The New Limited Liability Company in Florida

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Effective July 1, 1998, the Florida Legislature repealed the imposition of the 5.5 percent Florida corporate income tax on a limited liability company (LLC) which is structured as a partnership or an entity, which is not recognized as separate from its owner for federal income tax purposes. The repeal of this tax causes practitioners to re-evaluate the choice of entity recommended to their clients. The purpose of this article is to summarize the legislative process that resulted in the repeal of the Florida corporate income tax imposed on LLCs and to analyze some of the benefits and costs of the LLC compared with a limited partnership and a corporation electing Subchapter S status under the Internal Revenue Code of 1986, as amended (the I.R.C.).

The Legislative Process

Senate Bill 704/House Bill 1049 (1998). Senate Bill 704 (S 704), as enacted in May 1998, was the culmination of an intensive effort to eliminate the Florida corporate income tax on LLCs. Senator Ron Klein was the principal sponsor of S 704. Representative Lacasa was the principal sponsor of similar legislation under House Bill 1049, which was ultimately replaced by S 704. S 704 became law on May 22, 1998.

S 704 originally was drafted solely to eliminate the Florida corporate income taxes imposed against limited liability companies with two or more members. However, due to its momentum and likelihood of success in the final week of the 1998 Session, S 704 was amended to provide for the following:

- Single member LLCs;
- Elimination of the Florida corporate income tax on Qualified Subchapter S corporation (QSubs or QSSS);
- Allow LLCs to include "L.L.C." or "Limited Liability Company" in lieu of "L.C." or "Limited Company";
- Ability of partnerships to merge with corporations, partnerships, LLCs, and other entities;
- Ability of LLCs to merge with corporations, partnerships, LLCs, and other entities; and
- Ability of corporations to merge with partnerships, LLCs, and other entities (note that corporations already had the ability to merge with other corporations).

> This article compares the benefits and detriments of a limited liability company to a limited partnership and a corporation that elects to be taxed as a Subchapter S corporation.

Senate Bill 1696/House Bill 1513 (1999). During the 1999 Florida legislative session, Senate Bill 1696, also sponsored by Senator Klein, was proposed to substantially modify Chapter 608 to make the Florida Limited Liability Company Act more comparable to Delaware law. Senate Bill 1696 was combined with House Bill 1513, which was sponsored by Representatives Sanderson and Bloom, and became law in May 1999. Its effective date is October 1, 1999.

This law revises numerous glitches in the Florida Limited Liability Company Act. For entity selection purposes, the benefits of this law are:

- The term of the LLC may be perpetual;
- An LLC is less likely to dissolve because the death, retirement, resignation, expulsion, bankruptcy, or dissolution of a member of an LLC that continues to have at least one member will not cause a dissolution of the LLC whereas the occurrence of any such event by a general partner of a Florida limited partnership would likely cause a dissolution of the partnership for estate and gift tax purposes;
- No member of an LLC will have the right to withdraw from an LLC unless otherwise provided in the articles of organization or operating agreement as is similar with a limited partner of a Florida limited partnership; and
- Managers and managing members now will owe a fiduciary duty to other members as is similar with general partners of a Florida general or limited partnership to allow

a gift of a membership interest to qualify for the annual tax exclusion under I.R.C. §2503(b).[1]

Comparison of an LLC with a Limited Partnership

Benefits of an LLC over a Limited Partnership

• *One-Member LLC.* Due to the revisions under S 704, an LLC created under F.S. Ch. 608 may have one or more members.[2] However, a limited partnership created under F.S. Ch. 620 must have at least two partners.[3] The ability to create an LLC with only one member provides additional flexibility and more simplicity over a partnership.

• *Taxation Simplicity.* Under the "check-the-box" regulations,[4] any eligible entity can elect to be taxed for federal income tax purposes as a partnership, an association (*i.e.*, a corporation) or disregarded as an entity separate from its owner. An eligible entity includes any entity which is not defined as a corporation.[5] The definition of a "corporation" includes, among other things, any business entity organized under a federal or state statute if the statute describes or refers to the entity as incorporated or as a corporation, body corporate or body politic.[6] Therefore, an entity created under F.S. Ch. 607 or 617 cannot choose its method of federal income taxation because it is not an eligible entity. However, an LLC created under F.S. Ch. 608 and a partnership created under F.S. Ch. 620 both are eligible entities and can elect the method of federal income taxation.

If an LLC has only one member, it may choose either to be disregarded as an entity separate from its owner for federal income tax purposes or to be taxed as a corporation.[7] In the absence of an election, a domestic[8] eligible entity with a single member will be taxed as an entity is disregarded as an entity separate from its owner.[9] An LLC and a partnership with two or more members, respectively, may choose either to be taxed as a partnership or a corporation for federal income tax purposes.[10] In the absence of an election, a domestic eligible entity with two or more owners will be taxed as a partnership under Subchapter K of the I.R.C.[11]

Based on the foregoing rules, an LLC can be structured for federal income tax purposes either as 1) an entity disregarded from its owner, 2) a partnership under Subchapter K of the I.R.C., or 3) a corporation taxable under either Subchapter C or Subchapter S of the I.R.C. On the contrary, a partnership cannot be structured as an entity disregarded from its owners. By being an entity that is disregarded from its owner, such entity can avoid the complexities and expenses attributable to (x) entities taxable under Subchapters K, C, and S of the I.R.C., (y) the filing of a separate federal income tax return, and (z) the requirement to maintain books and records separate from the owner.

• *Limited Liability.* A limited partnership must have a general partner.[12] A general partner has unlimited liability for all debts and liabilities of the limited partnership which accrue while that person is a general partner of the partnership.[13] By contrast, no member of an LLC has liability for the debts and liabilities of the LLC other than to the extent of such member's capital contribution to the LLC.[14] A limited partnership limits this liability exposure by creating a "shell" corporation.[15] However, a limited partnership with a corporate general partner will file additional tax returns, maintain additional books and records and comply with the corporate formalities (*e.g.*, resolutions for shareholders and directors for the corporate general partner) and perhaps have a shareholders' agreement.

There is also potential liability exposure for limited partners of a partnership. Generally, the liability of a limited partner of a partnership is limited to that partner's capital contribution to the partnership.[16] However, if a limited partner becomes actively involved in the management of the partnership, that

limited partner could be deemed to be a general partner and become subject to the liabilities of a general partner of that partnership.[17] A limited partner may still be actively involved in the management of a partnership and attempt to limit this liability exposure if the limited partner serves as an officer of the corporate general partner. A limited partner generally will not be deemed to participate in the control of the business merely by being an officer, director, or shareholder of a corporate general partner of a limited partnership.[18] Notwithstanding such precautions, the limited partner actively involved in the management of the partnership under such structure could still have liability if the partnership's creditor pierced the corporate veil of the corporate general partner or if the limited partner failed to designate his status as an officer of the corporate general partner.

• *Reduced Professional Fees.* The legal costs in organizing a limited partnership should be greater than the legal costs in organizing an LLC because of the need to prepare and, where applicable, file: 1) a certificate of limited partnership for the limited partnership (together with an affidavit of capital contribution and acceptance of registered agent); 2) a limited partnership agreement; 3) articles of incorporation for the corporate general partner (together with an acceptance of registered agent); 4) bylaws for the corporate general partner; 5) a shareholders' agreement for the shareholders of the corporate general partner; 6) a Form SS-4 for both the partnership and the corporate general partner; and 7) a Form 2553 for the Subchapter S election by the corporate general partner. With respect to an LLC, the practitioner will prepare and, where applicable, file: a) articles of organization (together with an acceptance as registered agent); b) the operating agreement of the LLC (a combination of a partnership agreement and corporate bylaws); and c) a Form SS-4 for the LLC. In addition, ongoing administrative, accounting, legal, and tax preparation costs for the LLC should be lower because there is only one entity to maintain compared to a limited partnership and a corporate general partner in which there are two entities to maintain.

• *Reduced Organizational Fee and Annual Maintenance Fee.* The maximum fee to organize a limited partnership with a corporate general partner is $1,855.[19] The fee to organize an LLC is $125.[20] The combined maximum annual franchise fee of a limited partnership and corporate general partner is $676.25. The annual franchise fee of an LLC is $138.75.[21] Therefore, the organizational fee and annual maintenance fee of an LLC are less than the comparable fees for a limited partnership with a corporate general partner.

Increased Basis to Members. Under I.R.C. §752, liabilities of the LLC will generally be treated as nonrecourse indebtedness to its members because each member's liability is limited under F.S. §608.436. A nonrecourse liability is defined as a partnership liability to the extent that no partner or related person bears the economic risk of loss for that liability.[22] Nonrecourse liabilities are allocated first to a partner/member equal to his or her share of partnership minimum gain determined in accordance with special allocation rules under Treas. Reg. 211.704-2(d)(1); next to a partner/member equal to his or her built-in gain in the property contributed to the limited partnership or LLC under I.R.C. §704(c) (*i.e.*, the excess of the fair market value of the property at the time of contribution and the partnership/LLC's basis in the contributed property immediately after the contribution); and finally to each partner/member in accordance with his or her share of the profits of the limited partnership or LLC.[23] By comparison, only nonrecourse loans made to a limited partnership will be allocated as nonrecourse liabilities under I.R.C. §752. All other liabilities of the limited partnership will be "recourse liabilities" because of the unlimited liability of a general partner of a limited partnership under F.S. §620.125(2). Recourse liabilities are allocated to the partner that bears such risk of loss.[24] Therefore, with respect to a limited partnership, liabilities other than nonrecourse liabilities generally will be allocated initially to each limited partner to the extent of his positive capital account balance and any excess liabilities will be allocated to the corporate general partner of the limited partnership.[25]

The allocation of liabilities to the members of an LLC or the limited partners of a limited partnership is of great importance. Under I.R.C. §752(a), if liabilities are allocated to a member or limited partner, such member or limited partner is deemed to have contributed cash to the LLC or limited partnership equal to the amount of the allocated liabilities. This deemed contribution increases the member or limited partner's basis in his membership or partnership interest under I.R.C. §722 and increases the member or limited partner's distributive share of losses allocated from the LLC or limited partnership under I.R.C. §704(d). Because all liabilities to an LLC, absent a guaranty by a member, are treated as "nonrecourse liabilities," each member generally will receive a pro rata share of the accounts payable and other liabilities of the LLC and thereby increase the amount of distributable losses to each member under I.R.C. §704(d). This increase in basis also allows for additional distributions of cash to be made from the LLC to its members without being subject to any income tax under I.R.C. §731(a)(1). By contrast, these liabilities generally will not be allocated to the limited partners in excess of their capital account and therefore will not increase the amount of distributable losses to each limited partner under I.R.C. §704(d).

• *Passive Losses and Material Participation.* I.R.C. §469 disallows a deduction for the passive activity loss of an individual, trust, estate, personal service corporation and closely held C corporation.[26] A passive activity loss generally is the amount by which the passive activity deductions for the taxable year

exceed the passive activity gross income for the year.[27] A passive activity means any rental activity and any activity that involves the conduct of a trade or business and which the taxpayer does not *materially participate*.[28] An individual generally is treated as materially participating in the activity for the taxable year if he satisfies any of the following seven tests set forth under Temp. Reg. §1.469-5T(a):

a) The individual participates for more than 500 hours;

b) The individual's participation constitutes substantially all of the participation of all individuals;

c) The individual participates for more than 100 hours, and that participation is not less than that of any other individual;

d) The activity is a significant participation activity and the individual's aggregate participation in all other significant participation activities exceeds 500 hours;

e) The individual materially participated for any five taxable years during the 10 immediately preceding taxable years;

f) The activity is a personal service activity and the individual materially participated for any three preceding taxable years; or

g) Based on all of the facts and circumstances, the individual participates on a regular, continuous, and substantial basis.

A limited partner is deemed to materially participate only by qualifying under tests a), e), or f) above.[29] By contrast, a partner in a general partnership or a shareholder in an S corporation may satisfy any of the seven tests in order to materially participate in such activity. A "limited partner" is an individual whose liability for obligations of the partnership is limited to a determinable fixed amount under the law of the state in which the partnership is organized, such as capital contributions and contractual obligations to make additional capital contributions.[30] The Internal Revenue Service (IRS) has not addressed whether a member of an LLC should be treated as a limited partner, a general partner, or a shareholder in a S corporation. Due to the similarities in the definition of a limited partner to a member in an LLC, it is likely that a member must satisfy either tests a), e), or f) in order to materially participate in such activity. However, it may be argued that 1) a manager-member should be treated like a general partner and be allowed to satisfy any of the seven tests in order to materially participate in such activity, and 2) a nonmanaging member should be treated like a shareholder in an S corporation and be allowed to satisfy any one of the seven tests in order to materially participate in such activity.[31] Therefore, if a practitioner wants to avoid the automatic presumption of no material participation as a limited partner, he should consider using an LLC managed by its members.

Benefits of a Limited Partnership over an LLC

- *No Florida Annual Intangible Tax.* Florida imposes an annual state intangible tax based on the value of an intangible asset held by a Florida resident on January 1 of each year.[32] The Florida Department of Revenue has determined that an interest in an LLC is subject to state intangible taxes.[33] However, an interest in a limited partnership that is not publicly traded is not subject to the state intangible tax.[34] The intangible tax rate is approximately $1.50 per $1,000 of value.[35] For example, if a member's interest in an LLC was valued at $100,000 on January 1, 2000, his intangible tax with respect to such interest for 1999 would be $150.[36] Due to this tax on LLCs, many practitioners should consider recommending using limited partnerships in lieu of LLCs if the entity will own or it is anticipated to own significant equity (*e.g.*, a family limited partnership holding marketable securities or a real estate development with significant equity).
- *Self-Employment Taxes.* Under I.R.C. §1401, self-employment income is taxed at the rate of 15.3 per-

cent on the first $68,400 of such income and 2.9 percent on such income in excess of $68,400. Under I.R.C. §1402(b), "self-employment income" is defined generally as net earnings from self-employment minus the wages paid to such individual during such taxable year. Under I.R.C. §1402(a), "net earnings from self-employment" includes a partner or member's distributive share of income which is not separately stated under I.R.C. §702(a) and which is derived from a trade or business carried on by the partnership or LLC (whether or not such income is distributed to the partner or member). Under I.R.C. §1402(a)(13), the distributive share of income or loss from a limited partnership to a limited partner is generally excluded from the definition of net earnings from self-employment income. The IRS has informally taken the position that this exclusion is not applicable to a member's distributive share of income or loss from an LLC.[37] This position is clearly contradictory to the definition of a limited partner under Temp. Treas. Reg. §1.469-5T(e)(3)(i)(B), and a member would have a strong argument to support the exclusion of his distributive share of income or loss from an LLC from the imposition of self-employment income taxes. However, this issue remains unresolved.

Comparison of an LLC with a Subchapter S Corporation

Benefits of an LLC over a Subchapter S Corporation

• *Asset Protection.* A creditor's right against a member's interest in an LLC is limited to a charging order.[38] The creditor with the charging order only has the rights of an assignee of an interest in the LLC. An assignee of an interest in an LLC is entitled to share in the profits and losses of the LLC, to receive distributions from the LLC, and to receive such allocation of income, gain, loss, deduction, or credit of the LLC to which the assignor was entitled, to the extent of the interest so assigned.[39] An interest in an LLC is not assignable in whole or in part, unless a majority of the nonassigning members (voting per capita unless otherwise provided in the articles of organization or regulations of the LLC) approve such assignment.[40] The assignee is not entitled to the rights of the assigning member and the assignment does not dissolve the LLC.[41] Upon the assignment, the member ceases to be a member or have any rights or powers as a member.[42] An assignee of an interest in the LLC may only become a member of the LLC upon the consent of all other members of the LLC.[43] Similarly, F.S. §608.4232 provides that no person may become a member of the LLC unless each member consents in writing to the admission.

By contrast, there are no similar statutory provisions under F.S. Ch. 607 which prohibit the assignment of a shareholder's stock in a corporation or its levy and execution by a creditor of such shareholder. Although such assignment is restricted under F.S. §621.09 for professional associations, there is judicial precedent in which a creditor's right to levy and execute against stock in a professional association is superior to F.S. §621.09.[44] Finally, as discussed below, there are restrictions on the type of persons or entities that may own stock in an S corporation. If a corporate creditor levies and executes against the stock of a shareholder in an S corporation, the ownership of such stock by the corporate creditor can terminate the Subchapter S status of such corporation which could materially adversely affect the tax consequences to the remaining shareholders of such corporation.

• *Special Allocation of Profits.* S corporations may only have one class of stock that is determined based on the timing and amount of distributions made to the shareholder.[45] With an LLC, profits may be specially allocated among the members provided such allocation satisfies the substantial economic effect tests promulgated under Treas. Reg. §1.704(b).

• *Flow-through of Losses.* Although the losses of an S corporation flow through to a shareholder as is similar with the losses of an LLC flowing through to its members, such losses are limited to the shareholder's basis in his stock in the S corporation.[46] Unlike an LLC, a shareholder's basis for purposes of allocating loss is *not* increased by the debts of the entity (other than loans which are made by such shareholder and funded to the corporation) or such shareholder's guaranty of the entity's debts.[47]

• *Contribution and Disengagement.* There generally is no gain or loss to the member or the LLC upon the contribution of property by such member to the LLC.[48] By contrast, contributions by shareholders owning less than 80 percent of the equity interest in an S corporation may be taxable.[49]

If an LLC repurchases a member's interest, this redemption will result in ordinary income to the extent of that member's interest in the LLC's receivables and capital gain or loss with respect to the other amounts realized upon the redemption compared to that member's basis in the LLC.[50] The entity may then elect to increase its basis in its receivables and tangible assets for the benefit of the remaining members to the extent that the retiring member recognizes ordinary income or capital gains from such redemption.[51] By contrast, there is no benefit to the remaining shareholders of an S corporation upon the redemption of the stock of a retiring shareholder.

• *Death.* If any person acquires stock in an S corporation by reason of death of a decedent or by bequest, devise, or inheritance, I.R.C. §691 requires the recipient to recognize as "income in respect of a decedent" any item of income of an S corporation for which the decedent would have otherwise recognized.[52] This rule is broader than the judicially created rule requiring the recipient of a decedent's member interest in an LLC to recognize "income in respect of a decedent" only as to handling zero-based accounts receivable owned by the LLC.

• *Unwinding of the Entity.* A member seeking to leave the LLC and who receives a disposition of prop-

erty from the LLC generally does not recognize any gain nor does the LLC recognize any gain under I.R.C. §731(b). By contrast, the distribution of appreciated property results in a gain to the S corporation under either I.R.C. §311(b) or 336 and may result in a gain to the shareholder if the amount received from the corporation exceeds the basis in his stock.

• *Restriction on Shareholders.* An S corporation may have no more than 75 shareholders.[53] Only individuals and very limited types of trusts may be shareholders. Nonresident aliens may not be shareholders. There may be only one class of stock. Other than certain special purpose trusts, only a grantor trust, a Qualified Subchapter S Trust (QSST) or an Electing Small Business Trust (ESBT) may be a Subchapter S shareholder. In addition to many other restrictions, a QSST must distribute all of its income currently to one individual, thus eliminating the ability of the trustee to accumulate income for the benefit of minors or incapacitated persons.[54] An ESBT is taxed at the highest income tax rate. None of these rules is applicable to an LLC.

• *I.R.C. §754 Election.* If a third party purchases an LLC interest that is taxable as a partnership from a member, the LLC is able to increase its basis in its assets equal to the amount of gain recognized by the selling member in the transaction if the LLC has made an I.R.C. §754 election.[55] This increase in basis eliminates the potential future gain to the LLC and its members when the LLC sells its assets. An S corporation does not have any comparable provision.

Benefits of a Subchapter S Corporation over an LLC

• *Tax-Free Reorganizations.* An important advantage of an S corporation over an LLC is the availability of structuring tax-free reorganizations with an S corporation under I.R.C. §368. I.R.C. §368 allows for the tax-free merger, stock-for-stock or stock-for-assets divestiture of the S corporation if certain tests such as business purpose, continuity of business enterprise, and continuity of ownership are satisfied. However, if an LLC incorporates prior to a binding commitment to reorganize, the incorporated LLC may participate in a tax-free reorganization.[56]

• *Self-Employment Taxes.* Distributions made by an S corporation to its shareholders, other than compensation, currently are not subject to the employment taxes of 15.3 percent up to the first $68,400 and 2.9 percent for any amounts over $68,400. The Clinton health care bill threatened to subject all earnings attributable shareholders of an S corporation to employment taxes. As a compromise, a plan is currently being discussed in Congress to impose 80 percent of the earnings derived from an S corporation by each shareholder to employment taxes. By contrast, there is an open issue as to whether earnings attributable to a member of a limited liability company will be subject to employment taxes under I.R.C. §1401.

• *Discharge of Indebtedness Income.* In order to determine insolvency or qualify for the bankruptcy exception to avoid recognizing discharge of indebtedness income under I.R.C. §108, such determination is made at the entity level for an S corporation. However, with respect to a partnership or LLC, such analysis is made at the partner or member level making it much more difficult to satisfy I.R.C. §108.

Conclusion

Based on the foregoing, there are some general rules for advising clients on choosing between an LLC, limited partnership, and S corporation. First, with respect to an operating business, the general preference should be an LLC for the flexibility in profit allocation and ownership which are not available to a S corporation and the limited liability and simplicity not available to a limited partnership. Second, with respect to a real estate development entity or for estate planning, the general preference is still a limited partnership in order to avoid the Florida annual intangible tax if the parties anticipate significant

equity. If the Florida annual intangible tax is not a significant concern, then you should consider an LLC.❑

[1] See TAMs 9751003 (Dec. 26, 1997) and 913006 (Apr. 30, 1991).
[2] FLA. STAT. §608.407(2).
[3] FLA. STAT. §620.107(7).
[4] Treas. Reg. §301.7701-1, 2, 3 and 4.
[5] Treas. Reg. §301.7701-2(a).
[6] Treas. Reg. §301.7701-2(a).
[7] Treas. Reg. §301.7701-3(a).
[8] Under Treas. Reg. §301.7701-1(d), a "domestic" entity is any entity created or organized in the United States or under the laws of the United States or any state of the United States. Under Treas. Reg. §301.7701-1(d), a "foreign" entity is an entity that is not domestic.
[9] Treas. Reg. §301.7701-3(b)(1)(iii).
[10] Treas. Reg. §301.7701-3(a).
[11] Treas. Reg. §301.7701-3(b)(1)(i).
[12] FLA. STAT. §620.102(7).
[13] FLA. STAT. §620.125.
[14] FLA. STAT. §608.436.
[15] The limited partners of a limited partnership who also are shareholders of the corporate general partner may desire to further capitalize the corporate general partner to avoid an argument by a creditor that the corporate general partner is thinly capitalized facilitating the creditor's argument of piercing the corporate veil and imposing liability on the shareholders of the corporate general partner.
[16] FLA. STAT. §608.436.
[17] FLA. STAT. §620.129(1).
[18] FLA. STAT. §620.129(2)(a); *see also* Weidner, *New Liability for Florida Limited Partners*, 16 STETSON L. REV. 113 (1986).
[19] FLA. STAT. §§620.182(2) and (6)(b) and 607.0122(1) and (7).
[20] FLA. STAT. §608.452, as revised by House Bill 1513 (1999) effective Oct. 1, 1999.
[21] FLA. STAT. §608.452, as revised by House Bill 1513 (1999) effective Oct. 1, 1999, and FLA. STAT. §607.193(1).
[22] Treas. Reg. §1.752-1(a)(2).
[23] Treas. Reg. §1.752-3(a).
[24] Treas. Reg. §1.752-2(a).
[25] *See* Treas. Reg. §1.752-2(f), Examples 3 and 4. Even if the limited partner guaranteed the liability, a liability in excess of such partner's capital account will be allocated to the general partner unless the limited partner waives his right of subrogation against the general partner under the partnership agreement. *See* Treas. Reg. §1.752-2(f), Examples 4 and 5.
[26] I.R.C. §469(a)(1)(A).
[27] I.R.C. §469(b)(1).
[28] I.R.C. §469(c)(1).
[29] Temp. Reg. §1.469-5T(e)(2).
[30] Temp. Reg. §1.469-5T(e)(3)(i)(B).
[31] *See* Jordan and Kloepfer, *The Limited Liability Company: Beyond Classification*, 69 TAXES 203, 210 (Apr. 1991).
[32] FLA. STAT. §§199.032 and 199.103.
[33] Although the Florida Department of Revenue has not promulgated any formal opinion or statement as to the imposition of intangible taxes against a member's interest in a limited liability company, Nadine Posie and Joe Parimore of the Florida Department of Revenue have orally confirmed the position of the Florida Department of Revenue on this issue. According to the Florida Department of Revenue, a member's interest in a limited liability company is subject to Florida's annual intangible tax under FLA. ADMIN CODE §12C-2.002(1)(aa), which subjects shares or units of incorporated or unincorporated companies to Florida's annual intangible tax.
[34] FLA. STAT. §199.185(1)(c).
[35] Ignoring the exemption for individuals under FLA. STAT. §199.185(2)(a).
[36] The value of the stock held by a Florida resident in the corporate general partner as of January 1 of each year is also subject to the state intangible tax. Therefore, it is beneficial to the limited partners of a limited partnership for state intangible tax purposes to limit the value of the corporate general partner to a nominal amount.
[37] Priv. Ltr. Rul. 94-32-018 (Aug. 18, 1994). This private letter ruling by the Internal Revenue Service involved the conversion of a general partnership, which provided professional services and managed or operated property obtained by the partnership as fees or for investment, to a limited liability company. All of the former partners of the general partnership were actively engaged in the partnership's business and would be managers of the limited liability company. The ruling states that "the members' distributive share of LLC's income are not excepted from net earnings from self-employment by Section 1402(a)(13)." Unfortunately, the Internal Revenue Service did not state that I.R.C. §1402(a)(13) was inapplicable because all of the members of the limited liability company were actively involved in its business and were similar to general partners of a partnership.
[38] FLA. STAT. §608.433(4).
[39] FLA. STAT. §608.432(1)(c).
[40] FLA. STAT. §608.432(1)(a).
[41] FLA. STAT. §608.432(1)(b).
[42] FLA. STAT. §608.432(1)(d).
[43] FLA. STAT. §608.433(1).
[44] *See Street v. Sugarman*, 202 So. 2d 749 (1967).
[45] I.R.C. §§1361(b)(1)(D) and 1366(a)(1).
[46] I.R.C. §1366(d)(1).
[47] There is one exception to the foregoing rule for certain taxpayers located in the 11th Circuit (which includes Florida) as provided in *U.S. v. Selfe*, 778 F.2d. 769 (11th Cir. 1985). The *Selfe* case is not recognized by the Tax Court or any other Federal Circuit Court of Appeal.
[48] I.R.C. §721(a).
[49] I.R.C. §351.
[50] I.R.C. §751.
[51] I.R.C. §§734 and 754.
[52] I.R.C. §1367(b)(4).
[53] *But see* Rev. Rul. 94-43, 1994-2 C.B. 198.
[54] I.R.C. §§1361(c)(2) and 1361(d)(3).
[55] I.R.C. §734.
[56] This proposed incorporation may not be recognized by the IRS under the "step transaction" doctrine. However, under *Weikel v. Comm'r*, T.C. Memo 1986-58, the IRS recognized the tax-free treatment of a merger of a corporation which was incorporated approximately four months prior to the date of the merger based upon the business purpose and continuity of the general partner of the former partnership after such tax-free merger. The "step transaction" doctrine applied to whether the IRS recognizes an I.R.C. §351 incorporation of a partnership is the binding commitment test. *See Wilgard Realty Co. v. Comm'r*, 127 F.2d 514 (2d Cir. 1942), *cert. denied*, 317 U.S. 655 (I.R.C. §351 followed by a gift of 75 percent of the stock on the same day; although intent was clear to give away stock, taxpayer is not bound to give away stock and when he received it and could have changed his mind; it was immaterial how soon after the I.R.C. §351 transaction that the taxpayer chooses to dispose of the stock and whether such disposition was pursuant to a preconceived plan not amounting to a binding obligation). *See also West Coast Marketing Corp. v. Comm'r*, 46 T.C. 32 (1966) and Rev. Rul. 70-140, 1970-1 C.B. 73, holding that the I.R.C. §351 step transaction doctrine depends upon the binding commitment test.

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This column is submited on behalf of the Tax Section, David E. Bowers, chair, and Michael D. Miller and Lester B. Law, editors.