

pass-through tax treatment. It is recognized that in the past several bills have been introduced in Congress to increase the number of permissible shareholders for subchapter S corporations, but to date none have been enacted into law. Consequently, the proponents have sought a determination from the FDIC regarding the eligibility of Bank-LLCs for deposit insurance. In issuing this final rule it is not the FDIC's intent to influence the IRS either way. This final rule is focused on responding to a request for a determination as to whether under the FDI Act a bank that is chartered as an LLC could be considered to be "incorporated" and therefore eligible to apply for Federal deposit insurance as a State bank. Specifically, the FDIC takes no position on how such an entity should be taxed. We note that supporters of deposit insurance for Bank-LLCs argue that even if the IRS declines to amend its regulations to provide pass-through tax treatment for a Bank-LLC, there are still advantages to the LLC structure. State tax laws may provide the desired pass-through tax treatment with respect to State income taxes. Furthermore, it is argued that the increased flexibility provided by the LLC structure is itself a significant advantage over the corporation structure.

III. The Nature of Limited Liability Companies

Generally, an LLC is a business entity that combines the limited liability of a corporation with the pass-through tax treatment of a partnership.¹⁸ Wyoming was the first State to authorize LLCs in 1977; since that time the remaining 49 States and the District of Columbia have all enacted LLC statutes. Generally, LLC statutes were crafted to authorize a business entity that is neither a partnership nor a corporation, but an entity that has some of the more desirable features of each.¹⁹ As a result, an LLC has characteristics of both a partnership and a corporation. However, because an LLC is neither a partnership nor a corporation, State partnership laws and State corporation laws generally do not apply. For example, State corporation laws that require a board of directors, that specify how ownership interests (shares) may be issued, and that impose capital requirements generally do not apply to an LLC. LLC statutes generally allow the owners broad discretion in setting up an

LLC. According to some legal scholars, "[w]hole bodies of corporate law doctrine . . . are rendered irrelevant" when an LLC is utilized.²⁰

An LLC is established by filing articles of organization with the State. These articles are roughly equivalent to a corporation's articles of incorporation. Every LLC has an operating agreement which is a contract executed by the members that sets forth the manner in which the business of the LLC will be conducted. The operating agreement establishes the rights, powers, duties, and liabilities of the members with respect to each other and with respect to the LLC. It contains provisions detailing such matters as the LLC's management structure, capital contributions, accounting, distributions, transfers of a member's interest, and dissolution. As used in many LLC statutes, a "member" of an LLC is a person who owns an interest in the LLC and is roughly equivalent to a shareholder of a corporation. Furthermore, a "member's interest" in an LLC is generally the member's ownership interest in the LLC, and is sometimes evidenced by a certificate which is roughly equivalent to a stock certificate of a corporation.

Consistency of the LLC Structure With Corporate Attributes

Many LLC statutes authorize entities that do not possess the four corporate attributes. First, some State LLC statutes require, or permit LLC members to provide in the operating agreement, that the LLC will automatically terminate, or dissolve, or that its operations will be suspended pending the consent of the remaining members, upon the death, disability, bankruptcy, withdrawal, or expulsion of a member, or upon the happening of some other specified event.²¹ These automatic termination/dissolution/suspension provisions are inconsistent with the notion of perpetual succession because the continued existence and operation of the entity directly depends upon the existence, condition, or status of its owners. Second, some State LLC statutes require, or permit LLC members to provide in the operating agreement, that the LLC will be managed solely and directly by the members.²² Such member-management also tends to be inconsistent with the corporate attribute of centralized management because exclusive authority to manage the

institution is vested in the owners who may or may not possess adequate expertise to manage the institution and who, as a group, may be so large or so small as to present operational or supervisory problems for the entity. Third, while members of an LLC generally have limited liability, some LLC statutes permit the LLC to provide for one or more full liability members, *i.e.*, members who are fully liable for all of the liabilities, debts, and obligations of the LLC.²³ Finally, some State LLC statutes require, or permit LLC members to provide in the operating agreement, either that LLC members may not transfer their interests in the LLC without the consent of the remaining members, or that a member may not transfer the managerial or voting rights that accompany an owner's economic interest in the LLC without the consent of the remaining members.²⁴ Such a provision tends to be inconsistent with the concept of free transferability of interests because the requirement for prior consent prevents, or at least restricts, an owner's transfer of his or her ownership interest.

IV. Overview of Comments Received

On July 23, 2002, the FDIC published a notice of proposed rulemaking in the **Federal Register** (67 FR 48054) (the "notice of proposed rulemaking") which generally proposed that a bank chartered as an LLC would be considered to be "incorporated" if it had the four traditional, corporate attributes. The notice of proposed rulemaking also requested comments on three specific questions regarding the proposed rule. The FDIC received 23 comment letters from 22 organizations. All of the comment letters were generally in favor of granting deposit insurance to State banks organized as LLCs. The organizations filing comments included nine State trade associations, six State banks, three national trade associations, two law firms, an organization of State bank supervisors, and a State banking commissioner.

The three questions posed and a discussion of the responses received with respect to those questions, as well as the FDIC's analysis of those responses follow.

¹⁸ See Mark A. Sargent & Walter D. Schwidetzky, *Limited Liability Company Handbook* § 1:3 (rev. 2002).

¹⁹ See "Unif. Limited Liability Company Act," Prefatory Note, (amended 1996) 6A U.L.A. 426 (Supp. 2002).

²⁰ See Sargent & Schwidetzky, *supra* note 18, § 1:3.

²¹ See, e.g., Nev. Rev. Stat. § 86.491 (2001); Mass. Ann. Laws ch. 156C, § 43 (2002).

²² See, e.g., Mich. Comp. Laws § 450.4401 (2002); Ala. Code § 10-12-22(a) (2002).

²³ See, e.g., Vt. Stat. Ann., tit. 11, § 3043(b) (2002); Cal. Corp. Code § 17101(e).

²⁴ See, e.g., Mich. Comp. Laws § 450.4506 (2002); Pa. Stat. Ann. tit. 15, § 8924 (2002).