Series LLCs in Business and Tax Planning

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With the advent of series limited liability companies (LLCs), businesses face more options and complexity in making choice-of-entity decisions. Eight states currently authorize series structures for LLCs;[1] however, series LLCs have been used infrequently due largely to uncertainty about what protection they provide against liabilities and how they are treated for tax purposes. Despite these present uncertainties, series LLCs hold promise as favorable entities for business and tax planning.

Guidance about the classification of series LLCs is on the IRS's business plan. If such guidance reduces uncertainty about their tax treatment, more states might adopt series LLC legislation and correspondingly reduce uncertainty about their liability protection. Therefore, practitioners should familiarize themselves with current planning opportunities and issues related to series LLCs in anticipation of heightened interest by clients as the federal and state governments explore these entities.

Series LLCs

A series LLC is a "master" LLC with one or more series of members, managers, interests, or assets. Although contained within the master LLC, each series can have separate rights, powers, and duties with respect to specific property and liabilities and can have separate business purposes and investment objectives. The series may also have common members with identical ownership interests, common members with varying interests, or different members with unrelated interests—one series could even own an interest in another series. Accordingly, it is possible for each series to function as the equivalent to a freestanding legal entity such that a series, depending on state law, could contract, own property, and sue or be sued in its own name. For example, a retail furniture store that offers customer financing could place the retail operations in one series and the financing operations in another series within a

1 Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, and Utah. Minnesota, North Dakota, and Wisconsin permit LLCs to designate series of interests, analogous to issuing different classes of stock in a corporation. Unlike a series LLC, such designations do not segregate assets and liabilities within an LLC. In particular, series LLCs closely resemble segregated portfolio companies and protected cell companies used by the offshore mutual fund industry.

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single master LLC. The retail operations series and the financing operations series could then each have separately identifiable owners, managers, assets, liabilities, and business purposes.

The eight states with series LLC legislation envisioned that, with properly established and maintained series, creditors could enforce the liabilities of one series only against the assets of that series. The assets of the master LLC and any other series would remain outside the reach of such creditors. A series structure thus helps wall off assets and liabilities within a master LLC. In the context of the example above, a series structure could prevent a furniture manufacturer, which might seek payment for goods delivered to the retail operation series, from enforcing a retail-related liability against the assets of either the master LLC generally or the financing operation series specifically.

The use of series within a single LLC offers commonly perceived advantages over the well-established practice of forming multiple legal entities to segregate assets and liabilities. First, depending on a state's filing fees, the costs to organize and maintain a series LLC are often less than comparable costs for multiple entities. Second, a series LLC might require fewer unique organizational documents than multiple entities, particularly where the series have common members with identical interests. Finally, an LLC might find it easier and quicker to add a new series than to organize an entirely new entity. These economies of scale advantages might encourage the placement of real estate parcels, for example, in series of an LLC rather than in separate legal entities, such as multiple LLCs under an LLC holding company.

Liability Concerns

Despite those potential advantages, many advisers hesitate to recommend series LLCs due to their uncertain ability to contain liabilities within a series. An LLC generally provides a good external shield between the LLC and its members. Like a corporation, an LLC provides inside-out asset protection insofar as a creditor of the LLC (inside) generally cannot seek satisfaction of a liability from the members (outside). Unlike a corporation, an LLC also provides outside-in asset protection such that restrictions on the transferability of LLC interests generally limit creditors of members to taking an economic interest in distributions from an LLC. With a mere economic interest, a creditor cannot force distributions from an LLC, so the assets of the LLC (inside) remain protected from the liabilities of its members (outside). Because states authorized series LLCs by amending their existing LLC statutes, a series LLC and its members should similarly enjoy the benefits of an external shield relative to that series.

Greater uncertainty surrounds a series LLC's ability to construct internal shields between series or between a series and its master LLC. As noted above, the series LLC legislation intended to restrict the reach of creditors of one series to assets of that series. Regardless of that intention, courts might refuse to respect the internal shields and permit creditors to recover from assets of any series or the master LLC. This prospect of ineffective internal shields makes advisers wary of series LLCs.

Respect for Internal Shields

Courts in states with series LLC legislation presumably will respect internal shields. Given that the legislatures in Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, and Utah prescribed internal shields,[2] courts in those states generally should respect them. Such courts might nevertheless be amenable to (1) disregarding the shields for improperly formed series and series unable to account for their assets or (2) piercing internal shields where necessary to achieve justice, such as for inadequately capitalized series. Accordingly, the formation and maintenance of a series structure requires an exercise of reasonable diligence. Unfortunately, many business owners attribute informality to LLCs and are unaccustomed to maintaining documentation, such as records to substantiate the assets attributable

EXECUTIVE SUMMARY

- Statutes in eight states allow the creation of series LLCs, which consist of a "master" LLC and one or more series of members, managers, interests, or assets. Each series can generally function as the equivalent to a freestanding legal entity separate from the master LLC and any other series. This allows for the segregation of assets and business functions for liability purposes without the need to form multiple separate entities.

- Little guidance is currently available on the treatment of series LLCs. Significant uncertainties about series LLCs include whether other states will recognize them for liability purposes, how they will be treated in bankruptcy, and how they will be treated for federal and state tax purposes.

- The IRS has in previous guidance embraced the concept of separate entity treatment in the context of series structures, including a letter ruling where it approved this treatment for a proposed series LLC.

- The use of series LLCs is likely to increase as more guidance on their treatment is released, and practitioners should therefore become familiar with these entities and when their use may be appropriate.

2 See DE Code Ann. tit. 6, §18-215; 805 IL Comp. Stat. 180/37-40; IA Code §490A.305; NV Rev. Stat. §86.296; OK Stat. tit. 18, §2054.4; TN Code Ann. §48-249-309; TX Bus. Orgs. Code §101.601-.621; UT Code Ann. §§48-2c-606 through -616.

to a particular series. These owners and their advisers must recognize that adherence to series LLCs formalities—akin to the demands placed on corporations—is necessary to achieve protection from internal shields in any state.

For many advisers, a more significant question exists about whether courts in other states will respect the internal shields of series LLCs. A series LLC organized in one of the states with series LLC legislation could foreseeably face claims of creditors in other jurisdictions. For example, a series LLC duly organized in Delaware could face a personal injury lawsuit from the activities of a series in North Carolina. Whether a North Carolina court would respect the internal shields established by Delaware law raises an unresolved choice-of-law question, which could affect an adviser's choice-of-entity recommendation.

The Internal Affairs Doctrine

A determination of applicable law will likely reflect the internal affairs doctrine, which developed to resolve state law conflicts relative to corporations. The doctrine basically states that the laws of an entity's state of organization will govern the entity's internal affairs.[3] In a corporate context, the doctrine has been understood to govern relationships between management and shareholders as well as to establish a shareholder's limited liability for a corporation's debts. The doctrine seems well justified for disputes between management and shareholders, given that they voluntarily consented to the relationship under the laws of the state of organization. The doctrine seems more questionable for third-party claims against shareholders due to the often involuntary nature of such claims, yet the doctrine's application remains firmly established in the corporate context under case and statutory law.

States have codified aspects of the internal affairs doctrine in their LLC statutes. North Carolina statutes (like other state statutes) provide that in the example above, the laws of Delaware would govern the internal affairs of the series LLC and the liability of its managers and members.[4] At first glance, it might appear that a North Carolina court would uphold the internal shields of the series LLC as a permissible structure governing liability. However, North Carolina (like other states) limits its application of the internal affairs doctrine such that the statute would afford the Delaware series LLC no greater rights or privileges than, and would subject the Delaware series LLC to, the same liabilities imposed on a North Carolina LLC.[5]

This limitation makes advisers wary about the viability of internal shields against third-party claimants. In particular, it seems reasonable to expect that a North Carolina court would reject internal shields as assertions of rights or privileges or limitations on liability beyond those authorized for North Carolina LLCs rather than accept the series as mere devices to manage internal affairs under Delaware law. Although no court in North Carolina or any other state has resolved this issue, advisers appear reluctant to rely on a series structure as protection against plaintiff claims outside the eight states with series LLC legislation. As more states authorize series LLCs, however, these concerns about out-of-state claims should diminish insofar as courts equate the internal shields of foreign and domestic series LLCs.

Bankruptcy Considerations

Regardless of whether state courts respect internal shields,[6] advisers cautiously wonder how U.S. bankruptcy courts will treat series LLCs. Bankruptcy laws generally consider any person as an eligible debtor[7] that can voluntarily or involuntarily enter into bankruptcy. A "person," for this purpose, is defined to include an individual, partnership, or corporation.[8] Bankruptcy courts have accepted that this nonlimiting definition of "included" examples[9] permits LLCs to qualify as persons and correspondingly as debtors.[10] But the courts have yet to consider whether a single series qualifies as a person such that it could enter into bankruptcy independently of other series and the master LLC. Thus, the potential for a series to undertake separate proceedings and correspondingly for internal shields to insulate the liabilities of that series from other assets remains unclear in a bankruptcy context.

Whether a series qualifies as a person for bankruptcy purposes might depend on its status as a separate entity under state law. A bankruptcy court sits as a court of equity, which means it fashions remedies to achieve justice and fairness without being constrained by the form of a transaction. State law characterizations therefore will not bind a bankruptcy court. Nevertheless, any equitable motivation for treating a series as a person seems strongest where the state of organization treats the series as an entity separate from the master LLC and other series. Presently, only Illinois makes separate entity status available for each series of an LLC.[11] Series LLCs organized in other states thus risk that, under an objective to enlarge a bankruptcy estate, a court might be unwilling to recognize each series of an LLC as a separate person where the LLC's state of organization has failed to do so. Consequently, a mere ability of a series to function as the equivalent to a legal entity (e.g., contracting, owning property, and suing/being sued in one's own name) might prove insufficient to overcome a

3 *Restatement (Second) of Conflicts of Laws* §302(1) (1971).

4 See NC Gen. Stat. §57C-7-01.

5 Id.

6 The SEC staff recently concluded that the series LLC of a broker-dealer would not satisfy the SEC's financial responsibility rules where retail and institutional activities would be placed in separate series. See SEC No-Action Letter, Broker-Dealers Operating Under a Series LLC Structure (September 1, 2009), available at www.sec.gov/divisions/marketreg/mr-noaction/2009/finra090109.pdf.

7 11 U.S.C. §109(a).

8 11 U.S.C. §101(41).

9 11 U.S.C. §102(3).

10 See *In re Calhoun*, 312 B.R. 380 (Bankr. N.D. Iowa 2004).

11 See 805 IL Comp. Stat. 180/37-40(b) ("A series with limited liability shall be treated as a separate entity to the extent set forth in the articles of organization"). Tennessee ambiguously allows for classifications of interests and voting rights and permits distributions "as if the series were a separate LLC." See TN Code Ann. §§48-249-309(d) and (e).

court's equitable notion that it should include all the assets of an LLC and its series in a bankruptcy estate. But advisers should remain aware that a bankruptcy court could similarly disregard the separate entity status under Illinois law and ignore an internal shield in its proceedings under the pretext of equity.

Even if a bankruptcy court treats each series as a person, the court could invoke an equitable remedy known as substantive consolidation. That remedy involves treating a bankruptcy estate as composed of the assets of two or more persons—including, in some instances, the assets of debtors and nondebtors. So the assets of a master LLC and/or some or all of its series could comprise a single estate subject to their collective creditors as a result of a substantive consolidation. No uniform standard exists for invoking this remedy, but it is generally considered appropriate where creditors or owners have disregarded the separate identities of persons or where those persons have entangled financial affairs.[12] Although substantive consolidation is not a unique risk of series LLCs (courts have also applied the remedy to parent and subsidiary corporations), future decisions might reveal whether bankruptcy courts are more inclined to apply the remedy to series LLC structures.

Practice tip: Accordingly, advisers should emphasize compliance with series LLCs formalities, including recordkeeping for assets attributable to a particular series, to minimize the risk of a substantive consolidation.

Weighing the Costs and Benefits

Advisers thus express legitimate concerns about using internal shields to protect assets in series LLCs. Interestingly, those concerns echo sentiments expressed about LLCs generally in the early 1990s[13] and should similarly dissipate as more states enact series LLC legislation and bankruptcy courts continue to address LLC and series LLC issues. Accordingly, advisers striving for bulletproof asset protection structures or bankruptcy remote vehicles will justifiably reject series LLCs in favor of more familiar separate-entity holdings, such as multi-tiered corporate structures.[14]

Other advisers will likely gradually adopt series LLCs in the same manner as they had for LLCs: weighing the costs and risks of a series structure—in lieu of holding separate entities—in light of the jurisdictions in which a series LLC would operate and the emerging legal considerations for these variations of an otherwise acceptable LLC entity. Advisers thus must recognize that current uncertainties make series LLCs risky replacements for trusted separate-entity structures in choice-of-entity planning.

However, an adviser should consider using a series LLC as a replacement for an LLC in some current planning. Because series LLCs resulted from amendments to existing LLC statutes, a series LLC should provide the same inside-out and outside-in asset protection as any LLC. But a series LLC offers the potential of additional protection through internal shields, which an LLC cannot match. A choice must be made between the uncertain protection of internal shields in a series LLC and the certain lack of comparable protection of an LLC. An adviser should therefore carefully consider whether any recommendation to organize an LLC best serves a client's interests where the client could have used a series LLC instead. Various factors, such as higher compliance costs or a client's inability to maintain sufficient records, might make a series LLC infeasible; however, advisers cannot ignore series LLCs in business planning.

Advisers should increasingly rely on series LLCs in small business planning. Although the internal shields might not succeed, small businesses would face little downside risk because they generally cannot resort to separate-entity structures that are too costly or administratively burdensome. Thus, series LLCs provide a better-than-nothing opportunity to shield certain assets from claims of creditors. So, for example, an adviser making a recommendation for a business headquartered in Gary, Indiana, with significant activities in Chicago might consider organizing a series LLC in Illinois and placing particular operations in each series rather than merely organizing an LLC in Indiana and subjecting all the assets to the claims of creditors. The former structure would at least provide some protection against claims arising in Illinois at potentially a fraction of the cost and burden of a separate-entity structure.

Tax Concerns

Other concerns about series LLCs originate from their uncertain tax classifications. In

12 See, e.g., *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988) (finding substantive consolidation appropriate in light of "two critical factors: (i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit,' . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors"); *Eastgroup Properties v. Southern Motel Ass'n*, 935 F.2d 245, 249–50 (11th Cir. 1991) (adopting a standard for a prima facie case for consolidation where there is substantial identity between entities and consolidation is necessary to avoid harm or achieve benefit in light of factors, such as unity of interests, commingling of assets and business function, or disregarding legal requirements for separate entities); *In re Owens Corning*, 419 F.3d 195, 210 (3d Cir. 2005) (refusing to "endors[e] any prefixed factors" and instead "adopt[ing] an intentionally open-ended, equitable inquiry . . . to determine when substantively to consolidate two entities") (quoting *Nesbit v. Gears Unlimited, Inc.*, 347 F.3d 72, 87 (3d Cir. 2003)).

13 See, e.g., Price, "Tax Aspects of Limited Liability Companies: Is the LLC a State-of-the-Art Entity?" 174 *Journal of Accountancy* 48, 52 (September 1992) ("Today, the LLC's greatest weakness may be its status in states without LLC legislation, which may not follow LLC members' limited liability status"); Horwood and Hechtman, "The Limited Liability Company: The New Kid in Town," 20 *J. Corp. Tax'n* 334, 346 (1994) ("Limited liability is not assured, however, in jurisdictions that do not have an LLC statute. . . . In these states, the use of corporations . . . may be preferred to ensure limited liability"); Platner, "Limited Liability Companies Are Increasingly Popular," 47 *Tax'n for Accts.* 364, 370 (1991) ("Operating an LLC in a state that has not enacted LLC legislation poses the risk that the owners of the LLC may be held personally liable for the obligations of the LLC. . . . Because LLCs are relatively new, the Federal bankruptcy laws do not specify how an LLC should be treated").

14 It is noteworthy that a series LLC might actually provide better protection than a separate-entity structure insofar as courts pierce veils and require entities to pay liabilities of related entities, but series LLCs operate under specific statutory provisions that restrict the charging of liabilities to assets of a particular series. See Ribstein, "An Analysis of the Revised Uniform Limited Liability Company Act," 3 *Va. L. & Bus. Rev.* 35, 43–44 (2008).

particular, uncertainty exists about what significance, if any, a series structure has in identifying relevant business entities under the classification regulations of Sec. 7701. The check-the-box regulations allow a business entity, other than a *per se* corporation, to elect its federal tax classification. Accordingly, a multi-member business entity can choose treatment as a corporation or partnership, and a single-member business entity can choose treatment as a corporation or disregarded entity.[15] A series—which can have its own members, assets, liabilities, and business purpose—within a master LLC brings into question whether the master LLC, the series, or both constitute business entities that can elect tax classifications.

The regulations broadly define a business entity for classification purposes. They consider any entity recognized for federal tax purposes, other than a trust or specially treated entity, as a business entity.[16] Moreover, they clarify that the existence of such an entity does not depend on achieving entity status under state law and that the entity could result from a contractual arrangement to carry on a trade, business, financial operation, or venture and to divide any resulting profits.[17] The regulations, however, note that mere co-ownership of property is insufficient to warrant a finding of an entity separate from its owners even for leased or rented property.[18] Under this broad definition, several alternative conclusions appear supportable about what business entities exist for classification purposes relative to the diverse relationships within a series LLC structure.

Three alternative conclusions about classifications for series LLCs seem noteworthy.

1. The tax system might attribute no significance to a series structure such that it would determine the tax classification for a master LLC without regard to its series established under state law. This alternative would treat the series LLC as the single business entity.
2. The tax system might deem each series to be a wholly owned entity of an umbrella master LLC such that, absent any elections, it would disregard the series as being separate from the master LLC and classify the master LLC on the basis of its members and elections. The second alternative thus would recognize multiple business entities but would consider the master LLC as the sole owner of each series.
3. The tax system might respect a master LLC and each of its series as separate business entities, recognize ownership as established by state law, and permit independent determinations of their respective tax classifications. The last alternative would let tax classifications flow from the state law treatment of series LLCs.

IRS Rulings

Without definitively resolving how to classify series LLCs, the IRS has ruled informally—consistent with the third alternative—that each series determines its classification separately for federal tax purposes. In Letter Ruling 200803004,[19] the IRS considered the plan of a single business trust, which was composed of portfolios treated as separate regulated investment companies, to reorganize as a series LLC whereby each portfolio would form a series in a master LLC. Following the reorganization, each series would have its own assets, liabilities, and earnings, its own investment objectives and policies, and owners different than those of the other series. With minimal discussion, the IRS effectively concluded that each series constituted a business entity by holding that its classification as a disregarded entity, partnership, or corporation depended on the owners and elections of that series.

The IRS's holding in the private letter ruling was not surprising. A Tax Court decision[20] and numerous rulings[21] had previously found separate-entity treatment appropriate in the context of series structures. The IRS merely extended that treatment to a series LLC in Letter Ruling 200803004, whereas it had previously been applied in the context of series trusts. Unfortunately, neither the decision nor the rulings provide enough analysis to fully justify such treatment. One can only surmise that a sufficient degree of separateness was found in the specific situations, most notably with respect to regulated investment companies, to classify the various series as separate taxable entities.[22]

Although the private letter ruling informally embraces the concept that a series LLC can consist of several taxable entities, questions persist about whether such an approach to classification might vary in other situations. For example, the separateness of a series, which might provide the basis for separate-entity treatment for tax purposes, could diminish with common ownership and business objectives. As an illustration, assume two individuals organize a series LLC to conduct real estate development for parcels owned by separate series. If each individual owns 50% of the interests in each series, each series shares an overriding business objective to develop real estate, and the only meaningful difference between the series is the respective parcels they develop, then it seems reasonable to ask whether the series really amount to separate taxable entities despite their compliance with any state law formalities.

Similar concerns could arise about a series used solely to shield assets from creditors without conducting additional activities. For example, a series that merely holds property as a bankruptcy remote vehicle might not qualify as a separate *business* entity, which could elect its tax classification. Accordingly, despite issuing the letter ruling, the IRS continues to study factors that could affect the

15 Regs. Sec. 301.7701-3(a).
16 Regs. Sec. 301.7701-2(a).
17 Regs. Sec. 301.7701-1(a).
18 Regs. Sec. 301.7701-1(a)(2).
19 IRS Letter Ruling 200803004 (1/18/08).
20 *National Securities Series—Industrial Stocks Series*, 13 T.C. 884 (1949), *acq*., 1950-1 C.B. 4.
21 See, e.g., Rev. Rul. 55-416, 1955-1 C.B. 416; IRS Letter Rulings 9847013 (11/20/98), 9819002 (5/8/98), and 9435015 (9/2/94).
22 See, e.g., IRS Letter Ruling 9847013 (11/20/98) ("Provided that each Series is treated as a separate trust and that creditors of one Series of the Trust may not reach the assets of any other Series of the Trust, we conclude that each Series is a separate entity for federal income tax purposes").

classification of series LLCs.[23] Prior to the issuance of any formal guidance, advisers should not assume that a series within an LLC will automatically qualify as a separate taxable entity.

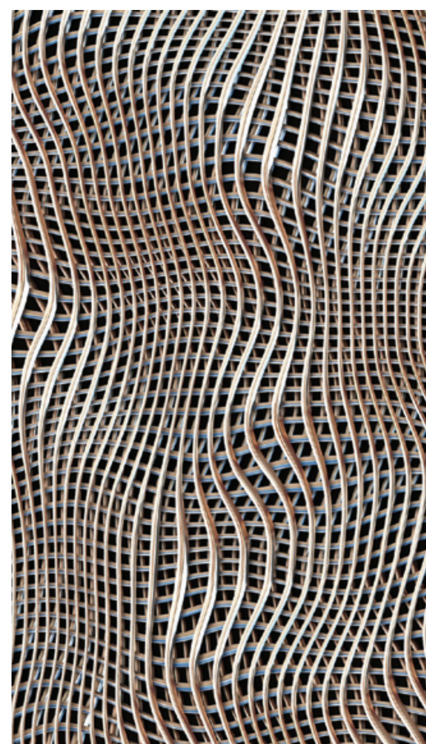
Planning for the Future

Advisers can reasonably expect more states to enact series LLC legislation if the IRS formally issues classification guidance. The present uncertainty about the tax classification of series LLCs arguably makes state legislatures hesitant to approve them.[24] But if history provides any insight about the future, it suggests a rapid enactment of series legislation after the IRS resolves most classification issues. For example, during an 11-year period, only two states enacted multi-member LLC legislation before the IRS classified them as partnerships in Rev. Rul. 88-76;[25] thereafter, every state enacted LLC legislation within 8 years. Only a few states had authorized a single-member variation of an LLC before the check-the-box regulations classified them as disregarded entities in 1997, but every state authorized them within a few years afterward.[26] If the IRS were to provide similarly favorable classification guidance for series LLCs, advisers could foresee more state legislation, which would correspondingly reduce the uncertainty about the viability of internal shields against out-of-state claims.

Even if states enact no more series legislation, advisers should begin thinking about the impact of series LLCs on tax planning. The likelihood of having at least some series classified as separate taxable entities, as evidenced by Letter Ruling 200803004, means taxpayers will face new opportunities and challenges from operating businesses in LLCs. Since the issuance of the check-the-box regulations, advisers have become comfortable with single-member LLCs functioning as "tax nothings"—legal entities disregarded for tax purposes. Series within LLCs currently offer a potential for "tax somethings"—legal constructs with limited state recognition that, if owned by multiple members, are regarded as separate entities for tax purposes. These tax somethings obviously could affect tax planning regardless of any further state law developments.

Despite a presumption of additional compliance burdens,[27] the relative ease of forming additional taxable entities through series could provide an interesting dynamic in planning, particularly for taxpayers with small businesses. A series structure could provide a small business with a comparable option to the less feasible, separate legal entity holding structure typically used by larger or more sophisticated taxpayers. Thus, a series LLC might draw appeal from its use for tax purposes—without concern about the strength of its internal shields—where a taxpayer would otherwise willingly operate a business in a single LLC to gain its inside-out and outside-in protection despite its lack of internal protection.

A few examples can illustrate potential tax advantages and disadvantages related to series LLCs. First, an LLC could use a series, which is treated as a separate taxable entity, to adopt particular methods of accounting. The LLC might use this strategy if it cannot qualify for the desired method as currently structured, if it seeks to avoid the administrative cost and hassle of requesting consent to change an existing method, or if it believes the IRS would deny such a request. Under this strategy, the LLC could transfer business operations to a nondisregarded series,[28] and that series then could select a method of its choice. An accrual-method taxpayer, for example, would likely find transferring a business to an intended cash-method series easier than securing consent for an



accrual-to-cash method change. The idea of transferring businesses to take advantage of accounting methods has generally been accepted in various holding structures,[29] but the series LLC offers a potentially less costly means to achieve that objective.

Second, a series LLC might avoid the rigors or minimize the impact of the uniform capitalization (UNICAP) rules. Those rules generally require the capitalization of certain costs properly allocable to property produced or acquired for resale by a taxpayer. In this regard, a taxpayer should recall a requirement to capitalize an arm's-length charge for costs incurred by a related person that are properly allocable to the taxpayer's property.[30] Relatedness, for this purpose, depends on whether the same interests own or control directly or indirectly two or more organizations, trades, or businesses.[31] Because a series structure permits members to own different interests

23 See Notice 2008-19, 2008-1 C.B. 366 (requesting comments about future classification guidance for non–insurance series companies).

24 See Revised Uniform Limited Liability Company Act (2006), prefatory note.

25 Rev. Rul. 88-76, 1988-2 C.B. 360.

26 See Bishop, "Through the Looking Glass: Status Liability and the Single Member and Series LLC Perspective," 42 *Suffolk U.L. Rev.* 459 (2009).

27 As a separate taxable entity, each series might discover an obligation to file separate federal and state tax returns.

28 A transfer to a new series could create additional tax issues, particularly under the partnership rules, which are not addressed here. See Gerson, "Series LLC Tax Issues," 35 *The Tax Adviser* 416 (July 2004).

29 See, e.g., *Textile Apron Co.*, 21 T.C. 147 (1953) (corporation formed from sole proprietorships), *acq.*, 1954-1 C.B. 7; *Fong*, T.C. Memo. 1984-402 (cash-method partnership of accrual-method partners). But see Regs. Sec. 1.1502-17(c) (stating an anti-avoidance rule for certain intragroup transfers in consolidated return contexts).

30 Regs. Sec. 1.263A-1(j)(1).

31 Id., referring to Sec. 482.

in series within one LLC, it appears possible to avoid common ownership and for such series to remain unrelated persons under this broad standard. Depending on business needs, an LLC could thereby isolate costs or activities within series in a way that avoids or minimizes an overall need to capitalize costs.

Third, an isolation of costs or activities within particular series, which are not under common control, could similarly increase any available deduction under Sec. 199. Because the deduction generally equals a percentage of a taxpayer's income attributable to U.S. production activities, a series could help increase the gross receipts or decrease the costs reflected in that income. For example, an LLC might find that its U.S. manufacturing activity is too insignificant—relative to all the activities associated with qualifying production property—to create domestic production gross receipts.[32] If the LLC placed only the manufacturing activity in a series, the significance of the manufacturing to that series might permit the recognition of domestic production gross receipts from sales of manufactured property to unrelated series within the master LLC. The use of a series in that situation might also affect the items included in costs of goods sold allocable to those gross receipts,[33] including the application of the UNICAP rules as described above, which would correspondingly affect a determination of qualified production activities income. As a separate taxpayer, the series would have its own gross receipts and costs that would factor into any Sec. 199 computation.

Finally, in contrast to the benefits described above, businesses conducted within series could adversely affect allowable deductions. The existence of separate taxable entities within a series LLC would preclude imputing the business of one series to other series or to the master LLC.[34] A series could therefore claim a deduction for an ordinary and necessary business expense only where it carries on the business to which the expense relates.[35] For example, a series that incurs investigatory costs, with respect to a business venture identical to that already conducted by another series, might find that the costs are not immediately deductible as expenses of carrying on an existing business and instead are recoverable only in a manner consistent with a deemed start-up election. Moreover, unless a master LLC conducts its own business, it might lack any basis to deduct purported *business* expenses. That situation could arise where a master LLC does not own interests in its series and therefore cannot claim that it incurred the costs in conducting a holding company business.[36] Accordingly, advisers should carefully consider what entity benefits from costs in determining and substantiating deductibility, which unfortunately adds another burden to the relatively more stringent recordkeeping requirements under state law for maintaining a series LLC.

Conclusion

Series LLCs present an attractive variation of a now familiar limited liability entity. Despite present uncertainty about the viability of internal shields against potential claimants and their effect on tax classifications, series LLCs will likely increase in popularity in the future, especially if the government's resolution of their tax classification hastens the adoption of more series LLC legislation. In the meantime, advisers should consider the opportunities and risks, particularly for small businesses, of using series LLCs in lieu of nonseries LLCs in business and tax planning.

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EditorNotes

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32 Regs. Sec. 1.199-3(g).

33 Regs. Sec. 1.199-4(b).

34 See *Moline Properties, Inc.*, 319 U.S. 436, 438–39 (1943).

35 Sec. 162(a).

36 Cf. *Campbell Taggart, Inc.*, 744 F.2d 442 (5th Cir. 1984) (finding that a holding company engages in a "business" for certain tax purposes).