



MEMORANDUM

TO: REF ATTORNEYS, PARALEGALS & LAW STUDENTS

FROM: MARY SABATINI DISTEPHAN *MSD*

RE: CHAPTER 526 OF THE LAWS OF 1994
LIMITED LIABILITY COMPANY LAW ("LLC")
CHAPTER 34 OF THE CONSOLIDATED LAWS

DATE 12/07/94

Attached is a brief overview of the new Limited Liability Company Law as promised by my October memo. I had intended to outline the statute in detail but since it is more than 100 single-spaced pages, I thought it might be better (and faster) to give you an overview, which for most purposes, should suffice. I am, however, outlining the statute in detail and will distribute it to those of you who express an interest. Those who requested a copy of the statute will receive it as soon as they are delivered to the library.

The new statute, effective October 24, 1994, provides for the formation of the limited liability company ("LLC"), the professional limited liability company ("PLLC"), and the limited liability partnership ("LLP") which is available to certain professionals. As you will see, these entities resemble both corporations and limited partnerships with regard to filing requirements, legal documentation and notices required. They generally¹ have the tax advantages of a partnership (no double taxation) while offering the safety of a corporation (a participant's liability is limited to his or her stake in the business). When an LLC is a sponsor, the principals of the sponsor who need to sign the certification (in addition to the sponsoring LLC itself) are those members who are managing members as indicated in the Articles of Organization (resembling a certificate of incorporation) and operating agreement (resembling a limited partnership agreement). That is, the members who play an active role must sign as principals. This is the same rule as we presently apply for corporate sponsors. The names of all limited liability companies must contain the words "Limited Liability Company" or the abbreviation "L.L.C." or "LLC".

The LLC may also be used as the entity which owns the real property. The members then divide up the space by means of proprietary leases, which resemble shareholders in cooperative corporations. This would appear to circumvent the co-op problems of 216, maintain the ability to have a blanket mortgage while having the advantages of the condominium form of ownership. I am doing further research on this particularly with regard to IRC §216 tax

¹ Not in all cases. Certain tests must be met.

problems and I shall keep you posted.

I am also attaching the memorandum submitted in support of this bill. It, too, gives an overview of the statute and explains its legislative intent.

If there are any questions, please see me, and we'll try to find the answers. I'm sure there will be many issues concerning these new entities which will not be resolved until some time passes and there is a body of caselaw to which we can refer. In the meantime, I hope you find this beneficial notwithstanding how abbreviated it is.

LIMITED LIABILITY COMPANY ("LLC") LAW
CHAPTER 34 OF THE CONSOLIDATED LAWS
EFFECTIVE OCTOBER 24, 1994

ARTICLE I - SHORT TITLE AND DEFINITIONS

The short title is the "New York Limited Liability Company Law".
There are 34 definitions to which one may refer.

ARTICLE II - FORMATION

This article generally indicates the purposes for which an LLC may be formed and its powers all of which are similar to corporations. It also explains how LLCs are formed: by filing properly executed Articles of Organization and Operating Agreement with the Department of State. Section 206 indicates what must be set forth in the Articles (name, county of office, date of dissolution or events of dissolution, designation of Secretary of State as agent for service of process, name and address of registered agent, if any, whether the LLC will be managed by one or more members or classes of members or managers, who is liable, etc.). Within 120 days after effectiveness of the Articles, a copy or a notice must be published once a week for six weeks in two newspapers of the county where the LLC office is located. Proof of the publication by affidavit of the publisher must be filed with the Department of State. The Article sets forth the manner for amending, correcting or restating the Articles of Organization.

ARTICLE III - SERVICE OF PROCESS

Every LLC must designate the Secretary of State as agent for service of process. In addition, an LLC may designate a registered agent upon whom process against the LLC may be served. The manner of serving process on an LLC is described at Sections 303 and 304. The Secretary of State will keep a record of each process served upon it pursuant to the law.

ARTICLE IV - MANAGEMENT BY MEMBERS OR MANAGERS

The members manage the LLC unless the Articles of Organization provide for management by a manager or managers or a class of managers. Voting rights are delineated at Section 402. Each member may vote in proportion to the member's share of the current profits of the LLC. Certain actions require majority vote (see Section 402(c)). Certain other actions require a two-thirds vote (see Section 402(d)). Annual meetings are required. Quorum requirements are specified in Section 404. Requirements for members' and managers' meetings are similar (see Sections 408 and 409). A manager may, but need not be, a member of the LLC. A member is an agent of the LLC only if a manager or managers are not vested with management of the LLC in the

Articles of Organization, in which case the manager or managers are the agents. The Operating Agreement spells out the offices and terms and responsibilities of managers as well as the manner for increasing or decreasing the number of managers.

Section 417 spells out the contents of the Operating Agreement which include the business of the LLC, the conduct of the affairs of the LLC, and the rights, powers, preferences, limitations or responsibilities of its members, managers, employees or agents.

The Articles of Organization may provide for classes or groups of members and/or managers with different voting rights.

ARTICLE V - CONTRIBUTIONS AND DISTRIBUTIONS

Generally, profits, losses and contributions are allocated to members on the basis of contributions of the members unless a different manner is provided in the Operating Agreement.

ARTICLE VI - MEMBERS AND MEMBERSHIP

A person may become a member on the effective date of the initial Articles of Organization or thereafter pursuant to the Operating Agreement or by the vote or written consent of a majority in interest of the members.

Membership interests are assignable in whole or in part but the assignee may not participate in the management and affairs of the LLC or become or exercise any rights or powers of a member. The only effect of assignment is to entitle the assignee the profits and losses to which the assignor would be entitled. Assignment of a member's interest does not dissolve the LLC. Upon assignment of all of a member's membership interest, such person ceases to be a member and loses any rights or powers of a member.

The Operating Agreement may provide that a member's interest be evidenced by a certificate issued by the LLC. Any restrictions on the sale or transfer of a membership interest must be noted conspicuously on the face or back of every certificate. Any sales or transfers in violation of such restrictions are void.

Rights of withdrawal, creditors, and estates are discussed in Sections 606, 607 and 608.

Pursuant to section 609 neither a member, manager nor agent is liable for any debts, obligations or liabilities of the LLC, solely by being a member, manager or agent unless assumption of such liability is stated in the Articles of Organization of the LLC and such members, managers or agents have

specifically consented in writing to such provision or shall have voted in favor of such provision.

ARTICLE VII - DISSOLUTION

This article deals with the procedures to dissolve, wind up and distribute assets.

ARTICLE VIII - FOREIGN LIMITED LIABILITY COMPANIES

This article deals with the requirements of a foreign LLC. Such LLCs must apply to the Department of State for authority to do business in New York.

ARTICLE IX

Not used

ARTICLE X - MERGERS

This article deals with procedures for mergers and consolidations and their effects.

ARTICLE XI - MISCELLANEOUS

This article deals with the fees which must be paid, the records which must be kept, and the fact that civil usury may not be used as a defense in any action brought against an LLC.

ARTICLE XII - PROFESSIONAL SERVICE LIMITED LIABILITY COMPANIES

This article deals with the requirements for a professional LLC.

ARTICLE XIII - FOREIGN PROFESSIONAL LIMITED LIABILITY COMPANY

This article deals with the requirements for a professional LLC organized outside New York State.

ARTICLE XIV - SAVINGS CLAUSES, EFFECTIVE DATES

This article deals with severability, statutory construction and the effective date (90th day after it becomes law).

739

27F
1077

MEMORANDUM

SENATE BILL: 27F

INTRODUCED BY: Senator John B. Daly

ASSEMBLY:

INTRODUCED BY: Assemblyman Albert Vann

AN ACT to create the limited liability company law, in relation to permitting the establishment of limited liability companies in New York State, and permitting the registration of limited liability partnerships in New York.

PURPOSE

This bill provides for the formation of limited liability companies (LLC's) under New York law and the recognition of foreign LLC's seeking to do business in New York. This bill strives to harmonize its provisions with existing New York law and practice, borrowing heavily from existing New York partnership law, especially the recently enacted New York Revised Limited Partnership Act which became effective July 1, 1991 (RLPA), and where applicable, corporate law. This bill also provides for the registration of limited liability partnerships under New York law and the recognition of foreign limited liability partnerships seeking to do business in New York.

SUMMARY OF PROVISIONS

LIMITED LIABILITY COMPANIES

Like a corporation incorporated under the Business Corporation Law, the bill provides that an LLC may be formed to carry on any lawful business purpose, subject to certain exceptions. An LLC must have at least one member at the time of formation. The name of the LLC and certain other information must be set forth in articles of organization (analogous to the partnership certificate of a limited partnership or the certificate of incorporation of a corporation) which are required to be filed with the Secretary of State.

The bill provides that a person may become a member of an LLC (i) upon the effective date of the initial articles of organization, in the case of initial members, (ii) in accordance with the operating agreement or (iii) upon receiving the vote or written consent of a majority in interest of the members entitled to vote thereon if the operating agreement makes no provision for the admission of new members.

The bill provides that unless the articles of organization to vest the management of a limited liability company in one or more managers management of the LLC is vested in the members. Unless management of the LLC is vested in managers, every member of the LLC is an agent of the LLC. Managers (or members where there are no managers provided for in the articles of organization) are required to perform their duties in good faith and with the degree of care that would be exercised by an ordinarily prudent person in a like position. Like a corporation's by-laws, an LLC's operating agreement may set forth a provision eliminating or limiting the personal liability of managers or such members to the LLC or its members for damages for any breach of duty in any capacity subject to certain exceptions, similar to those contained in Section 402 (b) of the New York Business Corporation Law (the BCL).

Members of an LLC vote in proportion of their respective shares of current profits, unless otherwise provided in the LLC's operating agreement. The bill permits articles of organization to provide for classes or groups of managers having such relative rights and powers as provided in the operating agreement.

The bill sets forth rules permitting an LLC to indemnify members, managers and other persons in a manner analogous to that provided in the RLPA.

Consistent with RLPA, member contributions to an LLC may be in the form of cash, property or services rendered or a promissory note or other obligation to contribute cash or property or to render services. Profits, losses and distributions of an LLC are allocated among the members as provided in the operating agreement. Consistent with the RLPA, if the operating agreement does not provide an allocation, profits, losses and distributions are allocated on the basis of the value of the respective members' contributions.

Creditors of members of the LLC cannot exercise legal or equitable remedies with respect to the property of the LLC. Creditors of an LLC who extend credit in reliance

on the obligation of any member to make a contribution may enforce the original obligation to the extent he or she reasonably relied on such obligation.

Many of the dissolution and winding-up provisions of the bill are adapted, with minor modifications, directly from the RLPA. Thus, an LLC is dissolved upon the first to occur of: (i) the occurrence of the latest date for dissolution, if any, set forth in the articles of organization, (ii) the happening of events specified in the operating agreement, (iii) the written consent or vote of at least two-thirds (or such other portion designated in the operating agreement) in interest of the members, (iv) the entry of a decree of judicial dissolution, (v) certain dissolution events (including the bankruptcy, death, dissolution or withdrawal of any member or a designated member or class or groups of members) unless within 180 days after such event, the LLC is continued by the vote or written consent of a majority in interest of the remaining members (or such other percentage agreed to by the members) or (vi) pursuant to a right to continue contained in the operating agreement.

Distributions following the winding-up of a limited liability company are governed by provisions adapted from the RLPA respecting distribution of assets upon the winding-up a limited partnership.

The bill requires foreign limited liability companies to apply for authority to do business in New York according to the terms and conditions set forth in the bill. These provisions are based closely upon provisions of RLPA.

The bill provides that to the extent not expressly prohibited by law, a domestic LLC may merge or consolidate with or into one or more other domestic LLC's or other domestic or foreign business entity. The procedures for mergers and consolidations set forth in the bill are adapted from the RLPA.

The bill provides for the formation of LLC's by professionals, including doctors, accountants, engineers, architects, attorneys, pharmacists, veterinarians and optometrists. The articles dealing with professionals are adapted with from the comparable provisions found the BCL and incorporate and carry over the standards of liability contained therein.

While the IRS has not ruled that an LLC formed pursuant to the bill will be classified as a partnership for federal income tax purposes, it is anticipated that such an LLC would be so classified if the LLC is structured in a manner consistent with the bill's "default" provisions.

LIMITED LIABILITY PARTNERSHIPS

The bill authorizes the registration of general partnerships that provide professional services as registered limited liability partnerships ("NYRLLPs") under New York law and recognizes the limited liability status of general partnerships that provide professional services that have registered as limited liability partnerships ("LLPs") in other states.

While the assets of the partnership will still be available to an injured party, the bill provides that a partner in a partnership which has registered as a NYRLLP is not personally liable for debts, obligations or liabilities of the partnership other than those arising out of any negligent or wrongful act or misconduct committed by such partner or by a person under the direct supervision and control of such partner while rendering professional services. Such standard of liability is the same as that accorded to shareholders of a professional corporation organized under the New York Business Corporation Law. It would also be the same as that accorded to members of a professional LLC under the bill. Such standard of liability is different from the legislation enacted in other states to date in that it not only deals with negligent or wrongful acts or misconduct, but also limits liabilities for contractual and other debts and obligations. Liability for a wrongful distribution to a partner may arise under Federal or state fraudulent transfer laws or similar provisions. Accordingly, a court that considers whether a distribution is wrongful and should be returned should take into account the fact that the distribution to a partner might actually constitute compensation (salary or bonus) for services rendered and should not be subject to return.

While other states have permitted general partnerships engaged in businesses other than the conduct of a profession to register as LLPs (and one state (Texas) has permitted limited partnerships to so register), the bill restricts the availability of LLPs to professionals practicing in general partnership form. The definition of "profession"

is that used in the New York Business Corporation Law and includes accountants, architects, attorneys, chiropractors, dental hygienists, dentists, optometrists, professional engineers, land surveyors, licensed masseurs and masseuses, pharmacists, physiotherapists, podiatrists, registered nurses, certified psychologists, social workers and certified shorthand reporters, physicians and veterinarians. The bill provides that partners of a NYRLLP (just like members of a professional service LLC) may include individuals (authorized to practice a profession) or other professional entities such as professional corporations, professional service limited liability companies or other NYRLLPs. Like the comparable provisions contained in the Business Corporation Law, the bill provides that professional services may only be rendered through individuals authorized by law to render such professional services. Accordingly, where there are partners (or members) who are not individuals, the professional services would be rendered on behalf of the NYRLLP (or professional service LLC) indirectly by individuals through the professional entities in which such individuals are partners, shareholders or members.

The bill provides that a general partnership that renders professional services may register as a NYRLLP by filing on a one-time basis a registration with the Secretary of State, accompanied by an entity-level filing fee. A NYRLLP would also be required to file a statement with the Secretary of State biennially (similar to the filing made by a professional corporation).

A foreign general partnership providing professional services that has registered as an LLP in another jurisdiction and wishes to conduct business in New York as an LLP would be required to file a one-time notice with the Secretary of State. The notice must be accompanied by an entity-level filing fee and a copy of the latest registration filed by it in its home state for purposes of registering as an LLP or a certificate issued by its home state substantially to the effect that the general partnership has filed a registration as an LLP, which is effective on the date of the certificate. A foreign general partnership that provides professional services that filed a notice in New York would be required to file a statement with the Secretary of State biennially (similar to the filing made by a foreign professional corporation). Liability limitations applicable to a foreign LLP and files in New York would be the liability standard applicable in the state of registration, but in no circumstances a lesser standard than that applicable to LLPs in New York. Foreign LLPs which fail to so file and which conduct business in New York, like foreign limited partnerships and corporations, would be restricted from maintaining an action, suit or proceeding in New York. A foreign limited partnership and a foreign non-professional general partnership (other than certain foreign limited liability partnerships related to a professional limited liability partnership) which is denominated as an LLP in its home state would not be recognized as LLPs in New York, but would be recognized as a limited partnership and a general partnership, respectively.

The name of a NYRLLP or foreign LLP conducting business or activities in New York must contain the words "Registered Limited Liability Partnership" or the abbreviation "L.L.P." or "LLP".

The bill also contains a series of conforming changes to the New York partnership law to give full effect to the limitation of liability intended by the LLP.

The IRS has issued at least one private letter ruling with respect to an LLP. In that ruling, a Texas general partnership that proposed to register as an LLP under the Texas Uniform Partnership Act was found to lack the corporate characteristics of centralization of management and free transferability of interests and would therefore continue to be classified as a partnership for federal income tax purposes. It is anticipated that a New York LLP would be accorded the same federal income tax treatment.

TAX PROVISIONS

GENERAL

Section 18 of the bill amends section 2 of the Tax Law to provide, in new subdivisions 5 and 6, that the term "limited liability company" in the Tax Law means a domestic or foreign LLC as defined in the Limited Liability Company Law, and the terms "partnership" and "partner" in the Tax Law will be deemed to include references to LLCs and members thereof, respectively.

Section 19 of the bill amends section 5.1(b) of the Tax Law, relating to the obtaining and furnishing of taxpayer identification, to include LLCs within the meaning of the term "person."

ARTICLE 9

Sections 20 through 24, 26 and 27 of the bill amend various taxing provisions in Article 9 so as to clarify that CLLCs are included within the meaning of the term "corporation" for purposes of Article 9. Section 183.1(a), section 183-a.1, section 184.1, section 184-a.1, section 186.1, section 186-b.1 and section 189.1(c) of the Tax Law are so amended. Section 25 of the bill amends section 186-a.2-a of the Tax Law to clarify that the treatment therein of revenue from interstate and foreign transmission service is applicable to all taxpayers, including LLCs, subject to tax under section 186-a.

Section 28 of the bill amends section 191 of the Tax Law, relating to the taxation of receivers and other fiduciaries who conduct the business of an Article 9 taxpayer, so as to render the same clearly applicable to the business of a CLLC.

Section 29 of the bill amends section 194 of the Tax Law, relating to certifications on tax reports, so as to render the same clearly applicable to CLLCs.

Section 30 of the bill amends section 204 of the Tax Law, applicable to reports relating to corporations made by the Secretary of State to the Commissioner of Taxation and Finance, so as to require reports as to the formation of LLCs and the authorization of foreign LLCs.

ARTICLE 9-A

Section 31 of the bill amends section 208.1 of the Tax Law to make clear that CLLCs are included within the meaning of the term "corporation."

MISCELLANEOUS

In various provisions throughout the Tax Law clarifying amendments are made to include in the term "person" a reference to LLCs and, similarly, to provide that references to officers and directors of corporations will apply to individuals with analogous responsibilities in the case of LLCs. Thus, sections 32 through 36 and 38 of the bill so amend the term "person" in sections 282.8 (Article 12-A, Tax on Gasoline and Similar Motor Fuel), 420.1 (Article 18, Taxes on Alcoholic Beverages), 447.9 (Article 18-A, Tax on Beverage Containers), 451.3 (Tax on Boxing and Wrestling Exhibitions), 470.3 (Article 20, Tax on Cigarettes and Tobacco Products), and 501.1 (Article 21, Highway Use Tax) of the Tax Law, respectively. Section 37 of the bill amends section 480.6(a) of the Tax Law (Article 20, Tax on Cigarettes and Tobacco Products) with reference to officers and directors.

ARTICLE 22 AND CITY PERSONAL INCOME TAXES

Section 39 of the bill amends section 601(f) of the Tax Law to provide that for purposes of Article 22 of the Tax Law (Personal Income Tax), the term "partnership" is deemed also to refer to KLLCs. In addition, definitions are provided for the terms "LLC"

TAX PROVISIONS CONT.

and "KLLC".

Sections 52 and 65 of the bill similarly amend section 1302(b) of the Tax Law (Article 30) and section 11-1701(c) of the Administrative Code of the City of New York, relating to the New York City resident income tax. Sections 53 and 68 of the bill similarly amend section 1322(b) of the Tax Law (Article 30-A) and section 92-83(b) of the Codes and Ordinances of the City of Yonkers, relating to the City of Yonkers resident income tax. Sections 54, 69, 64, and 67 of the bill similarly amend section 1340(c)(1) of the Tax Law (Article 30-B) and section 92-98(j) of the Codes and Ordinances of the City of Yonkers (relating to the Yonkers Earnings Tax on Nonresidents), and section 25-m(1) of Article 2-E of the General City Law and section 11-1901(n) of the Administrative Code of the City of New York (relating to the New York City Nonresident Earnings Tax).

Section 40 of the bill amends the Section heading of section 658(c) and section 41 of the bill adds new paragraph 658(c) (3) to impose an annual filing fee on KLLCs and RLLPs having income derived from New York sources. Such LLCs and RLLPs are subject under current law to the partnership filing requirement of section 658(c) (1) of the Tax Law, and the fee is required at the same time (generally, April 15) as such filing. The fee is equal to the product of \$50 and the number of members of such company or partnership as of the last day of the taxable year, but not less than \$325 annually.

The fee requirement of section 41, that the LLC or RLLP have income from New York sources, contemplates that the entity have income within the meaning of section 631 of the Tax Law, which section comprehends items of income, gain, loss or deduction determined for Federal purposes. Since at the Federal level the entity would not be required to file a return absent any such items, it is contemplated that the fee would apply only if a Federal partnership return (Form 1065) is required to be filed and then only if any such items of income, etc. have a New York source. This general rule does not, however, excuse from the fee an LLC which is not required to file a federal partnership return by reason of making the election under IRC Reg. section 1.761-2(a)(3) (relating to companies engaged in the production, extraction or use of property, where the income of the company is reported directly by the members.)

On the other hand, the fee prerequisite established in section 41 of the bill, that the entity have income, would exclude from the fee those entities without income or expenses, typically entities in start-up or dormant status. Further, the fee prerequisite of income from New York sources would exclude from the fee those entities having contacts with New York other than New York source income. Such contacts include the mere formation of the LLC under New York law (domestic LLCs) and the existence of resident members of the LLC. Finally, the fee prerequisite of New York source income would exclude from the fee those entities engaged solely in activity deemed under present law to be not business activity, such as investment activity which is confined to purchase and sale for the entities own accounts. (Tax Law section 631 (d).)

Section 42 of the bill amends section 685(n) of the Tax Law to include LLCs and managers thereof within the meaning of the term "person." Section 66 of the bill makes the same amendment to section 11-1785(n) of the Administrative Code of the City of New York.

MISCELLANEOUS

Sections 43 and 44 of the bill amend sections 951-a(b) and 1021(d) to include LLCs within the meaning of the term "person," for purposes of the Estate Tax imposed under Article 26 and the Generation-Skipping Transfer Tax under Article 26-B.

Section 45 of the bill amends section 1080(b)(2) of the Tax Law to render Article 27 of the Tax Law (Corporate Tax Procedure and Administration) applicable to CLLCs.

TAX PROVISIONS CONT.

Section 46 of the bill amends section 1085(j) of the Tax Law, contained in Article 27, to include LLCs within the meaning of the term "person." This provision relates to penalties for certain failures to act resulting from fraudulent intent, and to the penalty for aiding or assisting in the giving of fraudulent returns, reports, statements or other documents.

Sections 47 and 48 of the bill amend sections 1101(a) and 1131(1) of the Tax Law, contained in Article 28 of the Tax Law (Sales and Compensating Use Taxes), to render explicitly applicable to LLCs the terms "person," "persons required to collect tax" and "person required to collect any tax imposed by this article."

Section 49 of the bill amends section 1134(a)(4)(B) of the Tax Law (Article 28) to adapt sales tax certificate of authority provisions to LLCs.

Section 50 of the bill amends section 1145(e) of the Tax Law (Article 28) to adapt to LLCs a penalty provision relating to the failure to prepay sales tax on motor fuel and diesel motor fuel pursuant to section 1102 of the Tax Law.

Section 51 of the bill amends section 1201(g)(1) and (2) of the Tax Law (Article 29) to adapt to LLCs provisions relating to the New York City tax on motor vehicle registrations.

Sections 55, 56 and 57 amend section 1401(a) of the Tax Law (Article 31, Real Estate Transfer Tax), section 1424.1 of the Tax Law (Article 31-A, Tax on Real Property Transfers for Transportation Assistance) and section 1440.8 of the Tax Law (Article 31-B, Tax on Gains Derived from Certain Real Property Transfers), respectively, to include LLCs within the meaning of the term "person."

Section 58 of the bill amends section 1447-a.2 of the Tax Law (Article 31-B) to adapt certain requirements under the gains tax to LLCs.

Section 59 of the bill amends section 1550(a) of the Tax Law (Article 33-A, Tax on Independently Procured Insurance) to include LLCs within the meaning of the term "person." Section 60 of the bill amends section 1554(b) of the Tax Law to adapt the return requirements under such article to LLCs.

Section 61 of the bill amends section 1605(b) of the Tax Law (Article 34, New York State Lottery for Education) to include LLCs within the meaning of the term "person."

Section 62 of the bill amends section 1800(a) and (b) of the Tax Law (Article 37, Crimes and Other Offenses, Seizures and Forfeitures), to include LLCs within the meaning of the term "person."

Section 63 of the bill amends section 3002(b) of the Tax Law, relating to the Taxpayers' Bill of Rights, to include LLCs within the definition of the term "taxpayer."

Section 70 of the bill is an unconsolidated law provision designed to explain that a number of amendments which integrate the term "limited liability company" into the definitions of the terms "person," "partnership" and "association" are merely clarifying and are not to be construed to change the interpretation that LLCs were in fact included within the meaning of such terms prior to enactment of this bill.

Section 71 of the bill contains the effective date provisions. The bill is generally effective on the thirtieth day after enactment. Section 41 of the bill, which imposes an annual fee on KLLCs, applies to taxable years beginning on or after such thirtieth day. Section 62 of the bill, which relates to the criminal provisions of the Tax Law, takes effect September 1, 1994.

JUSTIFICATION

Since the passage of Limited Liability Company legislation by Wyoming, in 1977, approximately 35 other states (Alabama, Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, South Dakota, Texas, Utah, Virginia, West Virginia and Wisconsin) have enacted statutes permitting the organization of LLC's.

A properly structured LLC, although classified as a partnership for federal income tax purposes (i.e., taxed at the member level but not at the entity level), would afford its

members the advantages of limited liability under state law with respect to the activities of the company. This new entity is more flexible than either a limited partnership or an S corporation, alternative forms of business organization which combine limited liability with a single level of federal income tax, for a number of reasons. For example, while a limited partnership must have at least one general partner liable for the partnership's debts and generally may not have limited partners participating in the control of the limited partnership, each of the members of an LLC is protected from liability for the debts of the LLC and is permitted to participate in management. Similarly, LLC's avoid the numerous restrictions imposed on S corporations by the Internal Revenue Code of 1986, as amended.

It is anticipated that the bill will attract businesses to New York State--particularly real estate business, high technology business, venture capital firms, corporate joint ventures and small local businesses typically operated as sole proprietorships. The bill provides an attractive alternative to partnerships, corporations and trusts, and should be particularly desirable for foreign investors and entrepreneurs. Adoption of LLC legislation in New York will be a significant step in promoting New York as a competitive location for conducting and establishing business enterprises.

At this time, four states (Delaware, Louisiana, North Carolina and Texas) and the District of Columbia have enacted legislation permitting partnerships to register as LLPs. In addition, Minnesota and New Jersey have passed legislation that recognizes an LLP registered in another state. LLP legislation has been introduced in a number of other states, including Illinois, Massachusetts, Minnesota, Mississippi, New Mexico, Ohio, Pennsylvania, South Carolina and West Virginia.

PRIOR LEGISLATIVE HISTORY

1992: S.8882 and S.8180; A.11016
1993: A.8676 and A.8824

FISCAL IMPLICATIONS

It is anticipated that the bill will create revenue for the state through filing fees from sole proprietors, out-of-state business owners and out-of-state LLC's who will organize as New York LLC's, as well as from New York businesses that are currently being organized outside of New York which can organize in New York under this legislation. It is also believed that there will be an increase in New York State income tax revenues from members and employees resulting from businesses that will transact business in New York once New York recognizes limited liability companies.

An analysis of the income tax revenue impact of the bill would balance these factors as well as any anticipated income taxes to be paid by LLC's, against the potential loss of income tax revenues resulting from a decline in the use of corporations. In general, federal and New York state income tax would be incurred in connection with the conversion of existing corporations to LLC's. It is believed that these taxes would tend to discourage such conversions as well as any anticipated income paid by LLC's

EFFECTIVE DATE

This act will take effect on September 1, 1994