (holding that Salmon had violated the duty of loyalty by usurping a business opportunity without bringing it to his coventurer, Meinhard, and stating the "standard of behavior" among copartners as "[n]ot honesty alone, but the punctilio of an honor the most sensitive").

289. UNIF. LTD. P'SHIP ACT § 305(a)–(b) (UNIF. LAW COMM'N 2001).

290. *See, e.g.*, DEL. CODE ANN. tit. 6, § 17-1101(c)–(d) (2018).

291. *See id.* Other states contain similar provisions. Pennsylvania, in particular, has amended its act a second time, seemingly adding back default duties. *See* Hanaway v. Parkesburg Grp., LP, 168 A.3d 146, 156 (Pa. 2017) (comparing the 2017 Pennsylvania LP act, which contained a Delaware-like provision stating that freedom of contract was paramount, with a new provision that deleted that language); *see also* Carella v. Scholet, 824 N.Y.S.2d 185, 186 (2006) ("General partners owe a fiduciary duty to limited partners and are obligated not to engage in self-dealing, unless the partnership agreement permits such self-dealing."); UNIF. LTD. P'SHIP ACT § 110(b)(5)(A) (UNIF. LAW COMM'N 2001) (providing that the limited partnership agreement may define what activities do not violate the duty of loyalty if "not manifestly unreasonable"). *Compare* PA. STAT. AND CONS. STAT. § 8520 (2015) (repealed 2016), *with* PA. STAT. AND CONS. STAT. § 8615(d)(3) (2017) (allowing a partnership agreement to alter "aspects of the duty of loyalty" and the duty of care "if not manifestly unreasonable").

292. *See* Manesh, *supra* note 128, at 583–84 (reporting that 88% of publicly traded alternative entities "totally waive the fiduciary duties of managers or eliminate liability arising from the breach of fiduciary duties").

293. See Larry E. Ribstein, *Possible Futures for Unincorporated Firms*, 64 U. CIN. L. REV. 319, 322 (1996).

294. *See, e.g.*, Allen v. Encore Energy Partners, L.P., 72 A.3d 93, 95 (Del. 2013) (holding that LP may expand, restrict or eliminate duty of loyalty); Lonergan v. EPE Holdings, LLC, 5 A.3d 1008, 1025 (Del. Ch. 2010) (holding that general partner was not required to follow a different process for merger when LP had waived fiduciary duties); Emps. v. TC Pipelines GP, Inc., No. 11603-VCG 2016 Del. Ch. LEXIS, at *7 (May 11, 2016) (reasoning that the duty of good faith and fair dealing is a gap filler and provision eliminating fiduciary duties of general partner did not leave a "gap").

partnership is a creature of pure contract.[295] LLC acts are even more likely than state LP acts to allow for the elimination of fiduciary duties or not contain them as a default.[296]

Though Delaware corporations have avenues to decrease the consequences of breaching fiduciary duties through indemnification for the duty of care, eliminating liability for breaches of the corporate opportunity doctrine, and simplifying the business judgment rule, corporate shareholders are successful in cases against boards for conflict of interest transactions and breach of the duty of disclosure transactions.[297] However, for LPs, the consequences of breaching common law fiduciary duties can be reduced to zero. By eliminating all fiduciary duties, these entities have successfully thwarted challenges to many general partner actions, including conflict of interest transactions, actions that are taboo in corporate situations.[298] Under DRULPA, the only duty that may not be waived is the contractual duty of good faith and fair dealing,[299] which seems to be a fairly anemic duty.[300] Generally, the Delaware

295. *See* Larry E. Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 WASH. & LEE L. REV. 537, 540 (1997). The Delaware courts have held that general partners in a LP still owe the contractual duty of good faith and fair dealing. Recent cases have indicated that the courts may have encountered general partner actions that may breach that covenant. *See, e.g.*, Brinckerhoff v. Enbridge Energy Co., Inc., 159 A.3d 242, 262 (Del. 2017) (complaint adequately pleaded facts giving rise to inference of bad faith); Dieckman v. Regency GP LP, No. 11130-CB, 2018 Del. Ch. LEXIS 60, at * 7–11 (Del. Ch. Feb. 20, 2018) (holding that complaint survived a motion to dismiss on remand when it pleaded facts implying that the GP and managing board did not subjectively believe that the merger was in the best interest of the LP).

296. *See, e.g.*, 805 ILL. COMP. STAT. § 180/15-5 (2016 & Supp. 2018); FLA. STAT. § 605.0105(4)(c) (2017); N.J. STAT. ANN. § 42:2C-11(g) (West 2018); REVISED UNIF. LTD. LIAB. CO. ACT § 110(d) (UNIF. LAW COMM'N 2006).

297. *See, e.g.*, *In re* Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 105–06, 110 (Del. Ch. 2014).

298. *See* Allen v. Encore Energy P'ners, L.P., 72 A.3d 93, 95 (Del. 2013) (holding that when LP agreement replaces fiduciary duties with a contractually adopted fiduciary duty of subjective good faith, that duty is satisfied by following approval mechanism provided for in the agreement); Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* ELGAR HANDBOOK ON ALTERNATIVE ENTITIES 1, 1 (Robert W. Hillman & Mark J. Loewenstein eds., 2015) ("Eschewing the supposedly rigid mandatory default rules that characterize American corporate law statutes, the [Delaware] statutes that authorize alternative entities declare as public policy the goal of granting the broadest contractual freedom possible, and permit the parties to the governing instrument to waive any of the statutory or common law default principles of law and to shape their own relationships" (footnote omitted)).

299. *See* Gerber v. Enterprise Prods. Holdings, LLC, 67 A.3d 400, 426 (Del. 2013) (remanding for further proceedings after holding that contractual provision creating a presumption of good faith as defined in the agreement did not preclude or waive a claim under the implied covenant of good faith and fair dealing).

300. *See* Emp.'s Ret. Sys. of City of St. Louis v. TC Pipelines GP, Inc., No. 11603-VCG,

courts have not been eager to replace lost fiduciary duties with a robust version of the duty of good faith and fair dealing,[301] instead finding a violation only in extreme cases, such as fraud.[302] Other infrequent cases that find for the limited partners do so by finding a violation of the contractual terms of the LP agreement.[303]

C. *Nexus of Contracts*

Admittedly, the ability of corporate shareholders to enforce fiduciary duties against boards of directors has been significantly curtailed in recent decades by both caselaw and statutory innovation.[304] Proponents of freedom of contract have long argued that entities, particularly hybrid entities are mere bundles of contract rights.[305] Default rules regarding fiduciary duties and voting rights are unnecessary among sophisticated parties who can bargain for necessary protections or discount the price of ownership interests that lack those necessary protections.[306] Modern LP acts and LLC acts seem to reflect the idea that these entities are creatures of contract and that the participants should be given total freedom to create the "contract" to govern their relationship without regard to nonwaivable default rules.[307] The Delaware acts reflect this

2016 Del. Ch. LEXIS 71, *1–18, *21 (May 11, 2016) (reasoning that the duty of good faith and fair dealing is a "gap filler" and provision eliminating fiduciary duties of general partner did not leave a "gap").

301. In one case, the Delaware Supreme Court adopted as the test for pleading bad faith the test for pleading "waste," a notoriously weak claim. *See* Brinckerhoff v. Enbridge Energy Co., 67 A.3d 369, 373 (Del. 2013). The Delaware Supreme Court reversed itself in 2017, holding that bad faith could be pled with facts that support an inference that the GP did not reasonably believe it was acting in the best interest of the partnership. *See* Brinckerhoff v. Enbridge Energy Company, Inc., 159 A.3d 242 (Del. 2017).

302. *See* Dieckman v. Regency GP, 155 A.3d 358, 368–69 (Del. 2017) (holding that the duty was breached by the GP when it stated in proxy materials that the Conflicts Committee approving a certain transaction were independent, though one of the members contemporaneously resigned from the board of a party to the proposed merger and became a member of the Conflicts Committee, then rejoined the original board).

303. *See In re* Energy Transfer Equity, L.P. Unitholder Litig., 2018 WL 2254706 (Del. Ch. May 17, 2018) (though general partner had discretion over distributions, issuance of securities to unitholders for consideration would have to qualify under conflicts safe harbors in LP agreement).

304. Manesh, *supra* note 128, at 574–76, 578.

305. *See* Larry A. Ribstein, *Partnership Governance of Large Firms*, 76 U. CHI. L. REV. 289, 303 (2009) (arguing that PTP unitholders do not need corporate-type monitoring mechanisms because of the incentives to distribute excess cash).

306. Hurt, *supra* note 68, at 216.

307. *Id.*

value.[308] However, the resulting state of affairs for PTPs is an extreme example of owners having zero monitoring abilities and zero remedies for mismanagement.[309]

Though some LPs and LLCs may resemble a Platonic ideal of sophisticated investors conducting a robust bargain wherein fiduciary duties are priced in to the resulting governance document,[310] this seems to not be the case for many firms, particularly MLPs. In the retail investor arena, the investors in an MLP are perhaps less sophisticated than the average investor in a publicly held corporation, are strangers to each other and the general partner, and invest in units without negotiating the LP agreement.[311] In fact, in some MLPs, the general partner can amend the LP agreement without the consent of the limited partners, further stretching the thin fiction that the contract provisions of the agreement are bargained for and priced into the investment.[312]

Common unitholders in registered offerings of publicly traded LPs do not know the managers and may in fact be unsophisticated.[313] If shareholders of Delaware publicly held corporations need gap-filling duties and governance backstops, then so should common unitholders of publicly held LPs. In fact, MLP unitholders have fewer governance safety nets than corporate shareholders.

The contractarian argument for corporations focuses on the articles of incorporation, under which every shareholder purchases shares.[314] Amendments of this charter contract must be both proposed by the board of directors and voted on by the shareholders.[315]

308. DEL. CODE ANN. tit. 6, § 17-1101(c) (2018) ("It is the policy of this [limited partnerships] chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."); *id*. § 18-1101(b) ("It is the policy of this [limited liability company]chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.").

309. *See* Manesh, *supra* note 128, at 558, 583–84 (reporting that 88% of publicly traded alternative entities "totally waive the fiduciary duties of managers or eliminate liability arising from the breach of fiduciary duties").

310. *See, e.g.*, Andrew Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 179 (2006) (discussing fiduciary duty carveouts in LP agreements in the context of "customized agreements" that "encourage parties to seek legal advice").

311. *See* Sonia J. Toson, *The Master Limited Liability Partnerships Parity Act: Friend or Foe?*, 32 PACE ENVTL. L. REV. 285, 291 (2015).

312. Goodgame, *supra* note 129, at 83–87.

313. *Id*. at 86.

314. Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 782–83 (2006).

315. MODEL BUS. CORP. ACT §§ 10.03–0.4 (2002).

However, the LP agreement in a PTP may in fact be amended without the vote of the common unitholders, making the contract theory less compelling.[316]

D. *"Morals of the Marketplace" Versus "Duty of Finest Loyalty"*

In the market for entity formation innovation, the partnership theory set forth by Justice Benjamin Cardozo that (1) copartners are fiduciaries and (2) as such owe one another the "duty of the finest loyalty" that surpasses "honesty alone" has not prevailed.[317]" In its place, contract theory has created hybrid partnerships that, in trying to combine limited liability and pass-through taxation, have created entities unrecognizable as partnerships.[318] With stripped down fiduciary duties, centralized management, freely transferable shares, and limited liability, these LPs and LLCs retain only one partnership "characteristic": pass-through taxation.[319] The ultimate question is whether any theory under which partnerships were taxed more lightly than corporations survives when compared to the modern entity forms.

IV. TOWARD A THEORY OF PARTNERSHIP TAXATION

Today, the tax code seems to have distinguished between those entities that will be taxed as corporations and those that will be taxed as partnerships by deferring to state statutes.[320] As long as the entity is not organized as a "corporation" in a particular state, then the entity may be a partnership.[321] In 1913 and at least until the late twentieth century, one could argue that legislators distinguished between corporations and partnerships not based merely

316. *See* Brinckerhoff v. Enbridge Energy Company, Inc., 159 A.3d 242 (Del. 2017) (holding that an amendment of the agreement to shift the tax allocation of profits away from the GP and on to the unitholders was not actionable).

317. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

318. *See supra* notes 13–17 and accompanying text.

319. *See supra* notes 15–17 and accompanying text.

320. *See* I.R.C. § 7701 (a)(2) (2012) ("The term 'partnership' includes 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 title, a trust or estate or a corporation . . . .").

321. Treas. Reg. § 301.7701-2(c)(1) (2016) ("The term 'partnership' means a business entity that is not a corporation under paragraph (b) of this section and that has at least two members."); *see also id.* § 301.7701-2(b)(1) (defining "corporation" as a "business entity organized under a Federal or State statute, or under a statue of a federally recognized Indian "tribe").

on the name of the state statute but on general differences between the two entities that were understood at that time. Now that entities have reached a stage of convergence, perhaps a re-examination of some of those theories is helpful.

A. *Size*

The size of the entity has long been a driver of taxation. Not only do smaller corporations qualify for a version of pass-through taxation under Subchapter "S," but corporations taxed under Subchapter "C" traditionally have had graduated rates.[322] "S" Corporations are small with reference to the number of shareholders that they may have (no more than 100)[323] and the type (individuals).[324] This exemption from entity taxation arose in 1958 specifically to benefit small businesses;[325] in fact, the original limitation on the number of individuals was ten.[326] The tax code is replete with examples of ways in which smaller corporations are taxed more lightly than other corporations.[327]

However, size may also be a matter of income, revenues, or assets. In 1913, the legislators may have considered partnerships to be of a smaller size with respect to these factors as well.[328] In 1916,

322. These graduated rates were eliminated in the 2017 tax reforms in favor of the lower 21% tax rate applicable to all corporations. I.R.C. § 11 (Supp. V 2018).

323. *See id.* § 1361(b)(1)(A) (2012). However, this number can be much larger, given that shareholders that are "members of a family" count as one shareholder. *Id.* § 1361(c)(1).

324. *Id.* § 1361(b)(1)(B). This restriction does allow for certain types of trust to qualify. *Id.* § 1361(c)(2)–(3), (6).

325. *See* Warren Paul Kean, *After the Facelift, Is Subchapter S Any More Attractive?*, 46 LA. L. REV. 87, 87 n.1 (1985) ("Small business should be able to operate under whatever form of organization is desirable for their particular circumstances without incurring unnecessary tax penalties. To secure this result, I recommend that corporations with a small number of active stockholders be given the option to be taxed as partnerships and that certain partnerships be given the option to be taxed as corporations." (quoting President Eisenhower's Budget Message to Congress of January 21, 1954, 100 CONG. REC. 567, 571 (1954))). President Eisenhower had proposed that these small corporations be treated as partnerships without creating a separate regime. 83 CONG. REC. 3, 567–97 (1954) (Statement of President Eisenhower). That proposal proved unworkable, and Subchapter "S" was the end result of the proposal. *See* I.R.C. § 1370 (1958).

326. I.R.C. § 1371(a)(1) (1958). This number was gradually increased to fifteen (1976), then to twenty-five (1981), then to thirty-five (1982). *See id.* § 1371(e)(1)–(2) (1976); *id.* § 1371(a)(1) (1982).

327. *See* Hilt & O'Banion, *supra* note 50, at 631 (finding that at least until 1853, the average number of partners in a general partnership in New York was two, and the average number of partners in an LP was three).

328. *See generally* Arnando Gomez, *Rationalizing the Taxation of Business Entities*, 49 TAX LAW. 285, 285–89 (1996) (discussing the different treatment of corporations and partnerships in early 1900s).

the first year that the Treasury was required to maintain statistics, a little over 200,000 corporations filed returns showing positive net income.[329] Those corporation collectively reported $32 billion of gross income.[330] There is not a similar statistic for partnerships, as that income was reported along with other "business income" for individuals.[331] However, all "business income" for individuals amounted to only $2.6 billion of gross income.[332]

Though supporting small business is powerful political rhetoric in modern times, at the turn of the twentieth century, regulating large businesses was a more salient political goal.[333] Supporters of a corporate tax made a connection between the size of an entity and the negative externalities that large entities, particularly those with limited liability, imposed on the public.[334] Notably, those corporate entities that were targeted for an entity-level tax in the Civil War-era income tax regimes were those that tended to be large, such as railroads.[335] In 1913, legislators may have seen partnerships as being smaller and more personal than the corporations that were beginning to dominate industry.[336] The list of industries in which corporate taxpayers operated suggest a picture of medium- to large-sized firms with numerous employees large amounts of capital: steel products; lumber; leather; paper and printing; liquors; chemicals and allied products, stone, clay and

329. *See* 1916 TAX STATISTICS, *supra* note 162, at 10 (showing that 206,984 corporate returns reported a total net income of $23,765,187,985, though 134,269 corporations reported no net income).

330. *Id.*

331. *See id.* at 8.

332. *See id.* (showing that individual returns reported a total of $2,637,474,520 of "income from business," which included "business, trade, commerce, and partnership gains and profits").

333. *See* Ajay K. Mehrotra, *The Public Control of Corporate Power: Revisiting the 1909 U.S. Corporate Tax from a Comparative Perspective*, 11 THEORETICAL INQUIRIES L. 497, 500 (2010) ("One story [of the origin of the corporate tax] focuses on how populist and progressive anxieties about the growth of corporate power and prevailing judicial conceptions of corporate personality led congressional leaders and President William Howard Taft to use the tax as a regulatory tool to publicize and control the wealth and power of corporate managers and owners."); Bank, *supra* note 200, at 379, 381–82 (theorizing that the graduated corporate tax rate was not designed to help small business but merely targeted to affect the largest corporations more).

334. *See* Mehrotra, *supra* note 333, at 515–16.

335. *See* Bank, *supra* note 149, at 455, 457 (noting that the 1862 Act taxed railroads, steamboats, and ferry boat corporations and that the 1864 Act targeted banks, trusts, savings institutes, insurance companies, railroads, canal and turnpike companies, canal navigation companies, and slackwater companies).

336. *See id.* at 491 ("[T]he latter part of the nineteenth century is significant for the advent of the megacorporation.").

glass products; public utilities; banks; insurance companies; merchandising; agriculture and animal husbandry; and extraction of minerals.[337] Perhaps partnerships were treated differently in 1916 because of a distinction based on the relative size of the entities during that time. Though partnerships surely had a smaller number of partners than corporations at the time, there is no practical or statutory limit to the number of limited partners a LP can have,[338] as evidenced by publicly held partnership.

However, legislators in 1913 may have also been thinking about the size of the wealth of the shareholder as much as the size of the wealth of the corporation.[339] Commentators argue that the early corporate tax was a proxy for a tax on shareholder wealth.[340] In addition, only shareholders with significant other income or significant dividend income standing alone would pay tax on those dividends because of the generous personal exemption.[341] Until 1936, dividends were exempt from individual "normal" tax and only subject to individual surtax, so the full double-tax feature of corporate tax had not yet arrived.[342] Some commentators at the time noted that if dividends were taxed at the individual level without the exemption for the normal tax, instead of a corporate-level tax, the graduated rates and personal exemption would have ensured in some circumstances less tax paid than "stoppage at the source."[343] However, with the advent of World War I, the income tax, which had only affected a small amount of individuals and corporations,[344] would become a universal income tax with very high max-

337. 1916 TAX STATISTICS, *supra* note 162, at 11.

338. *See, e.g.*, UNIF. LTD. P'SHIP ACT § 2 (UNIF. LAW COMM'N 1916); Armando Gomez, *Rationalizing the Taxation of Business Entities*, 49 TAX LAW. 285, 296 n.88 (1996) (describing proposed rule in 1978 that LPs with over fifteen limited partners would be taxed as a corporation).

339. *See* Mehrotra, *supra* note 160, at 41 (arguing that the 1913 tax was designed to reach the "new managerial class of business executives" and their "industrial enterprises").

340. *See* STEVEN A. BANK, FROM SWORD TO SHIELD: THE TRANSFORMATION OF THE CORPORATE INCOME TAX, 1861 TO PRESENT, at 85 (2010).

341. *See id.* at 85–86. U.S. TREAS. DEP'T, STATISTICS OF INCOME FOR 1936, PT. 1, at 1, 3, 7 (1938), https://www.irs.gov/pub/irs-soi/36soirepptlar.pdf [https://perma.cc/6K3R-2TSJ].

342. *See id.* at 7; BANK, *supra* 340, at 160–62.

343. *See* Plehn, *supra* note 156, at 771–72.

344. *See* JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA 354 (Robert E. Burke & Frank Friedel eds., 1985) (explaining that President Woodrow Wilson had requested a high personal exemption, hoping to "'burden as small a number of persons as possible with the obligations involved in the administration of what will at best be an unpopular law").

imum rates, cementing the double-tax feature of corporate taxation.[345]

The 2017 tax reforms do not reflect a desire to grant tax advantages to smaller businesses. All corporations, regardless of size based on income, revenue, assets, or shareholders are taxed at the same 21% rate.[346] Partnership income that qualifies for the section 199A pass-through deduction also does not seem to correlate with smaller sizes.[347] For example, all MLP income qualifies for the deduction, even though MLPs have thousands of public investors and may also be large by other measures.[348] The types of "specified service trade or business" that do not qualify for the deduction also may be small: consulting businesses, performing arts, athletics, law, health, accounting, and brokerage firms.[349]

B. *Passive Ownership and the* Howey *Test*

Early versions of the corporate tax distinguished between corporations with active owners and those with passive, investor ownership.[350] One can distinguish between entities with passive owners, who are receiving merely a return on capital, and active owners, who participate in the business as a livelihood and receive a return on both human capital and on financial capital.[351] These smaller businesses are more like sole proprietorships with more than one owner than they are like other entities with centralized management. Particularly at the time of the institution of the income tax in 1916, taxpayers could be divided between workers and speculators. Speculative income may have been seen as more attractive to

345. *See* Blakey & Blakey, *supra* note 163, at 215, 217 (explaining that Congress kept the two-rate tax scheme in place and that the Revenue Act of 1918 increased the individual tax rate to 65%); War Revenue Act Pub. L. No. 65-50, § 2, 40 Stat. 301 (1917) (increasing the maximum individual tax rate to 50%).

346. I.R.C. § 11(b) (Supp. V 2018).

347. *See id.* § 199A.

348. J. Markham Collins & Roger P. Bey, *The Master Limited Partnership: An Alternative to the Corporation*, 15 FIN. MGMT. 5, 5–6 (1986); Patrick E. Hobbs, *Entity Classification: The One-Hundred Year Debate*, 44 CATH. U. L. REV. 437, 502–03 (1995); *see* I.R.C. § 199A (b)(1)–(2) (Supp. V 2018).

349. I.R.C § 1202 (2012); *id.* § 199A (b)(2), (d)(1)–(2) (Supp. V 2018).

350. Blakely & Blakely, *supra* note 163, at 222 (noting that in 1918, dividends from a "personal service corporation" were not taxed and defining such a corporation as "one in which capital is not a material income-producing factor and whose income is due primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation").

351. *See* I.R.C. § 469(c) (2012).

tax than active income,[352] and most taxpayers with passive income would have been fairly wealthy.[353] In addition, dividends were exempt from "normal" tax but not the surtax on higher incomes.[354] Accordingly, in 1916 returns, "[p]artnership gains and profits of all kinds" were classified as income from business along with sole proprietorship income, but interest income and dividends were classified as "income from property."[355] Furthermore, "income from business" was combined with "income from personal service," which included "salaries" and "professions and vocations."[356] At least in 1916, income to a partner from a partnership was seen as equivalent to the income that one received from a sole proprietorship, profession, or even employment.[357] Dividend income from a corporation was seen as a return on capital, like interest, rents, and royalties.[358] The taxation of income from business and income from property were taxed the same, however.[359]

This distinction between active and passive ownership is not without some precedent in modern-day tax policy, which makes some attempt to revoke partnership status to "super-passive" ownership in a publicly held entity.[360] At the same time that the Department of Treasury passed the check-the-box regulations, the department proposed regulations to ensure that most partnerships that were publicly traded would lose their tax partnership status.[361] Though a significant number of very large PTPs have been

352. The 1916 tax regime was heavily focused on the very wealthy. The first $20,000 of income to an individual or household was taxed at 2%. In 2018 dollars, that is the equivalent of almost $500,000. According to Treasury Department data, 90% of tax returns filed for 1916 declared income of less than $25,000. *See* 1916 TAX STATISTICS, *supra* note 162, at 5–6. In addition, the top 1.5% of filers paid almost 75% of all the taxes collected. *Id*. at 6.

353. The Revenue Act of 1913 set a high personal exemption ($4000, or $100,000 in 2018 dollars) that resulted in only 2% of households paying income tax, evidencing some intent to tax the most wealthy. *See* Joseph J. Thorndike, *Tax History: Original Intent and the Revenue Act of 1913,* TAX HISTORY PROJECT (2013).

354. 1916 TAX STATISTICS, *supra* note 162, at 6, 8.

355. *Id.* at 7–8.

356. *Id*. at 8.

357. *See id*.

358. *Id*.

359. Revenue Act of 1916, Pub. L. No. 64-271, § 2, 39 Stat. 756, 757.

360. *Passthrough and Partnership-Specific Considerations of Recently Released House Tax Reform Bill*, TAX NEWS UPDATE (Nov. 6, 2017), https://taxnews.ey.com/news/2017-1847-passthrough-and-partnership-specific-considerations-ofrecently-released-house-tax-reform-bill [https://perma.cc/V6DB-V2SR].

361. *See* I.R.C. § 7704(a)–(c) (2012) (exempting PTPs from corporate tax status if it meets qualifying income test); Treas. Reg. § 1.7704-1(a)(1) (1998) (explaining that a partnership will be taxed as a corporation if its interests are traded on "an established securities market" or "readily tradable on a secondary market").

able to thread that needle, the regulations reflect a sense that a publicly traded entity with thousands of "partners" should not escape corporate taxation merely because it is organized under a limited partnership statute and not a corporation statute.[362]

The sense that LPs or LLCs with publicly traded interests should generally not receive favorable partnership taxation coincides with a distinction made between active and passive ownership interests in federal securities laws: passive ownership interests are generally securities under federal law, but active ownership interests are not.[363] In *SEC v. W.J. Howey Co.*, the Supreme Court held that certain types of financial contracts would be considered securities if one party was anticipating generating profits from an investment "solely from the efforts of others."[364] Federal securities law has even distinguished between different types of ownership interests in LPs, LLPs, general partnerships, and LLCs.[365] Whether ownership interests in these entities are considered securities does not rest on what the name of the entity is or the name of the ownership interest, but on whether the owner invests in a common enterprise expecting profits "solely from the efforts of others."[366] If federal courts can make such fine distinctions in the federal securities realm, then tax regulations could make similar distinctions. Or, these distinctions could be identical; entities that issue "securities" could receive double taxation and entities that do not issue "securities" could have pass-through taxation.

Again, the 2017 tax reforms do not seem to make distinctions that hearken back to the original distinctions between small, actively managed partnerships and large corporations with passive ownership. MLPs and real estate entities receive the full pass-through deduction, but "service trade or business" firms, including

362. *See* Treas. Reg. § 17704-1(a)(1).

363. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).

364. *Id*. at 298–99, 301 (defining "investment contract" as a contract in which a person invests money in a common enterprise with an expectation of profit solely from the efforts of others. In essence, the test for whether a financial interest is a security is whether it is a passive interest—one in which profits are generated "solely from the efforts of others").

365. These interests are also not listed securities in the Securities Act, so they are subject to the *Howey* test. *See* 15 U.S.C. § 77b (2012); *Howey*, 328 U.S. at 297–99. To determine whether a partnership interest in an LP, LLP, or LLC is an "investment contract," courts look to the actual partnership or LLC agreement for the "solely from the efforts of others" prong to see if the holder of the interest has the power or ability to comanage. *See* Howey, 328 U.S. at 298, 301; Williamson v. Tucker, 645 F.2d 404, 423–24 (5th Cir. 1981) (focusing on general partnerships and joint ventures).

366. *See* Howey, 328 U.S. at 301; Williamson, 645 F.2d at 422–23.

trades or businesses that rely on the "reputation or skill" of the owner do not.[367] By definition, a business actively managed by its owners should rely to some extent on the reputation or skill of the owner, making the tax advantage of the pass-through deduction possibly go to investor-owners in the exact wrong type of entities.

C. *Limited Liability*

One argument that has been made to defend the double taxation of corporations is that the additional taxation is the cost of receiving limited liability, which leads to negative externalities absorbed by society.[368] A century ago, almost all entities that had full limited liability were corporations and were taxed as such.[369] To legislators worried about the increasing size and power of corporations, limited liability might seem like the facilitator of that size.[370] In fact, proposed revisions to the corporate tax would have made limited liability the deciding factor for double taxation.[371] However, today almost all entities have limited liability and the vast majority of them have pass-through taxation.[372] If the tax code distinguished between pass-through taxation and corporate taxation on the basis

367. *See* I.R.C. § 199A(d)(2) (Supp. V 2018); *id*. § 1202(e)(3)(A) (2012); Baldwin, *supra* note 211; Nitti, *supra* note 209.

368. *See* Gomez, *supra* note 328, at 287–88 (theorizing that the corporate tax was intended to regulate corporations, quoting President Taft as saying that the corporate form made possible "substantially all of the abuses and all of the evils which have aroused the public to the necessity of reform," namely, limited liability).

369. *See id*. at 288.

370. *See* Bank, *supra* note 200, at 381 (citing President Franklin D. Roosevelt as saying that the value of limited liability, which is conferred by government on corporations, increases as the size of the corporation increases).

371. *See* Bank, *supra* note 149, at 460–61 (describing the version of the 1894 Act that passed the House of Representatives as taxing dividends only if they were "paid by corporation or association organized for profit by virtue of the laws of the United States or of any State or Territory, by means of which the liability of the individual stockholders is in anywise limited"); Gomez, *supra* note 328, at 296 (citing proposed regulations favored by President Jimmy Carter that would have amended the *Kintner* factors to make limited liability a "super factor"); *see also* Classification of Limited Liability Companies, 45 Fed. Reg. 75,695, 75,709 (Nov. 17, 1980) (to be codified at 26 C.F.R. pt. 301).

372. *See* SCOTT GREENBERG, TAX FOUND., PASS-THROUGH BUSINESSES: DATA AND POLICY 1–4 (2017), https://files.taxfoundation.org/20170124162950/Tax-Foundation-FF5361.pdf [https://perma.cc/4JRZ-KUVD]. In 2012, "C" corporations filed 1.6 million returns, compared with nearly 8 million returns filed by "S" corporations and partnerships. Only around 575,000 of those pass through returns were from general partnerships with personal liability. *Id*. at 6–7 (citing *SOI Tax Stats—Integrated Business Data*, IRS, https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data [https://perma.cc/ZU2G-RSFT] (last visited Dec. 1, 2018)).

of limited liability, very few entities would have pass-through taxation, and most of them would be owned by corporations or another limited liability entity.

The window for distinguishing between and among entities on the basis of limited liability has closed. Though sole proprietors may feel comfortable doing business knowing that they are personally liable for their own torts and contracts,[373] entities with two or more partners generally would prefer not to be, regardless of the tax advantage.

D. *Capital Lock-In*

If lawmakers were attempting to construct an entity tax from scratch, much as the United States Congress was in 1913 and in the next decade, one challenge is that corporations have capital lock-in, and partnerships (at least at the time) did not.[374] If lawmakers want to tax entity profits one time, then they could do that at the entity level or at the investor level. However, if lawmakers tax profits only at the investor level, then entities have an incentive not to distribute earnings.[375]

The other alternative is a pass-through model that taxes profits at the investor level regardless of whether a distribution has been made. In a partnership under the UPA or the ULPA (1916), partners could force a cash distribution because they had the ability to dissolve the partnership by dissociating and withdrawing from the partnership.[376] Partners had the ability to do so and receive their liquidated share.[377] And, because most partners would be in the same situation of wanting to avoid immediate tax liability without

373. Sole proprietors may also realize that creditors might require personal guarantees regardless of business form, and piercing the veil for a sole proprietor can be a significant risk. *See* Mitchell F. Crusto, *Unconscious Classism: Entity Equality for Sole Proprietors*, 11 U. PA. J. CONST. L. 215, 226–27 (2009).

374. *See* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved For Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 388 409–10 (2003); Lynn A. Stout, *On the Nature of Corporations*, 2005 U. ILL. L. REV. 253, 254–55.

375. *See* Aaron Krupkin & Adam Looney, *Nine Facts About Pass-Through Businesses,* BROOKINGS INST. (May 15, 2017), https://www.brookings.edu/research/9-facts-about-pass-through-businesses/ [https://perma.cc/C4GR-KAT2].

376. *See* UNIF. P'SHIP ACT §§ 29, 38 (UNIF. LAW COMM'N 1914); UNIF. LTD. P'SHIP ACT § 16 (UNIF. LAW COMM'N 1916).

377. *See* UNIF. P'SHIP ACT §§ 21, 38 (UNIF. LAW COMM'N 1914); UNIF. LTD. P'SHIP ACT §§ 16, 23 (UNIF. LAW COMM'N 1916).

a corresponding cash distribution, partnerships would be incentivized to match cash distributions to income allocations.[378]

However, corporations are not set up well for pass-through taxation. One of the positive attributes of a corporation is "capital lock-in," meaning that investors have no right to redeem their ownership interests or receive their capital back.[379] Corporate shareholders also have no ability to force the Board of Directors to declare dividends.[380] This feature allows corporations to retain and employ large amounts of capital for long-term projects.[381] The downside is that shareholders must find a third-party to purchase their shares if they wish to cash out of the enterprise.[382] Therefore, pass-through taxation would be difficult for corporations because investors would have no way to force a dividend.[383] Some investors might want managers to borrow to make distributions, but others would not.

So, one could distinguish between pass-through taxation and entity taxation on the basis of whether the state law form of the entity has a capital lock-in mechanism. At the advent of entity taxation in the United States, neither general partnerships nor LPs had capital lock-in. General partnerships under the 1914 UPA could be dissolved by the express will of any partner.[384] The 1997 UPA retains this ability of partners to dissociate, rightfully or wrongfully; instead of automatically dissolving the partnership, however, the

378. *See* UNIF. P'SHIP ACT §§ 18, 36, 40 (UNIF. LAW COMM'N 1914); UNIF. LTD. P'SHIP ACT §§ 9, 17, 23.377 (UNIF. LAW COMM'N 1916).

379. *See* Blair, *supra* note 374 at 387 (arguing that no other legal form in the 1800s could enable organizers to amass and commit capital that could not be demanded by investors or reached by investor's creditors); Stout, *supra* note 374 at 253 (describing "the capacity to 'lock-in' equity investors' initial capital contributions" as "fifth, often-overlooked characteristic of corporations").

380. *See* Stout, *supra*, 374, at 257–58; Hunkar Ozyasar, *Can a Shareholder Force a Corporation to Pay a Dividend*, HOUSTON CHRON. (Oct. 16, 2018), https://smallbusiness.chron.com/can-shareholder-force-corporation-pay-dividend-61506.html [https://perma.cc/47FQ-DTHN].

381. *See* Stout, *supra* note 374, at 256.

382. One reason why corporations have freely transferable shares by default. *See* Blair, *supra* note 374, at 451.

383. *See* Sunley, *supra* note 169, at 622 (reporting that corporations fear some types of tax integration because of pressure from shareholders to declare dividends).

384. UNIF. P'SHIP ACT § 31(1)(b) (UNIF. LAW COMM'N 1914) (partner does not violate partnership agreement by dissolving partners by express will if partnership has no definite term or particular specified undertaking); § 31(2) (partner in a partnership with definite term or specified undertaking may also dissolve the partnership, but will be in violation of partnership agreement).

dissociation may just enable the exiting partner to have her partnership interest purchased by the partnership.[385]

LPs have evolved away from the general partnership model. The ULPA (1916) provided that a limited partner "shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in Sections 15 and 16."[386] Section 16 gave the limited partner the right to receive her contribution back under certain circumstances, including upon six months' notice.[387] RULPA (1976) creates a theoretical ability for limited partners to withdraw upon six months' notice, but that right was subject to amendment by the LP agreement.[388] RULPA (2001) does not give limited partners the "right" to withdraw, but they have the "power" to withdraw, which may be altered in the partnership agreement.[389] The Delaware version specifically does not give limited partners the right or the power to withdraw except in accordance with the partnership agreement.[390] Each iteration of the LP acts move closer to corporate capital lock-in. The RULLCA gives members, in an LLC, the right to withdraw, but not the power;[391] the Delaware Limited Liability Company Act does not give members the right or the power to withdraw.[392]

Distinguishing between entities with capital lock-in and those without would provide pass-through taxation for general partnerships only, which includes LLPs. Modern LPs, however, do not have capital lock-in.[393] Interestingly, however, LPs do have pass-

385. *Id.* § 602(a) (1997) ("A partner has the power to dissociate at any time, rightfully or wrongfully, by withdrawing as a partner by express will under Section 601(1)."); *id.* § 701(a) ("If a partner is dissociated as a partner without the dissociation resulting in a dissolution and winding up of the business under section 801, the partnership shall cause the associated person's interest in the partnership to be purchased for a buyout price determined pursuant to subsection (b).").

386. UNIF. P'SHIP ACT § 10(2) (UNIF. LAW COMM'N 1916).

387. *Id.* § 16(2)(c).

388. *Id.* § 603 (1976).

389. *Id.* § 601 (2001).

390. DEL. CODE ANN. tit. 6, § 17-603 (2018) ("Notwithstanding anything to the contrary under applicable law, unless a partnership agreement provides otherwise, a limited partner may not withdraw from a limited partnership prior to the dissolution and winding up of the limited partnership.").

391. UNIF. LTD. LIAB. CO. ACT § 601(a) (UNIF. LAW COMM'N 2006).

392. DEL. CODE ANN. tit. 6, § 18-603 (2018) ("Notwithstanding anything to the contrary under applicable law, unless a limited liability company agreement provides otherwise, a member may not resign from a limited liability company prior to the dissolution and winding up of the limited liability company.").

393. *See* Blair, *supra* note 374, at 387.

through taxation, so LP agreements generally arrive at a distribution schedule that ameliorates any hardship that immediate tax liability may cause.[394]

E. *Universal Entity Tax*

Many critics of the double corporate tax have long argued for parity between corporations and partnerships. While the 2003 Bush Tax Cuts may have narrowed the gap between corporate and partnership taxation by cutting the dividend rate, the 2017 tax reforms may have completed that goal by cutting the corporate tax rate.[395] Clearly, due to the evolutions in state law entity governance rules, no principled distinction can be made that entities labeled "partnerships" under state law are inherently different than entities labeled as "corporations" under state law.[396] Now that the combined tax differential may be nominal, eliminating the two systems of taxation may be logical. However, if public policy still favors a system in which income from some types of businesses should be taxed more lightly than others, then the assumptions underlying that policy probably relate more to the size or nature of those business interests than to the state law entity classification.

In 1913, Congress may have been attempting to grant pass-through taxation to mostly personal livelihood businesses run by sole proprietors, families, or small pairs or groups of unrelated partners, while creating entity taxation for enterprises with limited liability and passive owners. Perhaps entity classification at the time effectively made that distinction by creating bright lines between partnerships and corporations. However, those classifications do not currently distinguish clearly between those original two categories. Congress could simply grant pass-through status to entities with a small number of investors, similar to "S" corporation rules, but for all entities. In the alternative, Congress could

394. One standard provision in private equity firm LP agreements is a mandatory distribution upon certain recognition events, such as a firm investment being liquidated. These provisions work to cure several agency problems involving the fund manager, but they also solve the pass-through taxation problem. *See* Lee Harris, *A Critical Theory of Private Equity*, 35 DEL. J. CORP. L. 259, 276 (2010).

395. Don Leatherman, *The Treatment of Corporations and Partnerships Under the TCJA*, 19 TRANSACTIONS: TENN. J. BUS. L. 509, 578–79 (2018) (discussing Congress adding a tax preference in 2003 and the subsequent changes made by the TCJA in 2017).

396. *See* Fleischer, *supra* note 181, at 519 (discussing that regulations distinguishing between corporate and partnership tax treatment are ineffective and anachronistic, and that such tax distinctions are largely elective).

grant pass-through status only to entities with personal liability, which would effectively end pass-through status. Another solution would be to grant pass-through status only to entities and owners that hold ownership interests that would not be considered securities under the *Howey* test.[397]

V. WILL THE PARTNERSHIP SURVIVE?

The partnership form has been evolving and adapting to changing commercial circumstances over the past century. Having been endowed with preferential tax treatment based on its original characteristics, the hybrid entities were able to retain that treatment while becoming ever more corporation-like with respect to firm governance.[398] In fact, the modern LP is even more corporate-like than a corporation, yet it still has preferential pass-through taxation.[399] Though LPs and general partnerships are smaller in number than "C" corporations, their cousin, the LLC, has surpassed them all in number of existing and new incorporations.[400] The only hindrance to LPs and LLCs is that only a few of them have been able to go public as PTPs under the regulations.[401]

The rapid rise in popularity of the LLC post-1996 has lead contractarian theorists to surmise that the flexibility of LLCs, combined with the courts' deference to the parties' bargain as reflected in the operating agreement, is the key to the hybrid's success.[402] Supporters of the "uncorporation" have touted its ability to be tailored to specific situations, unlike the corporate dinosaur, a tax-

397. The same logic might lead to a different conclusion: give pass through taxation to every entity that is not publicly traded. See Anthony P. Polito, *Mandatory Passthrough Taxation for Non-Publicly Traded Businesses?* 36 VA. TAX REV. 449, 451–52 (2017). Interestingly, for tax purposes, partnerships are considered "publicly traded" based on trading history of partnership interests. *See* Treas. Reg. § 1.7704-1 (2018). For securities purposes, an entity is considered "public" and subject to mandatory reporting once it has over 2000 shareholders (or 500 unaccredited shareholders) and has more than $10 million of total assets. *See* 15 U.S.C. § 78(g)(1(A) (2012).

398. *See* Manesh, *supra* note 243, at 471; Ribstein, *supra* note 244, at 136–43.

399. *See* Treas. Reg. § 310.7701-2(c), -3(b)(1) (2018).

400. IRS, SOI TAX STATS—INTEGRATED BUSINESS DATA: TABLE 1: SELECTED FINANCIAL DATA ON BUSINESSES (2013), https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data [https://perma.cc/9BLT-FQPY].

401. *See* Manesh, *supra* note 243, at 467–68 (discussing the only three private partnerships that went public in 2007).

402. *See, e.g.*, Plaza Realty Investors v. Bailey, 484 F. Supp. 335, 348–49 (S.D.N.Y. 1979) (discussing that conflict of laws doctrine requires the court to give great deference to intent expressed in a contract); Clancy v. King, 954 A.2d 1092, 1099 n.13 (Md. 2008) (citing cases on LP agreements and the deference due to the terms of the agreements).

disadvantaged relic with default shareholder rights and management duties.[403] However, with the 2017 tax reforms, the "C" corporation may rebound. As discussed before, the tax differential between tax partnership and corporation may now be very small in some cases, and either entity may be more advantageous in others.

In fact, KKR & Co., L.P., a private equity LP that had gone public in 2010, announced shortly after the enactment of the 2017 tax reforms that it was converting to the corporate form as KKR & Co., Inc.[404] When the conversion occurred in July 2018, the stock price increased 8.5%, perhaps reflecting the fact that new investor types were now able to purchase its shares, and shareholders would not have the tax burden of reporting and paying annually taxes on their share of profits.[405]

The ultimate question is this: If there is no tax advantage to being either a corporation or a partnership, then which form emerges the victor?

A. *Familiarity and Transaction Costs*

Familiarity has allowed the "C" corporation to survive, even with the tax disadvantage to the LP or LLC. Investors understand corporations; the market knows how corporate governance works. Path dependence leads organizers to continue to incorporate. "S" corporations are more numerous than LLCs, which speaks to the staying power of corporate governance rules.[406]

As mentioned before, the costs to incorporate, draft foundational documents, and run a corporation are somewhat less than LPs and LLCs because partnership accounting requires more professional expertise.[407] In addition, investors prefer paying tax upon receipt

403. *See* Manesh, *supra* note 243, at 483, 502; *see also* Ribstein, *supra* note 244, at 141–42.

404. Joshua Franklin, *Private Equity Firm KKR Opts to Become C-Corp After U.S. Tax Reform*, REUTERS (May 3, 2018, 7:01 AM), https://www.reuters.com/article/us-kkr-results/private-equity-firm-kkr-to-convert-to-a-corporation-after-u-s-tax-reform-idUSKBN1I4164 [https://perma.cc/28KM-MS5U].

405. *See* Mark Vandevelde, *KKR Shares Surge After Ditching Partnership Structure,* FIN. TIMES (July 8, 2018), https://www.ft.com/content/b47e000c-8155-11e8-8e67-1e1a0846c475 [https://perma.cc/JQ74-86WB].

406. *SOI Tax Stats S Corporation Statistics*, IRS, https://www.irs.gov/statistics/soi-tax-stats-s-corporation-statistics [https://perma.cc/2WTH-HNKQ] (last visited Dec. 1, 2018).

407. *See* Thomas E. Rutledge & Lady E. Booth, *The Limited Liability Company Act: Understanding Kentucky's New Organizational Option*, 83 KY. L.J. 1, 101 (1994) (discussing how accountants tend to be more comfortable with S-corporation rules than rules for LLCs

of dividends or upon sale of shares, rather than receiving Form K-1s on an annual basis.[408] For LPs and LLCs that attract investors either through the private or public markets, the partnership tax structure makes hybrids less attractive for certain types of investors.[409]

For example, investors in MLPs face an additional layer of complexity not found in other investments, including the receipt of Schedule K-1s with their allocated share of partnership income and losses.[410] Institutional investors may also avoid these investments because of the lack of dividends-received deduction or imposition of Unrelated Business Interest Tax for 501(c)(3) investors, who hold LP interests.[411] Alternatively, lack of institutional interest may be a response to the lack of traditional governance rights inherent in MLP units.[412] Without a clear tax advantage, the MLP form may not be optimal for public investors.[413]

B. *It's the Taxes, Stupid*

If the entity tax rates are the same, but pass-through taxation creates immediate tax liability, then corporations offer the ability to defer about half the tax liability, the half that comes with the qualified dividend income tax (20%) or capital gains tax (20%).[414]

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and other entities).

408. *See supra* notes 248–51 and accompanying text (explaining why investors prefer corporate taxation, rather than PTP taxation).

409. *See* Vandevelde, *supra* note 405 (reporting that prior to converting to a corporation, KKR & Co. L.P. had about one-half the mutual fund investment of ordinary publicly traded corporations).

410. *See* DEP'T OF TREAS., PARTNER'S INSTRUCTIONS FOR SCHEDULE K-1 (FORM 1065) (2018), https://www.irs.gov/pub/irs-pdf/i1065sk1.pdf [https://perma.cc/3JQ-QLWR] (including instructions on adjusting basis in a partner's interest in a partnership and limitations on losses).

411. *See* Goodgame, *supra* note 129, at 95 (although institutional ownership of MLPS increased significantly between 2004 and 2012, institutions only own 31% of outstanding MLPs).

412. *See* Strine & Laster, *supra* note 298, at 14 (citing to Brent J. Horton, *The Going-Private Freeze-Out: A Unique Danger for Investors in Delaware Non-Corporate Entities*, 38 J. CORP. L. 53, 59 (2013) for the proposition that investor advisory services consider PTP entities more risky than comparable corporate firms because of lack of fiduciary protections).

413. Another advantage of the MLP form is the allocation of losses. If the industry, such as the oil and gas industry, enjoys other advantages such as bonus depreciation, then that advantage would remain. The 2017 reforms increased immediate depreciation of capital assets to 100%, though disallowing excess business interest expense. *See* I.R.C. § 168(k)(1)(A) (2012) (bonus depreciation); *id*. § 163(j) (interest expense).

414. *See* I.R.C. § 1(h)(1)(11)(B) (2012).

In addition, if shares are retained until the death of the shareholder, that half of the tax liability is never recognized. This type of deferral is unavailable with the tax partnership regime.[415]

For traditional livelihood tax partnerships, whether LPs or LLCs, which distribute profits annually to investor-owners that invest their human capital in the enterprise, the tax difference may be negligible. If the pass-through deduction is available to the investor-owners, making the tax consequences of distributing current profits less on a pass-through basis, then they would rationally decide to organize or remain as tax partnerships. However, the more investor-owners the LP or LLC has, the more difficult it is for the entity to make a rational choice about whether the pass-through deduction is available for all investor-owners.

C. *Management Control*

The one advantage that the LPs and LLCs retain following the 2017 tax reforms are the corporate governance changes that have made these entities more flexible than corporations with respect to eliminating fiduciary duties and concentrating management power with centralized management. Corporate managers, even with limitations of liability for the duty of care and waivers of the corporate opportunity doctrine, cannot escape additional scrutiny for conflict-of-interest transactions.[416] However, LPs and LLCs can completely eliminate the duty of loyalty.[417] Contractarians would argue that these advantages should continue to make LPs and LLCs the entity of choice even after the tax preference has eroded. The next few years will prove whether the hybrid entities have been successful because of the tax advantage or because of freedom of contract.

CONCLUSION

The current tax moment presents an opportunity to reflect on why the tax code has retained separate systems for the taxation of partnerships and taxation of corporations. Particularly at a time when entities classified as partnerships can bear more corporate

415. *See id.* § 1(h)(11).
416. *See* Steele, *supra* note 281, at 14–18.
417. *See supra* text accompanying notes 90, 118–21.

characteristics than partnership characteristics, providing those entities with tax advantages originally reserved for small, livelihood businesses seems perverse. Whatever distinction Congress was making in 1913 between partnerships and corporations, then, does not hold true in 2018. Like Adam and Eve, hybrid partnerships have ventured out of Judge Cardozo's partnership Eden,[418] lured by freedom of contract, and should accept the corporate tax regime that accompanies corporate characteristics. With tax rates converging for these entities, perhaps the time is ripe to either have one universal entity tax or to create a tax regime that relieves active owners of small, livelihood businesses.

418. *See* Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).