Federal Income Tax Classification of Limited Partnerships
Formed under the Revised Uniform Limited Partnership Act

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The authors bring great clarity to a controversial and frequently misunderstood area of the tax law. Specifically, they discuss the probable tax consequences to limited partnerships operating under the revised ULPA. The arguable result is a tax neutral statute.

—Brockenbrough Lamb, Jr.

The National Conference of Commissioners on Uniform State Laws appointed a Special Committee on the Uniform Limited Partnership Act in 1970 to study modernization of the Uniform Limited Partnership Act which had been approved in 1916 by the commissioners (ULPA (1916)) and subsequently adopted, with local modification, by forty-nine states. The commissioners approved the revision proposed by the Special Committee as the revised ULPA in August 1976 (revised Act). The revised Act has not yet been submitted for approval by the American Bar Association, and it has not been adopted by any state. As a practical matter it is doubtful whether a state would adopt the revised Act or, indeed, whether the American Bar Association would give its approval to it, until the Internal Revenue Service indicates whether limited partnerships formed under the revised Act will be eligible to be classified as partnerships and not as associations taxable as corporations for federal income tax purposes.

The commissioners have recognized the importance of the tax

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1. The District of Columbia and the Virgin Islands have also adopted the Uniform Limited Partnership Act (1916) [hereinafter cited as ULPA (1916)]. Some states have adopted it in modified form. See ULPA (1916), Table of Jurisdictions Wherein Act Has Been Adopted, 6 Uniform Laws Annotated 83 (Supp. 1977). Louisiana has not adopted the ULPA (1916) but has analogous provisions applicable to partnerships in commendam.
classification question by inserting the following statement in the pamphlet containing the text of the revised Act which it distributes:

At this time, provisions of this Act have not been ruled upon by the Internal Revenue Service. We advise any state or interested party to monitor the tax consequences carefully when considering it. Particularly, we suggest that a delayed effective date be inserted in any bills introduced. A substantially delayed effective date would permit an IRS ruling before that date with respect to an enactment, and would preclude any adverse consequences to those who might rely on the Act’s provisions.

Many lawyers to whom the tax classification question is an overriding legal problem in forming and utilizing limited partnerships may be surprised to learn that the impetus to preparation of the revised Act was not the tax classification question. The actual motivation was to resolve uncertainties such as the effect on the limited liability of limited partners who participate in some aspects of management activities of the partnership but do not assume full control of the business and the limited partnership status in one state of an organization formed pursuant to the laws of another state. The Special Committee felt strongly that its mandate did not include creation of a vehicle for national partnerships tailored to meet the needs of the tax and securities bar.

That is not to say that the tax question was ignored. The committee was well aware of the criteria embodied in the classification regulations and the controversy surrounding the regulations, but a basic decision was made that the revised Act should not try to change the ground rules of classification for federal income tax purposes. Thus, the commissioners sought to adopt a “tax neutral” statute. In this case, tax neutrality means that a given state of facts—the terms of the partnership agreement and the attendant

2. See generally Sell, An Examination of Articles 3, 4 and 9 of the Revised Uniform Limited Partnership Act 459 supra.

3. Treas. Reg. §§ 301.7701-2 and .7701-3, T.D. 6503, 1960-2 C.B. 409, as amended by T.D. 6797, 1965-1 C.B. 553, and T.D. 7515 (October 17, 1977). These regulations are widely referred to as the “Kintner” regulations because the Internal Revenue Service was rebuffed in its attempt to classify a professional association as a partnership under the pre-1960 regulations in United States v. Kintner, 216 F.2d 418, 422 (9th Cir. 1954) and as a result adopted the substance of the present regulations.

circumstances—would produce the same classification result under both the 1916 Act and the revised Act.

The commissioners did not intend to express any opinion or adopt a position in the revised act with respect to the validity of the existing regulations, the litigation spawned by them or the desirability of issuing new regulations. They have sought to have the Treasury Department and the Internal Revenue Service regard the revised Act as the ULPA referred to in the existing regulations in order to clear the revised Act for approval by the American Bar Association and adoption by the states.

This article examines how well the commissioners have achieved the goal of tax neutrality in the defined sense for the revised Act, and consequently, whether the Treasury Department and the Internal Revenue Service should regard the revised Act as the ULPA referred to in the regulations.

THE CLASSIFICATION REGULATIONS

Congress has never established rules for distinguishing partnerships from associations taxable as corporations, so the task of distinguishing between them has fallen to the courts and Treasury Department. With respect to limited partnerships, the regulations provide:

5. Two leading cases, Zuckman v. United States, 524 F.2d 729 (Ct. Cl. 1975) and Larson v. Commissioner, 66 T.C. 159 (1976), appeal docketed, No. 77-1056 (9th Cir. 1977), have been recently decided and are the subject of many commentaries. See materials cited note 4 supra. See also Outlaw v. United States, 494 F.2d 1376 (Ct. Cl.), cert. denied, 419 U.S. 844 (1974).


7. “Partnerships” is a residual category of unincorporated organizations which are not associations, trusts or estates, and section 7701 of the Internal Revenue Code currently states:

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(2) PARTNERSHIP AND PARTNER. —The term ‘partnership’ includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term ‘partner’ includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) CORPORATION. —The term ‘corporation’ includes associations, joint-stock companies, and insurance companies.
I.R.C. § 7701.

8. The principal authority is Morrissey v. Commissioner, 296 U.S. 344 (1935), on which
An organization which qualifies as a limited partnership under State law may be classified for purposes of the Internal Revenue Code as an ordinary partnership or as an association [taxable as a corporation]. Such a limited partnership will be treated as an association if, applying the principles set forth in § 301.7701-2, the organization more nearly resembles a corporation than an ordinary partnership or other business entity.\footnote{9}

Treasury Regulation section 301.7701-2 sets forth six so-called “major” characteristics ordinarily found in a corporation which, taken together, distinguish it from other business organizations. These characteristics are: (1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests.\footnote{10} In addition to these major characteristics, the regulations indicate that “other factors”—not defined—may be in some cases significant in classifying an organization.

The basic test for classification under Treasury Regulation section 301.7701-2 is whether an organization more nearly resembles a corporation than a partnership or trust. In discussing corporate resemblance of partnerships, the regulations state that since associates and an objective to carry on business and to divide the gains therefrom are generally common to both corporations and partnerships, the determination of whether an organization is to be classified as a partnership or an association depends on the facts of each individual case which bear on the presence or absence of the last four major characteristics. An organization is not classified as an association unless such organization has a preponderance of corporate characteristics, so a limited partnership is classified as a partnership unless it has more than two of the following major corporate characteristics: (1) continuity of life, (2) centralization of manage-
ment, (3) liability for debts limited to property of the partnership, and (4) free transferability of interests. The existence or absence of each of these characteristics is given equal weight, and it is generally thought that the regulations are intended to be applied mechanically.11

In discussing three of the four characteristics, the regulations refer to the ULPA and draw conclusions as to the presence or absence of the characteristics on the basis of the provisions of the ULPA (1916). The extent to which the commissioners have achieved tax neutrality is analyzed by examining the changes, if any, which have been made by the revised Act in the relevant provisions of the ULPA (1916) and the effect of such changes on the conclusions reached in the regulations with respect to the ULPA.

CONTINUITY OF LIFE

Treasury Regulation section 301.7701-2(b)(3) concludes that a limited partnership subject to a statute corresponding to the ULPA lacks continuity of life, and therefore, to achieve tax neutrality a limited partnership formed under the revised Act should also lack continuity of life.

Under the regulations continuity of life exists if the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause dissolution of the organization.12 Dissolution is defined as “alteration of the identity of an organization by reason of a change in the relationship between its members as determined under local law.”13 Thus, a corporation has continuing identity which is unaffected by changes in its shareholders, directors or officers, but a general partnership lacks continuity of life because the withdrawal of a general partner destroys the mutual agency among the partners even though the business is continued by the remaining partners.

Under the regulations there are two elements to the continuity question. A limited partnership will not have continuity of life (1) if the retirement, death or insanity of a general partner will cause a dissolution (2) even though dissolution may be avoided by the re-

11. See Larson v. Commissioner, 66 T.C. 199, 185 (1976), appeal docketed, No. 77-1056 (9th Cir. 1977). The dissenting opinions in Larson, however, indicate a contrary argument. See, e.g., id. at 191-92 (Raum, J., dissenting), 192 (Drennen, J., dissenting), 194 (Simpson, J., dissenting).
13. Id. § 301.7701-2(b)(2).
remaining general partners or all remaining members agreeing to continue the partnership. The second element of the continuity test referred to in the regulations is based on the decision of the Tax Court in Glensder Textile Company. In that case the Tax Court held that the possible continuation of a partnership pursuant to a right given under the ULPA (1916) as adopted by New York was too contingent to be analogous to the chartered life of a corporation.

Under the ULPA (1916) dissolution of a limited partnership occurs upon the retirement, death, insanity, or bankruptcy of a general partner unless the remaining general partners, under a right so stated in the certificate of limited partnership, or all partners, unanimously elect to continue the business. This is one basis for the conclusion in the regulations that a limited partnership organized under the ULPA (1916) lacks continuity of life.

The regulations place particular emphasis on the inherent power of a general partner to withdraw from a partnership governed by the ULPA (1916), thereby dissolving the partnership, even though the partnership agreement provides otherwise. The right of a general partner to withdraw from a limited partnership in contravention of his agreement is derived from section 31(2) of the Uniform Partnership Act. 14

[14. 46 B.T.A. 176 (1942).]
[17. ULPA § 20 (1916) provides: "The retirement, death or insanity of a general partner dissolves the partnership, unless the business is continued by the remaining general partners (a) Under a right so to do stated in the certificate, or (b) With the consent of all members."

18. UNIFORM PARTNERSHIP ACT § 31(5) provides: "Dissolution is caused: . . . [b]y the bankruptcy of any partner or the partnership . . . ." This section is applicable to ULPA by virtue of the Uniform Partnership Act § 6(2) which states that "[this act] shall apply to limited partnerships except insofar as the statutes relating to such partnerships are inconsistent herewith." There is some doubt whether the bankruptcy of a general partner of a limited partnership constitutes a "retirement" under ULPA § 20 (1916) which permits the remaining general partners or all members to avoid dissolution by continuing the business. Compare Larson v. Commissioner, 66 T.C. 159, 174-76 (1976), appeal docketed, No. 77-1056 (9th Cir. 1977) with id. at 200-01 (Simpson, J., dissenting).


20. The last two sentences of Treas. Reg. § 301.7701-2(b)(3) state:
Nevertheless, if, notwithstanding such agreement, any member has the power under local law to dissolve the organization, the organization lacks continuity of life. Accordingly, a general partnership subject to statute corresponding to the Uniform Partnership Act and a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act both lack continuity of life.

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ship Act (UPA)\textsuperscript{21} which is applicable to the ULPA (1916) by virtue of section 6(2) of the UPA. Of course, the withdrawing general partner may be liable to other partners for damages caused by the breach of his agreement.

The revised Act, like the ULPA (1916), recognizes that the general partner's agency relationship is terminable at will by a general partner, even if contrary to the partnership agreement and will cause dissolution of a limited partnership unless the remaining general partners under a right to do so stated in the certificate, or all partners, unanimously elect to continue the business.\textsuperscript{22}

In defining the events of withdrawal, section 402 of the revised Act\textsuperscript{23} is more comprehensive than the provisions of section 20 of the ULPA (1916). The ULPA (1916) referred only to retirement, death and insanity without defining them. The revised Act is much more precise. Thus, retirement is defined in terms of a general partner ceasing to be a member of the partnership by assignment of his interest, removal in accordance with the partnership agreement or withdrawal in violation of the agreement.

Under the ULPA (1916), it was unclear whether “death” had any application to general partners that were not natural persons. This ambiguity is eliminated by equating dissolution, liquidation and termination of non-natural general partners to the death of a natural person. Entry of a decree adjudging a person to be incompetent to manage his person or property is substituted for “insanity.” The revised Act also provides that, unless the partners provided otherwise in the certificate, commencement of bankruptcy or similar proceedings will constitute withdrawal of a general partner.\textsuperscript{24} These modifications expand the types of events which cause dissolution of a limited partnership under the ULPA (1916) and further emphasize the consensual relationship that is fundamental to both limited and

\textsuperscript{21} Uniform Partnership Act § 31 states: “Dissolution is caused: ... (2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this section, by the express will of any partner at any time ...

\textsuperscript{22} ULPA § 801 (1976).

\textsuperscript{23} Id. § 402.

\textsuperscript{24} Id. § 402(4)(iii) allows the partners to avoid having bankruptcy as an event of default by providing in the certificate that the general partner shall not cease to be a general partner upon being adjudicated a bankrupt. If the certificate contains such a provision, the rule of the Uniform Partnership Act § 31(5) would not apply, and the general partner would continue as a member of the organization after he has been adjudicated bankrupt. In the absence of such a provision in the certificate, the bankruptcy of a general partner will be an event of withdrawal with the same result under the revised Act as under the ULPA (1916).
general partnerships. Accordingly, the first element of the continuity question is the same under the revised Act as under the ULPA (1916).

Under the revised Act, as under the ULPA (1916), the business of the partnership may be continued after an event of withdrawal of a general partner and dissolution may be avoided only by the action of the remaining general partner under a right to do so stated in the certificate or by the unanimous action of all partners within ninety days after the event of withdrawal.25 The inclusion of the ninety day period is new and clarifies the uncertainty which exists under section 20 of the ULPA (1916) as to the time period in which all members of a partnership must act in order to prevent dissolution by continuing the partnership's business. Such right to prevent dissolution does not cause continuity to exist under the holding of Glensder because the exercise of such right to prevent dissolution under section 801(3) of the revised Act continues to require the unanimous action of the general partners or of all members. Thus, the second element of the continuity question is satisfied.

The experience of California limited partnerships after the amendments to the limited partnership act in that state illustrates the point at which the right to prevent dissolution by continuing the business amounts to actual continuity in the eyes of the Internal Revenue Service. In 1963 the California legislature amended section 20 and other provisions of the ULPA (1916) to permit, among other things, removal and election of general partners and amendment of the partnership agreement by less than a unanimous vote of the limited partners.26

The California amendment of section 20 specifically permitted the partnership to be continued by a new general partner (who could be elected by less than unanimous vote) after withdrawal of the last remaining general partner.27 In an unpublished memorandum of

26. Changes were made in ULPA §§ 2, 7, 9, 20 (1916); see CAL. CORP. CODE §§ 15502, 15507, 15509 and 15520 (West 1977).
27. CAL. CORP. CODE § 15520 (West 1977). The statute, as amended, states:

The retirement, death, insanity, removal or failure of reelection of a general partner dissolves the partnership, unless the business is continued by the remaining general partners and/or the general partner or general partners elected in place thereof

(a) Under a right so to do stated in the certificate,
or
(b) With the consent of all members. (Emphasis added).
technical advice, the national office of the Internal Revenue Service took the position that California limited partnerships had continuity of life as a result of these revisions of the California Limited Partnership Act. The memorandum gave as the reason for this position the fact that after withdrawal of the sole general partner, a limited partnership could be continued with less than unanimous consent of the limited partners by electing a new general partner who could continue the partnership. As a result of the position taken by the Internal Revenue Service with respect to continuity of life of California limited partnerships, the California legislature reenacted section 20 of the ULPA (1916) as an alternate to the modified version. Subsequently, the Internal Revenue Service ruled that California limited partnerships lack continuity if they elect to be governed by the section of the statute which is identical to section 20 of the ULPA (1916).

From the point of view of the Internal Revenue Service, it appears that the offense of the 1963 amendments to the California Limited Partnership Act was that they permitted decisions as to continuity to be controlled by majority vote even after the withdrawal of the last remaining general partner rather than by unanimous consent of all members as required by section 20 of the ULPA (1916). Provisions like those adopted by California substantially modify the basic consensual nature of limited partnerships and cause them to resemble associations by allowing the majority to force minority members to accept a new general partner against their will.

Majority election of general partners is apparently still permitted in California and other states, notwithstanding section 9 of the ULPA (1916), which is interpreted by some practitioners to allow admission of a new general partner only with the consent or ratification of all limited partners. The Internal Revenue Service has ap-

29. CAL. CORP. CODE § 15520.5 (West 1977).
32. Delaware, Nebraska, Nevada, Oregon and Washington have enacted provisions similar to the amendments adopted by California in 1963. See ULPA § 7, 6 UNIFORM LAWS ANNOTATED 89-90 (Supp. 1977).
33. ULPA § 9 (1916) states:

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parently not challenged these provisions, even though they too modify the consensual relationship associated with partnerships. This potential problem is avoided under the revised Act by prohibition of majority election of general partners inasmuch as section 401 requires the specific written consent of each partner for the admission of a new general partner. The comment to section 401 states that "such consents must specifically identify the general partner involved."  

In summary, limited partnerships formed under the revised Act will lack continuity of life under the regulations because (1) events equivalent to the retirement, death, insanity or bankruptcy of a general partner cause dissolution, and (2) such dissolution may be prevented only by unanimous action of the general partners pursuant to a right given in the certificate or of all partners. Furthermore, the revised Act does not permit avoidance of this result by continuation of a limited partnership by general partners elected by a mere majority of members. Thus, with respect to continuity of life, the revised Act achieves tax neutrality.

**Centralization of Management**

Under the regulations, a limited partnership does not necessarily have or lack centralized management, but rather the existence of such a corporate characteristic depends on the facts of the particular case. The regulations define centralization of management as meaning "a centralization of continuing exclusive authority to make independent business decisions on behalf of the organization [without] ratification by members of such organization." Such centralization exists if any person or group of persons which does not

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(1) A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to . . . (e) Admit a person as a general partner. . . . (Emphasis added). Although some practitioners interpret this provision as limiting only the powers of general partners, others interpret it as a limitation on the partnership as a whole on the grounds that a limited partnership can act only by or through its general partners. See ULPA § 401, Comment (1976).

34. ULPA § 401 (1976).

35. Id. § 401, Comment states: "Section 401 is derived from Section 9(1)(e) of the prior law and carries over the unwaivable requirement that all limited partners must consent to the admission of an additional general partner and that such consent must specifically identify the general partner."

include all members has authority to make decisions necessary to conduct the business for which the organization was formed. 37 The model of centralized management is the board of directors of a statutory corporation because the directors are not necessarily members or owners of the organization. Management cannot be centralized effectively in a general partnership because, regardless of any agreement limiting the authority of non-managing partners, the act of any partner within the scope of the partnership business binds the partnership to third parties who are without knowledge of such agreement. 38

A limited partnership is in between: the general partners exercise their authority on behalf of the limited partners, but they act also for themselves as members and not solely in a representative capacity. To the extent the general partners are in fact acting on their own behalf, they cannot achieve effective centralization of management as among themselves due to the mutual agency provisions of the UPA. Even though management by the general partners clearly achieves some centralization of management in a limited partnership, lack of participation by limited partners in the decision making process is disregarded. The regulations thus resolve the question of centralization by the facts of the particular case, and Treasury Regulation section 301.7701-2(c)(4) states:

[L]imited partnerships subject to a statute corresponding to the Uniform Limited Partnership Act, generally do not have centralized management, but centralized management ordinarily does exist in such a limited partnership if substantially all the interests in the partnership are owned by the limited partners. 39

Tax neutrality is achieved by the revised Act because section 403, 40 like section 9 of the ULPA (1916), 41 incorporates the mutual agency relationship of general partners under the UPA on which the regulations rely for the conclusion quoted above. Accordingly, the reference in the regulation to the ULPA should be interpreted to include the revised Act because unless substantially all of the interests in a limited partnership formed under the revised Act are owned by the limited partners, the limited partnership lacks centralization of management. Where the general partners do not have

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37. Id. § 301.7701-2(c)(1).
38. Id. § 301.7701-2(c)(4).
39. Id. § 301.7701-2(c)(4).
40. ULPA § 403 (1976).
41. ULPA § 9 (1916).
substantial interests, they are managers for the limited partners, and such limited partnerships ordinarily possess centralized management. 41

LIMITED LIABILITY

One of the more controversial areas of the classification regulations deals with limited liability of limited partnerships. 42 Clearly a limited partnership achieves limited liability for the limited partners. The regulations conclude, however, that with one exception, limited partnerships organized under the ULPA (1916) lack limited liability because of the liability of the general partners to creditors in the event that the assets of the limited partnership are insufficient. 43 The exception to the general rule is that a limited partnership achieves limited liability "when [the general partner] has no substantial assets (other than his interest in the partnership) which could be reached by a creditor of the organization and when he is merely a 'dummy' acting as the agent of the limited partners." 44

The revised Act continues the liability of general partners for debts of a limited partnership 45 and application of the exception is based on the facts of the particular case. Section 303(a) of the revised Act 46 also makes it clear that limited partners who participate in control of the partnership business or who exercise the powers of a general partner will be liable as general partners to third parties. Since the revised Act is essentially identical to the ULPA (1916) in these respects, it achieves its goal of tax neutrality with respect to limited liability.

This analysis is based on a literal application of the regulations. The commentators and courts, however, in addressing themselves to this portion of the regulations point out that the exception is virtually impossible to satisfy because the limited partners must be liable as general partners under section 7 of the ULPA (1916) if the general partner is a "dummy" acting as agent for the limited partners. 47 If the limited partners are liable as general partners the or-

41. Whether the grant to limited partners of the right to vote for removal of general partners affects centralized management is discussed beginning on p. 503, note 57 infra.

42. Treas. Reg. § 301.7701-2(d); see authorities cited note 3 supra.

43. Treas. Reg. § 301.7701-2(d)(1).

44. Id. § 301.7701-2(d)(2) (emphasis added).

45. ULPA § 403 (1976).

46. Id. § 303(a).

47. ULPA § 7 (1916) states: "A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."
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If this analysis is correct, then every partnership organized under the ULPA (1916) must be classified as a partnership for tax purposes because it then must lack two major corporate characteristics: continuity of life and limited liability. If this is the case under the ULPA (1916), the same result should be reached under the revised Act.

FREE TRANSFERABILITY OF INTERESTS

Like centralized management and limited liability, free transferability of interests depends upon the particular facts relevant to the organization. In determining whether interests are freely transferable, the regulations provide that one must look not only to whether a member may assign his right to share in profits and capital but also to his ability to assign his right to participate in the organization without the consent of other members. If only the right to participate in profits and capital is assignable and the assignee may not be substituted to the rights of the assignor without the consent of other members, free transferability does not exist.

The ULPA is not referred to in the portion of the regulations dealing with free transferability of interests except by implication where the regulations state that free transferability does not exist if, under local law, a transfer of the member's interest results in dissolution of the old organization and formation of a new organization. Under the UPA, the ULPA (1916) and the revised Act, general partnership interests are not freely transferable within the meaning of the regulations because the transfer of a general partner's entire interest in any partnership results in dissolution unless the business is continued. Because the revised Act does not alter this rule, tax neutrality is achieved by the revised Act with respect to transferability of the interests of general partners.

48. Treas. Reg. § 301.7701-2(d)(2) states: "Notwithstanding the formation of the organization as a limited partnership, when the limited partners act as the principals of such general partner, personal liability will exist with respect to such limited partners." This statement in the Regulations is apparently based on the liability of an undisclosed principal for the actions of his agent.

49. This of course assumes the analysis of the Tax Court in Larson v. Commissioner, 66 T.C. 159 (1976), appeal docketed, No. 77-1056 (9th Cir. 1977), and the Court of Claims in Zuckman v. United States, 524 F.2d 729 (Ct. Cl. 1975) and Outlaw v. United States, 494 F.2d 1376 (Ct. Cl.), cert. denied, 419 U.S. 844 (1974) continue to prevail and that no other corporate characteristics are present. See, e.g., materials cited note 3 supra.

50. Treas. Reg. § 301.7701-2(e).
The regulations do not refer to the ULPA or mention transferability of limited partnership interests. Under the ULPA (1916) the assignee of a limited partnership interest does not automatically become a member of the partnership unless that right is provided in the certificate. Thus, whether free transferability exists depends on the provisions of the partnership agreement and the certificate. The revised Act continues the basic provisions of the ULPA (1916) but clarifies certain ambiguities with respect to assignment of limited partnership interests and the substitution of assignees as limited partners as follows: section 702 of the revised Act eliminates the possible implication in section 19(1) of the ULPA (1916) that the assignability of a limited partnership interest may not be restricted by agreement. It continues the rule that such assignment neither dissolves the limited partnership nor entitles the assignee to exercise the right of the limited partner. Section 704 carries over most of the provisions of section 19 of the ULPA (1916) with respect to the time when the assignee may become a substitute limited partner and with respect to the rights and liabilities of a substitute limited partner but narrows somewhat the obligations assumed by a substitute limited partner. These revisions of section 19 of the ULPA (1916) do not modify assignability of the limited partnership interests except insofar as they eliminate any doubt about the effectiveness of restrictions on assignment contained in the partnership agreement. Thus, transferability of limited partnership interests remains a question of fact under the revised Act and tax neutrality is maintained.

**Other Factors**

As mentioned previously, the regulations state that other factors may be significant in the classification of unincorporated organizations. The regulations do not define any such other factor and the courts have been unable to agree on one. For example, in *Larson v. Commissioner* the following are some of the "other" factors which

51. ULPA § 19(4) (1916) states: "An assignee shall have the right to become a substituted limited partner if all the members (except the assignor) consent thereto or if the assignor, being thereunto empowered by the certificate, gives the assignee that right."

52. Id. § 19(1) states: "A limited partner's interest is assignable." The Comment to revised Act § 702 states that this provision raises a question whether any limitations on the right of assignment were permitted under ULPA (1916).

53. ULPA § 704 (1976).

54. 66 T.C. 159 (1976), appeal docketed, No. 77-1056 (9th Cir. 1977).
various judges considered relevant: (1) the general partner's right to cause the partnership to retain or distribute earnings, (2) the limited partner's right to vote on various matters, particularly removal of general partners and sale of assets, (3) the existence or absence of certificates representing limited partnership interests, and (4) the division of such interests into units or shares, and the methods employed in marketing the interests, including whether they constitute securities under state or federal law.55 The opinion of the Tax Court and some of the concurring opinions treat factors (1) and (2) as relevant only to centralized management. Factors (3) and (4) are relevant to free transferability of interests, but (4) may also be a separate characteristic in some cases.56

The right of general partners to retain or distribute earnings is a function of the agreement among the members and is unaffected by ULPA (1916) or the revised Act except insofar as this flexibility is recognized in section 601 of the revised Act.

The Tax Court in Larson held that the voting rights granted to limited partners under the California Limited Partnership Act57
bear primarily on centralized management. Under section 7 of the ULPA (1916) $^58$ a limited partner becomes liable as a general partner if he takes part in control of the partnership’s business. Application of this section to specific facts has often proved difficult, and practitioners are sometimes unable to determine whether a limited partner would incur liability as a general partner by exercising rights granted to limited partners in a particular partnership agreement. $^59$

Section 302 of the revised Act $^60$ authorizes the practice of granting voting rights to limited partners, and section 303(b) of the revised Act establishes a “safe harbor” of permitted activities in which a limited partner may engage without becoming liable as a general partner. $^61$ These provisions are similar to some of those adopted in California $^62$ and other states $^63$ permitting a greater degree of limited partner participation without jeopardizing limited liability.

At first it may seem that changes made by sections 302 and 303 of the revised Act make limited partnerships more like corporations than partnerships, but closer analysis demonstrates that this is not the case. As indicated by the Tax Court in Larson the principal effect of the permitted activities of limited partners under the revised Act would be on the issue of centralized management. In some respects the voting rights of limited partners may increase their participation in decisions affecting the management of the organization and thereby disperse management of a limited partnership by restricting the general partners’ authority to make decisions necessary to conduct the partnership’s business without ratification. The rules of section 303(b) have only limited application to management of the limited partnership’s business on a day to day basis. Instead these rules recognize (1) that it is not an uncommon practice for general and limited partnerships to retain, employ and consult with

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$^{58}$ ULPA § 7 (1916).


$^{60}$ ULPA § 302 (1976).

$^{61}$ Id. § 303(b).

$^{62}$ Cal. Corp. Code § 15507 (West 1977). It should be observed that the right to elect general partners is not granted under the revised Act. California has no analogue of revised Act subsections 303(b)(1), (2), (3), (5)(iii) or (5)(iv).

$^{63}$ The acts in Delaware, Nebraska, Nevada, Oregon and Washington correspond to the modifications enacted by California. The acts in Alabama and New York contain different safe harbor rules. See ULPA § 7, 6 Uniform Laws Annotated 89-90 (Supp. 1977).
partners other than in their capacity as partners, in the same manner as it does with third parties\(^4\) and (2) that limited partners should have some voice in organic changes in the organization.

In other respects the right of limited partners to vote for removal of general partners emphasizes the general partners' role as representatives of the limited partners, but this should have only limited weight in determining whether centralized management exists because such right does not necessarily diminish the general partners' role as principals managing the organization on their own behalf.

On balance it seems that if there is any departure from tax neutrality resulting from such changes, it is in the direction of making limited partnerships more like general partnerships than like statutory corporations because the changes underscore the consensual nature of the organization and permit an increase in the decision-making power of the owners of the organization and a corresponding decrease in the power of those acting in a representative capacity for the limited partners.

The use of certificates to represent limited partnership interests, the division of such interests into units or shares, and the methods employed in marketing such interests, including whether they constitute securities under state or federal law, are all factual matters which are unaffected by the revised Act, so tax neutrality is maintained. Nevertheless, it is worth observing that both the Tax Court in \textit{Larson} and the Court of Claims in \textit{Outlaw} viewed marketing partnership interest in a manner similar to corporate securities as an additional characteristic of some significance under the classification regulations as well as being indicative of the existence of free transferability of interests.\(^5\) The potential existence of such other

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\(^4\) This practice is also recognized by I.R.C. § 707(a) which states: "If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner." Amplifying this provision Treas. Reg. § 1.701-1(a) states:

Such transactions include, for example, loans of money or property by the partnership to the partner or by the partner to the partnership, the sale of property by the partner to the partnership, the purchase of property by the partner from the partnership, and the rendering of services by the partnership to the partner or by the partner to the partnership. Where a partner retains the ownership of property but allows the partnership to use such separately owned property for partnership purposes (for example, to obtain credit or to secure firm creditors by guarantee, pledge, or other agreement) the transaction is treated as one between a partnership and a partner not acting in his capacity as a partner.

\(^5\) Outlaw v. United States, 494 F.2d 1376, 1385 (Ct. Cl. 1974); Larson v. Commissioner, 66 T.C. 159, 184 (1976), appeal docketed, No. 77-1056 (9th Cir. 1977).
characteristic depends on the particular circumstances of the partnership involved, and such marketing is neither encouraged nor discouraged by the changes made by the revised Act.

**Changes Not Affecting Classification**

The revised Act makes a number of changes in the ULPA (1916) which have not previously been discussed. For example, the revised Act integrates the use of limited partnership names with those of corporations, provides for reservation of names, imposes a system of statewide central filing, and requires a limited partnership to maintain an office, an agent for service of process and certain minimum records within the state. Although these provisions are similar to those in use for corporations, they are merely for administrative convenience and do not change the basic nature of a limited partnership. In some instances these changes have been foreshadowed by the adoption of similar provisions in individual states applicable to both general and limited partnerships.

In addition to specifying permitted activities under section 303(b), the revised Act also changes the ULPA (1916) with respect to the ability of partners to transact business with their partnership. For example, section 107 of the revised Act removes the special fraudulent conveyance and creditor priority provisions of the ULPA (1916) and permits partners to lend money and transact other business with limited partnerships of which they are members subject to the general fraudulent conveyance statutes of the state and the bankruptcy laws.

The rights of partners to agree among themselves with respect to sharing profits, losses and distributions of the partnership are recog-

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66. ULPA § 102 (1976).
67. Id. § 103.
68. Id. §§ 201(b), 206.
69. Id. § 104.
70. Id. § 105.
71. See, e.g., CAL. BUS. & PROF. CODE §§ 17910 to 17930 (West Supp. 1977); N.J. STAT. ANN. §§ 56:1-1 to 56:1-7 (West 1968). See also N.Y. GEN. BUS. LAW § 130 (McKinney 1968) which imposes a certificate filing requirement on general partnerships but not limited partnerships apparently because the latter are required to file a certificate under the New York Uniform Limited Partnership Act.
72. ULPA § 13 (1916) arguably prohibits a limited partner from receiving or holding as collateral security any partnership property. ULPA § 13 (1916) also prohibits general partners from sharing pro rata with general creditors in the case of unsecured loans.
73. Twenty-four states and the Virgin Islands have adopted the Uniform Fraudulent Conveyance Act. See 7 Uniform Laws Annotated 283 (Supp. 1971-1976).
nized and provisions are included which apply in the absence of agreement.\footnote{ULPA arts. 5, 6 (1976).} One effect of these provisions is elimination of some of the special priorities provided in the ULPA (1916).\footnote{ULPA § 23 (1916) arguably requires that on dissolution limited partners must receive their share of profits and capital prior to any distribution to general partners with respect to their share of profits or capital.} Previously there was some ambiguity whether the provisions in the ULPA (1916) were mandatory or could be varied by agreement among the members. These changes enhance the flexibility of limited partnerships in defining the relationship among the partners. If they have any impact on the classification of limited partnerships formed under the revised Act, which they should not, they tend to indicate that limited partnerships are more like general partnerships than corporations in as much as they underscore the basic consensual nature of the organization.

Finally, the revised Act deals with the thorny question of the status of a limited partnership in a state other than the state of organization.\footnote{ULPA art. 9 (1976).} This matter is dealt with by providing for the registration of limited partnerships and specifying choice-of-law rules. This addition to the ULPA (1916) clarifies an area which neither case law nor administrative practice had previously resolved.

\section*{Conclusion}

The Special Committee of the National Conference of Commissioners on Uniform State Laws has labored since 1970 to produce a modern version of the ULPA. The revised Act makes substantial improvements in the ULPA (1916) by clearing up ambiguities, providing more precise definitions and dealing with issues not covered in the ULPA (1916). Although the revised Act modernizes the ULPA (1916), it does not materially alter the essential nature of limited partnerships.

The Special Committee's goal of creating a tax neutral statute was well conceived and executed. As discussed above, there should be no substantial difference under the existing regulations in the classification for tax purposes of a particular partnership whether formed under the revised Act or the ULPA (1916) because the revised Act corresponds to the ULPA (1916) with respect to provisions which are material to the characteristics differentiating partnerships from associations.
The Internal Revenue Service has been asked to examine the revised Act and to rule that it is or corresponds to the ULPA referred to in the classification regulations. The fate of this project now rests largely with the Internal Revenue Service. If the Internal Revenue Service takes a negative position or refuses to act, the revised Act will probably not be adopted by any state and the ULPA (1916) will continue to govern limited partnerships despite its obvious antiquity.