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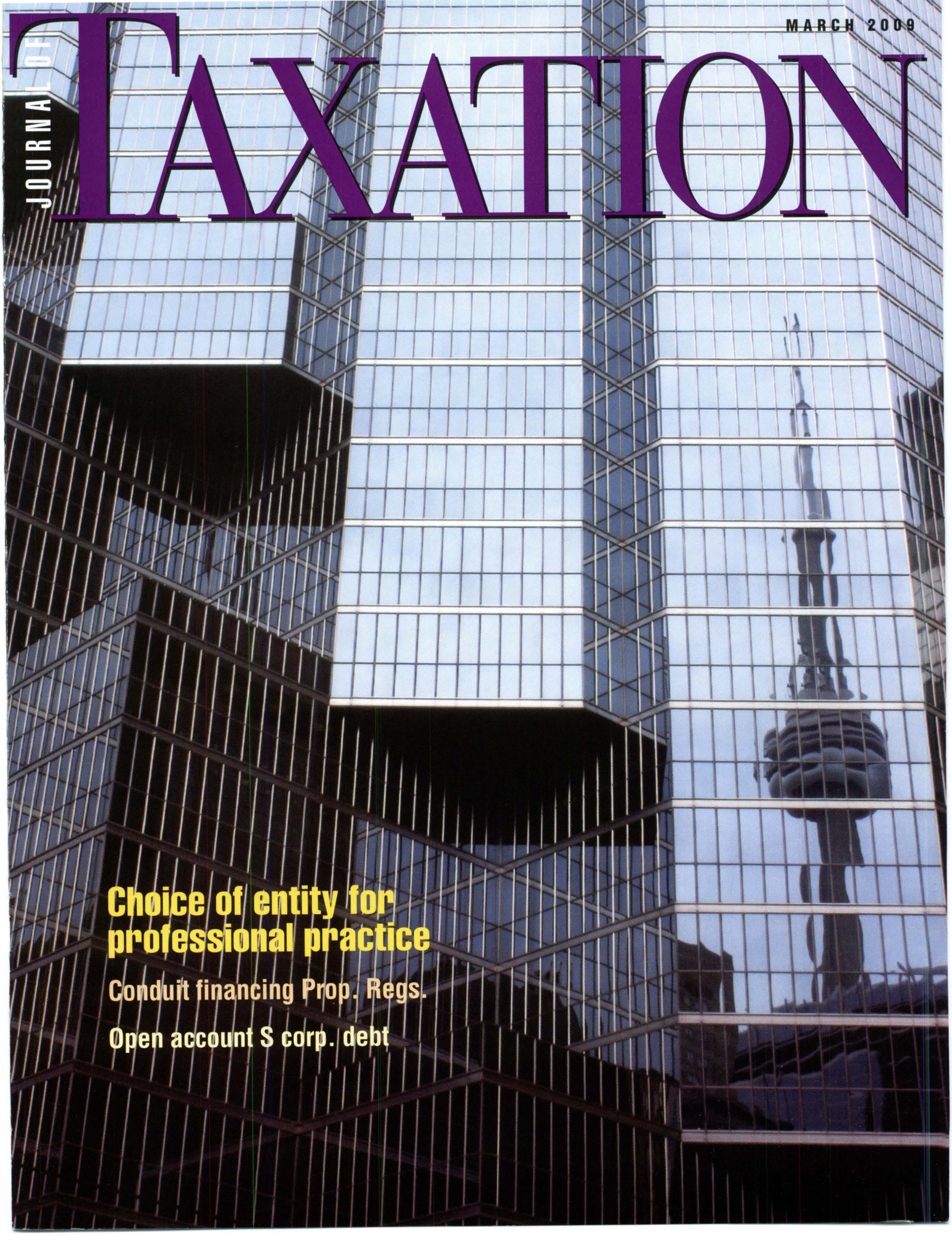

Choice of entity for professional practice

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ORGANIZING A PROFESSIONAL PRACTICE: AN AFTER-TAX CHOICE-OF-ENTITY CALCULUS

BY THOMAS E. RUTLEDGE, MARK S. FRANKLIN, AND STEPHEN M. LUKINOVICH

The tax tail should by no means wag the choice-of-entity dog, but practitioners agree that the overall tax liability projected to result from any particular form chosen for a professional practice is a serious consideration. The key to any comparison will be the assumptions made, including those relating to the client's income and the stability of the practice.

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A crucial decision made in any business venture is the choice of entity, a complex calculus that weighs and balances competing interests and objectives against the "standard models" that are available under the various business organization statutes. The standard model ultimately selected is then customized to the venture by private agreement. Or at least that is what should happen.

In most organizations, the client, the accountant, or the attorney makes a quick decision, informed by the advisor's prior practice and an up-to-date appreciation of recent changes in the law (both organization and tax). There are many discussions that compare, on a characteristic-by-characteristic basis, the various means of organizing a business structure.[1] Here, we attempt to quantify the impact of those various factors.

Basic facts. We assume our facts as follows: A veterinary practice owned equally by three licensed professionals, with four additional employees. In the practice, one owner has "allocable" gross income of $500,000 and deductible expenses (before determination of owner contributions to retirement savings accounts) of $150,000, resulting in $350,000 that is to be distributed in some manner to this owner.

After reviewing our facts and the state law governing the organization of professional practices, we consider, on a pro forma basis, the after-tax benefit realized by the professional owner of the venture under various classification scenarios. While this analysis is of necessity limited to its assumed facts, we conclude that assuming such is otherwise defendable. It is from the tax perspective most efficient to use an S corporation in which 25% of earnings are distributed as salary with the balance distributed in the form of dividends. The next most efficient approach is to organize an LLC taxed as a partnership in which 50% of the funds available to our owner are distributed as a guaranteed payment with the balance as a distribution, where this member is not a manager.

STATE LAW ORGANIZATION OPTIONS

Almost every state now allows a professional practice to be organized as a sole proprietorship, as a general partnership, as a professional service corporation (PSC), as an LLC, or as a limited liability partnership (LLP).[2]

Traditionally, a professional practice had to be organized either as a sole proprietorship or as a general partnership. Due to certain tax pressures, however, efforts were made to develop forms of business organization that, while not "incorporated," would have the tax benefits of corporate tax classification under the Code.

This course of action culminated in *Kintner*, 216 F.2d 418, 46 AFTR 995 (CA-9, 1954). In response to the government's loss in that case, the *Kintner* classification Regulations were adopted by Treasury with the purpose and effect of making it more difficult for professional firms to achieve the benefits of corporate classification even as state law incorporation was denied them. Proving Ludwig Borne's adage that "nothing is lasting but change," professionals in the various states turned to their respective state legislatures and lobbied for the adoption of professional service corporation statutes pursuant to which they could formally incorporate their practices.[3]

Eventually, every state adopted a PSC act, and with great reluctance the Service agreed that a PSC would, for purposes of the Code, be classified as a corporation.[4] As a general rule, these various PSC acts imposed structural limitations, such as who may serve as members of the board of directors, who may qualify as shareholders, requirements as to officers other than the treasurer and the secretary, the voting of shares, and mandatory buyout requirements on death or disability.[5]

Early in the 1990s, as the "LLC explosion" was taking place, this form of business organization was identified by several professions (most notably the accounting industry as represented by the AICPA) as a viable mechanism for the organization of professional firms. This categorization of the LLC was based on the availability of partnership taxation, not usually an option in the PSC. The closest analog, S corporation status, imposed significant limitations and, because of the maximum number of shareholders at times permissible, was not available to larger firms.[6]

Early in the 1990s, the LLC was identified by several professions as a viable mechanism for the organization of professional firms.

States have taken a variety of approaches to structural limitations on professional LLCs. For example, in Kentucky the only requirements applicable to a professional LLC that differ from a nonprofessional LLC involve name identifiers and a recitation in the articles of organization as to what profession or professions are being practiced through the LLC.[7] By contrast, the Tennessee LLC Act imposes on professional LLCs structural limitations roughly equivalent to those imposed on PSCs organized in that state.[8] The 2006 Revised Uniform Limited Liability Company Act (RULLCA)[9] contains no provisions specific to the regulation of professional firms, leaving such matters exclusively to the rules and regulations adopted by professional regulatory boards.

Even as the availability of LLCs moved across the country, there rose the effort, initially in Texas, to permit the formation of the LLP. A subspecies of the general partnership, as contrasted with a new form of business organization, the LLP modifies—to a greater or lesser degree, depending on the state statute at issue—the traditional rule that all partners are either jointly or severally liable for debts and obligations of the partnership.[10] As now embodied in the Revised Uniform Partnership Act (RUPA), an LLP affords all partners limited liability from the debts and obligations of the partnership, the same rule of limited liability that applies in the corporation and the LLC.[11] All states now permit the organization of a professional practice as an LLP.[12]

NOTES

1 See, e.g., McNulty and Kwon, "Tax Considerations in Choice of Entity Decision," 8 Bus. Entities 28 (May/June 2006); Keatinge and Conaway, *Keatinge and Conaway on Choice of Business Entity* (Thomson Reuters/West, 2007), Appendix A.

2 The California LLC act precludes the use of the professional LLC in California by licensed professionals. California Corp. Code section 17375. See also Calif. AG Opn. 04-103 (7/23/04).

3 See generally Rutledge, "The Place (If Any) of the Professional Structure in Entity Rationalization," 58 Bus. Law. 1413 (2003), pages 1415-16.

4 See, e.g., Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, Seventh Edition (Thomson Reuters/WG&L, 2006), ¶ 2.06. See also Rev. Rul. 70-101, 1970-1 CB 278.

5 See Model Professional Corporation Supplement (1984), § 20 (permissible shareholders), § 23 (mandatory redemption of shares of deceased or unlicensed shareholder or transferee), § 30 (requirements as to directors and officers), § 31 (proxies and voting trusts).

6 Starting in 1958, an S corporation was limited to ten shareholders under Section 1371 (a)(1). The threshold increased to 15 with conditions in 1976 and 15 generally in 1978. In 1981, the limit was raised to 25, and in 1982 to 35 under Section 1361(b)(1)(A). In 1996, that limit was increased to 75, and was raised again to 100 (and the method of counting the number of shareholders liberalized) by the American Jobs Creation Act of 2004. The 1996 legislation also provided for the electing small business trust and allowed charitable organizations as permissible shareholders of an S corporation. Other limitations on S corporation status include the requirement of a single class of stock, a prohibition of nonresident alien shareholders, and limits on trusts and estates as shareholders.

7 See Ky. Rev. Stat. Ann. sections 275.025(3) (articles of organization to set forth professional services to be rendered by LLC) and 275.100(1) (name requirements).

8 See Tenn. Code sections 48-249-1106 (professional services to be rendered only by individuals so licensed by the state), 48-249-1108 (name requirements), 48-249-1109 (eligible members), 48-249-1100 (transfers only to eligible persons) and 48-249-1111 (mandatory redemption).

9 6B U.L.A. 407 (2008).

10 See generally Rutledge and Hester, "Practical Guide to Limited Liability Partnerships," 5 *State Limited Liability Company and Partnership Laws* (Jacobson, Ludwig, Miller, and Rutledge, eds.; Aspen, 2008).

11 See RUPA section 306(c). See also Bishop, "The Limited Liability Partnership Amendments to the Uniform Partnership Act (1994)," 53 Bus. Law. 101 (1997). But see Ederer v. Gursky, 881 N.E.2d 204, 9 N.Y.3d 514 (N.Y., 2007), wherein the New York Court of Appeals held that section 26(b) of the New York Partnership Act applies, inter alia, only to claims of third parties against the partnership but does not apply to claims among the partners. In this instance, the court held that the partners in an LLP were personally liable on claims asserted by a former partner against the partnership. Based on Ederer, a similar holding was rendered in Kuslansky v. Kuslansky, Robbins, Stechel and Cunningham, LLP, 50 App. Div. 3d 1101, 858 N.Y.S.2d 212 (N.Y. App. Div., 2d Dept., 2008).

12 While all states authorize the formation of an LLP, four states restrict the LLP form to professional practices. See N.Y. Partnership Law section 121-1500 (LLP status available only to professional service partnerships without limited partners); Nev. Stat. section 87.020(5) (LLP status available only to partnerships formed to render professional services); Or. Rev. Stat. section 67.500 (LLP status available only to partnerships that render or are affiliated with an LLP that renders professional services); Cal. Corp. Code sections 16951 and 16101(8)(A) (LLP status available only to partnerships of architects, accountants, or attorneys).

This is not to suggest that there are not substantive distinctions between these various forms of organization and that for state law purposes they are fungible. For example, PSC acts typically restrict the firm to a single profession.[13]

AFTER-TAX COMPARISON

We compare the after-tax benefits realized by a hypothetical owner-professional in a professional practice organized as a PSC, an LLC, or an LLP. Our analysis is limited to a hypothetical year of ordinary operations; we ignore the tax implications to a continuing owner of a new owner joining the venture and the implications to each of a continuing and a departing owner on a voluntary or involuntary termination for the relationship.[14] Most professional firms in most years are not going to have persons joining or leaving the firm, so this analysis we submit is "typical."

Our hypothetical owner is allocated $500,000 of company income and $150,000 of deductible expenses, yielding $350,000 of income to be, in some manner, transferred to her.[15] Our question: Is it most tax-efficient to pay those funds to her in a combination of salary and dividends from a C corporation, salary and dividends from an S corporation, or distributions (or even distributions and guaranteed payments) from an LLC/LLP subject to Subchapter K?[16] For purposes of simplicity, we assume that the PSC is used for either of the

Assumptions

For all of the spreadsheets used herein, we made certain assumptions and determinations as to presentation.

State taxes. We have not included any state tax liability in our model. Such taxes should be included, however, especially in jurisdictions that impose entity-level income or franchise taxes on structures that are, for federal tax purposes, pass-through entities. For example, Alabama imposes a Business Privilege Tax on taxable net worth on entities structured as either S corporations or partnerships. New Mexico imposes no entity-level income tax on partnerships while S corporations in New Mexico must pay franchise tax at the entity level.

Federal tax rate. We have assumed, in all of our models, a federal tax rate of 35% for all C corporations' current-year earnings retained; graduated tax rates are not appropriate in a professional context by reason of Section 11(b)(2). Conversely, in our Subchapter K models, we have presumed an individual federal income tax bracket allocation of 35%. Any applicable alternative minimum tax (AMT) has not been included in these models.

Section 448(d)(2). As defined in Section 448(d)(2), a "qualified personal service corporation" is a corporation for which substantially all of the activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and substantially all of the stock is held directly or indirectly by employees performing services for the corporation in connection with the professional services being rendered, retirees who perform said services for the corporation, the estate of an individual who performed those services, and persons who acquired the stock by reason of the death of persons who performed said services. Our model assumes that the business in question falls within this definition.

Section 482. We assume, for purposes of this analysis, that Section 482, permitting the reallocation of gross income among related organizations where "necessary in order to prevent the evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses" is not applicable to any scenario presented. See also Section 1366(e). Nonetheless, we do not mean to suggest that any division between salary and dividends is, in any particular factual situation, appropriate or defendable.

Allocations of funds within our models. Our models begin with assumed divisions of the possible distributions between salary/dividends or, in the case of the LLC, distributions that are or are not subject to self-employment tax. These assumed divisions were chosen for purposes of illustration. The determination of a "sweet spot" division between various categories of earnings is a step that should be undertaken as the next step in the analysis.

"Taxable income." With respect to this item, we have included for federal tax purposes the tax treatment of salary vs. dividends as applicable plus self-employment taxable income vs. non-self-employment taxable income along with the effect of the deductibility of certain fringe benefits.

NOTES

13 See, e.g., Maryland Code Ann. Corps. & Assns. section 5-102(a)(1). Other states are more flexible, permitting "related professional services" in the same PSC. See, e.g., Ky. Rev. Stat. Ann. section 274.015(1).

14 For a listing of some of those tax issues, see, e.g., Committee on Partnerships and Unincorporated Business Organizations, ABA Section of Business Law, "Model Limited Liability Company Membership Interest Redemption Agreement," 61 Bus. Law. 1197 (May 2006), page 1198.

15 This being a professional practice in which capital is not a material income-producing item, we assume no retained earnings.

16 It is of course possible for an LLC or an LLP to elect classification as an association taxable as a corporation (Reg. 301.7701-3(a)), in which instance it will be subject to Subchapter C, or to elect S corporation status. See also Temp. Reg. 301.7701-3T(c)(1)(v)(C).

possible corporate subchapters of the Code, while the LLC is the model for Subchapter K.[17]

We here compare the after-tax dollars retained by a professional service-provider/owner across the three predominant tax systems, namely Subchapter C, Subchapter S, and Subchapter K. While our ultimate concern is with a "macro" analysis on an operating basis,[18] such analysis must, of course, first take account of the "micro" issues to be considered.

Initially, under both Subchapter K and Subchapter S, absent circumstances not considered here, earnings are not taxable to the business organization.[19] Conversely, in a C corporation, current-year earnings retained are taxable to the entity.[20] Further, in the context of a PSC,[21] all earnings are taxed at a flat rate of 35%.[22] In the C corporation, there exists the greatest flexibility for the organization of benefit plans, the cost of which is not treated as taxable income to the shareholder.

For example, a shareholder in a C corporation may, on a tax-advantaged basis, participate in an employer-maintained Section 125 cafeteria plan. Conversely, partners in a partnership (which would include the members of an LLC taxed under Subchapter K) or shareholders holding 2% or more of an S corporation's stock may not, on a tax-advantaged basis, participate in an employer-maintained cafeteria plan.[23]

Another issue that arises is the degree to which, by characterization of the mechanism by which they are transferred to the owner, particular dollars are or are not subject to either FICA or self-employment taxes. In a C or S corporation, funds distributed as "salary" are subject to FICA[24] while distributions made in the form of "dividends" are not.[25] Conversely, except for those made to "limited partners,"[26] normally all "distributions" made from a trade or business LLC to a member are subject to self-employment taxes.[27]

See also the basic assumptions set forth in the sidebar on page 137.

After-Tax Benefits to Professional Owners

It is always, at best, difficult to compare apples with oranges. Nevertheless, that is one of the tasks that needs to be undertaken in this venture. To the extent that benefits can be acquired on a pre-tax, as contrasted with an after-tax, basis, our owner has benefited.

By way of a simple example, if our owner can divert $100 to a flexible spending account (FSA) and then use those funds to purchase eyeglasses for her son, those $100 glasses have been purchased with pre-tax dollars. Conversely, absent an FSA, our owner will need to earn approximately $166 to generate, on an after-tax basis, the $100 necessary for the purchase of those glasses.[28] In that latter instance, the $66 that has been diverted to satisfaction of a tax liability is not available to be disposed of by the owner for other personal benefit.

Even as the availability of LLCs moved across the country, there rose the effort, initially in Texas, to permit the formation of the LLP.

We will assume on deferrals that an owner is making maximum annual contributions to a Section 401(k) plan with a 50% match of up to 3% of income, as well as a profit sharing contribution. Of the income otherwise distributable to an owner, up to a total of $46,000 has been placed in a profit sharing plan.[29] In addition, in the context of the C corporation, we assume that $4,000[30] is deferred into the FSA part of the cafeteria plan on behalf of our shareholder.[31] In addition, the company is paying her insurance premiums on a pre-tax basis through the cafeteria plan. Consequently, in certain circumstances the nominal $350,000 available for distribution to our owner will be reduced by deductible plan contributions.

The nondiscrimination rules applicable to plans subject to ERISA will affect the net earnings of the venture to a degree greater than just the funds diverted for the benefit of the professional owners. These differentiations must be taken into account in any choice-of-entity analysis.

Different Scenarios Under Subchapter C

With respect to each of our scenarios under Subchapter C, we assume that the company, on a pre-tax basis, has $350,000 that is ultimately available/transferable to our shareholder-

NOTES

17 The LLC analysis set forth herein should be equally applicable to an LLP taxed under Subchapter K.

18 Our analysis does not consider the tax results to an owner on either the redemption of her interest in the business or on the sale of that interest to a third party.

19 See Sections 701 and 1363(a).

20 See Section 11(a).

21 Defined in Section 448(d)(2) as any corporation whose owners provide services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. Pursuant to Rev. Rul. 91-30, 1991-1 CB 61, veterinary practices fall within the scope of Section 448(d)(2).

22 See Section 11(b)(2).

23 Section 125(d)(1)(A); Reg. 1.125-1(g)(2).

24 The FICA tax has two components. Old Age, Survivors, and Disability Insurance (OASDI) is assessed at the rate of 6.2% on the employee and 6.2% on the employer, both subject to an annually adjusted cap ($106,800 for 2009). The Medicare component is 1.45% imposed on the employer and 1.45% imposed on the employee, with no wage cap applicable to either.

25 Section 1402(a)(2). See also Reg. 1.1402(a)-5(a).

26 Section 1402(a)(13).

27 Under the self-employment tax regime, a tax of 12.4% is imposed on distributions, one-half of which is deductible by the member/partner. A Medicare-equivalent tax of 2.9% is likewise imposed, of which one-half is deductible. Reg. 1.1401-1(b). For purposes of the statement made in the text, we assume that, at least in the context here being discussed, it is not possible, with respect to a professional owner/service provider, to characterize her as a "limited partner" and thereby take advantage of Section 1402 and Reg. 1.1402(a)-1, pursuant to which she could receive a guaranteed payment that is subject to self-employment tax and an additional distribution that is itself not subject to such tax. Nevertheless, in certain of the examples discussed in the text, below, with respect to our models under Subchapter K, that we do make exactly that assumption.

28 Assuming an effective tax rate of 40%.

29 Sections 415(a)(1)(B) and (c)(1).

30 This amount will be covered by the limits set out in the plan document.

31 A cafeteria plan also can include other pre-tax benefits such as dependent care (up to $5,000), dental insurance premiums, or certain life insurance premiums.

EXHIBIT 1
Subchapter C Scenarios

		Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Assumptions:						
	Salary / Guaranteed Payment & Other Employment Benefits	0%	25%	50%	75%	100%
	Dividend or Distribution	100%	75%	50%	25%	0%
Entity Level:						
	Gross Revenue	$ 500,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
-	Non Salary Operating Expenses	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)
=	Net Earnings before Salary Related Expenses	$ 350,000	$ 350,000	$ 350,000	$ 350,000	$ 350,000
-	Salary / Guaranteed Payment & Other Employment Benefits:					
	"Net taxable salary"	-	(41,596)	(110,093)	(196,343)	(282,592)
	401(k) Deferrals	-	(15,500)	(15,500)	(15,500)	(15,500)
	Cafeteria Plan (FSA)	-	(4,000)	(4,000)	(4,000)	(4,000)
	Total Gross Salary / Guaranteed Payment	$ -	$ (61,096)	$ (129,593)	$ (215,843)	$ (302,092)
	Other Employment Benefits:					
	FICA Tax Deduction - Soc. Sec.	-	(3,540)	(6,324)	(6,324)	(6,324)
	FICA Tax Deduction - Medicare	-	(828)	(1,821)	(3,072)	(4,322)
	Health Insurance Premiums	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
	401(k) Match (3%)/Profit Sharing Contribution (22% C corp)	-	(15,274)	(30,500)	(30,500)	(30,500)
	Total Other Employment Benefits	(6,762)	(26,404)	(45,407)	(46,657)	(47,908)
	Total Salary / Guaranteed Payment & Other Employment Benefits	(6,762)	(87,500)	(175,000)	(262,500)	(350,000)
=	Entity Level Distributable Federal Taxable Income	343,238	262,500	175,000	87,500	0
X	Highest Entity Level Federal Income Tax Rate	35%	35%	35%	35%	35%
=	Entity Level Federal Income Tax Liability	$ 120,133	$ 91,875	$ 61,250	$ 30,625	$ 0
Individual Level:						
	Tax Liability on Salary / Guaranteed Payments					
+	Net Taxable Salary / Guaranteed Payment	$ -	$ 41,596	$ 110,093	$ 196,343	$ 282,592
-	100% Health Insurance Premiums	-	-	-	-	-
-	50% of Self Employment Tax - Soc. Sec.	-	-	-	-	-
-	50% of Self Employment Tax - Medicare	-	-	-	-	-
=	Taxable Income From Salary / Guaranteed Payment	-	41,596	110,093	196,343	282,592
X	Highest Individual Income Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability On Salary / Guaranteed Payment	$ -	$ 14,559	$ 38,533	$ 68,720	$ 98,907
	Allocation / Distribution of Entity's Income:					
	Profit Allocation / Distribution Received From Entity	$ 343,238	$ 262,500	$ 175,000	$ 87,500	$ -
X	Qualified Dividend Distribution Tax Rate	15%	15%	15%	15%	15%
=	Individual Federal Income Tax Liability From Profit Allocation / Distribution	$ 51,486	$ 39,375	$ 26,250	$ 13,125	$ -
	Employment Taxes:					
+	Self Employment Tax - Soc. Sec (Employer & Employee portions x 0.9235 per limitation)	$ -	$ -	$ -	$ -	$ -
+	Self Employment Tax - Medicare (Employer & Employee portions x 0.9235 per limitation))	-	-	-	-	-
+	Employment Tax - Soc. Sec. (Employer & Employee portions)	-	7,080	12,648	12,648	12,648
+	Employment Tax - Medicare (Employer & Employee portions)	-	1,656	3,642	6,143	8,645
=	Total Employment Tax Liability	$ -	$ 8,736	$ 16,290	$ 18,791	$ 21,293
Total Entity Federal, Individual Federal, and Employment Tax Liability		**$ 171,619**	**$ 154,544**	**$ 142,323**	**$ 131,261**	**$ 120,200**

employee. We consider in Exhibit 1 a variety of scenarios in which those funds will be distributed to the owner as salary, giving rise to a deduction by the company and a reduction in its taxable income,[32] those amounts being subject to FICA,[33] or as dividends, which amounts will not give rise to a deduction by the company (i.e., those amounts will constitute income taxable to the corporation) but which will be exempt from FICA.

Another issue is the degree to which, by characterization of the mechanism by which they are transferred to the owner, particular dollars are subject to FICA or self-employment tax.

Here we must account as well for the different rates that are applicable to salary/ordinary income[34] and dividends.[35] While we do consider here a scenario in which 100% of the available funds will be distributed in the form of salary, with no amounts distributed in the form of a dividend, we by no means suggest that it satisfies the "adequate compensation" requirements under the Code.[36]

In this example, the lowest combined tax liability results when all of the available funds are distributed to the employer in the form of either salary or tax-favored benefit plans. The corporation's tax liability is reduced to zero, there having been no funds retained as earnings. Conversely, where we grossly weight the payments to the shareholder-owner in favor of dividend characterization, not only has the ability to make contributions to a Section 401(k) plan or to receive benefits from a Section 125 cafeteria plan been diminished by reason of the "earned income" limitations,[37] but we have also radically increased the corporation's taxable income, all out of a desire to avoid the FICA tax regime.

Reviewing the possible scenarios under Subchapter C, we see that, notwithstanding the preferential 15% rate applied to dividends received, subjecting those dollars first to a 35% corporate tax rate significantly increases the overall tax exposure. Therefore, on our pro forma analysis, it generally is most tax efficient for our C corporation employee-stockholder to take the entirety of the income allocable to her in the form of salary (and bonus) payments as contrasted with dividends, even though the latter would be exempt from self-employment tax.

Different Scenarios Under Subchapter S

In the context of an S corporation, we must account for the rules of the partial pass-through regime that is Subchapter S. Our professional owner will have ordinary income to the extent of her allocable share of the corporation's earnings. S corporations do not benefit from the preferential rate applied to dividend distributions from a C corporation, so the effective income tax rates on salary and dividends are the same. But while salary is subject to self-employment tax, distributions are not.[38] As such, the total tax on distributions is lower than that on salary. See Exhibit 2.

In contrast with the situation under the C corporation, of all the S corporation examples we have analyzed, it is most efficient (albeit marginally), due to the retirement plan contribution/deduction, to weight the available funds toward dividend distributions and away from salary. As is true with the C corporation examples, it is possible to take the net benefits of the allocation of funds too far in shifting them to distributions rather than salary; the ability to place funds in a Section 401(k) plan has been diminished, as the contribution limits are determined in accordance with earned income.[39]

Furthermore, the long-term viability of the preferential treatment of distributions vis-à-vis salary in S corporations, particularly those rendering professional services, is open to question. Several proposals in Congress have sought to limit that preferential treatment.[40] As such, it is incumbent upon practitioners to continue to track these issues.

The nondiscrimination rules applicable to ERISA plans will affect net earnings to a degree greater than just the funds diverted for the benefit of the professional owners.

That said, the maximum differential of $4,629 between the S corporation scenarios considered, amounting to less than 1.5% of net earnings, is not significant when compared to the far greater differentials that exist in the C corporation scenarios.

Different Scenarios Under Subchapter K

A partnership, as such, is not a taxpayer; rather, tax liability with respect to the operations of the partnership is borne by the partners.[41] Consequently, for federal tax purposes[42] no tax liability is generated at the entity level, and all taxes are paid on the allocable share by the individual partners. This approach applies the aggregate concept of partnerships.[43]

NOTES

32 Section 162(a)(1).

33 See notes 24 through 27, *supra*, and the accompanying text.

34 Sections 1(a)-(d).

35 Section 1(h); 15% for 2008.

36 See generally Moran, 390-4th T.M. (BNA), *Reasonable Compensation*.

37 See, e.g., Section 415(c)(3)(B).

38 Section 1402(a)(2).

39 See note 37, *supra*.

40 See, e.g., Keatinge, "Self-Employment Tax Issues in LLCs Taxed as Partnerships," Suffolk University Law School Legal Studies Research Paper 07-33 (9/18/07); Culpepper, Holo, Keatinge, Lenz, Schippel, Shapack, and Yearout, "Self-Employment Taxes and Pass-through Entities: Where Are We Now?," 109 Tax Notes 211 (10/10/05); 2005 TNT 196-23.

41 Section 701.

42 As noted in the "Assumptions" sidebar, this analysis does not take account of state taxes. Attention is required, however, to such issue, especially in those jurisdictions that impose an entity-level tax on business organizations that, for federal purposes, are taxed as partnerships. For a review of state-level taxes imposed on LLCs and LLPs, see Ely, Grissom, and Thistle, "State Tax Treatment of LLCs and LLPs: Update for 2009," 19 J. Multistate Tax'n 20 (March/April 2009).

43 Section 701; Reg. 1.701-1.

EXHIBIT 2
Subchapter S Scenarios

		Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Assumptions:						
	Salary / Guaranteed Payment & Other Employment Benefits	0%	25%	50%	75%	100%
	Dividend or Distribution	100%	75%	50%	25%	0%
Entity Level:						
	Gross Revenue	$ 500,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
-	Non Salary Operating Expenses	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)
=	Net Earnings before Salary Related Expenses	$ 350,000	$ 350,000	$ 350,000	$ 350,000	$ 350,000
-	Salary / Guaranteed Payment & Other Employment Benefits:					
	"Net taxable salary"	-	(45,365)	(114,036)	(200,285)	(286,534)
	401(k) Deferrals	-	(15,500)	(15,500)	(15,500)	(15,500)
	Cafeteria Plan (FSA)	-	-	-	-	-
	Total Gross Salary / Guaranteed Payment	$ -	$ (60,865)	$ (129,536)	$ (215,785)	$ (302,034)
	Other Employment Benefits:					
	FICA Tax Deduction - Soc. Sec.	-	(3,774)	(6,324)	(6,324)	(6,324)
	FICA Tax Deduction - Medicare	-	(883)	(1,878)	(3,129)	(4,380)
	Health Insurance Premiums (S-Corp W-2)	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
	401(k) Match (3%)/Profit Sharing Contribution (22% S-Corp)	-	(15,216)	(30,500)	(30,500)	(30,500)
	Total Other Employment Benefits	(6,762)	(26,635)	(45,464)	(46,715)	(47,966)
	Total Salary / Guaranteed Payment & Other Employment Benefits	(6,762)	(87,500)	(175,000)	(262,500)	(350,000)
=	Entity Level Distributable Federal Taxable Income	343,238	262,500	175,000	87,500	-
x	Highest Entity Level Federal Income Tax Rate	0%	0%	0%	0%	0%
=	Entity Level Federal Income Tax Liability	$ -	$ -	$ -	$ -	$ -
Individual Level:						
	Tax Liability on Salary					
+	Net Taxable Salary	$ 6,762	$ 52,127	$ 120,798	$ 207,047	$ 293,296
-	100% Health Insurance Premiums	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
-	50% of Self Employment Tax - Soc. Sec.	-	-	-	-	-
-	50% of Self Employment Tax - Medicare	-	-	-	-	-
=	Taxable Income From Salary	-	45,365	114,036	200,285	286,534
x	Highest Individual Income Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability On Salary	$ -	$ 15,878	$ 39,913	$ 70,100	$ 100,287
	Allocation / Distribution of Entity's Income:					
	Profit Allocation / Distribution Received From Entity	$ 343,238	$ 262,500	$ 175,000	$ 87,500	$ -
x	Qualified Dividend Distribution Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability From Profit Allocation / Distribution	$ 120,133	$ 91,875	$ 61,250	$ 30,625	$ -
	Employment Taxes:					
+	Self Employment Tax - Soc. Sec (Employer & Employee portions x 0.9235 per limitation)	$ -	$ -	$ -	$ -	$ -
+	Self Employment Tax - Medicare (Employer & Employee portions x 0.9235 per limitation))	-	-	-	-	-
+	Employment Tax - Soc. Sec. (Employer & Employee portions)	-	7,547	12,648	12,648	12,648
+	Employment Tax - Medicare (Employer & Employee portions)	-	1,765	3,757	6,258	8,759
=	Total Employment Tax Liability	$ -	$ 9,312	$ 16,405	$ 18,906	$ 21,407
Total Entity Federal, Individual Federal, and Employment Tax Liability		**$ 120,133**	**$ 117,065**	**$ 117,567**	**$ 119,631**	**$ 121,694**

Generally speaking, with the exception of distributions to "limited partners," and assuming the allocable item is not generated from an exempt category such as real estate leasing activities,[44] all distributions from a partnership are subject to self-employment tax. There arises, then, the question of who constitutes a "limited partner" in structures that are governed by Subchapter K but which are not organized in the traditional form of a limited partnership.

Despite the preferential 15% rate on dividends, subjecting those dollars first to a 35% corporate tax rate significantly increases the overall tax exposure.

For example, in a manager-managed LLC in which the members, *qua* members, do not have agency authority on behalf of the LLC, and in which the members who are themselves not managers may not owe fiduciary obligations to either their co-owners or the venture,[45] their position is nearly indistinguishable from that of a limited partner in a traditional limited partnership structure. This leads to the question whether distributions made to those persons (other than guaranteed payments) are subject to self-employment tax.

Guaranteed payments (i.e., those determined without regard to partnership income[46]) made to a limited partner for services rendered are subject to self-employment tax.[47] Conversely, distributions to limited partners made with respect to partnership income are not necessarily subject to self-employment tax.[48] While there is no binding authority with respect to when and how such arrangements are appropriate, in certain LLCs—even in the professional context—one member may be designated the "manager" whose distributions will be subject to self-employment tax, while the others will be non-managerial members whose distributions are, arguably, not subject to self-employment tax so long as they are determined with regard to the earnings of the partnership ("scheduled payments").[49]

Accordingly, in our scenarios under Subchapter K, we provide an example in which, with respect to a presumed non-manager member in a professional LLC, a portion of the distributions made are in the form of payments that are not guaranteed[50] and therefore do not fall within the scope of Section 1402(a)(13).[51] See Exhibits 3 (member as manager) and 4 (non-manager member).

In prior years, issues also arose in using partnerships for professional practices by reason of limitations on retirement savings plans and the deductibility of premiums paid for health insurance. Fortunately, as of today, these distinctions have been substantially eliminated. For example, health insurance premiums are fully deductible by either a corporate payor[52] or by an individual partner.[53] Nevertheless, distinctions remain under cafeteria plans.[54]

The question is who is a 'limited partner' in structures governed by Subchapter K but not organized in the traditional form of a limited partnership.

Under Subchapter K, of the ten scenarios we have modeled, the lowest net tax liability arises from a balanced allocation of available funds to guaranteed payments and distributions.

COMPARISON OF VARIOUS SCENARIOS

Once we appreciate that the treatment of the net $350,000 to be distributed to our professional owner differs under the various Code subchapters, we can compare the most efficient form of organization from each of those subchapters. This comparison is presented in Exhibit 5. The entity's initial owners must determine the degree to which the resulting differences are material and need to be weighed against other factors such as the certainty associated with a PSC compared to the flexibility of an LLC.

Practice Notes

Among the many subjective and objective factors that go into a choice-of-entity analysis, federal income taxation may be the least subjective and most quantifiable. Practitioners must be careful, however, to ensure that tax modeling employs the appropriate assumptions, that possible changes in the law are taken into account where appropriate, and that the unique characteristics of any particular type of venture are reflected.

In reviewing the optimal outcome of our three models of Subchapter C, Subchapter S, and Subchapter K, we see that the comparison among them does not yield a material distinction as to ultimate tax liability and, conversely, funds available to our professional owner. The maximum differential of $3,135 (the difference between the Subchapter C total of $120,200 and the Subchapter S total of $117,065) is less than 1% of the $350,000 with which our analysis began.

The marginal tax rate under our highest tax C corporation scenario was 34.34%, while that for our low-

NOTES

44 Section 1402(a)(1); Reg. 1.1402(a)-4.

45 See, e.g., Ky. Rev. Stat. Ann. section 275.170(4).

46 See Section 707(c).

47 Section 1402(a)(13); Reg. 1402(a)-1(b).

48 Note that "limited partner" is not defined in the Code. See also Ltr. Rul. 9110003.

49 Reg. 1.1402(a)-2(b).

50 As such, the payments are with regard to partnership income. Contrast Section 707(c).

51 This position, while supportable under current law, is under review by the Service and likely would fail upon an implementation of the 1997 proposed amendments to the Section 1402 Regulations (REG-209824-96, 1/10/97). See Levine and Paul, "IRS Shifts Focus With Controversial New SE Tax Proposed Regulations," 86 JTAX 325 (June 1997).

52 Section 162.

53 Section 162(l).

54 Section 125(d)(1)(A).

EXHIBIT 3
Subchapter K—Member as Manager

		Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Assumptions:						
	Salary / Guaranteed Payment & Other Employment Benefits	0%	25%	50%	75%	100%
	Dividend or Distribution	100%	75%	50%	25%	0%
Entity Level:						
	Gross Revenue	$ 500,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
-	Non Salary Operating Expenses	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)
=	Net Earnings before Salary Related Expenses	$ 350,000	$ 350,000	$ 350,000	$ 350,000	$ 350,000
-	Salary / Guaranteed Payment & Other Employment Benefits:					
	"Net taxable salary"	-	(34,738)	(122,238)	(209,738)	(297,238)
	401(k) Deferrals	-	(15,500)	(15,500)	(15,500)	(15,500)
	Cafeteria Plan (FSA)	-	-	-	-	-
	Total Gross Salary / Guaranteed Payment	$ -	$ (50,238)	$ (137,738)	$ (225,238)	$ (312,738)
	Other Employment Benefits:					
	FICA Tax Deduction - Soc. Sec.	-	-	-	-	-
	FICA Tax Deduction - Medicare	-	-	-	-	-
	Health Insurance Premiums (Guaranteed Payments)	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
	401(k) Match (3%)/Profit Sharing Contribution (17% Partnership)	-	(30,500)	(30,500)	(30,500)	(30,500)
	Total Other Employment Benefits	(6,762)	(37,262)	(37,262)	(37,262)	(37,262)
	Guaranteed Payment & Other Employment Benefits	(6,762)	(87,500)	(175,000)	(262,500)	(350,000)
=	Entity Level Distributable Federal Taxable Income	343,238	262,500	175,000	87,500	-
x	Highest Entity Level Federal Income Tax Rate	0%	0%	0%	0%	0%
=	Entity Level Federal Income Tax Liability	$ -	$ -	$ -	$ -	$ -
Individual Level:						
	Tax Liability on Guaranteed Payments					
+	Guaranteed Payment	$ 6,762	$ 41,500	$ 129,000	$ 216,500	$ 304,000
-	100% Health Insurance Premiums	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
-	50% of Self Employment Tax - Soc. Sec.	(6,324)	(6,324)	(6,324)	(6,324)	(6,324)
-	50% of Self Employment Tax - Medicare	(5,075)	(5,075)	(5,075)	(5,075)	(5,075)
=	Taxable Income From Guaranteed Payment	(11,399)	23,339	110,839	198,339	285,839
x	Highest Individual Income Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability On Salary / Guaranteed Payment	$ (3,990)	$ 8,169	$ 38,794	$ 69,419	$ 100,044
	Allocation / Distribution of Entity's Income:					
	Profit Allocation / Distribution Received From Entity	$ 343,238	$ 262,500	$ 175,000	$ 87,500	$ -
x	Qualified Dividend Distribution Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability From Profit Allocation / Distribution	$ 120,133	$ 91,875	$ 61,250	$ 30,625	$ -
	Employment Taxes:					
+	Self Employment Tax - Soc. Sec (Employer & Employee portions x 0.9235 per limitation)	$ 12,648	$ 12,648	$ 12,648	$ 12,648	$ 12,648
+	Self Employment Tax - Medicare (Employer & Employee portions x 0.9235 per limitation))	9,374	9,374	9,374	9,374	9,374
+	Employment Tax - Soc. Sec. (Employer & Employee portions)	-	-	-	-	-
+	Employment Tax - Medicare (Employer & Employee portions)	-	-	-	-	-
=	Total Employment Tax Liability	$ 22,022	$ 22,022	$ 22,022	$ 22,022	$ 22,022
Total Entity Federal, Individual Federal, and Employment Tax Liability		**$ 138,165**	**$ 122,065**	**$ 122,065**	**$ 122,065**	**$ 122,065**

EXHIBIT 4
Subchapter K—Non-Manager Member

		Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Assumptions:						
	Salary / Guaranteed Payment & Other Employment Benefits	0%	25%	50%	75%	100%
	Dividend or Distribution	100%	75%	50%	25%	0%
Entity Level:						
	Gross Revenue	$ 500,000	$ 500,000	$ 500,000	$ 500,000	$ 500,000
-	Non Salary Operating Expenses	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)
=	Net Earnings before Salary Related Expenses	$ 350,000	$ 350,000	$ 350,000	$ 350,000	$ 350,000
-	Salary / Guaranteed Payment & Other Employment Benefits:					
	"Net taxable salary"	-	(50,655)	(123,571)	(209,738)	(297,238)
	401(k) Deferrals	-	(15,500)	(15,500)	(15,500)	(15,500)
	Cafeteria Plan (FSA)	-	-	-	-	-
	Total Gross Salary / Guaranteed Payment	$ -	$ (66,155)	$ (139,071)	$ (225,238)	$ (312,738)
	Other Employment Benefits:					
	FICA Tax Deduction - Soc. Sec.	-	-	-	-	-
	FICA Tax Deduction - Medicare	-	-	-	-	-
	Health Insurance Premiums (Guaranteed Payments)	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
	401(k) Match (3%)/Profit Sharing Contribution (17% Partnership)	-	(14,583)	(29,167)	(30,500)	(30,500)
	Total Other Employment Benefits	(6,762)	(21,345)	(35,929)	(37,262)	(37,262)
	Guaranteed Payment & Other Employment Benefits	(6,762)	(87,500)	(175,000)	(262,500)	(350,000)
=	Entity Level Distributable Federal Taxable Income	343,238	262,500	175,000	87,500	-
x	Highest Entity Level Federal Income Tax Rate	0%	0%	0%	0%	0%
=	Entity Level Federal Income Tax Liability	$ -	$ -	$ -	$ -	$ -
Individual Level:						
	Tax Liability on Guaranteed Payments					
+	Guaranteed Payment	$ 6,762	$ 57,417	$ 130,333	$ 216,500	$ 304,000
-	100% Health Insurance Premiums	(6,762)	(6,762)	(6,762)	(6,762)	(6,762)
-	50% of Self Employment Tax - Soc. Sec.	(419)	(5,425)	(6,324)	(6,324)	(6,324)
-	50% of Self Employment Tax - Medicare	(98)	(1,269)	(2,537)	(3,806)	(5,075)
=	Taxable Income From Guaranteed Payment	(517)	43,961	114,710	199,608	285,839
x	Highest Individual Income Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability On Salary / Guaranteed Payment	$ (181)	$ 15,386	$ 40,148	$ 69,863	$ 100,044
	Allocation / Distribution of Entity's Income:					
	Profit Allocation / Distribution Received From Entity	$ 343,238	$ 262,500	$ 175,000	$ 87,500	$ -
x	Qualified Dividend Distribution Tax Rate	35%	35%	35%	35%	35%
=	Individual Federal Income Tax Liability From Profit Allocation / Distribution	$ 120,133	$ 91,875	$ 61,250	$ 30,625	$ -
	Employment Taxes:					
+	Self Employment Tax - Soc. Sec (Employer & Employee portions x 0.9235 per limitation)	$ 774	$ 10,020	$ 12,648	$ 12,648	$ 12,648
+	Self Employment Tax - Medicare (Employer & Employee portions x 0.9235 per limitation))	181	2,343	4,687	7,030	9,374
+	Employment Tax - Soc. Sec. (Employer & Employee portions)	-	-	-	-	-
+	Employment Tax - Medicare (Employer & Employee portions)	-	-	-	-	-
=	Total Employment Tax Liability	$ 955	$ 12,363	$ 17,335	$ 19,678	$ 22,022
Total Entity Federal, Individual Federal, and Employment Tax Liability		**$ 120,908**	**$ 119,625**	**$ 118,733**	**$ 120,166**	**$ 122,065**

EXHIBIT 5
Comparison of Results

		C Corp	S Corp	Non-Manager Member Partnership
Assumptions:				
	Salary / Guaranteed Payment & Other Employment Benefits	100%	25%	50%
	Dividend or Distribution	0%	75%	50%
Entity Level:				
	Gross Revenue	$ 500,000	$ 500,000	$ 500,000
-	Non Salary Operating Expenses	(150,000)	(150,000)	(150,000)
=	Net Earnings before Salary Related Expenses	$ 350,000	$ 350,000	$ 350,000
-	Salary / Guaranteed Payment & Other Employment Benefits:			
	"Net taxable salary"	(282,592)	(45,365)	(123,571)
	401(k) Deferrals	(15,500)	(15,500)	(15,500)
	Cafeteria Plan (FSA)	(4,000)	-	-
	Total Gross Salary / Guaranteed Payment	$ (302,092)	$ (60,865)	$ (139,071)
	Other Employment Benefits:			
	FICA Tax Deduction - Soc. Sec.	(6,324)	(3,774)	-
	FICA Tax Deduction - Medicare	(4,322)	(883)	-
	Health Insurance Premiums	(6,762)	(6,762)	(6,762)
	401(k) Match (3%)/Profit Sharing Contribution (22% C corp/S corp; 17% Partnership)	(30,500)	(15,216)	(29,167)
	Total Other Employment Benefits	(47,908)	(26,635)	(35,929)
	Total Salary / Guaranteed Payment & Other Employment Benefits	(350,000)	(87,500)	(175,000)
=	Entity Level Distributable Federal Taxable Income	-	262,500	175,000
x	Highest Entity Level Federal Income Tax Rate	35%	0%	0%
=	Entity Level Federal Income Tax Liability	$ -	$ -	$ -
Individual Level:				
	Tax Liability on Salary / Guaranteed Payments			
+	Net Taxable Salary / Guaranteed Payment	$ 282,592	$ 52,127	$ 130,333
-	100% Health Insurance Premiums	-	(6,762)	(6,762)
-	50% of Self Employment Tax - Soc. Sec.	-	-	(6,324)
-	50% of Self Employment Tax - Medicare	-	-	(2,537)
=	Taxable Income From Salary / Guaranteed Payment	282,592	45,365	114,710
x	Highest Individual Income Tax Rate	35%	35%	35%
=	Individual Federal Income Tax Liability On Salary / Guaranteed Payment	$ 98,907	$ 15,878	$ 40,148
	Allocation / Distribution of Entity's Income:			
	Profit Allocation / Distribution Received From Entity	$ -	$ 262,500	$ 175,000
x	Qualified Dividend Distribution Tax Rate	15%	35%	35%
=	Individual Federal Income Tax Liability From Profit Allocation / Distribution	$ -	$ 91,875	$ 61,250
	Employment Taxes:			
+	Self Employment Tax - Soc. Sec (Employer & Employee portions x 0.9235 per limitation)	$ -	$ -	$ 12,648
+	Self Employment Tax - Medicare (Employer & Employee portions x 0.9235 per limitation))	-	-	4,687
+	Employment Tax - Soc. Sec. (Employer & Employee portions)	12,648	7,547	-
+	Employment Tax - Medicare (Employer & Employee portions)	8,645	1,765	-
=	Total Employment Tax Liability	$ 21,293	$ 9,312	$ 17,335
Total Entity Federal, Individual Federal, and Employment Tax Liability		**$ 120,200**	**$ 117,065**	**$ 118,733**

est S corporation scenario was 33.44%—a nine-tenths of one percentage point differential. On a pro forma basis, that is a slim reason to make a choice-of-entity determination. Rather, taking account of the different options available between the various subchapters and using the opportunities each presents, for all intents and purposes the ultimate tax burden under Subchapters C, S, and K can be leveled, leaving the choice-of-entity calculus to focus on distinctions between organizational forms under state law.

CONCLUSION

Choice of entity is a complicated question that requires the assessment and weighting of a wide variety of factors including, but in no manner limited to, tax treatment. Others of those factors include the mechanisms desired for decision-making and desired apparent agency structure,[55] capital lock-in or a desire for liquidity in the venture,[56] and the free transferability of interests in the venture or, by contrast, a rule of "pick your partner."[57] Those other factors, as between forms of organization, are relative to one another, providing more or less of a particular characteristic. By contrast, tax treatment is—at least pro forma—subject to quantification and comparison on an absolute basis. Likely such quantification is too seldom done.

We have here limited our analysis to a hypothetical fact situation. The conclusions reached herein cannot be applied to a different fact situation such as a real estate development venture involving, by way of example, a finance provider, a realty provider, and a developer who is receiving an incentive interest in return for the provision of development services. Further, our fact situation is rather static; we assume a stable, professional practice that is profitable without alterations in ownership.

The relative certainty of the rules governing a PSC will have to be weighed against the flexibility available in the LLC form.

Many start-up ventures incur losses that are supported by debt financing. In the context of an S corporation, failing to properly structure that debt as a personal obligation of the shareholder, rather than initially an obligation of the business organization that is in turn guaranteed by the shareholder, limits the deductibility of losses as the latter structure does not create at-risk basis. Conversely, in an LLC taxed as a partnership, a guarantee of the debt undertaken by the business organization is sufficient to create at-risk basis against which losses may be taken.[58] Additionally, in the context of an organization taxed under Subchapter K, Section 754 presents planning opportunities with respect to basis step-ups on transfers of ownership interests, an opportunity that does not exist with either the C or the S corporation.

These and many other considerations of this nature need to be taken into account in the choice-of-entity calculus. Still, the type of pro forma modeling done here may and should be employed irrespective of the nature of the venture. ■

NOTES

55 See, e.g., Rutledge, "The Lost Distinction Between Agency and Decisional Authority: Unfortunate Consequences of the Member-Managed versus Manager-Managed Distinction in the Limited Liability Company," 93 Ky. L. J. 737 (2004-05); Rutledge and Frost, "RULLCA Section 301—The Fortunate Consequences (and Continuing Questions) of Distinguishing Apparent Agency and Decisional Authority," 64 Bus. Law. 37 (2008).

56 See, e.g., Stout, "On the Nature of Corporations," 2005 U. Ill. L. Rev. 253. Practitioners need to recognize that individual characteristics may, in the same form of organization, be different between various states. For example, in the LLC, capital lock-in exists in LLCs organized in Virginia (Va. Code Ann. section 13.1-1040.2) but not those organized in Delaware (Del Code Ann. tit. 6, section 18-604).

57 See, e.g., RUPA section 401(i) (a person may become a partner only with the consent of all incumbent partners); Ky. Rev. Stat. Ann. section 275.275(1)(a) (a person acquiring an interest from an LLC is admitted as a member on the consent of all incumbent members).

58 See Melvin, 88 TC 63 (1987). But see Prop. Reg. 1.465-16.