

CORPORATE TAXATION

IRS ISSUES PROPOSED REGULATIONS ON "SERIES LLC'S"

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The Internal Revenue Service ("IRS") recently issued proposed regulations ("Proposed Regs") to clarify the federal income tax treatment of so-called "series LLC's," which are permitted by the laws of several states, including Delaware and Tennessee. In states that authorize series LLC's, a single limited liability company can have different owners for different assets and/or businesses that are owned by a single limited liability company. Under the Proposed Regs, each separate series will be taxed separately for federal income tax purposes. If the Proposed Regs become effective, one of the advantages to the use of series LLC's, reduced federal tax filing requirements, will be eliminated. Whether series LLC's also eliminate state and local tax returns and other organizational and reporting requirements will vary state by state.

The operation of the Proposed Regulations can best be shown by an example.

The Operating Agreement for Restaurant Co., a Tennessee limited liability company, which does not elect to be taxed as a corporation, provides that its three restaurants, Restaurants Nos. 1, 2 and 3, will be treated as a series LLC. Restaurant No. 1 is equally owned by A, B and C, all individuals. Restaurant No. 2 is equally owned by A and B. Restaurant No. 3 is wholly owned by A.

Under the Proposed Regs, Restaurant Nos. 1 and 2 must file separate partnership tax returns (Form 1065), one for Restaurant No. 1 (showing A, B and C each owning 33.333% of that restaurant's income and expenses) and the other for Restaurant No. 2 (showing A and B as 50% owners). The income, deductions and other activities of Restaurant No. 3 are treated as if Restaurant Co. were a disregarded entity, meaning all such activities are properly reported on Schedule C of A's federal tax return. Unless Restaurant Co. has residual income and deductions (other than those that relate to its three restaurants), it need not file a return. Because each series (each restaurant in the example above) is treated as a separate taxpayer that must file its own tax return, presumably each restaurant will need to obtain its own Employer Identification Number. In addition, each restaurant (called a series in the Proposed Regs) is required to file an information statement by March 15 that lists Restaurant Co. (called a series organization in the Proposed Regs) as the owner of its three series and that provides certain details as to each series that is owned by the series organization. Unless the LLC has income, deductions and credits apart from the total items of the one or more series that it owns, the LLC need not file its own tax return. Likely, the LLC will still need its own Employer Identification Number.

The above example illustrates that at least for federal tax purposes, there is no advantage to the use of a single legal entity to simplify a business operation's legal structure. In the example, it will likely be simpler to form three separate LLC's rather than face potential exposure from failure to comply with these filing requirements. Moreover, the Proposed Regs do not address whether the series LLC must obtain a separate employer identification number for each series and how employment tax filing requirements will be met by the LLC. The IRS specifically solicited comments on this latter topic.

FOR MORE INFORMATION, PLEASE CONTACT:



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