Journal of Multistate Taxation and Incentives
Volume 20, Number 9, January 2011
Department: *S CORPORATIONS, PARTNERSHIPS, AND LLCs*

IRS Issues Long-Awaited Guidance on Series LLCs; Will the States Soon Follow?

As the use of series LLCs inevitably grows, it will be crucial for state and local taxing authorities to provide their own guidance regarding whether they also will treat a series as a separate entity.

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In January 2007, the authors published an article in this Journal[1] addressing a number of potential state and local tax issues raised by a relatively new form of entity known as a "series limited liability company" ("series LLC"), the formation of which had been authorized under the laws of a handful of states.[2] There are two primary purposes of the series LLC provision: (1) to essentially subdivide the LLC into separate series between or among which a liability shield can be put in place; and (2) to minimize legal, accounting, and recording fees that might otherwise accrue when creating separate single-member LLCs underneath a series organization or "master LLC" (our term).

One of the conclusions reached in our earlier article was that many of the state tax questions raised by series LLCs would likely remain unanswered until guidance was issued by the Internal Revenue Service (IRS) and the U.S. Department of the Treasury as to how a series would be treated for federal income tax purposes. The Treasury Department finally issued that guidance in September 2010, in the form of proposed regulations (the "Proposed Series LLC Regulations").[3] Not unexpectedly, these proposals generally treat each series of an LLC as a separate entity and wisely apply the entity classification provisions of the so-called "check-the-box" regulations to each series.[4]

While many practitioners may assume that all states that levy a net income tax will simply adopt the position taken by Treasury and the IRS in the Proposed Series LLC Regulations, there are many situations where state tax treatment may diverge from the proposed regulations because the state does not conform to the Internal Revenue Code or chooses, for policy reasons, not to adopt the federal tax treatment. In addition, there are a number of state taxes not based on net income, for which states must determine whether adopting the federal income tax treatment of a series of an LLC is appropriate and, if not, what treatment should be provided for a series.

The following discussion will first examine the helpful and well-written guidance provided by Treasury in the Proposed Series LLC Regulations, and then will revisit some of the state tax questions raised in our January 2007 article and analyze the impact that these

proposed regulations may have on those issues. With the issuance of this long-awaited guidance, we likely will see an increased use of series LLCs as well as the issuance of additional guidance by the states regarding whether they will adhere to the federal tax treatment.

Series LLC Statutes

To date, eight states have enacted series LLCs statutes: Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, and Utah. [5] These statutes generally allow for the establishment of separate series underneath a series organization or master LLC. This essentially allows the LLC to be subdivided into separate series with separate rights, powers, and duties with regard to specific property or obligations of the LLC or with regard to profits and losses associated with specific property or obligations.

In addition, if certain statutory conditions are met, a series LLC can be formed such that the debts, obligations, and liabilities of one series will not be enforceable against the assets of another series—at least in a state that recognizes this type of legal entity. These series under the LLC are generally not treated as separate entities under state law [6] and thus cannot have members, but each series of the LLC will be "associated" with specific members, assets, rights, obligations, and objectives.

Even though series LLC statutes purport to limit liability between series, it remains to be seen how strictly the courts in states without series LLC statutes will enforce those foreign limited liability provisions. For example, if a series LLC is formed in Delaware with Series A holding valuable assets of the business, while Series B holds certain liability-prone operations of the business, will a court in another state, without a series LLC statute, uphold the limitation of liability where an individual is injured by an activity engaged in by Series B and Series B does not have sufficient assets to cover the damages? Similar to when LLCs were first created, there will be lingering questions about the enforceability of the liability shield of a series until more states enact series statutes. [7]

While similar, not all series LLC statutes are alike. The Delaware statute, for example, provides for the formation of a series with "a separate business purpose or investment objective" and, if the LLC agreement so provides, "the debts, liabilities, and obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only...." [8] The Illinois statute went a step further in establishing the separate existence of the series. The Illinois law specifically states that a series "shall be treated as a separate entity to the extent set forth in the articles of organization" of the LLC and that "[e]ach series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued, and otherwise conduct business and exercise the powers of a limited liability company...." [9]

Now that the Treasury Department has provided guidance as to the taxability of series, the use of series LLCs and related forms of entities will very likely increase, and that will eventually result (the authors hope) in more published guidance regarding the state tax and nontax issues related to the use of a series LLC. We also expect that a number of states will enact similar statutes, at least recognizing foreign series LLCs.

The Proposed Regulations: Determining the Tax Treatment of a Series

Under the Proposed Series LLC Regulations, the threshold question is whether a series of an LLC *should be treated as a separate entity for federal tax purposes*—not whether it is a separate entity under state law. The Proposed Series LLC Regulations provide that, for federal tax purposes, a series of an LLC formed under the laws of any state will generally be treated as a separate entity formed under local law. [10]

As such, each series' federal tax treatment is then determined under the check-the-box regulations. Readers may recall that these judicially endorsed regulations provide that the determination of whether an entity will be treated as an entity separate and apart from its owner(s) does not depend on whether the organization is recognized as a separate entity under state law. Thus, for example, certain joint ventures may be treated as entities for federal tax purposes even though they would not be recognized as such under state law. In addition, an entity may be disregarded for federal (and perhaps state) tax purposes even though it qualifies as an entity under local law, if, for example, it lacks a valid nontax business purpose. [11]

If the series does qualify as an entity separate from its owners, the check-the-box regulations will be applied to determine the federal tax treatment of the entity. Under those regulations, an "eligible entity" with two or more members can elect to be classified as either a corporation, or by default, as a partnership. An eligible entity with only one owner can elect to be classified as a corporation, or by default, as a disregarded entity treated as a division, sole proprietorship, or branch of its owner, depending on the owner's tax status. [12] An "eligible entity" is an entity other than one treated as a corporation under Treas. Regs. §§301.7701-2(b)(1) through (8).

Definitions in the proposed regulations.

The Proposed Series LLC Regulations define a "series organization" as a juridical entity that establishes and maintains, or under which is established and maintained, a "series." [13] Such entities include a domestic series LLC, foreign series, a series partnership, a series business or "statutory" trust, and a protected cell company. [14] The proposed regulations define a "series statute" as a statute enacted by a state or foreign jurisdiction that explicitly provides for the organization or establishment of a series and explicitly permits: "(1) [m]embers or participants of a series organization to have rights, powers, or duties with respect to the series; (2) [a] series to have separate rights, powers, or duties with respect to specified property or obligations; and (3) [t]he segregation of assets and liabilities such that none of the debts and liabilities of the series organization (other than liabilities to the State or foreign jurisdiction related to the organization or operation of the series organization, such as franchise fees or administrative costs) or of any other series of the series organization are enforceable against the assets of a particular series of the series organization." [15] The proposed regulations then drill down and define a "series" as a segregated group of assets and liabilities that is established pursuant to a series statute by agreement of a series organization. [16]

While the purpose of establishing a separate series is often to limit one series' liability for the debts and obligations of another series, these provisions may not apply for state law purposes if the series organization or series does not maintain records sufficient to adequately account for the assets associated with each series separately from the assets of the series organization or any other series of the series organization. Nevertheless, these putative limitations on liability generally will not alter the characterization of an entity for federal tax purposes. Thus, under the Proposed Series LLC Regulations, an election, agreement, or other arrangement that permits debts and liabilities of other series or the series organization to be enforceable against the assets of a particular series, or the loss of limited liability due to a failure to comply with recordkeeping

requirements, will not prevent a series from meeting the definition of "series" in the proposed regulations. [17]

The Proposed Series LLC Regulations treat a series as created or organized under the laws of the same jurisdiction in which the series organization (here, the master LLC) is established. Because a series may not be a separate juridical entity for state law purposes, this rule provides the means for establishing the applicable state law jurisdiction of the series for federal tax purposes. [18]

The Proposed Series LLC Regulations further provide that, for federal tax purposes, a series organization will not be treated as the owner of a series, or of the assets associated with a series, merely because the series organization holds legal title to the assets associated with the series. For example, if a state series LLC statute requires that a series organization hold legal title to assets associated with a series, the series not holding title will nevertheless be treated as the owner of the assets for federal tax purposes if it bears the economic benefits and burdens of the assets under general federal tax principles. [19]

To determine the ownership of interests in series and series organizations, the IRS will apply the same legal principles as it does to determine the owners of interests in other types of entities. These principles generally look to who bears the economic benefits and burdens of ownership. [20] In addition, common law principles will apply in determining whether a person is a partner in a series that is classified as a partnership for federal tax purposes under Treas. Reg. §301.7701-3.

Although some series LLC statutes, e.g., Delaware and Illinois, permit an individual series to enter into contracts, to sue and be sued, and/or to hold property in its own name, the failure of a statute to explicitly provide these rights will not alter the treatment of a domestic series as an entity formed under state law. These attributes primarily involve procedural formalities and do not appear to affect the substantive economic rights of series or their creditors with respect to their property and liabilities. Even in jurisdictions where series LLCs formed under that state statute may not possess these attributes, the statutory liability shields should still apply to the assets of a particular series, provided the statutory requirements are satisfied. [21]

Oddly, the Proposed Series LLC Regulations do not address the entity status, for federal tax purposes, of the series organization itself, only the status of each series underneath the series organization. For example, the proposed regulations do not address, and expressly leave open, the issue of whether a series organization is recognized as a separate entity for federal tax purposes if it has no assets and engages in no activities independent of its series. [22]

Continuing applicability of tax law authority to series. A series still may be disregarded under applicable law even if it satisfies the requirements of the proposed regulations to be treated as an entity formed under local law. For example, if a series has no business purpose or business activity other than tax avoidance, it may be disregarded. [23] Also, the anti-abuse rule of Treas. Reg. §1.701-2 is expressly made applicable to a series or series organization that is classified as a partnership for federal tax purposes. Under these rules, the partnership provisions of the Internal Revenue Code and the related regulations must be applied to this relatively new structure in a way consistent with their intent. [24]

Effect of state law classification on tax collection.

There are differences in state laws governing series LLCs (e.g., the rights to hold title to property and to sue and be sued are expressly addressed in some statutes but not in others) that may affect how creditors of series, including state taxing authorities, may enforce obligations of a series. The Proposed Series LLC Regulations provide that, to the extent federal or state law permits a creditor to collect a liability attributable to a series from the series organization or another of its series, the series organization and its other series also may be considered the taxpayer from whom the tax assessed against the series may be collected pursuant to administrative or judicial means. [25]

Effective date of proposed regulations.

The Proposed Series LLC Regulations are effective on and after the date the final regulations are published in the Federal Register. A grandfather rule was inserted for series established prior to the 9/14/10 publication of the proposed regulations where all series have been treated as one entity with the series organization and certain other requirements are met. [26] Such series may continue that prior treatment unless, on and after the date that any person or persons who were not owners of the series organization (or series) prior to 9/14/10 own, in the aggregate, a 50% or greater "interest" in the series organization (or series). Here, an "interest" is: (1) in the case of a partnership, a capital or profits interest; and (2) in the case of a corporation, an equity interest measured by vote or value. [27]

State Tax Issues Aplenty

As discussed in the authors' January 2007 article (noted above) on the potential state tax treatment of series LLCs, even though most states with corporate income taxes conform to federal tax law and will therefore likely adopt the treatment of a series as set out in the Proposed Series LLC Regulations, there are still many ways in which the state tax treatment of a series may differ from the federal tax treatment. Even those states with corporate income taxes that conform to the Internal Revenue Code may choose to legislatively opt out of conformity with the Proposed Series LLC Regulations, although practitioners certainly hope that does not occur. In addition, a number of states have recently enacted gross receipts-type taxes that do not conform to the federal income tax, and each of those states must determine how their unique taxes will apply to a series LLC. [28]

There are also other non-income-based taxes, e.g., sales and use taxes, imposed by most states that will not be directly affected by the income tax treatment of series LLCs under the Proposed Series LLC Regulations, unless the state specifically determines—be it by legislation, regulation, or ruling—that it will apply the same tax treatment to series LLCs as is provided by the IRS. [29] Since most states do not conform to the check-the-box regulations for purposes of their non-income taxes, it is unlikely that a series will be treated as a separate entity for purposes of these taxes simply based on the treatment of series in the Proposed Series LLC Regulations.

Practitioners should be aware of other instances in which the state tax treatment of a series may diverge from the federal tax treatment; they cannot assume that the series will be treated as a separate entity for state tax purposes just because it is for federal tax purposes. State departments of revenue will likely weigh the risks and benefits of following the federal treatment of a series before issuing any guidance or approaching their state legislature for a statutory change or confirmation. While ease of administration is the most obvious benefit of conformity, states may be concerned about the potential use of series LLCs in state tax planning and, thus, be reluctant to provide official guidance that implicitly approves them.

Entity-level state taxes on LLCs.

States that impose entity-level taxes or fees on LLCs may be quite eager to embrace the federal tax treatment of a series as a separate entity. States such as California, [30] Connecticut, [31] and Vermont [32] now impose taxes on LLCs. While California is the only state that has so far published guidance confirming that it will impose its LLC fee on each series of an LLC, [33] it seems likely that any state that has enacted a tax or fee levied on LLCs would be similarly inclined to extend it to each series of an LLC. Thus, the formation of numerous series under an LLC in these states could result in a substantial tax liability, and thus thwart one of the reasons most often given by proponents of series LLCs for their value.

Also, several states have recently enacted gross-receipts-based taxes that are imposed on all entities, including those treated as pass-through entities for federal income tax purposes. [34] For example, the Texas margin tax is imposed on most legal entities including limited liability companies. [35] While series LLCs are not specifically mentioned as taxable entities, there is a catch-all provision that says the tax is also imposed on "other legal entities." [36] The Texas Comptroller's Office has reportedly issued informal advice that it interprets this catch-all provision to include a series of an LLC as a separate taxpayer. Similarly, the Ohio commercial activity tax is imposed on most legal entities, including limited liability companies and "any other entities." [37]

Composite return and withholding provisions.

Another area where states are likely to conform to the Proposed Series LLC Regulations' separate entity treatment is with regard to composite income tax return and withholding provisions. Many states now require that pass-through entities with nonresident owners file composite returns that include all such owners or withhold and remit tax on income actually or constructively passed through to the nonresident owners. [38] This approach relieves the state of the responsibility of attempting to collect the tax from a nonresident who may have no contact with the state other than its ownership interest in the pass-through entity. Thus, a state with withholding requirements for partnerships with nonresident partners may quickly elect to apply those withholding provisions to a series that elects to be treated as a partnership for federal income tax purposes. For an LLC with numerous series, this could result in a substantial compliance burden and, again, thwart one of the oft-cited purposes for using a series LLC.

These circumstances would also be true for composite return requirements. If a series LLC were to form a number of series in a state that required the filing of composite returns, and that state follows the Proposed Series LLC Regulations, each series would be required to file a separate composite return if its owners were nonresidents. This could create a tremendous compliance burden. In contrast, if a state chooses not to conform to the federal tax treatment of a series, such that each series is not treated as an entity separate from the LLC, the compliance burden for the series would be substantially lessened.

Nexus.

Another pressing issue that should be addressed quickly is how a series will be treated for purposes of determining nexus for the owners—particularly any nonresident members—of the series. If the series is treated as a separate entity, the question will be whether a nonresident member of a series will have nexus based on its ownership interest in the series. If the series is not treated as an entity under state law, then arguably the member(s) would have a direct ownership interest in the assets of the series rather than the ownership of an intangible, i.e., the ownership interest in a separate entity.

In applying nexus requirements to LLCs, there has been much debate over whether the state law treatment or the tax law treatment of the entity should be controlling. [39] This issue also arises with respect to a series LLC, but the roles may be reversed.

Nexus and LLCs generally. When determining nexus for the nonresident members of an LLC, the question arises because an LLC is treated as a separate juridical entity for state law purposes but may be disregarded as a separate entity for tax purposes. If a nonresident member of the LLC is treated as having an (intangible) ownership interest in a separate entity, and has no other connection to the state, that ownership interest should not be enough to create nexus. [40] This determination is muddied, however, by the check-the-box regulations.

If the LLC elects, under the check-the-box regulations, to be taxed as a corporation for federal and state income tax purposes, the LLC will normally be treated as a separate entity under state law as well. In that case, it would seem clear that the nonresident member does not have nexus based solely on owning an intangible interest in a separate entity doing business in the state. If, however, a single-member LLC is disregarded as a separate entity under the check-the-box regulations, the LLC will not exist for federal and perhaps state tax purposes, even though it should still be a separate juridical entity under state law. The issue then becomes whether the nexus determination for the nonresident member should be based on the LLC's status as a separate juridical entity under state law or in accordance with its tax classification as a disregarded entity. In the latter case, the nonresident member would be treated as carrying on the business of the LLC directly. Thus, the question becomes whether the treatment of an entity under the check-the-box regulations controls in determining nexus. [41]

Nexus and series LLCs. When determining nexus for a nonresident member of a series of an LLC, the opposite situation could be created. If the Proposed Series LLC Regulations are followed by a state, the tax classification of the series does not depend on whether the series is organized so that it is a separate juridical entity under that state's law. Thus, a series might not be treated as a separate entity for state law purposes but nevertheless could be treated as a separate entity for tax purposes. Accordingly, if a series is itself doing business in a state and elects to be taxed as a corporation, and the state looks to the treatment under its own law and not the treatment under the check-the-box regulations, a series might create nexus for the nonresident member(s) of the series because the series does not qualify as a separate entity under state law.

For example, Company X is a series LLC that operates in State A and forms a series ("Series 1") that does business only in State B. Company X makes substantial sales into State B but has no other connection to the state except for its ownership of Series 1. State B imposes an income tax that is apportioned using a single sales factor. State B follows the check-the-box regulations and adopts the tax treatment of series LLCs set out in the Proposed Series LLC Regulations. Series 1 elects to be taxed as a corporation. Series 1 will be treated as a separate entity and subject to tax in State B regardless of whether it qualifies as a separate juridical entity under state law. [42] If the state looks to the classification of an entity under state law in determining nexus, then Company X will be considered to be carrying on the business of Series 1 in the state and thus may have nexus with the state. Series 1 will be required to pay State B tax on its income because it is taxed as a separate entity. But would Company X now be required to file a return based on its sales into the state because, for state law purposes, Series 1 is not a separate juridical entity even though it is treated as a separate entity for tax purposes? [43]

A similar approach was recently taken by the U.S. Tax Court with regard to whether an LLC should be treated as a separate entity for purposes of the federal gift tax. In *Pierre v. C.I.R.,* [44] the court considered whether, for gift tax purposes, the sale of an interest in a

single-member LLC was the sale of a separate entity. The LLC was treated as a disregarded entity under the check-the-box regulations, but the taxpayer argued that for gift tax valuation purposes, it was necessary to look to state law, not the federal regulations, to determine whether the sale was the transfer of an interest in an LLC or a sale of the assets of the LLC.

The court held that while the check-the-box regulations determined how a single-member LLC would be treated for federal income tax purposes, those regulations did not apply "in determining how a donor must be taxed under the Federal gift tax." Such an application of the regulations, the court determined, would "require that Federal law, not State law, apply to define the property rights and interests transferred by a donor for valuation purposes under the Federal gift tax regime." That result could not be proper because the question of how a transfer of an ownership interest in an LLC should be valued for gift tax purposes "is not the question addressed by the check-the-box regulations." A court could apply that same reasoning when examining how a taxpayer's ownership interest in a series of an LLC should be treated for state tax nexus purposes. The owner's rights in the LLC could be examined under state law and not based on the treatment of the series as a separate entity for federal income tax purposes.

Series LLCs also may allow companies to limit certain activities to particular states without the trouble and expense of forming new LLCs. For example, an LLC doing business in State A, which is a high-tax state, also has operations in State B, which is a low-tax state. The operations in State B generate substantial income. If the State B operations were placed in a separate series that elected to be taxed as a corporation, the income earned in State B would not have to be included in the State A return. The same could be accomplished by forming a subsidiary LLC in State B, but there are additional steps that must be taken and costs incurred in forming a new LLC that are not necessarily required for setting up a series.

Nexus and series treated as a tax partnership. Another question that appears to be unanswered by the Proposed Series LLC Regulations is the relationship of the series organization, i.e., the LLC itself, to a series treated as a tax partnership. The proposed regulations discuss how certain members are "associated" with a series but do not address the relationship between the series organization and the series for tax purposes. The proposed regulations state that the series organization will not be treated as the owner of the assets of the series merely because the series organization owns title to those assets. Presumably, if a series is treated as a tax partnership, the members associated with the series will be treated as the partners of the series, but it is not clear how the series organization will be treated with respect to the tax partnership. This situation could raise questions when analyzing state nexus issues.

For example, a series organization ("Master LLC") has two members and forms two series ("Series 1" and "Series 2"), which are treated as separate entities for federal tax purposes. Series 1 and Series 2 each elects to be treated as a tax partnership. The two members of Master LLC are "associated with" each series on an equal basis. Neither the two members nor Master LLC are engaged in business in the state where Series 1 and Series 2 operate.

Under the Proposed Series LLC Regulations, it would appear that the two members would be treated as partners in Series 1 and Series 2, with each having a 50% partnership interest. While the proposed regulations do not address the treatment of Master LLC in this situation, it does not appear that it would be treated as a partner in the tax partnership. Thus, when determining whether a partner has nexus in the state where Series 1 or Series 2 operates, would only the members associated with that series be

considered partners or could the state also assert that Master LLC has nexus based on the presence of the series in the state?

Sales of a series.

Questions as to whether a member of a series is treated as owning an interest in a separate entity or as owning the assets of the series will also affect the determination of how the sale of a series is treated. Most states will treat the sale of an LLC that is taxed as a partnership as the sale of an interest in the LLC, and not a sale of its underlying assets. If the LLC elects to be treated as a disregarded entity, however, the sale of the entity by the sole member will be treated as the sale of the LLC's assets.

Presumably, states that choose to follow the treatment of series as set out in the Proposed Series LLC Regulations would provide a similar analysis to the sale of a series of an LLC, and the sale would therefore be treated as the sale of an intangible. Conversely, states that do not adopt the federal tax treatment will likely treat the transaction as if the LLC sold its assets. To date, however, there is limited (if not inconsistent) guidance regarding how states will treat the sale of a partnership interest; and there likely will be little guidance issued in the near future on the state tax treatment of the sale of a series. In addition, in states that do not adopt the provisions of the Proposed Series LLC Regulations, or with respect to taxes other than net income taxes, it is far from clear how the sale of a series will be treated.

While sales and use taxes are generally based on form over substance, which would indicate conforming treatment of the series as a separate entity, that may not be the case when the series is not a juridical entity under state law. And given the ease with which a series can be established, if a state elects or is required to treat a series as a separate entity for sales tax purposes, it would be theoretically possible for a taxpayer to form a separate series for each taxable item to be sold and then sell its interest in the entity rather than the underlying property, thus transforming the sale into a nontaxable sale of an intangible. [45] These so-called "drop-kick transactions" and similar issues involving realty transfer taxes must be addressed by the states as the use of series LLCs increases in the years to come.

Employment/payroll taxes.

The Proposed Series LLC Regulations expressly reserve guidance on how a series should be treated for purposes of federal employment taxes (i.e., whether the series should be treated as a separate employer) and, indeed, request public comments on that issue. Given that the check-the-box regulations were amended only recently to make an otherwise disregarded single-member LLC (rather than its sole member) the employer, [46] it would seem logical that the IRS will follow that rubric with a series. But the federal determination often dictates the state determination, and the states may hesitate to issue guidance on this issue until the IRS makes up its mind. Indeed, one of the few state-related tax issues on which the IRS seeks comments is this very issue. [47]

Conclusion

By clarifying the circumstances under which a series will be treated as a separate entity and the interrelationship with the check-the-box regulations, the long-awaited Proposed Series LLC Regulations should benefit those taxpayers using, or considering the use of, series LLCs. We believe that once the proposed regulations are issued in final form, this guidance will result in a dramatic increase in the use of series LLCs. As the utilization of these hybrid (if not chameleonic) entities inevitably grows, it will be crucial for state and local taxing authorities to provide their own guidance regarding whether they also will

treat a series as a separate entity, for both income taxes and other types of taxes imposed on the entity. Given the multitude of state and local taxing jurisdictions, however, it is unlikely that there will ever be uniformity in the tax treatment of series LLCs, a situation that taxpayers could find both beneficial and harmful. Stay tuned. **[]**

NOTES

1

McLoughlin and Ely, "The Series LLC Raises Serious State Tax Questions but Few Answers Are Yet Available," 16 J. Multistate Tax'n 6 (January 2007). The authors of this and the current article are also members of a joint task force, composed of members of several committees of the American Bar Association (ABA) Section of Taxation, formed to provide comments to the IRS in response to its notice of proposed rulemaking (see note 3, *infra*) and request for comments on the Proposed Series LLC Regulations. The authors' side of the task force is concentrating on the SALT issues.

2

While the first series LLC statute was enacted in Delaware in 1996, it has only been in the last few years that a number of other states have followed.

3

REG-119921-09, filed 9/13/10, published 9/14/10 (F.R. Doc. 2010-22793; 75 Fed. Reg. 55699 *et seq.*), adding Prop. Treas. Regs. §§301.6011-6, 301.6071-2, and 301.7701-1(a)(5), and amending §§301.7701-1(e) and (f). Hereinafter, the "Proposed Series LLC Regulations."

4

See Treas. Regs. §§301.7701-1 through -5. Under the check-the-box rules, a domestic entity formed as a corporation under state law must be treated as a corporation for tax purposes. An "eligible entity" that is not a state law corporation and that has more than one owner can elect to be treated as either a corporation or a partnership. If it has only one owner, it can elect to be treated as a corporation or to be disregarded as an entity separate from its owner (i.e., like a branch or division of the owner). For background on these rules, see generally Peabody, "Check-the-Box Treasury Regs. Encourage States to Authorize Single-Member LLCs," 7 J. Multistate Tax'n 79 (May/Jun 1997); Peabody, "States Generally Endorse Check-the-Box but Key Issues Remain," 7 J. Multistate Tax'n 206 (Nov/Dec 1997). For a state-by-state analysis of conformity with these landmark regulations, see Ely, Grissom, and Thistle, "State Tax Treatment of LLCs and LLPs: Update for 2010," 20 J. Multistate Tax'n 6 (May 2010).

5

See Del. Code Ann. tit. 6, §18-215; 805 ILCS §180/37-40; Iowa Code §489.1201 *et seq.* (effective 1/1/09); Nev. Rev. Stat. §86.161; Okla. Stat. tit. 18, §2005; Tenn. Code Ann. §48-249-309; Tex. Bus. Org. Code §101.601 *et seq.* (effective 9/1/09); and Utah Code Ann. §48-2c-606. Puerto Rico has also enacted a series LLC statute (see P.R. Laws Ann. tit. 14, §3426p). Several other states, e.g., Wisconsin, Minnesota, and North Dakota, have language in their LLC statutes discussing "classes" and "series" of membership interests, but no provisions for the layers or "firewalls" of protection that the typical series LLC act contains.

6

The Illinois and Iowa series LLC statutes allow the series to be formed such that it is a separate entity, if the articles of organization so provide.

7

The Revised Uniform Limited Liability Company Act (2006) does not contain series provisions, while the Revised Uniform Statutory Trust Entity Act (2009) does. For the explanation from a member of the drafting committees, see Rutledge and Habbart, "The Uniform Statutory Trust Entity Act: A Review," 65 Bus. Law. 1055 (August 2010), page 1072, fn. 118. Note, however, that the ABA's Revised Prototype Limited Liability Company Act (in its present draft form) contains series provisions.

8

Del. Code Ann. tit. 6, §§18-215(a) and (b).

9

805 ILCS §180/37-40(b).

10

Prop. Treas. Reg. §301.7701-1(a)(5).

11

Proposed Series LLC Regulations, *supra* note 3, Preamble, page 6.

12

Treas. Reg. §301.7701-2.

13

Prop. Treas. Reg. §301.7701-1(a)(5)(viii)(A).

14

Id. A number of states have enacted statutes that authorize the formation of protected cell companies, segregated account companies or segregated portfolio companies. This article, however, focuses solely on series LLCs and not on other entities discussed or contemplated in the proposed regulations.

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Prop. Treas. Reg. §301.7701-1(a)(5)(viii)(B).

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Prop. Treas. Reg. §301.7701-1(a)(5)(viii)(C).

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Proposed Series LLC Regulations, *supra* note 3, Preamble, pages 16-17.

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Prop. Treas. Reg. §301.7701-1(a)(5)(v).

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Prop. Treas. Reg. §301.7701-1(a)(5)(vi).

20

Proposed Series LLC Regulations, *supra* note 3, Preamble, pages 16-17.

21

Beard, "Jurisdictional Competition and the Series LLC: Harnessing the Market for Innovations in Limited Liability," 12 Holy Cross J. Law & Pub. Policy 9 (2008), pages 35-37.

22

Proposed Series LLC Regulations, *supra* note 3, Preamble, pages 21 and 34.

23

Cf. Bertoli v. C.I.R., 103 TC 501 (1994); Aldon Homes, Inc. v. C.I.R., 33 TC 582 (1959).

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Proposed Series LLC Regulations, *supra* note 3, Preamble, page 19.

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Prop. Treas. Reg. §301.7701-1(a)(5)(vii).

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Prop. Treas. Reg. §301.7701-1(f)(3)(ii).

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Prop. Treas. Reg. §301.7701-1(f)(3)(ii)(B).

28

For background on some of these new tax regimes, see Grob and Roberts, "The Michigan Business Tax Replaces the State's Much-Vilified SBT," 17 J. Multistate Tax'n 8 (October 2007), and "Michigan Business Tax Update: Significant Amendments Enacted as the New MBT Goes Into Effect," 18 J. Multistate Tax'n 14 (Mar/Apr 2008); Sutton, Yesnowitz, Ford, Zins, and Conley, "Ohio's New Commercial Activity Tax: What It Means for Business," 15 J. Multistate Tax'n 8 (February 2006); Jackson and Wellington, "Major Tax Reform in Texas: An Overview of the State's New Margin Tax," 16 J. Multistate Tax'n 8 (October 2006).

29

A handful of states also recognize the check-the-box regulations' classification of LLCs for purposes of certain non-income taxes, such as sales, use, and lease/rental taxes. See, e.g., Ala. Code §10-12-8(b); Ala. Rev. Proc. 98-001, 3/16/98; see also Fenwick, McLoughlin, Salmon, Smith, Tilley, and Wood, *State Taxation of Pass-Through Entities and Their Owners* (Thomson Reuters/WG&L, 2006), Appendix, Table 17, "Status of Disregarded Entities in the Sales and Use Tax Context." (Also available on Thomson Reuters' Checkpoint database, updated, at this writing, to May 2010.)

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Cal. Rev. & Tax. Code §§17941 and 17942.

31

Conn. Gen. Stat. §12-284b, Conn. Special Notice No. 2006(12), 12/19/06.

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32 Vt. Stat. Ann. §5921.

33

See 2009 Limited Liability Company Tax Booklet (instructions to California Form 568, Limited Liability Company Return of Income), and Cal. FTB Informational Pub. No. 3556, September 2009 ("Limited Liability Company Filing Information"). See also Stein, "Tilting at Windmills: California's Treatment of a Foreign Jurisdiction's Series LLC," 10 Business Entities 16 (May/Jun 2008). For more background on the California LLC fee issue, see Pace, Moll and Ely, "Wrestling With Taxes in the Golden State—California's Unconstitutional LLC Fee," 16 J. Multistate Tax'n 24 (July 2006).

34

See Ely, Thistle, and McLoughlin, "Recent Developments in State Taxation of Pass-Through Entities and Their Owners," 20 J. Multistate Tax'n 6 (September 2010), pages 16-17.

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34 Tex. Admin. Code 3.581(c).

36

34 Tex. Admin. Code 3.581(c)(14).

37

Ohio Rev. Code Ann. §5751.01(A).

38

For a listing of states with such requirements, see Fenwick, McLoughlin, Salmon, et al., *supra* note 29, ¶6.01. See also Lee, Ely, and Rimkunas, "State Taxation of Partnerships and LLCs and Their Members," 19 J. Multistate Tax'n 6 (February 2010), pages 12-15.

39

For an analysis regarding the application of the check-the-box regulations to pass-through entities and their owners for state and local tax purposes, see McLoughlin and Hellerstein, "Nexus Issues for Corporate Partners and LLC Members After Check-the-Box," 13 J. Multistate Tax'n 6 (September 2003). That article draws freely from the same authors' "State Tax Treatment of Foreign Corporate Partners and LLC Members After Check-the-Box," which appeared in the 2003 issue of the ABA's *State and Local Tax Lawyer.*

40

For cases addressing nexus issues for owners of LLCs and other pass-through entities, see, e.g., Kulick v. Dept. of Revenue, 624 P2d 93 (Or., 1981), *app. dismissed* U.S. S.Ct., Docket No. 80-2047, 10/5/81; CRIV Investments, Inc. v. Oregon Dept. of Revenue, Or. Tax Ct., No. 4046, 4/23/97, 14 OTR 181, 1997 WL 215719; Borden Chemicals & Plastics, L.P. v. Zehnder, 726 NE2d 73 (Ill. App. Ct. 1st Dist., 2000), *app. den.* Ill., No. 89197, 5/31/00; Lanzi v. Alabama Dept. of Revenue, 968 So 2d 18 (Ala. Ct. Civ. App., 2006), *cert. den.* Ala., No. 1051475, 4/13/07; and Revenue Cabinet v. Asworth Corp., Ky. Ct. App., Docket Nos. 2007-CA-002549-MR, 2008-CA-000023-MR, 11/20/09, *as modified* 2/5/10, 2009 WL 3877518, *rev. den.* 8/18/10. The Journal has previously covered most of these cases: CRIV was discussed in Shop Talk, "Oregon Upholds Assessment of Income Tax on Out-of-State Corporate Investor," 7 J. Multistate Tax'n 234 (Nov/Dec 1997); Borden in Hughes and Fader, "Illinois: Court Allows Pass-Through of Investment Credits," 10 J. Multistate Tax'n 35 (June 2000); Lanzi in Ely and Houser, "Alabama: No Income Tax Nexus for Nonresident Limited Partner in Investment Partnership," 17 J. Multistate Tax'n 38 (August 2007) (also see Blackburn, "Due Process and States' Attempts to Tax Nonresident Limited Partners," 19 J. Multistate Tax'n 18 (September 2009)); and Asworth in Ely, Thistle, and McLoughlin, *supra* note 34.

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See McLoughlin and Hellerstein, *supra* note 39.

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Prop. Treas. Reg. §301.7701-1(a)(5).

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One of the principal questions contained in the ABA Section of Taxation's Task Force (see *supra* note 1) questionnaire to the states involves this issue.

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133 TC 24 (2009).

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See Ely, Thistle, and McLoughlin, *supra* note 34, pages 15-16.

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Treas. Reg. 301.7701-2(c)(2)(iv).

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Proposed Series LLC Regulations, *supra* note 3, Preamble, pages 26-28.

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