Series LLCs: 
Advanced Planning and Tax Implications 
Advantages and Disadvantages, Existing IRS Guidance, Tax Pitfalls, and Alternative Structures 

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Today’s faculty features:

Joseph C. Mandarino, Partner, Smith Gambrell & Russell, Atlanta
Allen Sparkman, Partner, Sparkman & Foote, Denver and Houston

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Series LLCs: An Advanced Planning Tool

Allen Sparkman
SPARKMAN + FOOTE LLP
2800 Post Oak, Ste.4100
Houston, TX 77056
713.401.2922 (voice)
713.859.7957 (cell)
1.218.783.6986 (fax)
sparkman@sparkmanfoote.com  www.sparkmanfoote.com
WHAT IS A SERIES LLC?

A series LLC is an LLC formed pursuant to a statute that allows a single juridical LLC to form one or more “series” having different members, assets, and liabilities associated with each series.

If notice and record-keeping requirements are satisfied, the state series statutes provide that an individual series is not liable for the debts of any other series or the series LLC, and vice-versa.
As of February 1, 2018, the jurisdictions permitting the formation of series LLCs are—
Alabama, Delaware, the District of Columbia, Illinois, Indiana, Iowa, Kansas, Missouri, Montana, Nevada, Oklahoma, Puerto Rico, Tennessee, Texas, and Utah
XYZ is taxable as a partnership. It has three members—individuals Able, Baker, and Charlie. ABC has two wholly owned subsidiary single-member LLCs—Single-Member LLCs 1 and 2. Under XYZ’s LLC agreement, Able and Baker have “special allocations” of ABC’s income and loss from SMLLC1, while Charlie has a “special allocation” of ABC’s income and loss from SMLLC 2.
COMPARISON OF SERIES STRUCTURE WITH OTHER STRUCTURES

ABC is taxable as a partnership. It has three members—individuals Able, Baker, and Charlie. It has two series—Series 1 and 2. Under ABC’s LLC agreement, Able and Baker are associated with Series 1. Charlie is associated with Series 2.

The series structure allows Able, Baker, and Charlie to accomplish their business and economic goals through a single entity.
The District of Columbia, Illinois, Indiana, Iowa, Kansas, Missouri, and Utah statutes permit a series to be treated as a separate entity. The other series jurisdictions do not permit this, and it is clear in such a jurisdiction that an individual series may not merge with or convert to another entity.

In the separate entity jurisdictions, an individual series arguably may engage in a merger or conversion. It is uncertain what the consequences would be.
Preliminary Issues with Series LLCs

Even in the series jurisdictions that do not permit a series to be treated as a separate entity, the series statutes provide that a series may hold title to assets and sue and be sued in its own name.
Preliminary Issues with Series LLCs

Delaware and Nevada do not require any public notice in connection with the formation of a series nor do they have any requirement that the name of an individual series indicate that it is a series.
In Texas, if the name of any series established by a series LLC differs from the name of the series LLC stated in its certificate of formation, the LLC must file an assumed name certificate for that series. Query whether the name of a series would not always vary from the name of the series LLC stated in its certificate of formation—which means Texas would always require an assumed name certificate for a named series—which may well be the intent of the statute.
Preliminary Issues with Series LLCs

The series jurisdictions that permit separate entity treatment generally require more notice, such as the filing of a public designation for each series.
Preliminary Issues with Series LLCs

Notwithstanding that some series require more notice, the lack of a notice requirement in Delaware and Nevada is serious.
Preliminary Issues with Series LLCs

Notwithstanding that some series jurisdictions permit a series to be treated as a separate entity, all series jurisdictions provide that the registered agent of the series LLC is the registered agent of each of its series, the annual or other reporting is to be done by the series LLC, and a series will be in good standing only if the series LLC is in good standing.
Preliminary Issues with Series LLCs—Accounting for Assets

To obtain the liability shield, Delaware requires that “separate and distinct records are maintained for any such series and the assets associated with any such series are held (directly or indirectly, including through a nominee or otherwise) and accounted for separately from the other assets of the limited liability company, or any other series thereof.”
The Uniform Protected Series Act

On July 19, 2017, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) approved and recommended for enactment in all of the States the Uniform Protected Series Act (“UPSA”). The final version of the UPSA, with prefatory note and comments, is dated November 14, 2017. The UPSA was drafted by the Drafting Committee on Series of Unincorporated Business Entities of NCCUSL. The author was an ABA Advisor to the Drafting Committee.
The Uniform Protected Series Act

Although I believe the UPSA to be a welcome advance in series LLC legislation, I do not think a uniform act was appropriate. To my knowledge, NCCUSL’s recommendation that the UPSA be enacted in all of the States is not based on any analysis.
The Uniform Protected Series Act

The UPSA uses the term “protected series” to describe an individual series of a series LLC.
The Uniform Protected Series Act

To form a “protected series,” the UPSA requires the series LLC to file a protected series designation that states the name of the series LLC and the name of the protected series.
The Uniform Protected Series Act

The UPSA also requires that the name of a protected series begin with the name of the series LLC and contain the phrase “Protected Series” or “protected series” or the abbreviation “P.S.” or “PS”. 
The Uniform Protected Series Act—Accounting for Assets

The UPSA provides and requires much more detail than do existing series LLC statutes.

Only an asset of a protected series may be an associated asset of the protected series, and only an asset of the series LLC may be an associated asset of the series LLC.
The Uniform Protected Series Act—Accounting for Assets

An asset of a protected series may be an associated asset only if the protected series creates and maintains records that state the name of the protected series and describe the asset with sufficient specificity to permit a disinterested, reasonable individual to:
The Uniform Protected Series Act—Accounting for Assets

Identify the asset and distinguish it from any other assets of the protected series, any assets of the series LLC, and any assets of any other protected series of the series LLC;

Determine when and from what person the protected series acquired the asset or how the asset otherwise became an asset of the protected series; and

If the protected series acquired the asset from the series LLC or another protected series of the series LLC, determine any consideration paid, the payor, and the payee.
The Uniform Protected Series Act—Accounting for Assets

Similar requirements apply to determining if an asset is an associated asset of a series LLC.
The Uniform Protected Series Act—Accounting for Assets

The UPSA permits the records and recordkeeping required to “be organized by specific listing, category, type, quantity, computational or allocational formula or procedure, including a percentage or share of any asset or assets, or in any other reasonable manner.”
The Uniform Protected Series Act—Accounting for Assets

A series LLC or a protected series may hold an associated asset directly or indirectly, through a representative, nominee, or similar arrangement, except that:

A protected series may not hold an associated asset in the name of the series LLC or another protected series of the series LLC; and

The series LLC may not hold an associated asset in the name of a protected series of the series LLC.
The Uniform Protected Series Act—Accounting for Assets

Why is it important if an asset is an “associated asset?” If a series or the series LLC holds assets that are not associated assets, perhaps because of poor record-keeping, those assets will be subject to liabilities of the series LLC or any of its series.
The Uniform Protected Series Act

The UPSA provides that a protected series may not engage in any entity transaction except that a series LLC may be a party to a merger if each other party to the merger is an LLC and the surviving company is not created in the merger.
A protected series may not:

- Be an acquiring, acquired, converting, converted, merging, or surviving entity;
- Participate in a domestication; or
- Be a party to or be formed, organized, established, or created in a transaction substantially like a merger, interest exchange, conversion, or domestication.
The Uniform Protected Series Act

A series LLC may not be an acquiring, acquired, converting, converted, domesticating, or domesticated entity and may not be a party to or the surviving company of a merger except that a series LLC may be a party to a merger only if:

- Each other party to the merger is an LLC; and
- The surviving company is not created in the merger.
Information rights present another issue that is complicated by a series structure. In Delaware, each “member of a limited liability company” is entitled to inspect certain records of the LLC. Unless limited by agreement, each member associated with a series of a series LLC has the right to examine all of the records of the limited liability company. Although at first blush one might think that a member’s information rights should be limited to the series that the member is associated with, there are some records that will always be relevant to all members.
Moreover, in some cases, members may need access to information about other series to understand fully the information about the particular series a member is associated with.
Texas law may limit the information rights of members associated with a series to information about the series LLC or other series. The Texas LLC Act provides that the information rights section of the Texas LLC Act will be applied to a series LLC by substituting series for limited liability company or company and by substituting member associated with a series for member.
This appears to limit a member’s information rights to the series with which the member is associated; however, another provision of Texas law, in the Texas Business Organizations Code but not in the LLC Act, states that “each owner [and] member of a filing entity” may examine certain records of the entity.
The Uniform Protected Series Act—Information Rights

Other series LLC jurisdictions are, at best, ambiguous.
A member of a series LLC that is not an associated member of a protected series has the same right to information about the protected series that a member that is not a manager of a manager-managed LLC has a right to information about that LLC under applicable law.
The Uniform Protected Series Act—Information Rights

A person who was an associated member of a protected series has the same right to information about the protected series that a person dissociated as a member of a manager-managed LLC has a right to information about that LLC under applicable law, if provisions of applicable law provide information rights to dissociated members.
The Uniform Protected Series Act—Information Rights

The legal representative of a deceased associated member of a protected series has the same right to information about the protected series that a legal representative of a deceased member of an LLC has to information about the LLC under applicable law.
The Uniform Protected Series Act—Information Rights

A protected series manager of a protected series has the same right to information about the protected series as a manager of a manager-managed LLC has to information about that LLC under applicable law.
The Uniform Protected Series Act—Information Rights

Whether a member associated with a series has rights to information about that series depends on the operating agreement and other provisions of the applicable jurisdiction’s LLC statute.

The series LLC has no right to information about any of its series unless provided in the operating agreement.
The Uniform Protected Series Act—Duties

A problem for the negotiation and drafting of any company agreement is the application of duties, including fiduciary duties. In the case of a series LLC, this requires determining how the duties will be applied among and between the officers, managers, and members of a series LLC and its individual series. The management structure desired by the parties will dictate the precise analysis of the problem, and the flexibility permitted to management structures in LLCs will require that analysis be made on a case-by-case basis.
The Uniform Protected Series Act—Duties

One issue that may arise in a series LLC is whether a breach by the manager of one series may materially impact another series. Consider a series LLC that operates several liquor stores, each in an individual series, under a single license. What if a manager of one of the series violates the liquor law so egregiously that the series LLC loses its license? Under existing series LLC statutes, the answer will be unclear unless the operating agreement provides a clear answer.
The Uniform Protected Series Act—Duties

The default rule under the UPSA is that a manager of one series will owe no duty to another series or to the series LLC.
This rule may be varied by agreement.
Income Tax Treatment of Series LLCs

Joseph C. Mandarino
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Smith, Gambrell & Russell, LLP
Promenade, Suite 3100
1230 Peachtree Street, N.E.
Atlanta, Georgia 30309
www.sgrlaw.com
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Background

• IRS issued proposed regulations on series LLCs on 9/14/2010 (REG-119921-09)

• Regulations are proposed to be effective on the date they are published as final in the Federal Register.

• The IRS has requested comments on the proposed regulations and on several open issues, but has not as of yet determined whether to schedule a hearing.
Key Definitions

• series organization
• series statute
• series
Series Organization

• “series organization” is a juridical entity that establishes and maintains, or under which is established and maintained, a “series”

• series organization includes a series limited liability company, series partnership, series trust, protected cell company, segregated cell company, segregated portfolio company, or segregated account company
Series Statute

• A “series statute” is a statute of a State or foreign jurisdiction that explicitly provides for the organization or establishment of a series of a juridical person and explicitly permits—
  – members or participants of a series organization to have rights, powers, or duties with respect to the series;
  – a series to have separate rights, powers, or duties with respect to specified property or obligations; and
  – the 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.
Series

• A “series” is a segregated group of assets and liabilities that is established pursuant to a series statute by agreement of a series organization.

• A “series” includes a series, cell, segregated account, or segregated portfolio, including a cell, segregated account, or segregated portfolio that is formed under the insurance code of a jurisdiction or is engaged in an insurance business. (But -- the term does not include a segregated asset account of a life insurance company.)

• 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 a failure to comply with the record keeping requirements for the limitation on liability available under the relevant series statute, is disregarded.
Critical Question

Are the series separate entities for federal income tax purposes?
Entity Classification Rules

• Is the arrangement/state law entity treated as a separate entity for federal income tax purposes?

• If yes – does specific rule govern? (i.e., §860A governing REMICs)

• If no special rule, turn to general classification scheme:
  – Is this a “trust” or a “business entity”? If former, taxed as trust per §301.7701-4.
  – Is this a “per se” corporation”? If yes, then taxed as a corporation.
  – All others:
    • single owner? -- taxed as disregarded entity (DRE) or can elect to be taxed as a corporation
    • multiple owners? -- taxed as partnership or can elect to be taxed as a corporation
Separate Entity Status

• Threshold question:
  – Is the arrangement/state law entity treated as a separate entity for federal income tax purposes?

• General Test:
    – “A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom.”
Examples from Regulations

- Examples from Treas. Reg. §301.7701-1(a)(2):
  - A separate entity exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent.
  - A joint undertaking merely to share expenses does not create a separate entity for federal tax purposes.
    - If two or more persons jointly construct a ditch merely to drain surface water from their properties, they have not created a separate entity for federal tax.
  - Mere co-ownership of property that is maintained, kept in repair, and rented does not constitute a separate entity for federal tax purposes.
    - If tenants in common of farm property lease it to a farmer for a cash or a share of crops, they do not necessarily create a separate entity for federal tax.
Effect of State Law Entity

• An arrangement that does not constitute a state law entity can be treated as a separate entity for federal tax purposes. Treas. Reg. §301.7701-1(a)(2).

• Conversely, a state law entity can be disregarded as a separate entity for federal tax purposes. Treas. Reg. §301.7701-1(a)(3).

• But generally a state law entity will be recognized as a separate entity if it has a business purpose and/or actually carries on a business.

• This is not a legal presumption, but is a practice point based on the weight of the cases and IRS guidance.

• This position can be defeated if the entity was utilized for tax avoidance.
Proposed Regulations

• A key point in the proposed regulations is that a domestic series will be treated as an entity formed under state law.

• So?

• As a practical matter, this facilitates the separate entity analysis:
  – If treated as a state law entity, the weight of case law and guidance means that provided you have a business purposes and not a tax avoidance purpose, the series will be treated as a separate entity.
  – If the series were not a juridical entity under state law, then it would present the more difficult task of proving that a mere contractual arrangement was a separate entity.
Caveats – Series

- Under the proposed regulations, a series is defined as “a segregated group of assets and liabilities that is established pursuant to a series statute by agreement of a series organization.”

- In many cases, the formation of a series will only involve a transfer or assignment of assets. But the definition also requires (apparently) that the series have liabilities as well as assets.

- Presumably the IRS will issue guidance on this or clarify the definition. In the meantime, planners should ascertain whether the series meets the liability side of the definition. If there is a question, then one approach would be to make the series liable for a ratable share of the series organization’s start up and related administrative expenses.
Caveats – Foreign Series

• State law entity status only applies to domestic series

• BUT – also applies to foreign series if it engages in an insurance business.

• We may see further developments on foreign series when the regulations are finalized – the IRS has specifically requested comments on foreign series outside of the insurance field.

• In practice we see many foreign series entities being used – to determine tax classification we use general tax rules described above without the practical benefit of being treated as a separate entity under local law.
Example – Foreign Series

• Some inbound transactions use foreign entities that permit cellular divisions. For example, a SARL (“societe a responsabilite limitee”), a limited liability company formed under the laws of the Grand Duchy of Luxembourg, can be used to create foreign series.

• Different classes or types of investors may be allocated different series.

• This can often present a challenging issue if a SARL invests in a US business or US transaction.
  
  – Who is the investor? The SARL or the series?
  
  – What are the US withholding obligations? Will this vary depending on whether a the SARL or the series is treated as the investor?
  
  – What sort of diligence is necessary? What sort of indemnities are reasonable?
  
  – State law issues.
Caveats – Series Organization

• A series -- but not the series organization – is treated as a state law entity.

• Planning point – a series organization may have significant expenses and may have revenues.

• Can set up reimbursement /allocation of expenses and revenues to effectively charge these back to the various series.

• Alternatively, can create a series that is a “back office” service provider of the other series and thus could be treated as a state law entity.

• Finally, it is possible that the IRS will issue guidance on this point – the treatment of series organization is a topic on which the IRS has specifically requested comments.
Caveats – Loss of Liability

• Some series statutes provide that certain record keeping failures and other lapses can void the inter-series liability protection offered under such laws.

• In addition, the owners or the series organization can waive the liability shield or can agree by contract to eliminate the liability shield between or among some or all of the series.

• The propose regulations provide that even if one of these events occurs, that will not change whether the series qualifies as a series and therefore is treated as a state law entity.

• Policy point – if the regulations had provided otherwise there would be significant practical difficulties because it might not be known for years whether a series met the test and it would open up complex retroactivity and tax avoidance issues.
Caveats – Ownership

• Many series statutes provide that the series organization is the owner of each series.

• The proposed regulations provide that owners of a series for federal income tax purposes are determined under federal tax law (i.e., tax common law).

• Generally, ownership is determined by reference to who bears the benefits and burdens of a given set of assets.

• Example: Series LLC has two series, Series A and Series B. Assets and liabilities are associated with each series. Series LLC has three members: Alpha, Beta, and Gamma. Alpha and Gamma are entitled to all the profits and bear all the losses of Series A. Beta is entitled to all the profits and bears all the losses of Series B. Under these facts, it appears that Alpha and Beta are the tax owners of Series A and Beta is the tax owner of Series B.
Caveats – Common Ownership

• What if each member of the series organization has the same interest in each series?

• If each series is a separate business, then arguably each series is a separate entity for tax purposes.

• Problem – separate tax returns for each series? That adds to the compliance burden and increases costs.

• What if all the series are treated as a single entity for tax purposes by the owners? Single tax return, less complexity, etc.

• Could the filing of a single tax return be used by creditors against the assertion of inter-series liability shields?
Caveats – Top Netting

- What if the governing documents permit the series organization to net the economics of different series that are held by common owners?

- Example: Jones owns varying interests in the two series of Newco, LLC. The governing documents permit Newco to net the economics of common interests. The governing documents also recite that Newco owns each series and not the members of Newco. Jones is entitled to a $100 distribution in connection with his interest in Series A, but is required to under the capital call provisions of Series B to contribute $75. Newco makes a net $25 distribution to Jones.

- It could be argued that under this fact pattern Newco owns the two series and Jones’ interest is in Newco rather than in the underlying series.

- Planning point – until more guidance is issued, blending or netting of economics at the series organization might be avoided, particularly if the member desire to treat each series as a separate entity.
Caveats – Tax Collection

• The proposed regulations set out some important caveats in connection with tax collection matters.

• Generally, a liability of one series could not be collected against another series.

• However, the proposed regulations provide that if federal or local law permits a creditor to collect a liability attributable to a series from the series organization and/or from other series, then a tax liability against that series can also be collected against the series organization and/or other series.

• Similarly, if federal or local law permits a creditor to collect a liability attributable to a series organization from any or all of the series under that series organization, then a tax liability against that series organization can be collected from such series.

• Note that it is unclear how this rules will apply with the advent of the new Centralize Partnership Audit Regime (“CPAR”).
Caveats – CPAR

• Beginning in 2018, the TEFRA audit rules are replaced with a new “Centralized Partnership Audit Regime” (CPAR).

• CPAR is similar in some respects to TEFRA (audits of partnership items are conducted at the partnership level), but go one step further by assessing any resulting liability against the partnership itself and not the partners.

• CPAR is quite complex, but a partnership can elect, instead of paying the IRS directly, to “push out” the liability to its partners. This replicates the effect of TEFRA, but also could encourage strategic elections.

• For example, a partnership could elect to push out a liability to its partners, but some or all of those partners could themselves be partnerships. The higher tier partnerships could then strategically elect to push out or internalize the tax liability.

• A series LLC could be used to facilitate this kind of structuring, given the ease with which new series can be formed.
Caveats – Trust Classification

• Generally a common law trust taxed under subchapter J is a construct of contract law and not a state law entity. Accordingly, a series would not appear capable of being classified as a common law trust.

• However, at least one commentator has suggested that the wording in one of the examples contained in the proposed regulations implies that a series can be classified as a trust if sufficient facts are present.

• This is an area where further clarification by the IRS would be helpful. In the meantime, planners will have to rely on the general test set forth in Treas. Reg. §301.7701-4(a):

• “Generally speaking, an arrangement will be treated as a trust . . . if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.”
The Information Statement

The proposed regulations contemplate a form or information statement that each series would complete and submit. The information statement would contain the following:

1. The name, address, and taxpayer identification number of the series organization and each of its series and status of each as a series of a series organization or as the series organization;

2. The jurisdiction in which the series organization was formed; and

3. An indication of whether the series holds title to its assets or whether title is held by another series or the series organization and, if held by another series or the series organization, the name, address, and taxpayer identification number of the series organization and each series holding title to any of its assets.
The Information Statement 2

• As a practical matter, the information statement will resolve many issues identified thus far. Unless there is a tax avoidance purpose or the information statement deviates from the actual facts, it is likely that the IRS will follow the statement.

• For that reason, it may be wise to agree on the form of the statement in the governing documents so that no owner or purported owner can later argue that he or she should be treated differently.

• In addition, the IRS is unlikely to countenance a deviation from the information statement after it is filed.

• It appears that the information statement would not be due at the IRS until after the end of the tax year to which it relates (i.e., the due date for the tax return).
Tax Identification Number

• The preamble to the proposed regulations contemplates that a series that is treated as a separate entity may obtain its own tax identification number.

• A TIN is usually a prerequisite to opening a bank account and other matters, so it can be very important to obtain one.

• The IRS is considering changes to Form SS-4 to expedite the issuance of series TINs.

• Query – If a series is not a separate entity for tax purposes presumably it will have to use its parent’s TIN. Does that count against the series if creditors seek to void the inter-series liability shield?
Transition Rule 1

• The proposed regulations generally are not effective until the date final regulations are published.

• If a series or series organization is treated differently for tax purposes prior to the effective date, the series or series organization will have to conform to the new regulations starting on the effective date.

• For example, if the members of a series LLC treated the series organization as a partnership and the series as disregarded entities, and under the final regulations the series would be treated as separate entities and the series organization disregarded, the partnership division rules under Section 708 may be triggered. Effectively, the series organization will be treated as converting into multiple separate partnerships. While generally this would be a tax-free transaction, gain can be recognized in certain circumstances.

• If the series organization was previously treated as a corporation, then subchapter C rules will determine if the division of the series organization can be accomplished tax free.
Transition Rule 2

• A series that was treated differently than required by the final regulations can nonetheless continue that treatment under very narrow circumstances.

• Among other pre-requisites, the series must have been established prior to September 14, 2010; the series conducted business or investment activity; no owner of the series treated the series as an entity separate from any other series of the series organization or from the series organization for federal tax purposes; the series and series organization had a reasonable basis for their claimed classification; and neither the series nor any owner of the series nor the series organization was notified in writing on or before the effective date of the regulations that classification of the series was under examination.

• Furthermore, this transition relief ceases if there is a cumulative change of 50% or more of the 9/14/2010 owners.
• The point of a series LLC is to shield one series from the liabilities of another.

• However, when the liability is contractual (a loan), different issues are raised.

• If the series is a separate entity for tax purposes and the owners of the series organization are treated as the owners of the series for tax purposes, the allocation of a liability can be very significant.

• If a series borrows money from a bank and pledges its assets as collateral, then the loan will be allocated solely to the tax owners of that series.

  – Aside: Remember that whenever a limited liability entity borrows money there is a tax classification issue of whether to treat the debt as recourse or non-recourse.
A bank lending to a series may wish more security and could require the following:

- Series and series organization are jointly and severally liable
- Series organization is the debtor and specifically pledges its interests in all or some of its series
- Series organization and all series are jointly and severally liable and each specifically pledges all its assets as collateral

Under any of these circumstances, the determination of how to allocate the debt may vary based on the overall ownership of the series organization and the individual series.

This can affect basis, allocation and related metrics.
Governing Documents

- States vary in the level and type of documentation needed to create a series organization and to create individual series.

- Careful attention is needed in the planning stage.
  - Do the parties desire to treat a given series as a separate entity for tax?
  - What will the entity be classified as? Partnership? Corporation?
  - Who will the owners of that entity be? The members of the series organization? The series organization? Combination of both?
  - Documents – Generally will want a partnership agreement or shareholder agreement.
  - Tax Agreements – Can be stand alone or incorporated into governing documents. Should cover partnership matters, tax classification, ownership, etc.
Employment Tax

• The proposed regulations provide no guidance on the treatment of employment taxes or employee benefits in the context of a series. Comments are specifically requested in the rulemaking.

• In many cases, series are used to hold financial or other assets and may not have employees. In that case, many of the employment tax and benefit issues are mooted.

• However, in other cases a complete business including employees may be contained in a series. If the other series under the common series organization hold unrelated businesses and/or there is no overlap in employees, it may make sense to treat each series as separate for income and employment purposes.

• If employees are working for businesses in different series but under a common series organization, it becomes more complicated. In that case, if the series are treated as separate tax entities, then a worker might be treated as having more than one employer and therefore more than one set of payroll withholding obligations. If the series are disregarded, then the series organization could be treated as the employer.

• Ideally, these issues can be worked out ahead of time by evaluating whether there will be overlapping workers or overlapping businesses.
Allocation of W-2 Amounts

• The Tax Cuts and Jobs Act of 2017 (the “Act”) creates a new tax deduction for partnerships equal to (potentially) 20% of income.

• There are several limitations on the pass-through income deduction, including some limitations that are based on the W-2 wages of the partnership.

• For planning purposes it may become increasingly advantageous to optimize the W-2 wages deemed allocated to a partnership.

• A series LLC may be useful in facilitating such optimization.
Check-the-Box Rules

• The check-the-box rules provide for default classification for certain entities.

• In the case of a series, the default classification is a partnership (if there are more than one owners) or a disregarded entity (“DRE”) if there is only one owner.

• A series can also elect to be taxed as a corporation.

• A series that wants to elect to be a corporation, or wishes to make a safe-harbor election as to its default classification makes the election on IRS Form 8832.

• Generally, the effective date of the election is the date the form is filed. However, the entity can select and effective date as much as 75 days prior to the filing date or as much as 12 months after the filing date. In addition, the IRS will sometimes grant an extension of time to make an election.

• Generally, an entity cannot change its election for 60 months, but there are exceptions.
State Tax Treatment

• Taxes upon Formation, Etc.
• General State Income Tax Treatment
• Nexus
• Sale of A Series
• Sales Tax Exemption
Formation Taxes

• Some states levy fees or minimum taxes upon the formation of an LLC or the registration of an out-of-state LLC in the state.

• If a series is treated as a separate LLC under federal income tax principles, such a state may treat the series as a separate entity for purposes of such fees and taxes.
General State Tax Treatment

• Most states have no guidance and no plans to issue guidance in the future.

• Many states follow the federal tax treatment of an entity (with, as you would expect, numerous exceptions).

• If a series is treated as a separate entity under federal income tax regulations or principles, then we would expect the states to general follow this approach.

• So, a series treated as a partnership for federal income tax purposes is likely to be treated as a partnership for state income tax purposes.
Nexus

• Generally, a partner in a partnership is deemed to have nexus in every jurisdiction in which the partnership has nexus.

• If a series LLC has a series that has nexus with a given state, but has other series that do not have nexus with that state, what happens to the owners of the series LLC?

• The proposed regulations generally treat the series as a separate entity, but do not as yet recognize the series LLC. If the series LLC is not recognized for federal tax purposes, then on reasonable approach would be to trigger nexus only for the owners with an economic interest in the series that does business in that state.

• The question is less clear if the series LLC is respected for federal income tax purposes.
Sale of Series – Income Tax

• Under current law, a sale of an LLC is generally not treated as an asset sale but rather as a sale of an entity (subject to various look-through rules).

• But if a series is sold, rather than the LLC itself, how is that treated for state law purposes?

• If a series is treated as a separate entity for tax purposes, will a sale of just the assets within that series be treated as an asset sale or as a sale of a partnership interest?

• A state following the federal proposal should treat the transaction as a sale of a partnership interest.
Sale of Series – Other Taxes

• One advantage of using separate LLCs for separate assets, is that instead of selling the asset, the LLC itself can be sold.

• In some states, look-through rules treat the transaction as an asset sale.

• Example: If an LLC owns real property, the parties may simply transfer the LLC rather than conveying the real property. This could save on local real estate conveyance and registration fees.

• However, several states look through this and impose the tax whenever there is a change in control in the entity owning the real property.
In the case of a sale of a series rather than the whole LLC, how is the transfer accomplished? Presumably the transaction is documented as an asset sale.

If so, then even in states without look-through rules the transfer would presumably trigger local conveyance and registration fees.

If this is the case, is the advantage of a series LLC (versus separate LLCs for each significant asset) diminished?
Alternatives to Series

Given the complexity associated with series LLCs and the uncertain state law and state tax treatment, are there viable alternatives?

– Holding Company LLC with LLC subsidiaries
– Multiple separate LLCs
– Single LLC with schedular allocations
Holding LLC with Subs

- Member 1: A = 25%, B = 1%, C = 90%, D = 1%
- Member 2: A = 1%, B = 1%, C = 1%, D = 59%
- Member 3: A = 1%, B = 90%, C = 1%, D = 30%
- Member 4: A = 73%, B = 8%, C = 8%, D = 10%

- LLC A
- LLC B
- LLC C
- LLC D
Holding LLC with Subs

- Holding LLC owns 4 separate LLCs, each a “subsidiary” LLC.
- Note that by using separate LLCs, the assets of each LLC are walled off from the other LLCs.
- The Holding LLC also provides an additional layer of protection, and need not be an LLC that is formed under the same jurisdiction as the subsidiary LLCs.
- Each subsidiary has only a single owner, so should be treated as “disregarded entities” for income tax purposes.
Holding LLC & Subs

• Will Holding LLC be treated as a separate partnership for income tax purposes?

• This an open question because of the schedular allocations. Under current law, Holding LLC may be ignored and the four subsidiary LLCs may be treated as separate entities.

• In fact, it may be preferable to ignore Holding LLC and treat the subsidiary LLCs as separate entities.

• It would be beneficial if the final regulations addressed this structure and allowed taxpayers to elect to treat the subsidiaries as separate entities and to ignore the Holding LLC where it exists as a mere organizational convenience.
Separate LLCs

Member 1
A = 25%
B = 1%
C = 90%
D = 1%

Member 2
A = 1%
B = 1%
C = 1%
D = 59%

Member 3
A = 1%
B = 1%
C = 1%
D = 59%

Member 4
A = 7%
B = 8%
C = 8%
D = 10%

LLC A

LLC B

LLC C

LLC D
Separate LLCs

- The use of separate LLCs to hold, say, related real estate projects, is a structure that is frequently used.
- The tax treatment should be identical between the separate LLCs and a series LLC with schedular allocations.
- Note that by using separate LLCs, the assets of each LLC are walled off from the other LLCs.
- But, the use of separate LLCs can often be unwieldy. For convenience sake, it may be easier to form a single entry point and then as each investment opportunity comes up, provide for the specific economics of each investment.
Single LLC

GiantCo LLC

Asset/Line of Business A
Asset/Line of Business B
Asset/Line of Business C
Asset/Line of Business D
Single LLC

• In this variation, we form a single LLC, put all the assets in it, and set out allocations based on specific assets or lines of business.

• Does not wall off one group of assets from another.

• Will this be viewed as four separate LLCs for income tax purposes because of the asset/business allocations?
Thank You

Joseph C. Mandarino
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Smith, Gambrell & Russell, LLP
Promenade, Suite 3100
1230 Peachtree Street, N.E.
Atlanta, Georgia 30309
www.sgrlaw.com
jmandarino@sgrlaw.com